TOWARDS A JOINT PACIFIC ALLIANCE AGENDA FOR PROMOTING SME INTERNATIONALISATION AND INTEGRATION IN GLOBAL VALUE CHAINS

TABLE OF CONTENTS

Figures

Boxes

EXECUTIVE SUMMARY

The Pacific Alliance (PA) represents an economic region with a combined GDP of USD 1.9tn and an integrated market of more than 200 million people. Created in 2011, with the purpose of enhancing policy convergence, fostering synergies, and promoting economic integration among its members through trade and investment, the PA unites Chile, Colombia, Mexico and Peru.[1] The PA is the second largest economic aggregation in Latin America and the Caribbean (LAC) after the Mercosur. Its relevance is increasing, given the dynamism of the member economies and its fast demographic expansion.

SMEs[2] are an important source of employment in PA countries, accounting for approximately 99% of businesses and 67% of employment. If micro-enterprises are excluded from this category[3], SMEs then represent between 1.8% (Peru) to 12.2% (Colombia) of businesses in PA economies.

Yet, intra- and extra-regional PA trade are dominated by large enterprises, particularly those active in commodity production and primary commodity processing, with the largest 1% of exporting firms accounting for more than 70% of total exports. Only approximately 10% of LAC SMEs engage in export activities, a significantly lower rate than the 40% of European SMEs who do so.

The PA's process of economic integration is starting from a limited base, with relatively low levels of intra-PA trade and cross regional investment flows. In 2013, intra-PA trade represented only 3.5% of its total trade, while the corresponding figures in the European Union (EU), the NAFTA region and the ASEAN+5 region[4] were 59.1%, 49.6% and 49.8%, respectively.

However, intra-regional integration has significant potential for expansion, underpinned by the PA's ambitious programme of trade and investment liberalisation. A higher level of economic integration among PA members would open opportunities to diversify and deepen the economic productive structure of the countries, develop new comparative advantages, and increase employment.

SMEs may play a vital role in fostering economic integration. While exporting to large consumption markets may require substantial capabilities for PA SMEs, in order to comply with technical standards and overcome logistic, commercial and even language barriers, exporting to other PA countries may be more accessible for SMEs who are already competitive in their home markets.

[1] In 2014, Costa Rica began the process to join the group.

[2] This paper uses the following classification for SMEs, applicable for all PA countries: Micro: 0-10, Small: 11-50, Medium: 51-250, Large: 251+ employees.

[3] The differentiation between micro-enterprises and SMEs is particularly important in emerging markets, where informality is an important phenomenon. While informality is by no means synonymous with micro-enterprises, the two are closely interlinked.

[4] Includes the 10 members of ASEAN plus China, Japan, Korea, Hong-Kong and Chinese Taipei

Furthermore, internationalisation of economic activity, especially for SMEs, can take many forms other than directly exporting finished products. The globalisation of value chains is central in today's discussions on trade and has resulted in the physical fragmentation of production among optimal locations for each of the various stages. This opens up new possibilities for developing/emerging economies, allowing them to engage in areas of production that were not previously feasible, and industrialize more rapidly.

Overall, both the building of a PA regional market and the fragmentation of international production into global value chains (GVCs) opens new opportunities for SMEs, through direct and indirect trade participation, business collaboration, and direct investment.

However, trade and investment liberalisation alone will not be sufficient to secure a higher level of SME internationalisation; instead, it should be closely associated with policies promoting economic diversification and supporting entrepreneurship and enterprise development. This is due to the current structure of PA economies, which are concentrated in a few resource-oriented sectors where SMEs play a marginal role, particularly in the cases of Chile, Columbia and Peru. The building of productive capacities and emergence of new comparative advantages in the manufacturing and service sectors is thus a necessary condition for the broadening and deepening of PA trade flows and a more active role for SMEs.

Against this background, this scoping paper aims to identify policy alternatives for PA countries to carry out joint initiatives oriented to promote the internationalisation and greater integration of SMEs at both the intra-regional level and into global value chains (GVCs). It also indicates what kind of support the OECD could provide. Five areas of intervention have been identified:

1. Finance

PA countries have in place relatively well-developed policies for SME financing, including direct funding, factoring, reverse factoring, provision of credit under favourable conditions and guarantees for credit, micro insurance, and facilitation of access to venture capital for start-ups. No country, however, has all of these options well developed.

In light of new OECD research which highlights that traditional bank finance poses challenges to SMEs, PA countries should consider diversifying their own portfolio of instruments for financing SMEs, as well as take advantage of existing joint efforts in the creation of the Latin American Integrated (Stock) Market (MILA) to create joint financing instruments for the most advanced and innovative SMEs, proving a new alternative source of equity financing to support their expansion.

The OECD has developed an advanced tool to measure financing flows to SME Financing, entitled the "SME Financing Score Board", covering a broad section of financing tools, from bank lending to equity financing. The OECD Score Board could be used to monitor progress in the provision of SME financing within the PA and to compare it with OECD and OECD countries.

2. Business Environment

An important strength of PA countries is their openness to international trade and investment. All PA countries have a variety of well-established institutions and are conducting proactive policies aiming at promoting exports; attracting foreign investment; supporting clusters; and facilitating the adoption by local enterprises of internationally recognised technical and quality standards.

PA countries should consider developing and developing further business clusters and linkages between SMEs and larger enterprises in sectors where there are opportunities for greater participation of SMEs in GVCs. PA countries could also undertake joint initiatives of FDI attraction and Investor after-care services with an emphasis on MNEs, particularly on those with multiple operations in the PA region that will promote technology and knowledge transfer to local suppliers and contractors.

The OECD has upgraded its Policy Framework for Investment, which supports countries in revising their investment policies to ensure that they encourage investment and open opportunities for integration into GVCs. PA countries could build on their joint participation in the OECD Investment Committee and adherence to the Guidelines for Multi-National Enterprises to increase synergies in their Investment Policies, and avoid mutually damaging actions. The OECD will prepare a synthesis report on LAC countries that have undertaken an Investment Policy Review; as this group includes all PA countries and Costa Rica, this could support and better inform these joint efforts. This could be further complemented by a policy dialogue between the SME and investment groups of the PA, where this report could be discussed and the OECD could support the identification of joint initiatives.

3. Firm Capabilities

PA countries have developed a variety of incubation, supplier development, innovation, and skills development programmes for SMEs. Some of them are in line with internationally recognised good practices and merit being shared among PA countries.

PA countries should consider creating joint supplier development programmes that offer clear mechanisms for the strengthening of SME-MNE linkages and technological and managerial skills upgrading, as this could serve as a platform to both direct and indirect internationalization. These programmes could be supported by the development of a PA certification that helps MNEs identify quality suppliers in PA countries. More broadly, PA countries should develop a balanced policy mix to encourage creation and scale-up of innovative SMEs, which often involves integrated support programmes that simultaneously offer finance, business services, and entrepreneurial skills learning.

In terms of policy responses to the finding that an adequate-sized pool of human capital is key for the expansion of participation in GVCs, both short and long-term actions are needed. In the short term, the entry of professionals from other countries should be facilitated. In the long term, alliances need to be created between the private sector, academia, and the public sector in order to ensure that education provides students with the right set of skills for key sectors.

4. Market access

PA countries vary in their level of market access programme development, however it is here where most PA joint initiatives have occurred, led by both their Export and Investment Promotion agencies.

The PA extended market provides an expansion opportunity for many SMEs already competitive in their own market, given the similarity of markets and the same-language advantage. Many of these firms may have not considered exporting before, since exporting traditionally often implied complying with very high standards for the U.S., European, or Asian markets. PA countries should exploit this opportunity by facilitating the creation of PA-wide distribution channels and providing relevant information for SMEs.

Yet, developing direct export activities requires a set of skills and resources that only the most productive and well managed SMEs are able to gather and organise. SMEs most often participate in international trade as suppliers of trade and services to larger enterprises. Therefore, the PA countries should include supplier development programmes and a SME-Larger Enterprises linkages component in their SME national development strategies. These supplier and linkages programmes should follow international best practices, including the combination of matchmaking services with training, merit-based selection criteria, transparent diagnosis and auditing processes.

PA countries could also encourage greater participation of SMEs in the PA-wider market through public procurement of governmental institutions serving national markets and SOEs serving national and international markets. The new OECD recommendation on Public Procurement recommends targets for public expenditure that is to be delivered by SMEs, dividing contracts into smaller pieces that SMEs can more easily deliver, and reducing the complexity and cost of applications. Opening bids to SMEs from PA countries could create healthy competition and encourage intra-PA partnerships.

5. Trade and trade-related policies

While tariff negotiations among PA member countries have concluded with the Additional Protocol of the Framework Agreement of the PA, a number of initiatives could be undertaken to further engage in unilateral tariff reductions along specific value chains, taking advantage of the network of trade treaties that the PA has subscribed to, as well as joint initiatives of trade facilitation.

PA countries should assess and evaluate tariffs and policies that restrict access to foreign intermediate goods and services in key value chains that could have a detrimental impact on their position in regional and global supply chains, as well as policies that aim to artificially increase the domestic content of exports; fully exploit trade facilitation instruments to facilitate SME access to foreign markets and develop joint initiatives based on best practices within the PA; and consider join initiatives for reducing services trade restrictions and improving transport and communication logistics and infrastructure, which greatly impact the cost and capacity of SMEs to take part in GVCs.

The OECD is undertaking a diagnostic of Chile´s integration into GVCs that could be used as a basis for preparing similar diagnoses and building a more comprehensive strategy in this field. The OECD's Trade Facilitation Indicators and Service Trade Restrictiveness Index also provide key insights.

Placing SME development at the core of the PA integration agenda

Addressing SME´s barriers to internationalization requires a broad, coordinated policy agenda which spans across many areas of government, and, in this case, governments of various countries. Building on the PA's existing working groups, which have facilitated policy dialogue among stakeholders within the relevant policy communities across the PA, PA countries should develop a comprehensive inter-agency coordination for effective SME internationalization support. This approach should consider SME internationalization as a learning process, encompassing different types of support for individual SMEs depending upon where they are in their learning process, and allowing them to evolve over time as they gain more experience and knowledge.

A variety of future proposed studies for PA countries, both as a group and individually, are proposed in Section III. In particular, the OECD could produce a SME Policy Index in support of the PA, which could provide in-depth evaluation, comparative analysis, and exchange of practices.

This Scoping Paper is structured as follows: Section I provides a general context of the existing trade structure and of SMEs in the PA, and concludes by enumerating a number of challenges and opportunities that SMEs face when engaging in international activities. Section II provides a summary of existing OECD work on relevant topics; takes stock of PA countries' current policy efforts and initiatives carried out to promote SME development and internationalisation; and provides elements for the PA to consider in advancing their joint agenda, grouped in the following policy domains: finance, business environment, firm capabilities, market access and trade. Section III summarizes key conclusions, and outlines how the OECD could support and accompany such an agenda with ongoing or proposed projects.

SECTION I: CHALLENGES AND OPPORTUNITIES RELATED TO PARTICIPATION IN GVCS AND SMES INTERNATIONALISATION IN THE PACIFIC ALLIANCE

Introduction

1. The Pacific Alliance (PA) represents an economic region with a combined GDP of USD 1.9tn and with an integrated market of more than 200 million people. Created in 2011, the trade bloc unites Chile, Colombia, Mexico and Peru. In 2014, Costa Rica began the process to join the group. The PA is the second largest economic aggregation in Latin America and the Caribbean (LAC), after the Mercosur. Its relevance is increasing, given the dynamism of its member economies and their fast demographic expansion. The member's aim is to use the alliance as a platform for economic and trade integration.

2. This section provides a general context of the existing trade structure and of SMEs in the PA, and concludes by enumerating a number of challenges and opportunities that SMEs face when engaging in international activities.

Trade and GVCs Context in the Pacific Alliance

Gross trade figures for 2013 show that PA countries have different sectoral and regional trade specialisations.

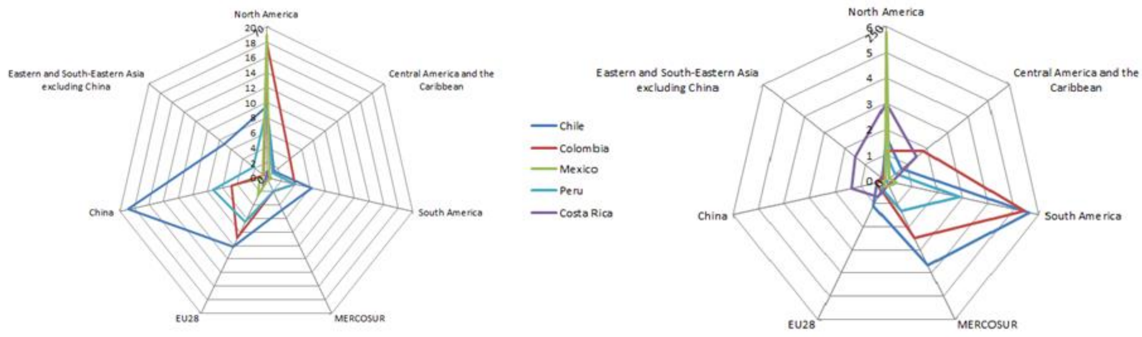
3. *Two clear sectoral specialization patterns emerge: while 77% of Mexico's exports are manufactured goods and only 23% primary commodities, an inverse pattern is found in the rest of the PA countries, with 81%, 78% and 84% of exports consisting of primary commodities for Chile, Colombia and Peru, respectively.* Mexico's volume of trade is also significantly larger, in the order of USD 289bn in the manufacturing sector and USD 86bn in commodities, while the respective figures for Chile, Colombia and Peru are USD 13bn, USD 12bn, and USD 6bn for manufacturing and USD 58bn, USD 42bn, and USD 32bn for commodities.

4. *Regional specialization patterns are also diverse and complementary*. Mexican trade is strongly biased toward the NAFTA region (82% of total exports and 52% of total imports, in 2013), while the other countries have a more diversified pattern. Chile is the most diversified, in terms of trading patterns, with 27% oriented to Eastern Asia (China), 16% to NAFTA countries, 16% to the EU and 16.5% to South America.[5]

5. *A further sectoral analysis by main trading partners confirms these patterns (see Annex).* On the one hand, the Mexican economy is strongly linked to the United States, through both intra-industry and cross-sectoral trade. Trade in machinery and transport equipment with the US represents 47% and 18% of Mexico's total exports and imports, respectively. Exports to the US of petroleum and related products represent 9% of Mexico's total exports, while imports of chemicals and related products from the US represent 7% of Mexico's total imports. On the other hand, Chile, Colombia and Peru's economies are more focused on a limited range of commodities exports, and rely more heavily on importing machinery and manufactured goods. The exports of ores and non-ferrous metals represent 58% of Chile's total exports; petroleum and related products represent 69% of Colombia's total exports; and Peru's total exports mainly consist of ores and non-ferrous metals (47%).

[5] All data taken from UNCTADStat.

Figure 1. Pacific Alliance Trade by Destination (in USD billions), 2013



Source: UNCTADStat

Intra-PA trade is relatively low and therefore has significant potential for enlargement under the agreed tariff reductions:

6. *In 2013, intra-PA trade represented only 3.5% of its total trade, while the corresponding figures in the EU, the NAFTA region and the ASEAN+5 region*[6]*, were 59.1%, 49.6% and 49.8%, respectively* (UNCTADStat). This low intra-regional trade is not a unique feature of the PA, but rather applies to the LAC region more generally. While MERCOSUR's intra-regional trade flows are significantly higher than those of the PA, they still correspond to only 14% of its total trade (CEPAL, 2014). According to UNCTAD estimates, with intra-regional GVC flows totalling only 11% of total regional GVC participation, Latin America is the region with the second-lowest intra-regional flows, just ahead of Africa (6%). A deeper analysis could be done through the application of a trade gravity model to the region, but it is clear that given the robust economic size and cultural homogeneity between countries in the region, as well as the relatively short distances separating them, there is significant potential for stronger trade integration in the PA.

7. *In terms of intra-PA trade values, in 2013, Mexico exported USD 4.7 billion to Colombia, USD 2.1 billion to Chile, and around USD 1.7 Billion to Peru.* In the same year, Chile exported close to USD 2 billion to Peru and USD 1.3 billion to Mexico. Peru's exports to Chile in 2013 totalled 1.6 billion. All other exchanges are below the USD 1 billion mark (see Table 1). In primary commodities, intra-PA trade has a more balanced pattern. Colombia exports to Chile around the same value of primary commodities (USD 1.2bn) that Peru exports to Chile (USD 1.06bn).

8. *In terms of intra-PA trade composition, Mexico's intra-PA exports are clearly concentrated in machinery and electronics, transportation, and chemicals.* In contrast, Chile's intra-PA exports are concentrated in food products, wood, chemicals, metals, and vegetables, along with exports of machinery and electronics to Peru. Over 70% of Colombia's exports to Chile are made up of fuel, with other significant exports in the chemicals sector (with the exception of to Chile), transportation sector (to Mexico) and plastic and rubber. Peru's exports are concentrated in the fuel sector (Mexico), metals (Colombia) and minerals (Chile). This breakdown supports a general distinction between the Mexican and Chilean, Colombian, and Peruvian economies, with Mexico clearly standing out in terms of its exports of machinery and electronics, and Chile, Colombia, and Peru's export activity concentrated in natural resource sectors.

[6] Includes the 10 members of ASEAN plus China, Japan, Korea, Hong-Kong and Chinese Taipei.

Table 1. Matrix of Exports of Intra-Pacific Alliance (millions of USD), 2013

Destination/ Origin	Chile	Colombia	Mexico	Peru	Pacific Alliance	PA/total exports
Chile		867	1,314	1,907	4,089	5.43%
Colombia	1,571		863	1,273	3,709	6.56%
Mexico	2,084	4,735		1,771	8,590	2.26%
Peru	1,670	843	509		3,023	8.93%
Pacific Alliance	5,326	6,448	2,694	5,008	19,476	3.56%

Source: COMTRADE Database

The degree and type of participation of PA members in GVCs is diverse, following two distinct patterns:

9. *In the case of Mexico, which is closer to the demand side of GVCs, backward linkages are predominant.* Mexico has a strong and growing proportion of foreign value-added embodied in its exports (26% in 1995 to 30% in 2009) (See Annex, Figure 8), i.e. a backward GVC participation ratio (See Box 1). Its sales into other countries' value chains, i.e. the domestic value added embodied in the exports of other countries as a share of its gross exports, or forward GVC participation ratio (See Box 1), is comparatively small (going from 10% to 11% in the period 1995 to 2009) (See Annex, Figure 8). This suggests larger 'assembly' rather than production of intermediate goods, happening in manufacturing sectors such as 'electrical and optical equipment' or 'transport equipment'. While it is true that assembly activities often represent a very small share of the value added of the final product, Mexico is a good example of another important truth that has been evidenced in recent research[7], namely that the volume of the activity may matter just as much as the domestic share of the value of the product. From the point of view of the firm, it is the value that is created from its economic activities that matters, rather than the share that the firm occupies in the value of the final product.

10. *Chile, on the other hand, has a lower, albeit growing, foreign value added content embodied in its exports –i.e. its backward participation index* (15% in 1995 to 18% in 2009) (See Annex, Figure 8). Yet, its sales into GVCs early in the production process are much more prominent. Chile is at the opposite extreme from Mexico regarding the Forward Participation Index, which grew from 22% in 1995 to 33% in 2009 (See Annex, Figure 8). Its participation is mainly characterised by sales of products from primary sectors, where it has a strong comparative advantage, to other countries' productions of exports. Colombia and Peru's economic structure and trade specialization patterns are closer to those of Chile than to those of Mexico. The estimated backward participation ratios of Colombia and Peru in 2005 are 16% and 10% respectively, and their forward participation ratios are estimated at 18% and 16%, respectively (See Annex, Figure 8).

Box 12. Measuring participation in Global Value Chains

The OECD TiVA database released in 2013 defines GVC participation in terms of the value-added embodied in exports both looking backward and forward from a reference country: backward when it comes to foreign value added embodied in exports, and forward when it refers to domestic value added that is used as inputs to produce exports in the destination country.

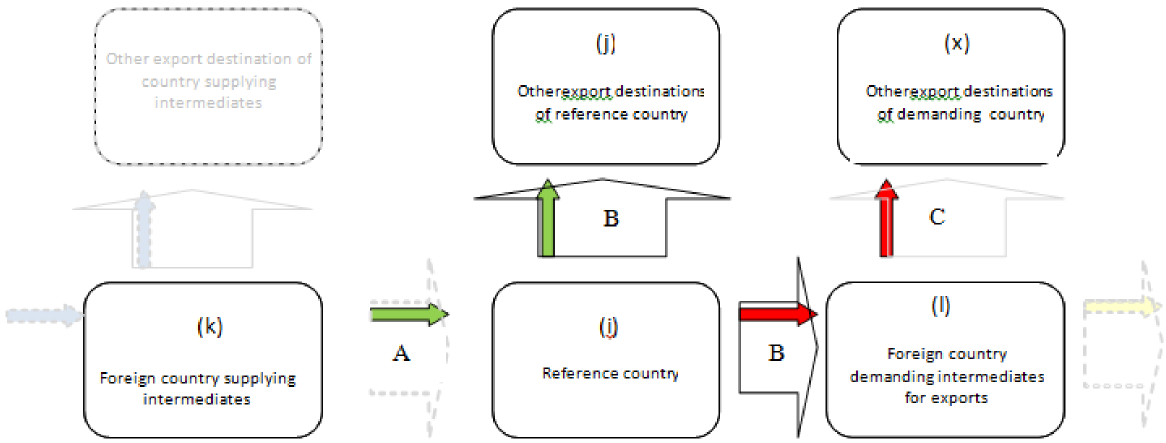
Figure 2 provides a schematic illustration of the backward and forward linkages. The reference country (*i*), which sources foreign value added from abroad (*k*) to be processed for exports to its trading partners (*j*), is in the core of the GVC node— in value terms, it *buys* foreign inputs (A), combines them with domestic value added and sells the resulting output to foreign customers via exports (B). In the case of forward participation, on the other hand, the reference country (*i*) is the source of value added that its foreign partner (*l*) uses for exports (in value terms this link is

[7] OECD (2015) Participation of Developing Countries in Global Value Chains-Implications for Trade and Trade-Related Policies

represented by C) to a third country (*x*)—it *sells* its inputs. The implication is that the backward participation index (A/B) may reflect the reference country's characteristics more closely than forward (C/B), a claim for which supporting evidence is found in the TiVA database.

While both the backward participation index (foreign intermediate value added used in the export activity of a given country) and the forward GVC participation index (domestic value added embodied in exports used by firms in partner countries as inputs into their own exports) are expressed as shares of the reference country's exports, in fact they measure very different forms of engagement. For example, a country that is predominantly assembling products into final goods and subsequently exporting these will have a strong backward participation index, but a small forward participation measure. Conversely, a country which predominantly supplies intermediates to an assembler will have a highly developed forward participation indicator, but a small backward participation measure.

Figure 2. Backward and forward participation: supply and demand of intermediate inputs



1. The green arrows denote the foreign value added embodied in imported intermediates used for exports of reference country (i)—the backward linkage. The red arrows denote the value added of the reference country (i) embodied in its exports of intermediates which are used for exports of country (l)—the forward linkage.

Source : OECD, 2015b

11. *The relevant economic concept is the principle of comparative advantage.* It is clear that in the past three decades, Mexico has diversified its economy and developed significant comparative advantages, output, and jobs in the assembly of relatively advanced manufacturing products (see Box 2), while Chile and Peru have strong revealed comparative advantages in mining, and Colombia has advantages in minerals, fuels and related materials.

Box 13. Revealed Comparative Advantages in the PA

The Revealed Comparative Advantage (RCA) was first introduced by Bela Balassa (Balassa 1965) to measure international specialisation and can be defined as:

$$RCA_{ij} = \frac{X_{ij} / \sum_i X_{ij}}{\sum_j X_{ij} / \sum_i \sum_j X_{ij}}$$

The numerator represents the percentage share of a given sector in national exports – X_{ij} are exports of sector *i* from country *j*. The denominator represents the percentage share of a given sector in world exports. A country has comparative advantage if RCA>1. If RCA is<1, the country is said to have a comparative disadvantage.

Table 2. Revealed Comparative Advantage (RCA) (2013)

	Chile	Colombia	Mexico	Peru
0. Food and Live Animals	5.64	2.63	1.65	4.8
1. Beverage and tobacco	6.6*	0.4	2.54*	0.24
2. Crude materials, inedible, except fuels	16.05*	1.63	0.97	14.41*
3. Minerals fuels, lubricants and related materials	0.11	8.51*	1.63	1.66
4. Animals and vegetable oils, fats and waxes	1.17	1.66	0.19	3.57
5. Chemicals and related products	0.83	1.13	0.73	0.51
6. Manufactured goods classified chiefly by materials	5.4	0.81	1.17	2.11
7. Machinery and transport equipment	0.17	0.18	3.24*	0.06
8. Miscellaneous manufactured articles	0.24	0.44	1.54	0.78
9. Gold, non-monetary (excluding gold ores and concentrates)	1.94	4.11*	1.67	20.55*

*The Top 2 RCA values for each country are highlighted

The analysis of PA countries' RCA values confirms the trade pattern discussed before. While Chile, Colombia and Peru have strong comparative advantages mainly in primary commodities, Mexico has a more diverse export structure, with an emphasis on manufactured products.

Chile reveals significant comparative advantages in non-ferrous metals, metalliferous ores and metal scrap, and pulp and waste paper, with RCA index values of 31.6, 28.0 and 27.7 respectively. Colombia has robust comparative advantages in coal, coke and briquettes, crude animal and vegetable materials, and coffee, tea, cocoa, spices, and manufactures thereof, with RCA index values of 32.6, 15.7 and 14.3, respectively. Mexico displays comparative advantages in road vehicles (5.3 RCA index value), and telecommunications and sound-recording and reproducing apparatuses and equipment (5.0). Peru has substantial comparative advantages in animal oils and fats (48.5), metalliferous ores and metal scrap (28.9), and gold (20.5).

Source : Bela Balassa (1965), "Trade Liberalization and Revealed Comparative Advantage"; COMTRADE Database

Foreign Direct Investment (FDI) reinforces trade specialization patterns

12. *In the case of Mexico, the so-called 'maquila' industry is characterized by "vertical MNEs" that import intermediate goods for production and export a large share of their production, taking advantage not only of the close distance to the US market and the lower labour cost, but also, increasingly, the qualifications and experience accumulated in the manufacturing labour force.*

13. *In the cases of Chile, Colombia, and Peru, the most prevalent pattern is that of "greenfield FDI", which is oriented to developing natural resource deposits* (see Table 3). "Greenfield FDI" brings capital and expertise to the country and develops forward GVC linkages, usually by exporting extracted raw materials, which are often processed elsewhere. While this FDI typology is mostly driven by large enterprises, SMEs may be able to play a role as suppliers of services and upstream/downstream suppliers to these large foreign ventures.

Table 3. FDI in the PA (as a percentage of GDP), 2013

Sector	Chile	Colombia	Mexico	Peru
Agriculture and food industry	0.01	0.08	0.01	0
Mining related activities	0.8	0.78	0.33	2.25
Energy extraction and production	1.75	1.44	0	0.62
Greenfield FDI	**2.56**	**2.3**	**0.34**	**2.87**
Others	3.93	1.94	3	1.72
TOTAL	**6.49**	**4.24**	**3.34**	**4.59**

Source: IDB 2015

14. *While this analysis reveals PA countries' most prominent forms of economy-wide engagement in GVCs, it is also important to analyse other types of engagement in particular industries.* Forthcoming OECD analysis will provide greater insights about specific sectorial interactions between PA countries that could better inform policy decisions. At this stage, using the information on the distribution of firms by size across different sectors in PA countries presented in the next section, a number of preliminary conclusions can be drawn.

15. *The above analysis highlights the importance of recognising the heterogeneity in the degree and type of engagement of PA countries in GVCs, as well as GVC participation's growing importance, both for sales and purchases of value added.* The analysis evidences the need for wider structural reform, through target policies fostering diversification, especially in the cases of Chile, Colombia and Peru. The low level of current regional GVC integration, coupled with the possible complementarities arising from differing specialisations along specific value chains and differing sectoral specialisations, suggests that there might be scope to significantly increase the share of the PA's GVC participation.

SMEs Context in the Pacific Alliance

SMEs are an important source of employment in PA countries.

16. *As in OECD and LAC countries, SMEs account for approximately 99% of businesses and 67% of employment in PA countries* (See Table 4). If micro-enterprises are excluded from this category, a distinction which might be important when discussing the specific topics of internationalisation and participation in GVCs[8], SMEs then represent between 1.8% (Peru) to 12.2% (Colombia) of businesses in PA economies.

Table 4. Number of SMEs in PA Countries (percentages)

	Chile	Colombia	Mexico	Peru
Micro	90.4	93.2	95.4	98.1
SMEs	9	6.5	4.4	1.8
• **Small**	7.8	5.5	3.6	1.5
• **Medium**	1.2	1	0.8	0.3
Large	0.6	0.3	0.2	0.1

Source: OECD/ECLAC 2012

[8] SMEs generally must reach a threshold in terms of both productivity and size in order to be successful in directly exporting and/or gaining the interest of large companies. Thus, policymakers should be aware that small and medium sized companies are much more likely to be successful in exporting among their SME peers than micro-enterprises.

However, SMEs' contribution to GDP in the region is relatively low compared to other regions, reflecting important shortcomings in terms of labour productivity[9].

17. *In Latin America, approximately 30% of GDP in the LAC region is produced by SMEs.* This contrasts with the much higher contribution of SMEs to GDP in OECD countries, which reaches 60% (OECD/ECLAC 2012). While it is a normal phenomenon worldwide for larger companies to be more productive than microenterprises, the gap in LAC is much wider than that experienced in OECD countries. Large LAC companies reach labour productivity levels up to 33 times greater than LAC microenterprises and up to 6 times greater than small firms (OECD/ECLAC 2012). PA economies reflect this, as evidenced in Table 5, with large firms experiencing productivity rates that are on average 33, 6.25, and 16.66 times greater than microenterprises, and 3.84, 2.86, and 6.25 times greater than small firms, in Chile, Mexico, and Peru, respectively[10]. In contrast, large companies in OECD countries are only 2.4 and 1.6 times more productive, on average, than microenterprises and small firms, respectively (OECD/ECLAC 2012).

Table 5. Relative labour productivity of firms in Chile, Mexico, and Peru[11]
(as percentages, productivity of large firms = 100%)

	Chile	Mexico	Peru
Micro	3	16	6
Small	26	35	16
Medium	46	60	50
Large	100	100	100

Source: OECD/ECLAC, 2012

18. *This lower than average performance by SMEs is reinforced and perpetuated by structural heterogeneity, with marked asymmetries among segments of enterprises and workers and the concentration of employment in strata characterized by very low relative productivity* (OECD/ECLAC 2012). In 2008, over 70% of workers in the LAC region were employed in low-productivity sectors, such as agriculture, construction, retail and personal services; 20% were employed in medium-productivity sectors, such as manufacturing and transport; and 8% were employed in high-productivity sectors, such as mining, finance and energy (OECD/ECLAC 2012). These asymmetries and employment patterns lead to a vicious cycle, as large productivity gaps reinforce inequality in other areas (skills, access to networks, adoption of technical developments, etc.) (OECD/ECLAC 2012). For example, a high wage gap exists between SMEs and large firms (see Table 6), contributing to and reinforcing inequalities in the social sphere.

Box 14. Measuring SMEs' contribution to employment and GDP in the context of informality

Among LAC countries there are at least two different definitions of SMEs. One is based on the number of employees in the firm, and the other uses sales revenue to determine the economic size of production units. The first definition ignores what are usually major differences among sectors (and among branches within each sector). As the OECD *LEO 2013* argues, this often results in SMEs' contribution to the economy being overestimated. (OECD/ECLAC 2012). However, as this is the criterion used in national statistics departments, this paper uses the following classification, applicable for all PA countries: Micro: 0-10, Small: 11-50, Medium: 51-250, Large: 251+ employees.

In OECD countries, SMEs represent over two-thirds of formal employment and over half of national output. To narrow this category, SMEs are sometimes distinguished from microenterprises as having a minimum number of

[9] Measuring the contribution of SMEs to GDP is a complex task, particularly in emerging economies, as informality plays a major role (see Box 3).

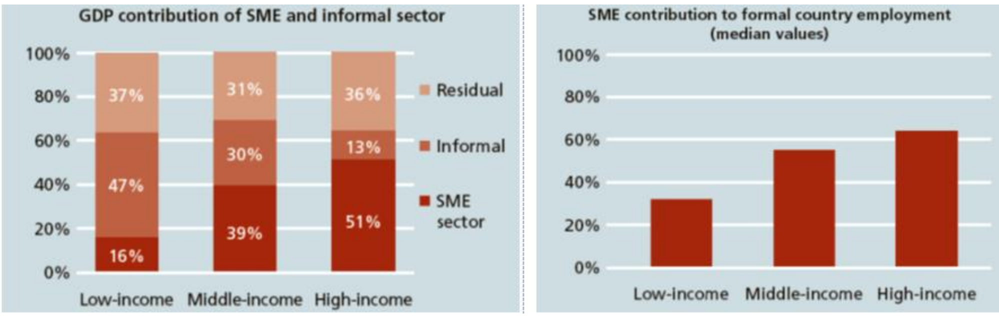
[10] It is important to note that relative labour productivity may also be influenced by large companies' specialisations in capital intensive sectors, such as mining in Chile and Peru.

[11] Colombia not included in data set.

employees (5 or 10).

The differentiation between micro-enterprises and SMEs is particularly important in emerging markets, where informality is an important phenomenon. While informality is by no means synonymous with micro-enterprises, the two are closely interlinked. The World Bank estimates that in middle-income countries, such as PA countries, the contribution of the SME sector to GDP is close to 39%. It also estimates that formal SMEs contribute to more than half of total employment in middle-income countries.

Figure 3. GDP and Employment: SME and Informal Sector Contributions



1. “Residual” includes sources such as large enterprises and public sector

Source : Ayyagari, Beck, and Demirguc-Kunt (2003)

Table 6. Wage gaps relative to large firms, 2006 (as percentages)[12]

	Chile	Mexico
Micro	-	21
Small	52	56
Medium	69	55
Large	100	100

Source: OECD/ECLAC, 2012

In addition, PA SMEs have limited participation in exporting activities and global and regional value chains.

19. *Direct and indirect export levels of the PA’s SMES are very small.* Latin American SMEs exports are only half of those recorded in Europe and are one-third less than those seen in four East Asian countries (see Table 7). This region-wide phenomenon is also reflected in PA countries, with less than 15% of SMEs in each PA country engaged in direct exporting, and less than 6% in Mexico (IDB, 2014a). Of these direct-exporting SMEs, exports make up approximately 20% of their sales in Chile, Colombia and Mexico, and just over 30% in Peru (IDB, 2014a). If indirect exporters are added, then the percentage of SMEs engaged in exporting in PA countries approaches 10% for Mexico, 20% for Chile and Peru, and slightly exceeds 20% for Colombia, with indirect exports making up approximately 25-30% of these firms’ sales (IDB, 2014a).

20. *In PA countries, more than 70% of total exports are accounted for by large Multi-National Enterprises* (MNEs). In most countries, more than 50% of total exports are from MNEs. Within the OECD, some of the countries with the highest values are the United States (75%), Hungary (73%) and Finland (72%) (OECD, 2011). However, this pattern is more acute in Latin America and in PA countries,

[12] Colombia and Peru not included in data set.

ranging from 84% in Colombia to 73% in Mexico (CEPAL, 2014). Some of these large firms are state-owned enterprises (SOEs) in the extractive sectors, including PEMEX, ECOPETROL, and CODELCO, which rank 2, 5 and 6 among the largest exporter firms of Latin America; and others include the so-called "Multilatinas group" (CEMEX, FEMSA, Groupo Alfa, Escondida, Grupo Mexico, Bimbo, Penoles and Minera Antamina) and MNEs based in PA countries (such as Volkswagen Mexico and Chrysler Mexico), both groups of which also appear in the top 20 exporters group of Latin America.

Table 7. Enterprises that export directly or indirectly, by size and by region, 2009-2010 (as percentages)[13]

	Latin America	Eastern Europe	East Asia
Small	9.12	18.78	13.19
Medium	12.86	26.45	25.51
Large	20.05	32.21	50.18

Source: OECD/ECLAC, 2012

21. *The median exporter in each PA country exports only two products to a single market* (IDB, 2014a). Furthermore, exporters of a single product to a single market in Chile, Colombia, Mexico and Peru make up 38.5%, 27.5%, 40.1%, and 29.8% of all exporters, respectively. These types of exporters contribute relatively little to export value, totalling only 0.8%, 3%, 1.2% and 3.8% in Chile, Colombia, Mexico, and Peru, respectively (IDB, 2014a). This poses a significant barriers to further diversification and productivity, as it has been shown that, in the LAC region, SMEs' product introductions tend to be followed by a larger number of firms than are new product introductions by larger firms. Furthermore, increases in export variety have also been shown to lead to increases in productivity (IDB, 2014a).[14]

Opportunities and Challenges of Promoting SME Internationalisation in the Pacific Alliance

The next sub-sections look at opportunities for SMEs both in general, and then more specifically in the PA context; the following sub-sections repeat this pattern, this time examining key factors that affect the participation of SMEs in international activities, first in general and then more specifically in the context of the LAC region and the PA.

General Opportunities

International fragmentation of production has changed international trade patterns and presents an opportunity for SMEs.

22. *Internationalisation of economic activity, especially for SMEs, can take many forms other than directly exporting finished products.* The globalisation of value chains is central in today's discussions on trade. It is linked to the growth of global production networks in which multinational companies play an important role and has resulted in the physical fragmentation of production among optimal locations for each of the various stages.

23. *While most international trade between industrialised and developing countries in the past consisted of manufactures being exchanged for raw materials and primary goods, many goods are now made across multiple countries, with each being allocated differing production stages.* Intermediate products and services account for 56% of world trade in goods and 73% of world trade in services,

13 East Asia includes 4 countries (Philippines, Indonesia, Lao People's Democratic Republic and Vietnam), Europe 12 and Latin America 18.

14 .Recent IDB research finds that a 10 percent increase in export product variety of all industries leads to a 1.3 percent increase in productivity (IDB, 2014a).

demonstrating that finished products are now less important in trade flows (OECD, 2015b). This opens up new possibilities for developing/emerging economies, allowing them to engage in areas of production that were not previously feasible, and industrialize more rapidly. Without these chains, economies would have to implement and master entire production processes in order to compete on the world market. Furthermore, the fragmentation of production opens up opportunities in niche products and services. As noted in previous OECD work, "New niches for the supply of novel products and services continuously emerge where the small firms can position themselves, exploiting their flexibility and their ability to move quickly. Small firms with quality tangible and intangible assets, such as niche products and advanced technologies, are becoming partners in international strategic alliances, targets of crossborder mergers and acquisitions, specialised suppliers to multinational enterprises (MNEs), and participants in actual and virtual business networks on a global level" (OECD, 2008a).

24. *Stronger links with MNEs and state-owned enterprises (SOEs) could increase the scope of participation of SMEs in international activity.* Even in countries with strong SME sectors, it is rare to have SMEs (especially micro and small-size business) that directly export. Instead, large companies tend to export directly, while SMEs instead seek to access foreign markets indirectly in various ways, such as partnership schemes, consortia, sales groups, market operators, sub-contracting, and integration into global value chains (OECD/ECLAC 2012; OECD, 2008d). Indeed, previous OECD work has concluded that the establishment of sustainable linkages between SMEs and MNEs is one of the most effective ways to integrate domestic suppliers into GVCs (OECD, 2008a). A number of PA SMEs have adequate quality standards to be reliable suppliers of inputs and services to MNEs and SOEs, including through both the "vertical MNEs" model characteristic of the Mexican economy and the "greenfield FDI" model of the Chilean, Peruvian and Colombian economies, as will be explained in this paper.

25. *Overall, participation in GVCs and supply chains can help to diversify exports, create new jobs, and obtain new technological capabilities and knowledge through spillovers and transfers, as well as offer potential benefits in efficiency or productivity* in the following categories: production process efficiency upgrading; product upgrading; functional upgrading, which involves adding new functions to the chain, with a greater added value; and inter-sectoral upgrading, which involves expanding the clusters towards new production activities. As stated in a previous OECD study on barriers to SME access to international markets, "…there are strong links between innovation, internationalisation and productivity growth. Internationalisation allows access to new markets, allows the absorption of excess production capacity or output, and improves resource utilisation and productivity. It exposes the SME to international best practice, knowledge, and technology through greater experience of the competitive pressures of the international trading environment" (OECD, 2008d: 14).

26. *Despite all of the potential benefits outlined above, it must be recognised that SMEs are limited in their ability to participate in international activities.* Especially in the cases of Chile, Colombia and Peru, whose economies are currently concentrated in a few resource oriented sectors where SMEs play a marginal role, significant complementary efforts in the areas of diversification, attracting FDI, and attracting companies in the manufacturing sector will be necessary in order to open up wider opportunities for SMEs to benefit from GVCs. More generally, SMEs are greatly concentrated in the non-tradable service sector, rather than in more internationally-oriented sectors such as manufacturing, and generally must reach a threshold in terms of both productivity and size in order to be successful in directly exporting and/or gaining the interest of large companies. Thus, policymakers should be aware that small and medium sized companies are much more likely to be successful in exporting among their SME peers than microenterprises.

Specific Opportunities

In addition to the opportunities for SMEs provided by global value chains, the building of a PA regional market opens new possibilities for SMEs' direct exports, as well as their indirect trade participation, business collaboration, and direct investment.

27. *While exporting to large consumption markets, such as the United States or Europe or East Asia, may require substantial capabilities for SMEs in PA countries, in order to comply with technical standards and overcome logistic, commercial and even language barriers, exporting to other PA countries may be more accessible for many competitive SMEs already successful in their home markets*. Partnerships with other similar firms could represent an additional important alternative in this regard. Developing intra-PA distribution channels would be an important policy priority in this regard; this is particularly true for sectors with strong SME participation such as light manufacturing, food products, textiles and clothing, wood, vegetables, animals and footwear.

28. *Indeed, focusing attention on fostering SME internationalisation through the development of intra-PA trade could be a particularly fruitful engine for the PA's economic integration and growth*, given the aforementioned current structure of the PA economies, as well as the relatively low volume of intra-PA trade that currently exists (3.5%),when compared to the total trade of PA countries.

29. *There are strong existing trade links that emerge when looking at intra-PA trade in detail.* An in-depth analysis of the value added figures is not within the scope of this paper; nonetheless, the Annex provides specific percentages by sector, and Figure 4 highlights some of these trade links.

Figure 4. Existing Representative Trade Links between PA Countries

Sectors representing 10% or more of intra-country trade flows

1. Sectors in bold text indicate that this sector makes up not only more than 10% of exports from one country to the other, but also more than 10% of the recipient country's imports from that country.

Source: Author's calculations with information from WITS-UNSD COMTRADE, see Annex for details

30. *Strengthening existing trade linkages among PA countries could also open significant opportunities for SMEs participation in GVCs and consolidating intra-PA value chains*. In sectors heavily dominated by MNEs, where PA countries exports are concentrated, there is also scope for increasing participation of SMEs in GVCs as quality providers of goods and services. Existing trade linkages depicted in Figure 4 could be exploited.

31. *A higher level of economic integration among PA members would open opportunities to diversify and deepen the economic productive structure of the countries, to develop new comparative advantages, and to increase economic activity and employment.* SMEs may play a vital role in fostering this economic integration.

32. *Yet, trade and investment liberalisation alone will not be sufficient to secure a higher level of SME participation in intra- PA trade and investment flows. In order to achieve this goal, trade and investment liberalisation should be closely associated with policies promoting economic diversification, supporting entrepreneurship and enterprise development.* The emergence of new comparative advantages in the manufacturing and service sectors is a pre-condition for the broadening and deepening of trade flows in the PA and a more active role for SMEs in the Alliance's trade and economic integration.

General Challenges

SMEs face a number of challenges in engaging in international activities, particularly in the areas of innovation, compliance with standards, uneven bargaining power, lack of capacity and resources, skills, and information gaps.

33. A*chieving the strict product quality standards required for participation in global value chains is difficult and costly*. SMEs are often dissatisfied with the proliferation of private standards set by contractors and the fact that they differ from each other, alleging that this makes the costs of compliance even more burdensome (OECD, 2008d). Furthermore, not only does entry into the chain necessitate higher standards, but firms also need to be prepared to rapidly switch to new standards, due to changes in technology or company strategy (OECD, 2008d). Costs of certification are, on average, very high for small firms. Small volumes of orders can limit a small firm's ability to afford costs associated with investment in new equipment and systems, obtaining certification, and developing the capabilities required to meet new standards (OECD, 2008a). Yet, lead firms are under increasing pressure to adopt both more and higher levels of standards, in response to security and health concerns from government; environmental concerns; and ethical concerns from consumers and civil society. Despite these challenges, certifications and meeting of standards are strongly associated with increased exports, and evidence generally shows that these benefits tend to outweigh compliance costs (IDB, 2014c). Thus, there is a clear need to assist SMEs in taking on these initial costs so that they can reap the benefits of increased exports through this investment.

34. *SMEs face uneven bargaining power, including in the management of their intellectual assets.* However, the issue of intellectual property should not be reduced to one of protection. For some SMEs, in fact, the realisation of value from their innovations comes from selling them to the market instead of keeping them in-house. For this reason, it is the overall management of intellectual assets that assistance to SMEs should target (OECD, 2008d).

35. *To move up the value chain, SMEs need to take up larger and more complex sets of tasks.* SMEs are concerned with both the inadequate availability of managerial and financial resources, and the inability to upgrade, protect in-house technology, and to innovate, consistently stressing that they do not have the critical dimension necessary to support R&D costs and the training of personnel (OECD, 2008a). An important phenomenon in the globalisation of value chains is the disengagement of lead companies from several stages of production along the value chain, which has implied the transfer of greater responsibilities

to subcontractors. Contractors demand more of their partners not only to manufacture a product or provide a service, but also to contribute to its development, organise and monitor a network of sub-suppliers, implement internal systems of quality control and assure compliance with an increasing set of standards, and ensure delivery and quality at competitive costs. A lack of managerial capacity to deal with the complexity of these tasks is often stated by SMEs. The need to attract, develop and retain high-quality personnel is thus key, as the internationalisation process calls for efficient management at the corporate, business and functional levels and firms seeking to join GVCs thus must improve their skills and capacities above average levels in order to successfully compete (OECD, 2008d; IDB, 2014c).

36. *SMEs struggle to obtain the above average level of skills needed in order to successfully obtain and maintain a position within a GVC.* A wide variety of sources have shown that developing country firms which join GVCs tend to have superior skills and capabilities than those operating outside of GVCs (IDB, 2014c). For example, analysis on a sample of Chilean businesses finds that vertically linked affiliates employ about 27% more workers, have 16% more skilled workers, and have 42% higher total factor productivity, demonstrating both SMEs' lower representation within this group, and the superior quality of skills employed in these firms. Vertically linked affiliates are also found to be superior to exporters in these categories, having 82% more exports overall, exporting 17% more products, and having 32% more exports per product than other exporters (IDB, 2014c). In addition, from a broader perspective, exporting SMEs in the LAC region have been found to have 55% higher sales, 54% higher value-added per worker, and be 9 percent more skill-intensive than non-exporting SMEs (IDB, 2014a). Other studies have found similar results related to other forms of offshoring, with the general result that firms participating in international production networks, even just through selling to MNEs located in their own country, tend to have superior skills and capabilities in comparison to other firms (IDB, 2014c). While this level of expertise can certainly develop once a firm enters a GVC, evidence points to there being a threshold level of skills that is needed in order to successfully facilitate even this initial entry (OECD, 2008d).

37. *Awareness and understanding of the structure and dynamics of global value chains by SMEs is generally insufficient,* although unequal across firms and sectors. A majority of SMEs across different industries are not able to identify their competitive strengths within the value chain. These companies also do not fully understand that this identification is important to optimise their participation in GVCs. SMEs state that they have a lack of time and resources to understand the evolving global context and devise a market strategy. This, in turn, translates into an insufficient ability to define the adequate business model to gain or reinforce a firm's competitiveness (OECD, 2008d). This seems to be a function of the complexity of the sector and/or the position of the firm in the chain. In sectors with especially complex configurations of their value chains, such as the tourism or cinema industries, or that can serve a variety of very different industries, such as in the scientific and precision instruments industries, it can be difficult for SMEs to obtain knowledge beyond their immediate surrounding environment. Indeed, for many, the concept itself of a value chain is not always easy to grasp. The same has been found for companies, usually SMES, which occupy a low position in the chain (OECD, 2008a). Lack of knowledge of overseas markets and contacts was unanimously identified as the main internal barrier SMEs faced concerning internationalisation during an OECD-APEC workshop in 2006 (OECD, 2008d).

Specific Challenges in the LAC and Pacific Alliance Context

A number of these challenges are more acute in the PA, and more generally in the LAC region. This is the case especially in the areas of information and communications technology (ICT), financing, skills and education, governance and institutions, regulation related to the starting and closing of businesses, the regional export and productive structure, and the size and presence abroad of export promotion organisations (EPOs).

38. *LAC SMEs have a low use of advanced ICT, which leads to fewer opportunities to connect, enter international markets, and increase competitiveness* (OECD/ECLAC 2012). Previous OECD work has found that the use of ICT-technologies and related services plays an important role in facilitating small firms' access to foreign markets, as it allows them to extend their network of business partners and reach new customers with greater ease and at lower costs (OECD, 2008a). However, the low levels of penetration of fixed broadband access in the region and in particular the low level of adoption of technology among SMEs limits their capacity to grow and expand their market opportunities.

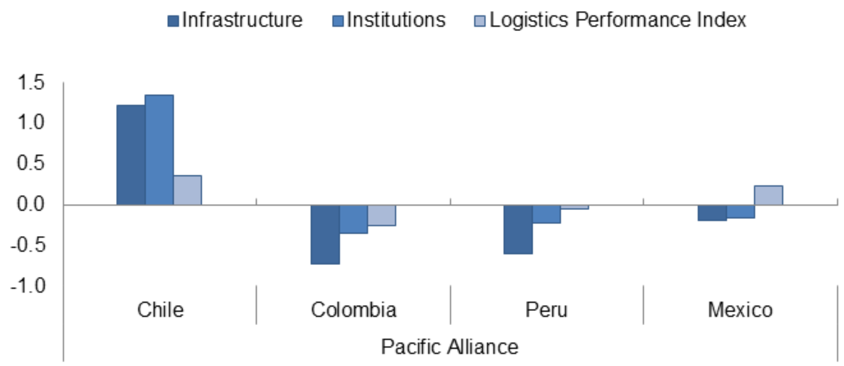
39. *LAC SMEs face substantial challenges related to financing.* LAC SMEs receive only 12% of total credit in the region, as compared to 25% in OECD countries (OECD/ECLAC, 2012). Long-term financing is also more expensive for SMEs in the region due to both the ongoing transition of the banking sector and high collateral requirements. While regional net interest margins have already been lowered to 8.6%, this rate still sharply contrasts with the OECD average of 2.7% (OECD/ECLAC, 2012). Furthermore, collateral requirements for SMEs remain high, exceeding 200% of the value of the loan in the cases of Peru, Chile and Mexico (IDB, 2014a). Demand-side issues exist as well; the approval rate of SME loans is relatively high, and yet very few overall have financing. Within the PA, Chile emerges as a leader, with close to 100% of its SMEs having a checking and/or savings account, and approximately 80% with a bank loan/line of credit. While Colombia also has rates of close to 100% in terms of SMEs with checking and/or savings accounts, only approximately 60% of its SMEs have a bank loan/line of credit. Mexico ranks significantly lower, with only approximately 60% of its SMEs having a checking and/or savings account, and less than 40% with a bank loan/line of credit.[15] Percentages of SMEs that identified access to capital as a major constraint in 2009 totalled approximately 8% in Peru, 20% in Chile, 30% in Mexico, and 45% in Colombia (IDB, 2014a).

40. *LAC SMEs have important skills gaps.* Almost 37% of companies in the region believe finding a workforce with the necessary training is one of their main obstacles, which is higher than both the global average and figures for other developing regions (OECD/ECLAC 2012). Technical skills and "soft skills" are most in demand for the region's SMEs, with most deficiencies existing in soft skills, which consist of critical thinking, teamwork, problem-solving and change management, oral and written communication, responsibility at work, and the capacity to adapt to new environments (OECD/ECLAC 2012).

41. *Poor infrastructure and institutions strongly affect the capacity of SMEs to thrive in the LAC region.* Investment in infrastructure and quality institutions is key for trade facilitation and the reduction of trade costs, as both uncertainty in international contracts and low quality infrastructure can lead to delays and sub-optimal outcomes in terms of trade and investment (OECD, 2015b). Indeed, high-quality logistics affect trade even more than distance or transport costs; it has been estimated that every extra day needed to ready goods for export and import reduces trade flows by approximately 4% (Korinek & Sourdin, 2011). Increasingly complex international transactions necessitate institutions that can create appropriate contracting environments to ease difficulties, demonstrated by institutional quality's close association with backward participation in GVCs (OECD, 2015b). Chile is the only PA country who performs above the world average in terms of both the quality of infrastructure and institutions (see Figure 5).

15 . Peru falls in the middle, with rates of approximately 90% and 70%, respectively.

Figure 5. Infrastructure and institutional quality in PA countries with respect to the global average



Source: World Competitiveness Indicators 2010 and Logistics Performance Index 2014

42. *Concerning regulatory barriers, the length and costs of processes to start and close a business are important considerations for the SME sector* (OECD/ECLAC 2012). Lengthy processes and high costs during start-up encourage SMEs to operate informally, further restricting them from access to assistance and finance by formal and governmental institutions, and from the ability to join GVCs. On the other hand, lack of an appropriate framework to close-down companies imposes creditors to significant risk, making them less likely to invest in new, smaller businesses. The World Bank Entrepreneurship Database reveals a strong relationship between the level of cost, time, and procedures required to start a business and new firm registration. Table 8 demonstrates how PA countries fare compared to LAC and OECD averages when it comes to new business density, revealing divergent outcomes: only Chile performs above the OECD average, with Peru above the LAC regional average, and Colombia and Mexico significantly below both. Yet, PA economies stand out as the top players in the LAC region when it comes to overall rankings for "Doing Business", as measured by the World Bank's *Doing Business* survey. The PA economies are the top four ranked LAC economies in the survey, with Colombia taking the top position (34th place overall), followed by Peru (35th place overall), then Mexico (39th place overall), and then Chile (41st place overall). This presents a two-sided picture: while PA economies are doing well relative to LAC regional standards, there is still room for improvement to reach the standards of other regions and OECD countries.

Table 8. New business density for PA Countries, LAC region and OECD countries (number of newly registered private, formal sector companies per 1,000 working-age people (ages 15-64))

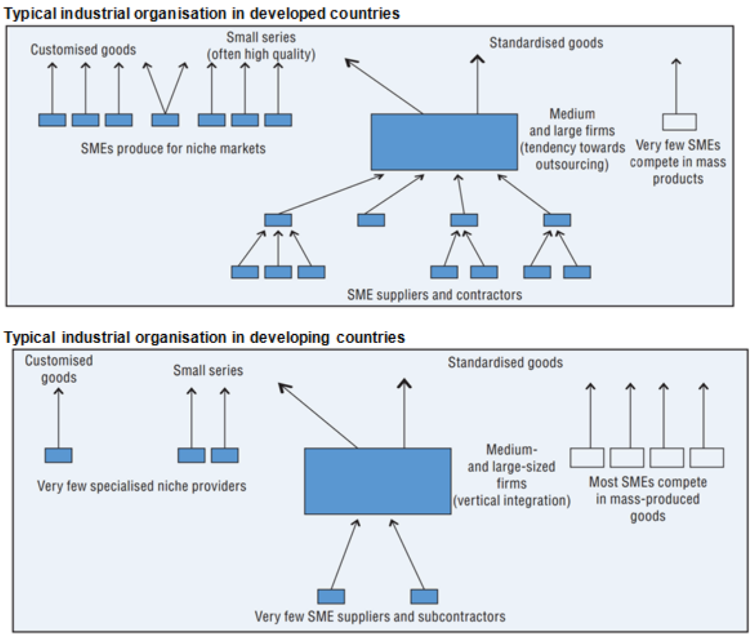
	Chile (2012)	**Colombia (2012)**	**Mexico (2012)**	**Peru (2012)**	**LAC Region**	**OECD Countries**
New business density	5.69	2	0.88	3.83	3.12	5.1

Source: Author's calculations based off of World Bank Entrepreneurship Database (https://ideas.repec.org/p/wbk/wbrwps/5493.html)

43. *The productive structure prevalent in LAC countries often poses barriers to SME productivity and internationalisation*. The regional export structure does not encourage SMEs to access more innovative processes through a stimulus to export, as it is centred on natural resources and their derivatives and dominated by large firms due to the heavy required investment costs in these sectors (OECD/ECLAC 2012). Furthermore, the regional productive structure of LAC SMEs markedly differs from what is found in OECD countries. As stated in the OECD's *2013 LEO*, "In OECD countries, SMEs can only survive in the industrial development process if they produce specific goods and services that do not compete with products mass-produced by large industrial firms… almost all of them [LAC SMEs] operate in

standardised forms of production that are not knowledge-intensive, thus competing directly with mass producers and/or large commercial enterprises" (pg. 52). As displayed in Figure 6, this productive structure limits LAC SMEs' ability to link with larger firms, as rather than complementing their production they attempt to compete with them. LAC SMEs' particularly low rates of productivity also impacts their ability to link with large firms, who are not apt to choose suppliers that will struggle to meet the necessary quality standards or volume of production. This results in a vicious cycle, with the SMEs' initial low productivity fuelling an absence of knowledge transfer among businesses, and vice versa (OECD/ECLAC 2012).

Figure 6. Typical industrial organisation in developed and developing countries



Source: OECD/ECLAC (2012)

The task of subsequent chapters will be to explore how PA countries are currently addressing these challenges and analyse a variety of policy alternatives that the PA could jointly employ in order to expand and improve these current activities (Section II). The *goal is to provide clarity regarding the overall scope of current knowledge on this topic; apply this knowledge to the PA region in order to generate a set of preliminary policy recommendations; and use this preliminary scoping analysis in order to aid the PA in the preparation of a programme of work to support their SMEs in taking full advantage of their integrated market and utilising the PA as a springboard for internationalisation. To support this final aim, specific proposals for future OECD projects to support these efforts, which will provide more in-depth analysis on key policy areas and recommendations, will be given at the end of the paper (Section III).*

SECTION II: CURRENT EFFORTS BY THE PACIFIC ALLIANCE AND ELEMENTS TO CONSIDER FOR A JOINT AGENDA

Introduction

44. *Previous OECD work on SME internationalisation has identified a core group of key challenges across a variety of global contexts.* Two surveys conducted by the OECD in 2008, entitled "The Member Economy Policymaker Survey" and "The Survey of SMEs' Perceptions of Barriers to Access to International Markets" obtained detailed insights regarding barriers facing international SMEs as perceived by policymakers (Member Economy Policymakers Survey) and SMEs themselves (Survey of SMEs' Perceptions) (OECD, 2008d).

45. *The barriers to internationalisation identified in the survey were classified into four categories:*

1. **Finance** – *e.g.* programmes to overcome systemic inefficiencies in financial markets

2. **Business environment** – *e.g.* programmes to improve the general business environment within which SMEs operate

3. **Firm capabilities** - *e.g.* programmes to assist in human resource development and to help enhance the capability of SMEs to survive and compete

4. **Market access** - *e.g.* programmes to provide access to information and markets

46. *This section will provide a summary of existing OECD work on each topic, take stock of PA countries' current policy efforts, and provide elements for the PA to consider in advancing their joint agenda in each of these policy areas*[16]*, with the addition of a fifth category that specifically focuses on trade*, in line with this paper's special focus on SME internationalisation. The stocktaking is based off of questionnaire information provided by PA member countries to the OECD, and thus should not be viewed as either a comprehensive or in-depth review of current PA actions. Rather, the intention is to provide an overview of activities in order to facilitate a baseline understanding between the OECD and PA of current efforts. Similarly, the suggested elements to consider are based off of both this stocking information and previous OECD work and recommendations on relevant topics. Thus, these are meant to support the PA in advancing a joint policy agenda and facilitate a baseline of understanding between the OECD and PA regarding OECD work and understanding of best practices, which can be utilised as a platform for (i) identifying subjects in need of future targeted research, (ii) determining and designing future PA joint actions, and (iii) determining where the OECD can best offer support. Prior to using these categories, an overview of the major institutions that support SME development in each PA country will be given, setting the stage for the subsequent categorical evaluation of their efforts.

[16] While possible programmes and types of interventions have been divided into the above four main categories, it should be noted that many of these interventions could be placed underneath more than one category, as they address multiple categories of support. Efforts have thus been made to highlight these overlaps in the following descriptions of these various policies, and advice related to them.

Institutional Environment Supporting SMEs in the Pacific Alliance

SME Development Institutions

47. *PA countries have both autonomous SME development institutions and SME development institutions that fall under the responsibility of various ministries.* Both types of institutions are mandated to implement SME supporting programmes; policy elaboration is instead under the remit of the line ministries. Colombia, Mexico and Peru have SME Development institutions under the responsibility of a ministry (see Table 16), while the Production Development Corporation (CORFO) of Chile stands out as the single autonomous institution. While having these types of organisations work more closely with government ministries (production, industry or finance) can make it easier to match policies aimed at SMEs with the national economic development agenda, having institutions that have a certain level of independence can generate a greater capacity to design and implement policies (OECD/ECLAC, 2012).

Table 9. SME Development Institutions in PA Countries

Country	Policy Implementation Institution/s	Overseeing Ministry
Chile	Production Development Corporation (CORFO)	Independent
Colombia	MSME Department	Ministry of Commerce, Industry and Tourism – MINCIT
Mexico	National Institute of the Entrepreneur (INADEM) Under-secretariat for SMEs Nacional Financiera (NAFIN)	Secretariat of Economy
Peru	SME and Industry Bureau Foreign Trade Development Bureau	Ministry of Production Ministry of Foreign Trade and Tourism

Source: Based on Official Information from Countries

48. *The export and investment promotion organisations of PA countries also support SME internationalisation in a variety of ways.* On a number of occasions, these agencies have joined efforts with the specific goal of "present[ing] the Pacific Alliance and Latin America to the world"[17], including conducting joint seminars on attracting business and strategies for international promotion; the organization of an annual "Pacific Alliance Business Matchmaking Forum", offering PA entrepreneurs opportunities to interact and generate business and partnerships; and an annual Innovation Promotion and Entrepreneurship Forum. Overall, 87 jointly coordinated activities for promoting trade, investment and tourism were organized from 2013-2014.

Table 10. Export and Investment Promotion Organisations in PA Countries

Country	Institution	OverseeingMinistry
Chile	ProChile	Ministry of Foreign Affairs
Colombia	ProColombia	Ministry of Commerce, Industry and Tourism – MINCIT
Mexico	ProMéxico	Secretariat of Economy
Peru	PromPerú	Ministry of Tourism and Foreign Trade

Source: Official Information from Countries

49. *PA countries also stand out as top regional performers concerning the presence of export promotion organisations (EPOs) abroad, though there is definite room for improvement in relation to other countries outside of the region*, with ProChile, ProMéxico, and ProExport (ProColombia) taking the region's top three places. Peru on the other hand, has no listed EPOs abroad, most likely relying, like other LAC countries, on the support of embassies and consulates for exporting companies (IDB, 2014b).

[17] *Negocios: The Pacific Alliance Issue*, May 2014

Budget Allocation

Budgetary constraints pose a key constraint to proper SME development and support in the LAC region.

50. *All LAC countries have budgets of less than 0.1% of GDP allocated to developing SMEs, and in many countries it is less than 0.01%* (OECD/ECLAC, 2012). These low numbers hold true for PA economies, with only Mexico and Chile's expenditures rising above 0.01% of GDP (see Table 11).

Table 11. Expenditure by institutions to develop SMEs, 2005 (pecentage of GDP)

	Expenditure
Chile	0.03
Colombia	0.008
Mexico	0.015
Peru	0.004

Source: OECD/ECLAC, 2012

51. *Only Brazil and Mexico's EPOs have budgets of more than USD 100 million, though average annual budgets in developed countries regularly exceed this figure, and can even exceed USD 300 million* (IDB, 2014b). Furthermore, within the region, only ProChile, ProMéxico, and PromPerú have staff totalling more than 300 employees (IDB, 2014b). Most LAC countries underperform relative to their level of development in allocation of resources to EPOs, with the exceptions of Costa Rica (ProComer), ProChile, PromPerú, and ProColombia (IDB, 2014b).

52. *The presence of PA countries among these top-resource allocators is a positive sign of the importance bestowed on export promotion.* For example, it is notable that, while only Brazil and Mexico spend more than USD 100 million on their EPOs, Colombia, Chile, and Peru take the next three places after these two countries, respectively. Furthermore, expenditure on SMEs in PA countries is increasing; for example, Colombia had a 66.89% increase in its budget for SME promotion and support from 2014-2015, going from approximately USD 32.25 billion in 2014 to USD 53.8 billion in 2015.

1. Finance

***New OECD research highlights the fact that traditional bank finance poses challenges to SMEs*, in *particular to newer, innovative, and fast-growing firms with a higher risk profile, and thus recommends that diversified funding sources for SMEs can better serve the needs of firms at different stages of their life cycle, as well as help to mitigate systemic risk, strengthen the economy's resilience to critical shocks, and foster new sources of growth* (OECD, 2015a).**

53. *Overall, the report indicates that it is essential to address obstacles limiting SMEs' use of a broader range of financial instruments by* (OECD, 2015a):

- Addressing the SME skills gap in finance
- Designing regulation that balances financial stability, investor protection and the development of innovative financing channels for SMEs
- Creating information infrastructures to improve credit risk assessment
- Increasing participation of private actors in SME finance

54. *An active private equity industry helps to assist firms with the constraints posed by scale-up, through investing in companies, improving their management practices, and restructuring the firm to operate at a higher scale.* Thus, the lack of a healthy private equity industry could be part of the reason behind low scale-up rates in the region[18] (IDB, 2014b).

55. *In addition, venture capital can be a powerful aide for the expansion of start-ups with high growth potential and productivity.* Furthermore, it can have strong complementarities with other policies, such as incubators; indeed, incubation may be unable to meet its potential without a strong venture capital industry that can offer its firms an exit. The average LAC economy has only 10% of the venture capital relative to GDP that China and India have, despite having twice as much income per capita; indeed, only Chile and Colombia mentioned venture capital within their SME development activities (see pg. 28).

56. *Policies that are intended to help SMEs can also end up dampening incentives to scale-up*. This phenomenon has been identified in Mexico, where policies ranging from tax exemptions and electricity subsidies to zoning rules have resulted in perverse incentives to stay small and the protection of "mom and pop" businesses from modern competitors, allowing these businesses to continue at a sub-par rate of productivity without facing consequences (Bolio and McKinsey, 2015).

PA countries have a large variety of financing instruments in place for SMEs, including direct funding, factoring, reverse factoring, provision of credit under favourable conditions and guarantees for credit, micro insurance, and facilitation of access to venture capital for start-ups, which vary significantly in terms of orientation, size and the targeted segment of the SME population. No country, however, has all of these options well developed.

As many of these instruments are linked to other programs, this section will be limited to a short review of bank financing and other SME financing support schemes.[19]

57. *Mexico has engaged in supplier financing through "factoring" and "reverse factoring", targeting SMEs linked to GVCs and MNEs.*[20] In addition, Mexico's National Entrepreneurship Fund allocates approximately 36% of its funding towards a guarantees programme, intended to enhance access to finance for SMEs by allocating resources to financial institutions while still having the Federal Government incur the financing risk.

18 . Little is known about why firms scale-up relatively poorly in the LAC region; thus, this is a key potential area for future research. Research shows that, for example, firms in the United States that have survived for 40 years employ nearly eight times as many workers as firms that are 5 years old or younger, while the same scale-up factor for Mexico is only two times (IDB, 2014b).

19 . Peru's report of activities stated that its efforts are focused more on provision of expertise and assistance in different areas, rather than highlighting financing elements, which is why it is not mentioned in this section.

20 . Factoring is a type of supplier financing in which firms sell their credit-worthy accounts receivable at a discount (equal to interest plus service fees) and receive immediate cash. There is no debt repayment and no additional liabilities on the firm's balance sheet, although it provides working capital financing. Factoring is not a loan but a comprehensive financial service that includes credit protection, accounts receivable bookkeeping, collection services and financing. In reverse factoring, the lender purchases account only receivable from high-quality buyers (*i.e.* large internationally accredited firms) so that the credit risk is equal to the default risk of the buyer and not that of the SME (OECD, 2008: 31).

58. *Countries such as Chile provide more general loan programmes*, such as the "CORFO Credit for Micro and Small Enterprises", along with a variety of measures aimed specifically at financing start-up and growth; providing guarantees to lessen risk, and facilitating access to venture capital[21].

59. *Colombia's entrepreneurial development bank, Bancoldex, designs and offers a variety of financial and non-financial instruments to promote competitiveness, productivity, growth and development.* Bancolodex aims to increase SMEs' access to financing by offering longer repayment terms and lower interest rates, with credit lines that provide funding for working capital, investment and company modernization, green financing, and innovation and entrepreneurship. Microinsurance to protect entrepreneurs' equity is also available, as well as a private equity and venture capital fund aimed at developing the capital investment industry in Colombia.

Box 15. Elements to Consider for a Joint PA Agenda - Finance

The above actions demonstrate the PA's understanding of the role that governments can play in helping to bear part of the risk that SMEs undertake when they venture into international markets, thus increasing incentives for more SMEs to internationalise, as well as the need for a variety of targeted financial products which correspond to SMEs core needs (innovation; start-up, etc.).

Going forward, PA countries should consider:

- *Diversifying their own portfolio of instruments for financing SMEs, learning from other PA country experiences, and ensuring that their instruments are complementary to those adopted by their PA partners.* The OECD SME Financing Scoreboard provides comparisons of financing mechanisms for SMEs across OECD countries. A specific report could be undertaken for the PA, building on this analysis (see Section III).

- *Taking advantage of existing joint efforts in the creation of the Latin American Integrated (Stock) Market (MILA) to create joint financing instruments for the most advanced and innovative SMEs*, providing a new alternative source of equity financing to support their expansion.

- *Organizing a workshop on SME financing where PA countries and other countries could share their own practices.* The OECD could support PA countries in this endeavor.

- *Sharing of existing venture capital programmes (in Chile and Colombia) and investing in further research in order to identify key barriers to scale-up in PA countries.*

2. Business Environment and Provision of Business Services to SMEs

Previous OECD work has outlined a number of important considerations and recommendations in the areas of development of industrial clusters; attracting foreign direct investment; facilitating international certification; and protecting intellectual property rights.

Further Development of Industrial Clusters

60. *A focus on developing strong clusters aligns well with the goal of internationalising SMEs, especially through GVCs, as, once a cluster is developed, MNEs can play a key role in helping to integrate*

[21] Within its questionnaire, Chile noted the following activities to promote access to finance: Venture Capital Direct Investment in Mutual Funds (Capital de Riesgo Corfo Inversión Directa en Fondos de Inversión); Venture Capital for Innovative Enterprises (Capital de Riesgo Corfo para Empresas Innovadoras); Corfo Credit for Micro and Small Enterprises (Crédito Corfo Micro y Pequeña Empresa); Phoenix Mining Exploration Fund (Fondo de Exploración Minera Fénix); Development and Growth Fund (Fondo Desarrollo y Crecimiento); Early Stage Fund (Fondo Etapas Tempranas); Guarantee Funds for Mutual Guarantee Institutions (IGR) (Fondos de Garantía a Instituciones de Garantía Recíproca (IGR)); Corfo Foreign Trade Guarantee (Garantía Corfo Comercio Exterior); and Corfo Investment and Working Capital Guarantee (Garantía Corfo Inversión y Capital de Trabajo).

them into GVCs (OECD, 2008a). Clusters can also help to foster skills development, especially through sector-specific worker training. As noted in the OECD's 2008 report on Enhancing the Role of SMEs in Global Value Chains, "cluster initiatives allow for economies of scale and agglomeration, and also help develop an experienced local pool of skilled labour and a network of firms cooperating in complementary areas of specialisation. By doing so, they strengthen their competitive advantages in a sustainable manner and become attractive sites for quality FDI" (pg. 13). Quality cluster programmes should create frameworks for private-private, public-private, and public-public collaboration. Public-public coordination has proved to be the most difficult; in this regard, horizontal development agencies, such as CORFO, may be better placed to oversee clusters, as they can thus coordinate across agencies, have implementation capacity, and are less constrained by the political cycle of ministries (IDB, 2014b).

61. *Clusters can also help to foster mergers, when this would serve the interests of the SMEs involved.* In response to heightened demands and expectations for sub-contractors from lead firms, as discussed previously, there are heightened pressures on SMEs to merge in order to attain the needed level of capacity and resources to comply with lead firms' demands (OECD, 2008a; IDB, 2014c). Indeed, research has found that firms seldom join GVCs on their own; instead, they leverage resources with other firms in order to obtain needed capabilities, and often collaborate through clusters and associations in order to overcome information gaps (IDB, 2014c). Thus, a position within an industrial cluster can serve to overcome information and trust barriers regarding potential partners, and facilitate mergers that serve to upgrade SMEs capacities to participate in GVCs.

62. *More mature and/or large firms can help to scale-up and link start-ups with international markets through acquisitions.* Research on innovative companies shows that most of the successful exits of venture-capital backed firms in the U.S. are acquisitions by older firms, as well as that when companies get access to public stock markets, they increase the acquisition of innovative technology (IDB, 2014b). The integration of all PA countries into the MILA stock market is thus a significant development in this regard, which could potentially assist firms in the scale-up process.

63. *Overall, the value of cluster development lies in the creation of networks of enterprises, which can then foster sharing of information, best practices, and access to markets and opportunities.*

Attracting Foreign Direct Investment

64. *The OECD has also done considerable work on policy frameworks which support and encourage investment, thus, creating opportunities for integration into GVCs.* In its '2015 OECD Latin American Economic Outlook' the OECD draws two conditions for FDI to create ties with foreign markets, which can boost technology uptake because those markets have more stringent competitiveness demands (price and quality): "Meanwhile, two conditions must be met for these positive effects to become a reality: investment must be channeled towards the most technology-intensive sectors or activities, and beneficiary countries need an environment that is conducive to spillovers and linkages with the rest of the economy. Both aspects require an institutional environment and policies that prevent new technologies from becoming an enclave with scant linkages to the rest of the production system" (OECD/CAF/ECLAC, 2014).

Facilitate International Certification

65. *OECD work recommends that governments should ensure that national certification systems do not impose an excessive burden on small firms and encourage SME participation in the standard-setting process in order to do so.* PA efforts to harmonise sanitary measures and certifications are a positive measure in this regard, and show clear recognition of the barriers that complex certifications systems can pose to internationalisation. The public sector can also assist SMEs by helping to develop and administer quality labels in order to assist their efforts to attract the attention of global buyers. Indeed, IDB research

found that many firms regard their certifications as similar to business cards, utilising them in order to introduce themselves to global buyers.

66. *Furthermore, interventions related to closing information gaps are also highly useful in terms of educating firms about the importance of and steps needed to achieve quality and certification standards.* The kinds of exchanges listed within the sub-section on "Provision of Information" (pg. 39) can serve to close information gaps surrounding this topic, as potential exporters are often not fully aware of all the steps needed to obtain certain standards or certifications, and/or may not be convinced that these certifications are worth the cost (IDB, 2014c).

Protection of Intellectual Property Rights

67. *Protection of intellectual property rights is also a key policy area, as small firms' incentives to innovate may be reduced if appropriation of economic benefits is threatened* (OECD, 2008a). SMEs have reported that requests for complete transparency from sub-contractors on virtually every relevant aspect of their business has facilitated unfair business behaviour, consisting in the contractor passing original designs and plans submitted by SME partners to lower-cost competitors (OECD, 2008d).

While PA countries have a variety of well-established and proactive activities in the areas of forming business clusters (see Table 12) and attracting foreign investment, Mexico, in particular, also provided reporting on efforts to facilitate international certification.

Table 12. Examples of Cluster Programmes in PA Countries

	Programme Name	Key Points
Chile	PROFO (Programas Asociativas de Fomento)	- In place since 1992 - Brings together groups of at least five SMEs in order to improve their access to markets - Had reached over 10,000 SMEs by 2014
Colombia	iNNpulsa, - Competitive Routes Programme	- Seeks to develop clusters that increase the competitiveness of local businesses, and integrate all actors within value chains, including foreign companies - 67 clusters are currently in place, covering both goods and services
Mexico	INADEM – National Entrepreneurship Fund - Public call for "Development and Strengthening of the Exportable Offer"	- Category "Business cooperation for exports" refers to projects that either set-up or consolidate exporting consortia composed of Mexican partners
Peru	ProInversión (in collaboration with UNCTAD)	Peru's Private Investment Promotion agency has implemented a technical co-operation programme, which includes the following elements: module on promotion of the entrepreneurial relationship (to assist SMEs and individual entrepreneurs); encouragement of entrepreneurial associations and cluster development; expansion of modern business practices through the creation of a global network

Source: Official Information from Countries; IDB, 2014b; OECD, 2008c

An important strength of the PA is its openness to international trade and investment.

68. *The "GVC revolution" has been driven to a large extent by Multi-National Enterprises (MNEs) and FDI* (OECD, 2013). PA member countries are broadly open to international investment and have played a major role in the growth of FDI flows in Latin America. According to the OECD FDI Regulatory Restrictiveness Index, the PA is on average more open to international investment than the other 54 countries included. Over the past decade, FDI to the PA has grown almost twice as fast as flows to all emerging markets, and the four member countries have captured more than 51% of total FDI flows to Latin

America in 2000-13. According to the World Investment Report (UNCTAD, 2014), Mexico, Chile and Colombia were within the world's top-20 recipients of FDI flows in 2013, with inflows totalling USD 38bn, USD 20bn and USD 17bn , respectively, and ranking, after Brazil, as the next top recipients in the region. Peru occupied the fifth position in the region with USD 10bn. There is considerable potential for raising intra-PA FDI flows, currently equal to only 3% of total FDI received from all sources. Most current intra-area flows correspond to the activities of Chilean "multilatinas". However, programmes supporting linkages between local SMEs and foreign owned enterprises are still relatively underdeveloped in the PA, with the exception of Mexico and Chile (see pg. 40).

69. *Regarding FDI, concrete PA initiatives in support of economic integration include the activities of the Committee on Trade and Investment and of the Working Group on Services.* A joint committee composed of an investment subcommittee and a service trade committee has been established to improve the institutional and policy environment through enhanced cooperation and exchange of information. Healthy competition among national and sub-national investment promotion agencies also exists, as well as collaboration in high-level forums like those organized in New York in 2013 and in Miami in 2014, where the four Heads of State jointly promoted the PA.

70. *In the area of international certification, INADEM's National Entrepreneurship Fund allows for the support of projects focused on certifications* within Category I (Regional and Sectoral Development) of its "public calls" programme, as well as within specific calls for "High Impact Entrepreneurs" and "Development and Strengthening of the Exportable Offer". *Elements to Consider for a Joint Agenda*

Box 16. Elements to Consider for a Joint PA Agenda - Business Environment

In light of the above OECD work and already implemented PA efforts, going forward, PA countries should consider:

- *Developing and developing further business clusters and linkages between SMEs and larger enterprises in sectors where there are opportunities for greater participation of SMEs in GVCs.* This may include measures to promote business networks and intra-firm cooperation; the introduction of SME mentoring schemes; and the expansion of quality certification programmes to ensure that SMEs acquire the technical and quality standards required to qualify as suppliers to multinational enterprises and to integrate into GVCs.

- *Going beyond the development of clusters at the national level, and working to form PA clusters by sector* (automotive, textile, etc.), as a way to identify synergies among Alliance members, and encourage further trade, mergers, and sharing of information.

- *Building on its already substantial initial joint efforts aimed at attracting FDI*. Future policies can explicitly be designed to meet a variety of needs, such as attracting MNEs that will promote technology and knowledge transfer to local suppliers and subcontractors, or helping established foreign affiliates to enter and/or upgrade into higher-value activities. Investor after-care services are also a key policy area to consider, as this can influence investors' decisions on initial and/or continued linkage development (OECD, 2008a). PA countries could thus undertake joint initiatives of FDI attraction and investor after-care services with an emphasis on MNEs, particularly on those with multiple operations in the PA region that will promote technology and knowledge transfer to local suppliers and contractors.

- *Building on their joint participation in the OECD Investment Committee and adherence to the Guidelines for Multi-National Enterprises to increase synergies in their Investment Policies, and avoid mutually damaging actions* such as incentive competition to the bottom; the non-respect of environmental, IPR, and labour regulations; and the tolerance of anti-competitive practices directly harming SMEs.

- *Including provisions for technology transfer from small subcontractors to MNEs, within the context of the OECD Guidelines for Multinational Enterprises*

3. Firm Capabilities

Services provided by SME Development Institutions in the area of developing firm capabilities usually covers a broad range of general instruction in business management, such as on how to start a company, manage cash flow, etc. This section will instead focus on surveying previous OECD work and PA efforts in more specialised service provision, covering the areas of supplier development programmes; promotion of start-ups and innovation; skills development; and incubation.

Supplier Development Programmes

71. *A firm's productivity is strongly related to its ability to participate in export markets, making the productivity gap between SMEs and large firms in Latin America, which, as stated in Section I of this paper, is comparatively much larger than gaps found in other regions, an area of key concern.*

72. *The continued development of supplier development programmes is thus a key policy area for the PA, offering clear mechanisms for the strengthening of SME-MNE linkages that can serve as a platform to both indirect and direct internationalisation.* When designing these types of programmes, PA countries should keep in mind that interventions that boost a company's productivity and competitiveness need to be paired with interventions that strengthen links and integration (OECD/ECLAC, 2012). Supplier development programmes can increase SMEs' ability to boost productivity and increase sales, while creating stable, qualified suppliers for large companies.

73. *In order for SMEs to capture more value added from their participation in GVCs, or even make their first successful entry into a GVC, technological upgrading is essential.* This can be fostered through public policies targeting supplier development and/or supplier financing. Policies in this area should aim to support training and capacity building via skills development programmes; to promote partnerships between SMEs and organisations overseas that can develop or transfer technology, products, processes or management practices; and to facilitate the technological upgrading through various financial schemes, such as credit lines for upgrading (OECD, 2008a).

Innovation

74. *In the field of innovation, the OECD has made relevant recommendations to PA countries within its Innovation Policy Reviews (Colombia 2014; Peru 2011; Mexico 2009; Chile 2007); in addition, the recent OECD study entitled Start-up Latin America: Promoting Innovation in the Region identified key elements that could constitute elements of a PA agenda, including:*

1. *Increase co-ordination in strategy planning.* Start-up support programmes can only reach their full potential when they are set within broader productive transformation strategies that contribute to generate a favourable environment for these companies to develop.

2. *Ensure the availability of a balanced policy mix targeted to the different development stages.* Often, countries tend to focus on one particular tool, overlooking other important elements which are critical for these firms to develop. For instance, while venture capital is essential for the expansion stages of start-ups, its effectiveness will depend on the existence of seed funding available for entrepreneurs in earlier development stages.

3. *Design and implement more sophisticated support tools that are more in line with emerging global trends.* Despite the region's recent progress in promoting start-ups, Latin American countries still face important barriers that need to be overcome by: *i)* simplifying the regulatory framework to facilitate the creation and expansion of start-ups; *ii)* identifying opportunities to

promote business angel networks; *iii)* investing in promoting an entrepreneurial culture, particularly among young people; *iv)* introducing performance-based management criteria in incubators and agencies that facilitate access to public development programmes; and *v)* designing integrated support programmes that simultaneously offer financing, business services and entrepreneurial skills learning.

4. *Take advantage of emerging private sector open innovation trends, corporate venture capital and knowledge-sharing* to foster both the quantity and quality of innovative entrepreneurial projects

5. *Evaluate programmes and adjust incentive schemes based on performance.* This also requires investing in creating new, better metrics for measuring the dynamics of creation and expansion of start-ups in LAC in order to improve the capacity to design better policies based on results.

Skills Development

75. *While, participation in GVCs can result in the transfer of knowledge and technology and subsequent upgrading of SMEs' human and technological resources, it is also true that initial entrance into a GVC, or continuance within the chain, can be a very demanding process.* This is true especially in light of the previously discussed disengagement of lead companies from several stages of production in the chain, and subsequent transfer of greater responsibilities for oversight, and product development/innovation to sub-contractors. Thus, an initial threshold of capabilities is often necessary to successfully enter value chains. Policies that aim at raising technical and managerial skills in SMEs can boost integration of these firms into global chains (OECD, 2008a).

76. *A growing body of empirical studies has found that having an adequate pool of human capital seems to be a key factor for exporting a wide range of services related to GVCs, demonstrating that, while quality of education is almost certainly an important factor, it is not enough in and of itself.* (IDB, 2014c). Rather, there needs to also be a sufficiently large pool of individuals with the skills that the market demands (IDB, 2014c). OECD work on Costa Rica echoes this, finding that although the country has a quality education system, it needs to increase its overall quantity of human capital to continue its participation levels in information and knowledge-intensive sectors (OECD, 2012).

77. *Thus, free movement of human resources is critical to the realization of the PA's vision and economic development of the members.* Joint PA efforts to waive tourist visa requirements for citizen travel within the PA and introduce a scholarship program in order to promote academic mobility, as well as Peru's elimination of business visas for PA citizens to improve market access, are positive developments in this regard.

78. *In addition, informality also has implications for skills development, generally leading firms to underinvest in this area*.

Incubators

79. *The development of high-quality incubators is a potentially important policy area for facilitating the success of firms with high-growth potential* (IDB, 2014b). Incubators should aim to provide things that markets are less likely to generate, such as quality mentoring, and matching youth firms with assets and ideas that could help them to grow (IDB, 2014b). Incubators should also structure themselves in ways that align incentives between the incubator itself and the firms it seeks to help, as CORFO's 2010 reform aimed to do (see above), and thus avoid paying incubators a fixed fee based on the number of firms incubated.

In the area of firm capabilities, PA countries have developed a variety of programmes to support the development of local suppliers and strengthen SME-MNE linkages; are increasingly creating

programmes with the aim of fostering innovation; and have put together a variety of successful programmes in the area of skills development. In addition, Chile's experience with reforming its incubation programmes could be highly instructive for the rest of the PA bloc.

Supplier Development Programmes in the PA:

80. *Both Chile and Mexico's supplier development programmes (see Table 13) are aimed at overcoming coordination failures in order to strengthen the relationship between MNEs and their SME suppliers, as well as improving SME suppliers' prospects for internationalisation, in the case of Chile's BHP Billiton- CODELCO programme.* Without these programmes, coordination failures often arise, as companies can be unwilling to assist their producers, for fear that they will potentially switch buyers, and producers are often not motivated on their own due to information gaps concerning foreign market requirements and potential pay-off (IDB, 2014c).

Table 13. Examples of Supplier Development Programmes in PA Countries

	Programme Name	Key Points	Key Achievements/Goals
Chile	CORFO - Programa de Desarrollo de Proveedores (PDP)	- "Leader" or applicant must submit a development strategy for a group of its suppliers[2]; if accepted, the leader provides complementary funds	- Particularly successful in assisting Chilean companies in the process of adhering their products to new standards upon signature of a variety of free trade agreements in the 1990s
	BHP Billiton-CODELCO (National Copper Corporation)-CORFO	- Offers participating local businesses the chance to increase their efficiency and competitiveness through technical-training activities about the production process, setting targets for improving the quality of products and services, and providing consulting services to improve business management	- Goal is for 250 suppliers to meet an international quality standard by 2020 and improve competitiveness and their prospects for internationalisation - From 2008-2013, 50 BHP Billiton suppliers and 20 CODELCO suppliers joined - CORFO joined in 2011
Mexico	INADEM – National Entrepreneurs hip Fund - Public Call for "Development of Suppliers"	- Grants are aimed at supporting one or several SMEs with the explicit support or interest of larger enterprises, in areas such as equipment, infrastructure, consulting and training, design and innovation, transfer of technology, certifications and others - Grant amounts can total up to USD 1.3 million, or 50-60-% of the project	

2. Must be composed of a minimum of 10 companies if belonging to the agroforestry sector, or five companies in other productive sectors

Source: Official Information from Countries; OECD/ECLAC, 2012; IDB, 2014b

Innovation in the PA

81. *Start-ups are an emerging phenomenon in LAC innovation strategies* (OECD, 2013). Table 14 displays the status of PA countries regarding the state of implementation of various policy tools to promote start-ups, revealing Chile as a leader within the PA in this policy area. For more information on selected programmes within PA countries, see Table 15, which outlines a number of programmes highlighted by the respective countries.

Table 14. Targeted policy tools to promote start-ups in Latin America: Pacific Alliance countries, 2012

Category	Tool	Chile	Colombia	Mexico	Peru
Financing	**Seed capital**	✓	◆		◆
	Angel investors	x	◆		
	Venture capital	✓	◆	x	
Business services and entrepreneurial training	**Incubators**	✓	x	x	◆
	Accelerators	x		x	
	Corporate spin-offs				
	Technology transfer and university spin-offs	x		✓	
	Business training	✓	x	x	x
Regulatory framework	**Ease of creating or closing down businesses**	x	x	x	x
	Taxation and special legislation	x		x	

✓ (Implemented) x (In development) ◆ (Recently created) Blank indicates needs to be created or reformed

Source: OECD, 2013

Table 15. Examples of Programmes to Promote Start-Ups and Innovation in PA Countries

	Programme Name	Key Points
Chile	InnovaCORFO	- Programme that provides tax incentives (up to 35% of resources allocated to R&D eligible) for investment in R&D - Co-financing of prototype development and/or improvement of products/innovative processes
Colombia	iNNpulsa Mipyme Fund SME Innovation Support Initiative iNNpulsa Mipyme Fund Value Chain Relationships Support Programme	- Provides resources totaling up to either COP $400 million or 65% of the project cost, to firms developing new goods or services with market potential - Provides resources totaling up to either COP $700 million or 65% of the project cost to support process upgrading, product development, and meeting market requirements in order to increase SMEs' efficiency and scale - Provides up to COP $200 million or 70% of total costs for start-up and beginning operational costs
Mexico	See sub-section below on "Skills"	- current efforts mainly focused on technology transfer and utilization of universities
Peru	"Start-Up Peru" "Innovate Peru"	- Uses an incubation system to promote the creation and development of SMEs offering innovative products and services with high technological content, with an emphasis on connection to international markets - Promotes research and development, as well as transferring knowledge through competitive funds, such as the Fund for Research and Development for Competitiveness – FIDECOM

Source: Official information from countries

Skills Development in the PA

PA countries such as Chile, Mexico and Peru have developed successful skills development programmes.

82. *For example, the Mexican "Promotion Programme of Exportable Supply for SMEs" supports companies interested in beginning to export and/or diversify their products.* It does so through comprehensive and integrated services, such as qualification, specialised consultancy, promotion of international markets and commercialisation, and institutional and management support in developing export projects, thus combining assistance in both capabilities development and gaining access to markets (OECD, 2008d). Similarly, the Exportable Supply Impellers Promotion Programme in Mexico brings together foreign trade organisations to support SMEs, and specifically assists in developing infrastructure for product promotion and storage; inventory management; determination of costs; and international marketing, providing comprehensive assistance across the areas of financing, capabilities development, and access to markets (OECD, 2008d). In Peru, the "Generating Capacities for Export Chains" programme aims to generate capacities that will allow micro and small enterprises to become incorporated in export chains, through non-financial training and information services (OECD, 2008d).

83. *In addition, various LAC countries, such as Mexico and Colombia, have successfully experimented with including scientific research institutions, universities and centres of excellence in their offerings of support services*, which, despite having knowledge and high quality infrastructure for the production environment, were often were not properly connected or integrated into production activity for cultural or regulatory reasons (OECD/ECLAC, 2012). An example is the software cluster in Mexico City, where the Monterrey Institute of Technology and Higher Education and the University of León created training programmes for universities and businesses (OECD/ECLAC, 2012). Furthermore, Colombia's Bancoldex provides entrepreneurial training developed in association with academic partners to help micro and small companies gain access to and appropriately administer credit, and acquire knowledge on administration, marketing, human development, and international trade.

84. *PA initiatives to increase the exchange of master and PhD students; the promotion of cross country enterprise internships; and the intra-regional movement of professional and highly qualified technical staff could also provide more general support to the creation of innovative start-ups, the spreading of cross-country fertilisation processes, and the emergence of innovative enterprise hubs, embedded in the larger PA market*. The challenge for the region is to build alternatives to limit the drain of highly qualified staff to the US and other advanced countries.

Incubators in the PA

85. CORFO's 2010 reform of its incubation system could serve as a roadmap for other PA countries. By changing the payment of incubators from a flat fee per firm incubated into a renewal system that evaluated various performance criteria, such as quality of corporate governance, management, services provided, and the firm selection process; sales performance of incubated firms; the degree to which firms have been able to internationalise; and the extent to which firms were able to gain financing, CORFO helped to align incentives around the success of incubated firms (IDB, 2014c). Indeed, preliminary evaluations have found improvements in the quality of both incubators and incubated firms, as a well as a change in hiring practices, with a shift from the hiring of former CORFO officials to professionals from the bank and retail sectors (IDB, 2014c). Incubators can also now choose to retain up to 7% ownership in an incubated firm, providing further incentives to both select firms with high potential and provide high-quality incubation services (IDB, 2014c).

Box 17. Elements to Consider for a Joint PA Agenda - Firm Capabilities

In light of the above OECD work and already implemented PA efforts, going forward, PA countries should consider:

- *Joint development of supplier development programmes that offer clear mechanisms for the strengthening of SME-MNE linkages and technological and managerial skills upgrading, which can serve as a platform to both direct and indirect internationalization.* These programmes could be supported by the development of a PA certification that helps MNEs identify quality suppliers in PA countries.

- *Placing emphasis on having a balanced policy mix to encourage creation and scale-up of innovative SMEs, which often involves having integrated support programmes that simultaneously offer finance, business services, and entrepreneurial skills learning.*

- *In terms of policy responses to the finding that an adequate-sized pool of human capital is key for the expansion of participation in GVCs, both short and long-term actions are needed:*

    - *In the short term, the lack of an adequate-sized pool of skills can be addressed through facilitating the entry of professionals from other countries.* As noted above, Peru has made advances on this through the elimination of business visas for PA citizens, which could be a potentially fruitful joint policy option for other PA members to consider.[1]

    - *In the long term, alliances need to be created between the private sector, academia, and the public sector in order to ensure that education provides students with the right set of skills for key sectors.*

- *While it is too early to evaluate the success of Mexico's national formalization strategy[22], PA countries could certainly consider similar efforts both jointly and at the national level, taking note of the need to offer both simple instructions and clear incentives to encourage formalization.* In addition, results for the World Bank "Doing Business" Survey 2014 indicate opportunity for intra-PA sharing of best practices and peer learning.[23] If this sharing of experiences is utilised to enact policy reform that streamlines processes and costs for both opening and shutting down businesses, it could work to increase incentives for business formalization, especially for SMEs and entrepreneurs, who are disproportionately affected by high costs due to their small size, and may find complex or cumbersome processes particularly overwhelming to navigate.

1. Indeed, PA countries currently differ in their openness to foreign professionals; to use a proxy developed by the IDB, a restrictiveness index for the temporal movement of professionals in accounting and auditing services, while Chile and Peru rank better on this than the LAC average, Colombia and Mexico rank significantly below the LAC average, showing potential for intra-PA learning and sharing of best practices in this area (IDB, 2014c).

22 . Mexico's national formalization strategy, "Crezcamos Juntos", launched in 2014, aims to provide a simple, online portal to facilitate business formalization, offering various incentives, including access to IMSS (Mexican Social Security Institute); medical and social services; retirement pensions; employee housing loans with low interest rates; support for SMEs from INADEM; access to commercial bank loans with a NAFIN guarantee; and various trainings.

23 For example, Chile and Mexico have significantly shorter average periods of time to start a business (5.5 and 6.3 days, respectively) than Colombia and Peru (11 and 26 days, respectively); Colombia is a top performer worldwide in the "Getting Credit" category; and Mexico and Colombia significantly outrank Chile and Peru in the category of resolving insolvency (see Tables A1.10-A1.12).

4. Market Access

Previous OECD work has outlined a number of important considerations and recommendations in the areas of direct export promotion and SME-Large Enterprise linkages; production linkage mechanisms; public procurement; and provision of information.

Direct Export Promotion and SME-Large Enterprise Linkages

86. *Concerning direct export promotion, the consolidation of PA countries as a bloc offers clear opportunities for increasing intra-PA trade*. This could, in turn, provide new windows for SMEs in PA countries who have not previously engaged directly in exporting, to begin exporting within the PA market. While successfully exporting to other regions is a very difficult process, as outlined throughout this paper, the ongoing efforts to harmonise various aspects of trade policy within the PA bloc, as well as the common language shared by PA countries, should provide a more simple process for first-time exporters, which can serve as a foundation for eventually expanding export activity beyond PA borders. Recent research supports this recommendation, finding that once firms have successfully exported to neighbouring/other Latin American countries, they are more likely to reach larger OECD markets, with a 24% chance of reaching an OECD destination (IDB, 2014c). This thus demonstrates the potential of both starting small, regional, and learning-by-doing, as the productivity increases gained through exporting to regional markets helps to set exporters on a path for future, expanded success (IDB, 2014c).

87. *In addition, creating linkages between SMEs and large enterprises, where SMEs serve as in-country suppliers to large enterprises who then export, is a strategy with potential for increasing the internationalisation of SMEs*, as it is very difficult for SMEs to export directly on their own, and direct exporting by SMEs is thus relatively rare, even in countries with highly developed SME sectors. While the aforementioned efforts of Colombia and Mexico demonstrate that some PA member countries are advancing in this area, other countries, such as Peru, have expressly noted that this is a policy area in which they currently lack developed efforts. Thus, the relatively undeveloped nature of programs within this policy area could serve as a particularly fruitful platform for the development of joint PA efforts.

88. *The IDB's review of a variety of country experiences with programmes to try and foster SME-MNE linkages resulted in the following list of general lessons* (IDB, 2014c):

1. Programs based exclusively on matchmaking services seem to have more limited effects than programs that also provide complementary support to the suppliers, such as training
2. Most successful linkage programs are founded on merit-based selection criteria
3. Any assistance to the supplier should be based on transparent diagnosis and auditing processes
4. A pilot program may be the best way to start, followed by periodical reviews to fine tune objectives, strategies, targets, and action plans

Production Linkage Mechanisms

89. *Previous OECD work has set out basic conditions that production linkage mechanisms must meet in order to produce positive results:* (OECD/ECLAC, 2012: pgs. 165-166)

1. Incorporating these mechanisms into industrial policy and into the national development strategy
2. Operational decentralisation of the instruments to broaden the programme's reach into the various regions
3. Availability of all the agents, especially those in the public sector, to implement participatory processes that use consensus to define short-, medium- and long-term action plans

90. *Concerning the first condition, OECD work has emphasised that in order for production linkage policies to have more impact, it is essential for them to be a part of countries' national development policies* (OECD/ECLAC, 2012). As stated by the OECD's 2013 LEO, "When there are scattered development initiatives in a weak institutional context with a lack of priorities for industrial policy and for selecting production chains and sectors, there is less chance for complementarity, co-ordination of support and institutional learning" (pg. 179).

Public Procurement

91. *The OECD's 2008 Framework for the Evaluation of SME and Entrepreneurship Policies and Programmes explains that the low share of SMEs in the public contract can be explained as a natural outcome of the market place, and thus necessitates direct government intervention in order to change this outcome.* Most public contracts are simply too large for SMEs to effectively bid for; governments tend to place a higher value on reliability than some parts of the private sector, disadvantaging small and new firms, and the often high application costs provide a further advantage to large firms, who can afford the costs of many applications more easily (OECD, 2008b). Thus, it is overall more risky for a government to utilise SMEs for public sector work, and governments need to take this into account when deciding if and how to increase the presence of SMEs in this area.

92. *New recommendations of the OECD Council on Public Procurement recommend the facilitation of access to procurement opportunities for competitors of all sizes*. In order to do so, the recommendations state that countries should (*i*) have in place clear, simple, coherent, and stable institutional, legal, and regulatory frameworks; (*ii*) deliver clear and integrated tender documentation, with specific designing of tender opportunities for SMEs, as well as alignment of the extent and complexity of information required to the size and complexity of the procurement; (*iii*) use competitive tendering, limiting the use of exceptions and single source procurement; and (*iv*) employ recent digital technology developments that allow integrated e-procurement solutions covering the public procurement cycle, avoiding excessively complicated systems that could create challenges for new entrants or SMEs (OECD, 2015c).

93. *Possible approaches include targets or "set asides" for proportions of public expenditure that are to be delivered by SMEs (as already implemented by Peru and Mexico); commitments to deliver public programmes/contracts in smaller pieces so that SMEs can deliver more easily; and reducing the complexity and costs of application forms* (OECD, 2008b). Other OECD work recommends the development of SME consortia for entering joint bids on government procurement projects, as SMEs are often effectively shut out of this market otherwise, due to the mismatch between their size and the needs stipulated in the bids (OECD, 2008a).

Provision of Information

94. *The OECD's 2008 study on Removing Barriers to SME Access to International Markets identifies three main skill sets that should be viewed as pre-requisites for any SME wishing to compete effectively in international markets: planning, manning and scanning* (see Table 16). "Planning" refers to the way a company navigates its involvement in foreign markets (finances, legal matters, production, resources, logistics); "Manning" refers to the management process by which a company organises or develops its resources to service foreign markets; and "Scanning" refers to the way in which the business informs itself about international markets (OECD, 2008d).

95. *This study notes that the majority of support programmes for developing international SMEs address elements located within the "scanning" process, bypassing the first two stages*. While information about opportunities in a foreign market can be sufficient to create an exporting opportunity, a company often first needs to assess its readiness and ability to export effectively and in a sustained manner; in this

situation, information about foreign markets needs to be aligned in a more structured way with the company's plans (OECD, 2008d).

Table 16. Planning, Manning and Scanning - Skills, Purposes and Knowledge Breakdown

	Skills	Purpose (find answers)	Knowledge
Planning	• Markets • Financial • Legal • Production • Competition	• What are the reasons for going international? • Is the company ready to do it? • What will be the impact of this decision on the organisation?	• Do the responsible managers know how to build a strategy?
Manning	• Communication (foreign languages) • Sales • Production • Competition	• Do we have the resources to support exporting? • Do we have the skills to meet the needs of overseas clients? • Are we prepared to build and develop relationships with key partners?	• Do the responsible managers know how to structure and skill up the company?
Scanning	• Market research • Identifying opportunities • Building the best channels to market • Building networks • Monitoring the competition	• Is there a market for our products and, if so, what do we need to know about it? • How do we find these things out? • How do we exploit these opportunities?	• Do the responsible managers know how business practice differs in other markets and how this might impact on the company?

Source: OECD, 2008d

96. *Furthermore, research notes an empirical regularity across a case studies conducted to study GVCs in Latin America: firms that are part of GVCs generally have a manager, CEO, or owner who has previous international business experience* (IDB, 2014c). This once again demonstrates the strength of the barrier that lack of information about international markets and GVC standards and common practices can be to a firm that wishes to internationalise its operations. Public policy has a clear role here: there is a need to promote environments that produce information exchange across actors (IDB, 2014c). This can be implemented through workshops with global buyers, in order to learn about their standards; coaching programmes with successful exporters; and/or through EPOs, who can offer training for inexperienced firms on export procedures, marketing, and business negotiations, specialised counselling and technical assistance, and/or coordinate, support, and co-finance participation in international trade missions, trade shows and meetings with global buyers (IDB, 2014c). Previous experiences show that, although companies do indeed compete against one another, successful firms are often willing to share their experiences with others (IDB, 2014c).

PA countries vary in their level of programme development related to market access, however it is in this area where most PA-wide joint initiatives have been carried out, led by their Export Promotion and Investment Promotion agencies.

Direct Export Promotion and SME-Large Enterprise Linkages in the PA

97. *While all PA countries have developed programmes that specifically provide support to SME exporters, only Colombia and Mexico also mention additional programmes that seek to develop linkages between SMEs and MNEs, with Peru, in contrast, specifically stating that it does not currently have any of these types of programmes in place* (see Table 17).

98. *Both ProColombia and PromPerú have also developed "Ruta Exportadora" web portals, which provide roadmaps for entrepreneurs interested in exporting, taking them through key stages and questions that must be addressed*. Additional information, such as export statistics, market access conditions, a tool for exporters to input their product information and identify potential opportunities, and a variety of logistical information; as well as information on various educational seminars, programmes and exploratory missions, trade fairs, and showrooms, is also provided on both portals.

99. *Additionally, in response to ProColombia's findings of very low exporting activities among companies in key sectors such as agribusiness and manufacturing, ProColombia has developed an advisory programme for SMEs aimed at fostering an export culture and allowing countries to effectively internationalize*. The programme has four modules, consisting of the following elements:

1. Market Intelligence: information on specialization and value-added through seminars, publications, and web content
2. Identification of Exportable Offerings
3. Exploratory missions to learn about market requirements in countries of interest
4. Adjustments to Proposed Exportable Offerings and Creation of a Business Plan

Table 17. Examples of Direct SME Export Assistance and SME-MNE Linkage Programmes in PA Countries

	Programme Name	Key Points	Key Achievements/ Goals	Type of Assistance
Chile	ProChile – Plan C	- Provides training related to exporting and marketing, and supports the SME in the creation of an online crowdfunding page, with access to preferred status within ProChile, Fundación Chile, País Digital and Imagen de Chile's respective networks	- Aims to assist SMEs that are already successful in Chile; have a unique, exportable product; and have an interest in expansion through exporting, but are hindered by their size and lack of experience - Aims for crowdfunding success rates of 66% (currently 33%), and improving the capture of export value from 33% to 80% of the margin	Direct Assistance to SME Exporters
Colombia	ProColombia – Mipyme Internacional	- Provides and funds 90% of the cost of a foreign trade advisor, who creates a working plan to implement export activity within a one year timeframe	- Aims to support MSMEs that offer goods for which there is international demand, but no corresponding foreign trade department or unit to offer assistance	Direct Assistance to SME Exporters
	ProColombia – Product Adaptation Programme	- Includes support to develop an adaptation program; price review and adjustment; assessment and definition of potential clients; and support in negotiations, product delivery, and promotion during market entry	- In 2014, 455 people participated in this programme, across 18 different product departments	Direct Assistance to SME Exporters
	ProColombia – Export Training Programme (PFE)	- Consists of introductory, specialized and practical seminars on the topics of good, services and tourism - Also has a web portal focused on identifying best market opportunities for exports across countries and sectors	- In all, in-person and online seminars were attended by 6,200 people in 2014	- Direct Assistance to SME Exporters
	ProColombia – Exporter Mentor Programme	- Connects companies with export experience, or foreign investors, to MSMEs that are interested in internationalizing their operations	- Supermarket chain Grupo Éxito has used the programme to train its suppliers to begin exporting, identifying markets with good potential through assistance from ProColombia	Fostering SME-MNE Linkages

Mexico	INADEM - National Entrepreneurs hip Fund Public Call for "Development and Strengthening of the Exportable Offer"	- Grants of up to USD 6,000, or 50% of the project, are offered for consulting, training, market studies, export plans, information systems, product image design, participation in export missions, export consortia and products	- Aim is to develop MSME's exportable offers and integrate offerings with export consortia and/or business associations models for export, in order to promote and improve these products' competitive position in the international market	Direct Assistance to SME Exporters (Project area #1: Direct exporting for increasing the exportable offer of MSMEs) Fostering SME-MNE Linkages (Project areas #2 Supplier development of MSMEs for global firms and #3 Business cooperation for exports)

Source: Official Information from Countries

Public Procurement in the PA

100. *Regarding public procurement, while Colombia, Peru and Mexico all have various legal requirements to help prioritize and/or include SMEs in these processes, these efforts vary considerably, with only Peru setting a quota for SME involvement* (see Table 17).

Table 18. Public Procurement and SMEs in the PA

	Legal Provisions	**Programmes**
Chile	None reported	*"ProSME Council" (Consejo ProPYMEs):* established in 2012 to promote participation and opportunities for SMEs in public procurement
Colombia	Articles 33[1], 152[2] and 153[3] of Decree 1510	*ProColombia seminars:* - inform entrepreneurs about opportunities for exports to the public sector of other countries, as well as the relevant requirements, and contracts, payments and registration processes.
Mexico	Federal policy requires setting increasing goals for public procurement that must come from Mexican MSMEs	*INADEM National Entrepreneurship Fund:* – core strategy implemented through 31 annual public calls, which provide subsidies for the undertaking of projects to support entrepreneurs or MSMEs within the five categories of regional and sectoral development; entrepreneurial development; entrepreneurs and financing; programmes for MSMEs; and incorporation of ICT *"Expo for Government Purchases":* - organized each year by the Secretariat of Economics - ministries and SOEs display their areas of interest in buying goods and services from MSMEs - training, consulting, and information sessions also included
Peru	Productive Development and Business Growth Law of 2013[4]	*"Compras MYPERU":* - Platform in which the state can buy SME products and services

[1] Stipulates that in the event of a tie between the total score of two or more bids, priority should be given to bids submitted by a national SME, among other criteria.

[2] Stipulates that public calls should be limited to SMEs (with a minimum of one year of experience in the procurement process) when the value of the project is less than USD 125,000 or three requests to do so have been received from national SMEs in advance to the opening of the call (at least one business day)

[3] Stipulates that state entities can perform limited public calls to national SMEs that are located within the territorial municipality/department where the contract will be implemented, as long as the SMEs are already registered/ have a formal certificate of existence

[4] States that "State institutions must schedule at least 40 percent of their contracts to be met by SME in those goods and services that are able to supply".

Source: Official information from countries

Box 18. Elements to Consider for a Joint PA Agenda - Market Access

In light of the above OECD work and already implemented PA efforts, going forward, PA countries should consider:

- *Facilitating the creation of PA-wide distribution channels and providing relevant information for SMEs.* The PA extended market provides an expansion opportunity for many SMEs already competitive in their own market, given the similarity of markets and the same-language advantage. Many of these firms may not yet be exporting or may have not considered exporting before, since exporting traditionally often implied complying with very high standards for the U.S., European, or Asian markets. PA countries should exploit this opportunity by facilitating the creation of PA-wide distribution channels and providing relevant information for SMEs.

- *Including supplier development programmes and a SME-Larger Enterprises linkages component in their SME national development strategies.* These supplier and linkages programmes should follow international best practices, including the combination of matchmaking services with training, merit-based selection criteria, transparent diagnosis and auditing processes.

- *Encouraging greater participation of SMEs in the PA-wider market through public procurement of governmental institutions serving national markets and SOEs serving national and international markets.* Possible approaches include targets or ¨set asides¨ of public expenditure that are to be delivered by SMEs, dividing contracts into smaller pieces that SMEs can more easily deliver, and reducing the complexity and cost of application forms. Opening bids to SMEs from PA countries could create healthy competition and encourage partnerships among SMEs of different PA countries.

- *The preparation of a ¨how-to¨ guide for SME engagement in the PA market,* either through direct exporting activity or through provision of quality goods and services for MNEs engaged in GVCs.

5. Trade and Trade-related Policies

Previous OECD work has outlined a number of important considerations and recommendations in the areas of trade facilitation; and services, transport, and communications logistics and infrastructure. [24]

Trade Facilitation

101. *Trade facilitation could be a powerful instrument for PA countries to further enjoy gains from trade.* Trade facilitation helps countries participate in GVCs by cutting costs, avoiding unnecessary delays, and reducing uncertainty at the border. As goods cross borders many times, first as inputs and then as final products, fast and efficient customs and port procedures are essential to the smooth operation of supply chains. Trade cost reductions from practical and relatively inexpensive actions could be as high as 16% for some developing countries (OECD/WTO/UNCTAD, 2013).[25]

102. *Policymakers should also consider the formation of consultation schemes and other support programmes that help exporting SMEs diagnose trade barriers and/or discuss issues related to trade barriers directly with policy makers.* Previous OECD work has recommended that policymakers develop a framework to facilitate SMEs' integration into the trade policy process, in order to create a more co-operative and facilitating relationship comprised of two major elements: (i) SME participation in governmental mechanisms for public consultation, and (ii) programmes that assist firms to understand and overcome trade barriers (OECD, 2008d). Governmental consultation models vary widely, but generally

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24 . Tariffs and trade agreements will be considered later on in this section, specifically in the context of the PA.

25 .These gains would be derived from full implementation of the new WTO Trade Facilitation Agreement – further gains can be made by going beyond such measures.

include both formal and informal mechanisms.[26] While OECD countries in general have more formalised and extensive consultative mechanisms involving business interests in policy discussions and technical matters, the public consultation mechanisms of many developing countries tend to suffer from resource constraints that limit private sector participation. Yet, as nations adopt more open trading regimes, business input becomes more important.

Services, transport and communications logistics and infrastructure

103. *GVCs are particularly sensitive to the quality and efficiency of services.* The services content of exports in Chile and Mexico in value added terms is close to 30%, highlighting the importance of reducing barriers in this sector, as well as the potential gains. If established firms or potential new entrants cannot find local services supporting their activities, they will have to rely on cross-border provision when feasible or establish elsewhere.

104. In terms of transport and communications logistics and infrastructure, research clearly indicates that the LAC region as a whole has less adequate infrastructure in the areas of transport and communications in comparison to the EU and Asia, as well as the importance of having high-quality infrastructure in these areas, showing a clear relationship between the quality of logistics infrastructure and the share of vertical affiliates within a country (IDB, 2014c). Yet, the importance of logistics infrastructure does differ by sector: while dynamic industries with short product life cycles and high levels of demand variability tend to base their location decisions on the quality of transport and communication logistics, less dynamic and highly price-sensitive industries tend to place a higher weight on raw material and component prices than logistics (IDB, 2014c).

105. *Thus, while it is clearly important overall for PA countries to improve their telecommunications and transportation infrastructure, the relative level of importance of these improvements may vary by country, based upon its primary industries that it engages with*. However, research also indicates that countries with better logistics infrastructure attract not only more vertical affiliates overall, but also, particularly, affiliates in sectors that are more dependent on logistics services (IDB, 2014c); thus, investing in these logistical areas could also be a way for PA countries to advance the diversification of their participation in GVCs. Indeed, the additional finding that logistics infrastructure is even more important for countries that are farther away from large global buyer centres than for those that are close[27] is especially important for the PA to consider.

While PA countries have already made substantial joint efforts to foster trade integration and facilitation, there remain areas for improvement that could further foster intra-PA trade and the integration of the PA into regional and global supply chains.

26 Some governments provide for formal SME groups to solicit specific trade policy advice, such as the Industry Trade Advisory Committee on Small and Minority Business (ITAC 11) in the United States, the SME Envoy in the European Union, and the Canadian SME Advisory Board, whose mandate is to promote SME needs and perspectives in government policies, including on trade issues, thus enabling SMEs to have a voice and engage in a formal and systematic dialogue with government (OECD, 2008d).

27 According to an IDB simulation, if LAC countries were to improve their logistics infrastructure to the average level of EU-27 countries, the region would have a 20% increase in its number of vertical affiliates. For PA countries, Colombia and Peru have the most to gain, with projected 20% and 17% increases in vertical affiliates, respectively. While both of these countries have the most to gain in terms of improving ICT infrastructure, the rest of Colombia's gains are spread quite evenly across sectors, while Peru has little to gain in terms of ports improvement. Mexico and Chile, with 12% and 6% projected increases, respectively, also have the most to be earned through improvements in ICT infrastructure (IDB, 2014c).

Tariffs in the PA

106. *While tariff negotiations among PA member countries have concluded with the signature of the Additional Protocol to the Framework Agreement for the PA, MFN tariffs in the region remain higher than in other parts of the world.* Mexico's MFN tariff on intermediates fell from 12% to 8% in the period 1995 to 2009. For Peru, the change is more pronounced, going from 16% to 5% for intermediates whilst Costa Rica has seen a reduction from 9% to 3%. While the reduction is a step in the right direction, tariffs on intermediates remain comparatively high (both the EU and US tariffs on intermediates are around 3.5%). These protection measures against imports of intermediate products increase the costs of production and can have adverse effects on a country's ability to compete in export markets: tariffs and other barriers on imports are effectively taxes on exports.

Trade Agreements in the PA

107. *While the LAC region is unfortunately characterized by a vast array of trade agreements that use different rules of origin, the PA has made substantial progress in this respect, both through the signing of the Additional Protocol to the Framework Agreement for the PA, and agreement on a mechanism for accumulation of origin and common rules of origin,* which should significantly assist the process of economic and commercial integration within the Alliance.

108. *The Protocol should be noted for its plans to remove all trade barriers within the PA,* removing 92% of these upon signature, and the remaining 8% in the short and medium term (3-17 years). Furthermore, the Protocol covers key issues related to trade facilitation, customs cooperation, sanitary control, conflict resolution, and trade in border zones, with the aim of further stimulating intra-bloc trade. Yet, as explained above, MFN tariffs remain comparatively high.

109. *Regarding rules of origin, PA countries' respective promotion agencies have already identified various specific opportunities in which products from one member country could undergo a productive transformation in another member country in order to allow it to comply with rules of origin and/or other conditions required by outside nations, thus allowing the final product to fall under this third countries' preferential tariffs.* For example, ProColombia has made note of 25 specific opportunities, with final destinations of Japan, China, New Zealand, and Australia, across the agribusiness, cosmetics, containers, auto parts and mechanics, mobile phones, artificial dyes, and apparel industries. Integration efforts that proceed in this manner allow firms to take advantage of differing factor prices across economies, and thus choose the location for various aspects of the production process based upon comparative advantage (IDB, 2014c). Furthermore, while this certainly has the potential to increase SME internationalisation through increased activity across PA member countries, it also has the potential to serve as a platform for greater ties with other regions, due to facilitating the production of more competitive and cost-effective goods (IDB, 2014c). Along similar lines, but at the country level, Colombia has set up a Trade Agreement Leveraging Centre (Centro de Aprovechamiento de Acuerdos Comerciales) in order to take advantage of the opportunities provided by trade agreements, which is tasked with the creation of strategies to leverage benefits from trade agreements currently enjoyed by the country.

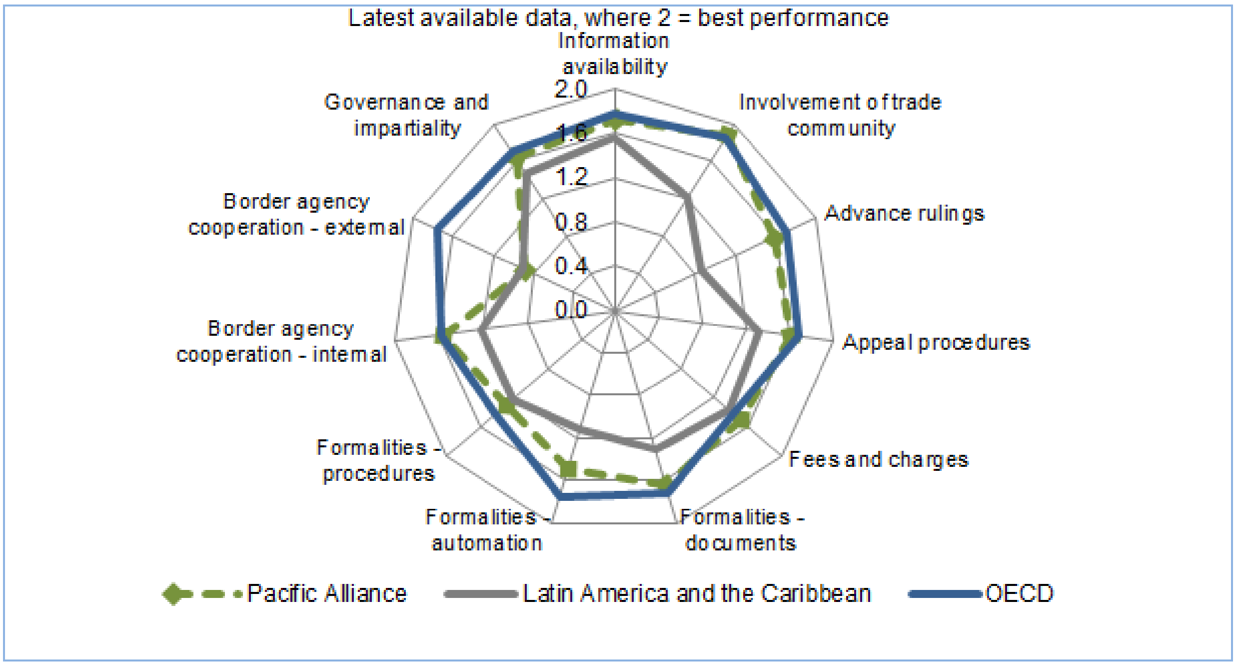
110. *Overall, the already "deep" nature of the PA's integration and its integration plans for the future are an asset in terms of GVC participation.* Deep integration agreements tend to create conditions that are important for GVCs, as they incorporate disciplines beyond the reduction of tariff rates, such as rules in investment policy, intellectual property rights, or the harmonization of management techniques in customs procedures to expedite clearance of goods (IDB, 2014c). In a recent investigation of the impact of trade agreements on vertical FDI, which examined three types of agreements: preferential trade agreements (PTA), free trade agreements (FTA) and deep integration agreements, covering customs unions (CU), common markets (CM), and economic unions (EU), results supported the conclusion that deep trade

agreements are positively associated with greater vertical FDI (IDB, 2014c). While PTAs had no significant effect on cross-border production sharing, countries with FTAs had 9% more subsidiaries than countries without, and countries with deep agreements had 12% more subsidiaries than those without (IDB, 2014c). Further analysis found that this increase is primarily the result of an increase in the total number of parent companies operating subsidiaries, rather than an increase in the number of subsidiaries opened by parent companies, and occurs mainly due to a greater diversification of sectors in which the plants operate. Thus, the PA's integration efforts seem well-poised, from these predictions, to serve as a platform for greater diversification of their participation in GVCs.

Trade Facilitation in the PA

111. *The PA has several trade facilitation initiatives in place.* Figure 7 highlights some of the strengths and weaknesses of PA countries with respect to best practices in trade facilitation. Overall, PA countries performs on par with the average for OECD countries with respect to information availability, involvement of the trade community, simplification and harmonisation of documents, internal border agency co-operation, and governance and impartiality. Continued efforts are warranted in the areas of advance rulings, automation, streamlining of procedures and external border agency co-operation.

Figure 7. Performance of PA Countries in the OECD Trade Facilitation Indicators



	Chile	Costa Rica	Colombia	Mexico	Peru
Main strengths	• involvement of trade community • information availability • automation	• involvement of trade community • appeal procedures • internal border agency co-operation	• information availability • border agency co-operation (internal) • governance and impartiality	• automation • governance and impartiality • involvement of the trade community	• involvement of the trade community • advance rulings • automation
Challenges	• fees and charges • internal border agency co-operation	• external border agency co-operation • automation	• automation • internal border agency co-operation	• information availability • advance rulings	• border agency co-operation (internal and external) • streamlining of procedures
Areas for action with greatest potential gains	• streamlining of procedures • simplification and harmonisation of documents • advance rulings • fees and charges • governance and impartiality	• formalities (procedures, documents, automation) • governance and impartiality • information availability • involvement of trade community • advance rulings • fees and charges	• formalities (procedures, documents, automation) • governance and impartiality • information availability • involvement of trade community • advance rulings • fees and charges	• information availability • advance rulings • fees and charges • automation • streamlining of procedures	• simplification and harmonisation of documents • automation • streamlining of procedures • governance and impartiality • information availability • involvement of trade community • advance rulings • fees and charges

1. The OECD average includes the indicators' values for 26 OECD countries. The PA includes Chile, Colombia, Costa Rica, Mexico and Peru. Analysis is based on the TFI's latest available data as of October 2013, collected through questionnaires for OECD member countries Chile and Mexico, and publicly available information for Colombia, Costa Rica and Peru.

Box 19. Elements to Consider for a Joint PA Agenda - Trade and trade-related policies

In light of the above OECD work and already implemented PA efforts, going forward, PA countries should consider:

- *Accelerating tariff reductions and applying them on a MFN basis, to more fully gain the benefits of a low tariff regime.*

- *Assessing and evaluating other policies that restrict access to foreign intermediate goods and services in key value chains that could have a detrimental impact on their position in regional and global supply chains, as well as policies that aim to artificially increase the domestic content of exports.* The OECD is undertaking a diagnostic of Chile´s integration in GVCs that could be used as a basis for preparing similar diagnoses for the other PA countries and building a more comprehensive strategy in this field.

- *Fully exploiting trade facilitation instruments to facilitate SME access to foreign markets and developing joint initiatives based on best practices within the PA.* OECD Trade Facilitation Indicators highlight that areas where PA countries could improve include advance rulings, automation, streamlining of procedures, and external border agency co-operation. A joint strategy to advance in those four areas could be developed by PA countries, assisted by the exchange of best practices. For example, according to the TFIs, an area for improvement for Colombia is automation, a field in which Chile, Mexico and Peru perform relatively well. Information availability and advance rulings are areas where Mexico needs to improve where Chile, Colombia and Peru perform relatively well. Likewise, Peru and Chile could significantly improve in border agency co-operation by learning from the Colombian experience. Learning from Costa Rica, currently in process of joining the PA, would also be useful.[1]

- *Developing joint initiatives for reducing services trade restrictions and improving transport and communication logistics and infrastructure, which greatly impact the cost and capacity of SMEs to take part in GVCs.* The OECD Service Trade Restrictiveness Index provides insights with regards to restrictions in key sectors that could be reduced. The OECD could undertake a workshop with the trade and SMEs group of the PA to identify specific actions.

1. With the introduction of a 'single window', Costa Rica reduced clearance time for dairy products from 10 to 1.5 hours and for agrochemicals from 26.5 to 2.2 hours. PA experience with single-window initiatives is mostly limited to foreign trade[28]; in this area, the margins for doing better are considerable, especially in view of the considerable gaps that still exist – for instance, it takes 54 days on average to obtain a construction permit in Colombia and more than three times longer in Peru (173 days).

[28] Such as Colombia's Single Window Facility for Foreign Trade — VUCE web portal, which allows 21 countries to address foreign trade formalities in a single platform, as well as facilitating digital signatures and electronic payments

SECTION III: KEY CONCLUSIONS AND PROPOSALS FOR FUTURE OECD SUPPORT

Introduction

112. As demonstrated in Section I, while clearly highly important in terms of number and employment generation, the productivity gap between SMEs and large firms is a crucial limitation for a stronger and more inclusive growth in Latin American countries in general and PA countries in particular.

113. Section II provided a number of elements to consider for a joint PA agenda within five specific policy areas: Finance, Business Environment, Firm Capabilities, Market Access, and Trade. A summary of these considerations is provided in Box 10. This section will provide some final, overarching, conclusions to guide action across these policy areas, as the PA moves forward with the creation of a joint agenda to support SME internationalization, as well as proposals for OECD work that could support this agenda.

Box 20. Summary: Elements to Consider for a Joint PA Agenda *(from Section II)*

Finance

- Diversifying their own portfolio of instruments for financing SMEs, learning from other PA country experiences, and ensuring that their instruments are complementary to those adopted by their PA partners.
- Taking advantage of existing joint efforts in the creation of the Latin American Integrated (Stock) Market (MILA) to create joint financing instruments for the most advanced and innovative SMEs, providing a new alternative source of equity financing to support their expansion.
- Organizing a workshop on SME financing where PA countries and other countries could share their own practices.
- Sharing of existing venture capital programmes (in Chile and Colombia) and investing in further research in order to identify key barriers to scale-up in PA countries.

Business Environment and Provision of Business Services to SMEs

Further Development of Industrial Clusters

- Developing and developing further business clusters and linkages between SMEs and larger enterprises in sectors where there are opportunities for greater participation of SMEs in GVCs. This may include measures to promote business networks and intra-firm cooperation; the introduction of SME mentoring schemes; and the expansion of quality certification programmes to ensure that SMEs acquire the technical and quality standards required to qualify as suppliers to multinational enterprises and to integrate into GVCs.
- Going beyond the development of clusters at the national level, and working to form PA clusters by sector as a way to identify synergies among Alliance members, and encourage further trade, mergers, and sharing of information.

Attracting Foreign Direct Investment

- Undertaking joint initiatives of FDI attraction and Investor after-care services with emphasis on MNEs that will promote technology and knowledge transfer to local suppliers and contractors.
- Building on their joint participation in the OECD Investment Committee and adherence to the Guidelines for Multi-National Enterprises to increase synergies in their Investment Policies, and avoid mutually damaging actions.

Protection of Intellectual Property Rights

- Including provisions for technology transfer from small subcontractors to MNEs, within the context of the OECD Guidelines for Multinational Enterprises

Firm Capabilities

Supplier Development Programmes

- Joint development of supplier development programmes that offer clear mechanisms for the strengthening of SME-MNE linkages and technological and managerial skills upgrading.
- Development of a PA certification that helps MNEs identify quality suppliers in PA countries.

Innovation

- Placing emphasis on having a balanced policy mix to encourage creation and scale-up of innovative SMEs, which often involves having integrated support programmes that simultaneously offer finance, business services, and entrepreneurial skills learning.

Skills Development

- In the short term, the lack of an adequate-sized pool of skills can be addressed through facilitating the entry of professionals from other countries.
- In the long term, alliances need to be created between the private sector, academia, and the public sector in order to ensure that education provides students with the right set of skills for key sectors.

Market Access

Direct Export Promotion and Indirect internationalisation through SME-MNE linkages

- Facilitating the creation of PA-wide distribution channels and providing relevant information for SMEs.
- Including supplier development programmes and a SME-Larger Enterprises linkages component in their SME national development strategies.

Public Procurement

- Encouraging greater participation of SMEs in the PA-wider market through public procurement of governmental institutions serving national markets and SOEs serving national and international markets.
- Opening bids to SMEs form PA countries to create a healthy competition and encourage partnerships among SMEs of different PA countries.

Trade and trade-related policies

Tariffs

- Accelerating tariff reductions and applying them on a MFN basis, to more fully gain the benefits of a low tariff regime.
- Assessing and evaluating other policies that restrict access to foreign intermediate goods and services in key value chains that could have a detrimental impact on their position in regional and global supply chains, as well as policies that aim to artificially increase the domestic content of exports.

Trade Facilitation

- Fully exploiting trade facilitation instruments to facilitate SME access to foreign markets and developing joint initiatives based on best practices within the PA. OECD Trade Facilitation Indicators highlight that areas where PA countries could improve include advance rulings, automation, streamlining of procedures, and external border agency co-operation. A joint strategy to advance in those four areas could be developed by PA countries, assisted by the exchange of best practices.

Services, transport and communications logistics and infrastructure

- Developing joint initiatives for reducing services trade restrictions and improving transport and communication logistics and infrastructure, which greatly impact the cost and capacity of SMEs to take part in GVCs. The OECD Service Trade Restrictiveness Index provides insights with regards to restrictions in key sectors that could be reduced.

114. *Additional in-depth analysis is required in order to thoroughly apply and evaluate these conclusions in light of advancing a joint PA agenda for SME internationalisation.* While this goes beyond the scope of this scoping paper, proposals for future OECD work that would provide analysis on topics of key importance for the PA in advancing this agenda are provided at the end of this section (see pgs.51-54).

Placing SME development at the core of PA integration agenda: towards a Joint PA Strategy for SME Internationalisation

115. *Addressing SME´s barriers to internationalization requires a broad, coordinated policy agenda which spans across many areas of government, and in this case of governments of various countries.*

116. *A joint PA policy agenda for SMEs should consider SME internationalization as a learning process, encompassing different types of support for individual SMEs depending upon where they are in their learning process and allowing them to evolve over time as they gain more experience and knowledge.*

117. *The PA's work to coordinate the efforts of their member countries' respective export and investment promotion agencies (ProColombia, ProMéxico, PromPerú, ProChile) as well as form a PA technical working group on SMEs to identify priorities and develop joint initiatives is a clear recognition of and step in the right direction regarding the need for coordination and integration of SME internationalisation efforts into the PA's overall developmental strategy.* The PA has clearly stated their specific goal to enhance the internationalisation of their SMEs; utilise the PA as a platform for internationalization; and to prioritize engagement with the Asia-Pacific region, providing a clear framework for efforts by the bloc, national agencies, and the private sector. Plans to develop regional bodies in order to foster joint efforts between SMEs located in different PA countries are a positive sign in this regard, and in light of the experiences and recommendations outlined in this paper, as are the joint seminars on attracting international business and joint trade fairs that have already been conducted.

118. *While the various forums, seminars, and fairs that have been developed and implemented jointly by these promotion agencies, such as the Pacific Alliance Business Matchmaking Forums offered in 2013 and 2014, are already substantial and steadily increasing, with over 40 joint activities taking place in 2014 across 18 foreign countries, there is ample room for PA countries to develop additional joint measures in the areas of financing and capabilities development, as well as other joint programmes focused on generating access to markets, such as through various forms of linkages and clusters.* While current events' focus on creating and promoting a strong and positive image of the PA bloc to global buyers is well-placed and an important initial step, these reputation-building and access-facilitating measures should, in line with the experiences and recommendations outlined in this paper, be supported by the development of a more comprehensive range of joint measures that can offer support to SMEs at various stages of internationalisation. Initial efforts at developing joint training tools, through co-operation agreements between specialist technical schools in all four member countries, are a solid first step in this regard, and in line with the identified need to expand pools of human capital in order to support the skills and capabilities demanded in internationalised firms.

119. *One of the biggest constraints on progress towards structural adjustment and cooperative arrangements to move in this direction is largely a matter of sharing information, experience, expertise and knowledge.* This kind of cooperation is in line with the comparative advantage of the OECD in its capacity as a "Global Think and Do Tank". Future work by the OECD for the PA on this topic could provide a specific and in-depth evaluation of the PA's current efforts as a bloc, and within their own national governments, to develop coordinated and comprehensive strategies for SME internationalisation, using this evaluation as a platform to develop highly informed and targeted policy recommendations for future joint efforts and comprehensive, coordinated, and targeted strategies to boost SME internationalisation.

Proposals for Future OECD Work to Support the Pacific Alliance in Advancing Its Joint Agenda for SME Internationalisation

120. *A variety of ongoing OECD projects, as well as future proposed OECD studies for the PA bloc and PA countries in the areas of SMEs, GVCs, and internationalisation, could support the PA in advancing its joint agenda for SME internationalisation* (see Table 19).

Table 19. Overview of Completed and Proposed OECD STUDIES for the PA in the areas of SMEs, GVCs, Internationalisation, and Investment

	Chile	Colombia	Mexico	Peru	Pacific Alliance	Latin America	OECD Countries	Other Regions
REGIONAL								
OECD SME Policy Index					Strongly Suggested	Strongly Suggested		West Balkans (2006, 2009, 2012) Eastern Europe (2012) MENA (2008; 2013) ASEAN (2014)
SME Financing Scoreboard	✓ (2012-2015)	✓ (2015)	✓ (2012, 2014, 2015)	Strongly suggested		Proposed in collaboration with IDB	✓[1]	
OECD Report on Participation in GVCs						✓ Forthcoming (end 2015)		SE Asia and Africa (2015)
COUNTRY-SPECIFIC								
OECD Studies on SMEs and Entrepreneurship	Strongly suggested	Strongly suggested	✓ (2013)	Strongly suggested			✓[2]	
OECD Diagnostic of Engagement in Global Value Chains	✓ Forthcoming (2015)	Strongly suggested	Strongly suggested	Strongly suggested				
Investment Policy Reviews	✓ (1997)	✓ (2012)	Strongly Suggested	✓ (2008)	Proposed in collaboration with OECD-LAC Investment Initiative[3]			

1. Annual Publication
2. Regular Publication
3. Proposed publication will include Costa Rica

SME Policy Index

121. *The SME Policy Index is a benchmarking tool designed for emerging economies to assess SME policy frameworks and monitor progress in policy implementation over time.* The Index was developed by the OECD in partnership with the European Commission, the European Bank for Reconstruction and Development (EBRD), and the European Training Foundation (ETF) in 2006. Since this time, it has been applied to the West Balkans (2006, 2009 and 2012); the OECD's Eastern European Partnership Countries (2012); the Middle East and North African (MENA) region (2008; 2013); and the Association of Southeast Asian Nations (ASEAN) (2014). The assessment framework for the Western Balkans, Eastern Partnership Countries, and MENA is structured around the ten principles of the Small Business Act for Europe (SBA), providing a wide-range of pro-enterprise measures to guide the design and implementation of SME policies based on good practices promoted by the EU and the OECD. For ASEAN, the OECD has applied the tool in co-operation with the Economic Research Institute for ASEAN and East Asia, using the ASEAN Policy Blueprint for SME Development as underlying framework.

122. *The Index identifies strengths and weaknesses in policy design and implementation, allows for comparison across countries, and measures convergence towards good practices and relevant policy standards.* It aims to support governments in setting targets for SME policy development and to identify strategic priorities to further improve the business environment. It also helps to engage governments in policy dialogue and exchange good practices within the region and with OECD members. The Index assesses the following policy dimensions: education and training for entrepreneurship; cheaper and faster start-up; better legislation and regulation; availability of skills; improving online access for tax filing and company registration; getting more out of the Single Market; taxation and financial matters; strengthening the technological capacity of small enterprises; successful e-business models and top class business support; developing stronger, more effective representation of small enterprises. An example of findings related to SME internationalisation that have emerged from OECD SME Policy Indexes of other regions can be found in Boxes 8 (MENA) and 9 (Eastern Partner Countries).

123. *Conducting a full SME Policy Index for the PA would allow its member countries to have a clear picture of where the PA stands in relation to good practices and policy standards, as well as providing a clear basis for policymakers to develop policies and set targets in order to further improve the environment that SMEs operate in.*

124. *This study could be supported by the creation of an OECD-PA Policy Network on SMEs.* Indeed, the already significant levels of co-operation between the EPOs of PA countries could serve as a convenient platform from which to launch and coordinate this network. Additionally, regional and national associations of entrepreneurs could also be represented in these meetings, in order to facilitate dialogue between entrepreneurs and government agencies tasked with supporting them.

Box 21. Internationalisation of SMEs in the MENA Region - SME Policy Index Findings 2014

The OECD's analysis of the MENA region's efforts to facilitate SME internationalisation in 2014, conducted through a comprehensive SME Policy Index evaluation, paid particular attention to the role of initiatives to promote trade such as the implementation of trade promotion strategies, export promotion programmes, and the simplification and facilitation of trade procedures, finding a need to update and/or adopt strategic approaches towards export promotion and increase efforts for the facilitation of trade through electronic procedures and virtual one-stop shops.

The assessment framework focused on two elements: proactive trade policy and measures for the simplification of procedures for international trade. The first element focuses on four specific areas as indicators: export promotion strategy; intra-region trade agreements; providing advice and high value information on the international market; and export capacity-building programmes. The second element focuses on three areas: level of computerisation of procedures for foreign trade; quality of access to regulatory and procedural information relating to foreign trade; and virtual one-stop shops to deal with the formalities of foreign trade.

Regarding export promotion strategy, Morocco was found to have particularly improved since the last Index conducted in 2008, through implementation of two coordinated and inter-departmental strategies. The first, developed by the Ministry of External Trade, was launched for the 2009-2015 period as the National Pact for Industrial Emergence (PNEI). The PNEI links a number of executive bodies and high-level steering committees across the areas of export promotion, regulation, conforming to standards, and the simplification of procedures, aiming to mobilise and co-ordinate actions to develop strategic industrial sectors where Morocco can exploit comparative advantages and improve the competitiveness of Moroccan exports. The second programme, entitled Maroc Export Plus and in place since 2008, aims to double exports by 2015 and triple them by 2018 by focusing on key sectors and markets and supporting exporting firms through sectoral, horizontal and organisational measures.

Source : OECD/The European Commission/ETF (2014)

Box 22. Internationalisation of SMEs in the OECD's Easter Partner Countries (EaP) - SME Policy Index Findings 2012

The OECD's analysis of EaP countries' efforts to facilitate SME internationalisation in 2012, conducted through a comprehensive SME Policy Index evaluation, assessed regional export promotion programmes; financial support for export promotion activities; and national SME promotion events.

Overall, the analysis found that export promotion agencies in EaP countries could further improve the capabilities of domestic firms to compete internationally by improving their access to trade finance and export insurance, assisting them in obtaining creditworthiness, rating potential international partners, providing international market information, fostering research and development and implementing international quality standards. Furthermore, it identified co-ordination of the export promotion activities of various government and non-government agencies, as well as the set-up of monitoring and evaluation mechanisms as additional crucial measures.

Source : OECD et al., 2012

SME Financing Scoreboard

125. *The OECD's Scoreboard on Financing SMEs and Entrepreneurs monitors SMEs' and entrepreneurs' access to finance across an array of indicators, including debt, equity, asset-based finance, and framework conditions.*

126. *The OECD Score Board could be used to monitor progress in the provision of SME financing within the PA and to compare it with OECD and OECD countries.* Mexico, Chile and Colombia are already participating in the OECD Score Board, providing data on regular basis. Peru could also be associated, once internal support is mobilised, allowing for data from all the four PA countries to be incorporated into the 2016 edition. The data gathering process requires the active support of central banks and other financial institutions in each of the PA countries.

127. *A Latin American Scoreboard is currently under discussion, in collaboration with the IDB.* In order to provide more targeted analysis for the PA, another alternative could be the creation of a scoreboard specifically for the PA and/or the creation of a country note for Peru within the next regular OECD edition (2016).

OECD Diagnostic of Engagement in Global Value Chains

128. *The forthcoming (2015) diagnostic for Chile aims to provide Chile's Directorate General of International Economic Relations (DIRECON) with an analysis of its current level of participation in global value chains (GVCs) and to identify key constraints to increasing its level of participation, particularly in terms of trade, investment and innovation policies.* The paper is structured along three complementary themes. The first; trade and production – will provide a general appraisal of the evolution of participation in GVCs by looking at the evolution of the domestic and foreign value added content of exports both in aggregate and at the sectoral level (including a discussion on the role of services). The second; GVCs and investment – will complement the earlier section through an analysis of the linkages between GVC engagement and foreign direct investment. The third section will analyse Chile's participation and position in GVCs in direct relation to its investments in innovation and knowledge-based capital. An overall conclusion will aim to summarise the main findings of the report and to provide some tentative policy action areas in view of aiding the work of DIRECON to maximise the benefits derived from participation.

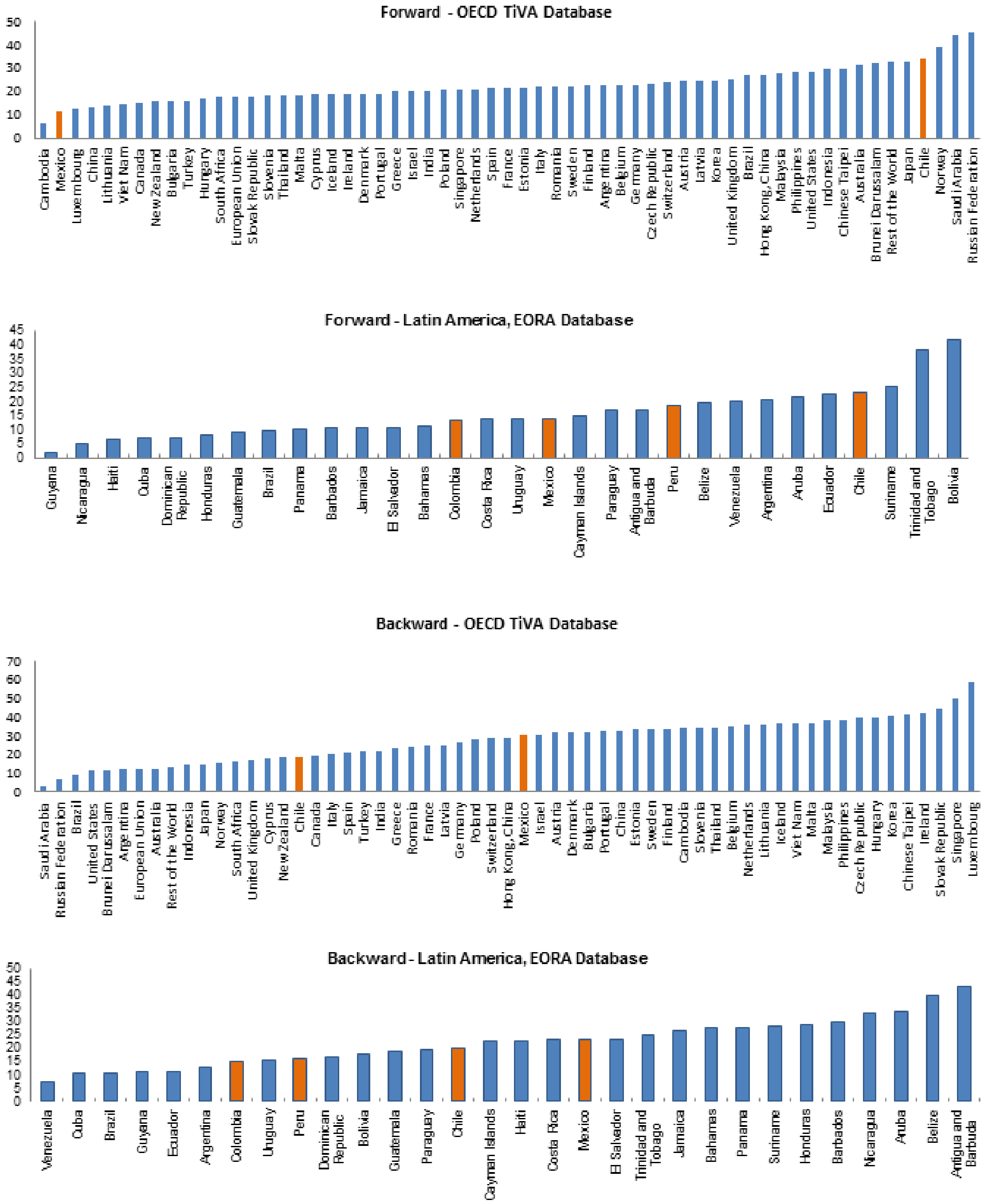
129. *Similar reviews are strongly suggested for other PA countries.* This type of review would particularly useful in building on the preliminary analysis provided in this paper on the GVCs context in the PA (Section I).

Investment Policy Reviews

130. *The OECD will prepare a synthesis report on Latin American Countries which have undertaken an Investment Policy Review, which includes all PA countries and Costa Rica, which could support and better inform joint efforts in this policy area.* This could be complemented by a policy dialogue between the SME and investment groups of the PA, where this report could be discussed and the OECD could support the identification of joint initiatives.

ANNEX

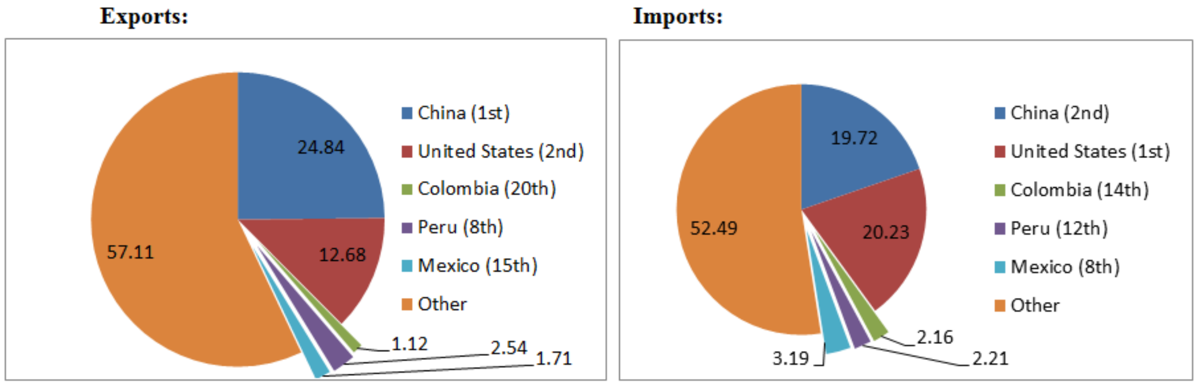
Figure 8. Forward and Backward GVC Linkages (2009)



3. The OECD TiVA database does not yet have information available for Colombia and Peru. Thus, these estimations are based on the EORA database. While EORA offers data for a wider range of developing countries, the quality of the underlying input-output and trade data is inferior to that of TiVA, where great care is taken to harmonise the trade and input-output data. Notwithstanding, the EORA database performs adequately, particularly at capturing backward participation.

Source: OECD TiVA Database, EORA database for Latin American Countries, including Peru and Colombia

Figure 9. Chile, total exports and imports by partner (%)



Source: WITS-UNSD COMTRADE http://wits.worldbank.org Nomenclature: HS 1988/92

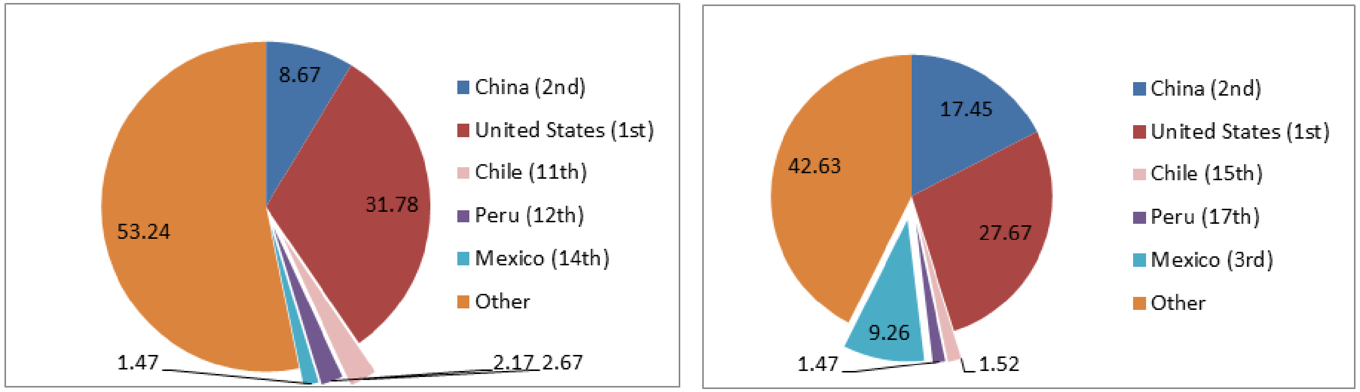
Table 20. Chile, Exports and Imports by Sector - PA Partners (% of total for each country)

EXPORTS																
	Mach and Elec	Food Products	Textiles and Clothing	Plastic or Rubber	Miscellaneous	Wood	Chemicals	Metals	Vegetables	Transportation	Animals	Footwear	Fuels	Minerals	Stone and Glass	Hides and Skins
Peru	16.98	10.99	9.23	5.72	4.99	13.29	10.29	7.5	6.71	3.44	3.31	2.74	1.38	1.21	0.8	1.43
Mexico	5.29	15.94	0.42	2.6	0.19	21.57	12.24	9.17	12.41	1.32	14.87	0.18	0.01	3.36	0.41	0.02
Colombia	5.17	15.51	0.75	5.11	0.83	19.63	5.05	16.27	20.67	2.5	7.3	0.12	0.01	0.16	0.45	0.46
IMPORTS																
	Mach and Elec	**Food Products**	**Textiles and Clothing**	**Plastic or Rubber**	**Miscellaneous**	**Wood**	**Chemicals**	**Metals**	**Vegetables**	**Transportation**	**Animals**	**Footwear**	**Fuels**	**Minerals**	**Stone and Glass**	**Hides and Skins**
Peru	2.18	8.66	4.38	3.65	0.48	2.75	12.42	5.12	4.79	2.92	0.46	0.53	13.17	33.86	4.54	0.1
Mexico	34.37	5.35	1.17	3.54	4.92	0.99	13.88	10.6	0.53	17.05	0.01	0.12	0.09	5.31	1.81	0.25
Colombia	2.64	8.74	1.53	5.01	1.07	2.12	10.46	0.91	4.44	1.04	0.08	0.15	60.68	0.07	0.97	0.09

Source: WITS-UNSD COMTRADE http://wits.worldbank.org Nomenclature: HS 1988/92

Figure 10. Colombia, total exports and imports by partner (%)

Exports: **Imports:**



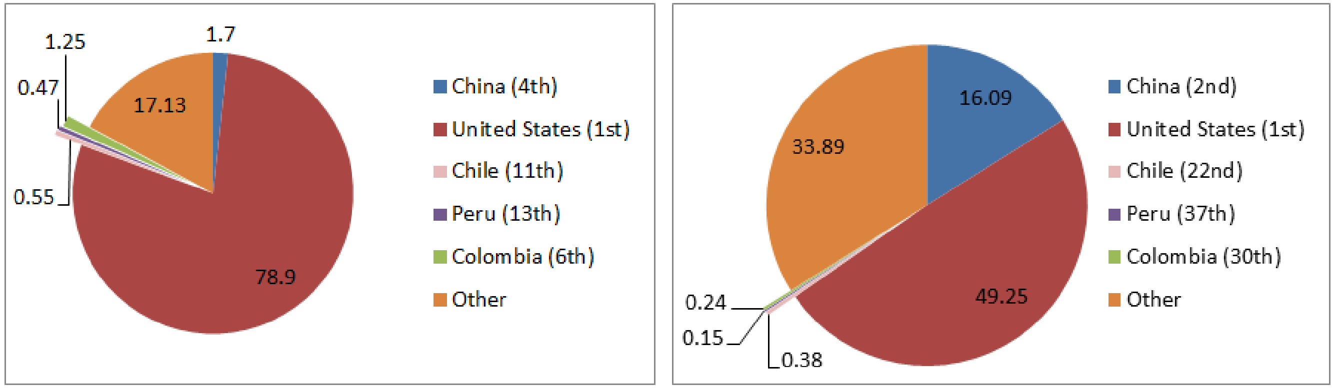
Source: WITS-UNSD COMTRADE http://wits.worldbank.org Nomenclature: HS 1988/92

Table 21. Colombia, Exports and Imports by Sector - PA Partners (% of total for each country)

								EXPORTS								
	Mach and Elec	**Food Products**	**Textiles and Clothing**	**Plastic or Rubber**	**Miscellaneous**	**Wood**	**Chemicals**	**Metals**	**Vegetables**	**Transportation**	**Animals**	**Footwear**	**Fuels**	**Minerals**	**Stone and Glass**	**Hides and Skins**
Peru	8.88	11.76	5.7	13.69	2.52	8.9	23.66	2.93	0.5	3.07	0.1	0.22	15.13	0.48	2.19	0.27
Mexico	3.82	2.82	12.06	9.29	1.92	3.87	15.22	3.21	4.14	29.6	0.19	0.27	9.17	0.46	2.5	1.47
Chile	2.85	6.11	1.37	5.71	0.84	2.15	5.02	0.7	1.82	2.09	0.01	0.14	70.06	0.01	1.09	0.04
								IMPORTS								
	Mach and Elec	**Food Products**	**Textiles and Clothing**	**Plastic or Rubber**	**Miscellaneous**	**Wood**	**Chemicals**	**Metals**	**Vegetables**	**Transportation**	**Animals**	**Footwear**	**Fuels**	**Minerals**	**Stone and Glass**	**Hides and Skins**
Peru	2.06	10.57	10.72	17.25	1.07	5.39	6.91	22.38	12.14	1.99	1	0.57	2.98	0.9	3.98	0.11
Mexico	27.28	1.91	2.15	6.02	1.84	0.75	10.87	14.61	0.17	21.09	0.03	0.24	11.09	0.28	1.64	0.01
Chile	4.29	15.91	1.21	5.07	0.64	19.98	5.39	15.45	22.61	0.21	7.85	0.06	0.01	0.35	0.46	0.5

Figure 11. Mexico, total exports and imports by partner (%)

Exports: **Imports:**



Source: WITS-UNSD COMTRADE http://wits.worldbank.org Nomenclature: HS 1988/92

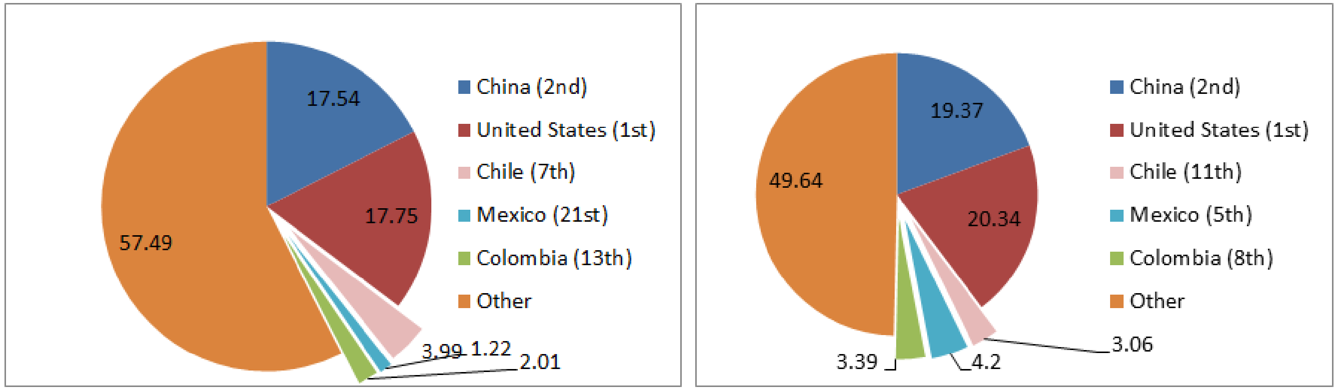
Table 22. Mexico, Exports and Imports by Sector - PA Partners (% of total for each country)

EXPORTS																
	Mach and Elec	Food Products	Textiles and Clothing	Plastic or Rubber	Miscellaneous	Wood	Chemicals	Metals	Vegetables	Transportation	Animals	Footwear	Fuels	Minerals	Stone and Glass	Hides and Skins
Peru	29.37	3.26	1.5	4.76	1.15	1.48	15.08	4.79	1.23	20.31	0.01	0.05	0.12	15.8	1.04	0.06
Colombia	26.66	1.94	2.11	6.99	1.1	0.8	11.27	15.26	0.28	21.42	0.04	0.18	9.98	0.23	1.71	0.03
Chile	35.55	5.42	1.12	4.76	1.29	1.03	17.24	7.58	0.6	20.65	0.06	0.13	0.12	2.43	1.98	0.04
IMPORTS																
	Mach and Elec	Food Products	Textiles and Clothing	Plastic or Rubber	Miscellaneous	Wood	Chemicals	Metals	Vegetables	Transportation	Animals	Footwear	Fuels	Minerals	Stone and Glass	Hides and Skins
Peru	3.35	0.8	7.62	6.6	0.96	6.71	3.19	4.67	6.86	0.09	2.01	0.3	46.86	7.74	1.63	0.61
Colombia	3.37	2.61	13.22	12.88	2.53	4.16	15.89	3.37	4.51	20.89	0.15	0.32	11.37	0.68	2.69	1.35
Chile	5.16	14.93	0.37	2.99	0.71	21.99	14.06	8.04	13.54	0.48	14.35	0.03	0.01	2.92	0.4	0.02

Source: WITS-UNSD COMTRADE http://wits.worldbank.org Nomenclature: HS 1988/92

Figure 12. Peru, total exports and imports by partner (%)

Exports: **Imports:**



Source: WITS-UNSD COMTRADE http://wits.worldbank.org Nomenclature: HS 1988/92

Table 23. Peru, Exports and Imports by Sector - PA Partners (% of total for each country)

	Mach and Elec	Food Products	Textiles and Clothing	Plastic or Rubber	Miscellaneous	Wood	Chemicals	Metals	Vegetables	Transportation	Animals	Footwear	Fuels	Minerals	Stone and Glass	Hides and Skins
EXPORTS																
Mexico	6.5	1.6	8.56	4.88	0.85	6.16	4.09	2.74	5.46	0.55	1.35	0.57	47.1	7.1	1.79	0.7
Colombia	2.96	9.69	11.21	16.8	1.37	5.2	7.2	21.05	10.1	1.14	0.85	0.58	7.03	0.58	3.98	0.24
Chile	2.42	9.23	5.27	3.96	0.49	2.81	10.89	5.59	4.59	2.19	0.49	0.41	13.28	33.74	4.52	0.1
IMPORTS																
	Mach and Elec	**Food Products**	**Textiles and Clothing**	**Plastic or Rubber**	**Miscellaneous**	**Wood**	**Chemicals**	**Metals**	**Vegetables**	**Transportation**	**Animals**	**Footwear**	**Fuels**	**Minerals**	**Stone and Glass**	**Hides and Skins**
Mexico	39.04	3.29	1.58	4.82	1.73	1.67	14.78	4.65	0.97	23.15	-	0.07	0.1	2.86	1.26	0.03
Colombia	7.93	11.03	6.14	12.67	2.03	8.28	22.33	2.3	0.45	2.43	0.11	0.2	20.82	0.67	2.42	0.18
Chile	10.4	13.22	1.01	6.94	1.43	20.72	17.11	8.88	10.07	1.56	5.25	0.04	2.04	0.21	1.02	0.1

Source: WITS-UNSD COMTRADE http://wits.worldbank.org Nomenclature: HS 1988/92

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