

## Chapter x

### **Sensitivity of Rural Enterprises to Globalization and Trade Liberalization: A Japan/Canada Comparison**

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### **Abstract**

Japanese and Canadian small and medium sized rural enterprises (SMEs) use different strategies to cope with globalization and trade liberalization. This comparative study, conducted in 2000, explores the distinction between globalization and liberalization and concludes that they bring quite different issues to bear on efforts to revitalize rural enterprise. Both final and primary manufacturing are vulnerable to liberalization while intermediate industries in the new rural economy appear to be better positioned to gain from globalization.

The new rural economy is being retooled with information technology. It is more sensitive to competition practices than the old rural economy when transactions costs were higher. Nevertheless, SMEs in the new rural economy remain tied to the old rural economy goals for family, heritage preservation and community. Rural SMEs in both countries need to learn a totally different management and organization style to be sensitive to opportunity as globalization unfolds. Revitalization policy in both countries needs to take a look at exchange rates, productivity, governance, competition and property rights to avoid blocking the benefits of globalization for rural SMEs.

## Purpose and Scope

Globalization happens. Trade liberalization is negotiated. Globalization is driven by technology, proprietary rights and by constant ongoing organization in a process called co-evolution. Trade liberalization is a politically driven process about access to markets across national boundaries. Liberalization accelerates globalization. Globalization enables liberalization to achieve greater specialization and is expected to improve efficient use of the world's scarce resources. Both processes concentrate wealth.

Can SMEs be the engines of a rural revitalization strategy for the new rural economy? The answer depends on how they are sensitive to globalization. If they are sensitive and unable to organize within themselves in response, they are part of the problem. If, on the other hand, they can size up the situation in time and rearrange their assets to escape the squeezes and expand into markets that value their outputs, they are part of the solution.

The scope of this paper is the sensitivity of the new rural economy [NRE] through its SMEs to globalization at this second and indirect level, with particular reference to trade liberalization. The essential feature of the NRE is its relatively greater exposure to global market forces and geo-political strategies for global security than the old rural economy.

By 'globalization', is meant the reduction in the cost of making transactions with the rest of the world. This includes transportation costs, communication costs, costs of negotiating contracts, the costs of finding and signing deals, the costs of enforcing and insuring deals. The new rural economies now have 'greater exposure' relative to old rural economies and relative to urban economies.

The new rural economy, emerging in both countries, is a system of new and established enterprises self-organizing to seize opportunities offered by IT [information technology]. They are retooling their technology and restructuring their ownership, operations, financial equity and management. In rare cases, IT enterprises themselves locate in rural places. Some IT enterprises choose a rural location for the multi-functional slow-life attributes they offer. Most IT and other enterprises choose metro or metro adjacent locations for the fast-life multi-functional amenities found in urban places.

Sensitivity to globalization is as diverse as the NRE itself. The new rural economy is not homogenous either across territories or within single places. It is characterized by considerable diversity of resource endowments, property rights, and degree of remoteness, culture, and heritage. This diversity may be grouped into a formal and an informal rural economy. Openness to global opportunities and pressures vary as much as income between each rural place and within each rural place. Generally the formal rural economy is much more open than the informal economy.

In this paper we distinguish three rural types of economies: Rural I uses world-class technology, is globally oriented and well endowed with assets. Rural II is domestically

focused, active in political organization, uses artisan-type technology, and benefits from entitlements from the State. Rural III is marginalized, heavily involved in the informal economy, and includes a preponderance of seniors, youth, and women. Rural I may account for up to 5% of the rural population, Rural II, 60-75% and Rural III, 20-35%.

This paper provides the results of exploratory research in 20 Canadian and 2 Japanese rural sites involved in the Canada-Japan [CJ] Project of the New Rural Economy Research Program of the Canadian Rural Revitalization Foundation [CRRF] and the Organization for Urban/Rural Interchange Revitalization [OUR], in Japan. The first part of the paper is a review of recent literature. The second part presents summaries of results of interviews with owners/managers of small and medium size enterprises. The paper ends with some suggestions for a next stage of research.

The results indicate that it is normal within Canada for rural SME entrepreneurs to be 'globalized', in the sense of always having had to compete with American competitors. Thus, Canadian businesspersons were not familiar with the words or concepts of 'globalization' or 'trade liberalization' because this has been the norm for decades. Within rural Japan, rural entrepreneurs are just now starting to see the entry of foreign competitors into their market. Thus, they expressed much greater awareness and sensitivity to globalization.

Rural small and medium sized enterprises [SMEs] have difficulty scaling up. That is, they have problems organizing assets and market relationships needed to grow substantially beyond their start-up scale of operations, employment and sales. Successful rural SMEs are learning how to adopt totally new management styles and are able to scale up their operations. Overall, SMEs could benefit with more support from policy on issues of market competition, internal trade barriers and finance. The results also point to the need for a strategy to market into segmented urban markets. The forms and degrees of sensitivity could affect scaling up for SMEs and job creation strategies. The ways businesses start up could influence their subsequent sensitivity to trade.

## **What is Trade Liberalization?**

Trade liberalization is progressively freer crossing of national borders into 'local' markets. Ricardo first established the understanding that countries would gain by specializing with trade in those things for which they held a comparative advantage. This advantage is based largely on natural resource endowments. Globally efficient use of scarce resources would also be the outcome.

Liberalization phases out protection from offshore competition for domestic producers. But countries have geopolitical and domestic strategic interests as well as the desire for efficiency. They construct 'competitive advantage' using mercantile entitlements to achieve their objectives. Globalization means that to the extent that policy-constructed

competitive advantage diverges from comparative advantage the policies become more expensive and come under attack. These competing pressures for advantage determine which country will produce what for trade. Today trade negotiations seek to govern mercantile policy, having focussed in earlier decades on dismantling protection.

The strongest argument for liberalization is the global efficiency argument. The world's resources are limited. Efficiency is gained from specialization of all factors of production in their highest value use, when markets are freely competitive. The specialization process is painful, but justified by global scarcity, or so the argument goes. However, markets are not usually freely competitive. Governments seek national geopolitical competitiveness by promoting aggressiveness in firms. Liberalization has become the method of choice to pressure domestic firms with the threat of do or die.

Recent liberalization is part of the post-war and post-colonial effort to stimulate productivity. Rounds of negotiation led to the General Agreement on Tariffs and Trade ([GATT] and in the last Uruguay Round, its successor, the World Trade Organization [WTO], both with exemptions for agriculture. The current Seattle/Doha Round, is focused on agriculture and intellectual property rights.

Liberalization has generally followed the pattern of replacing quotas and variable import levies with tariffs. The initial tariffs, generally high, are then reduced gradually to allow adaptation to increasing global competition. State trading enterprises are also targeted, especially on the import side. Managed trade is often an intermediate step using voluntary export quotas and minimum access commitments. All trade, whatever the negotiations over liberalization, is but one instrument within a range of national geopolitical and economic strategies.

The expected consequence of liberalization is a stronger more robust national economy better able to play in the rough and tough of global competition among nations. This strength lies in the responsiveness by firms to global market signals transmitted more rapidly to domestic markets and onward to producers. Ironically the consequence of globalization, accelerated by liberalization, is to make nations less relevant as the basis for organization of global economic activity.

The less anticipated outcome of liberalization is that economic instability is also communicated more quickly into domestic balance sheets. The risk component of 'instability' is normally insurable. The uncertainty component of 'instability' is not. It lacks predictability and must be addressed strategically.

Perhaps the central issue for liberalization arises in the notion of 'trading down'. Trading down occurs when trade-induced competition sacrifices standards for environmental security, consumer safety, decent work conditions moving societies to the lowest common denominator. Carswell et al. (2000) argue that rather than trading-down, liberalization results in trading-up; this is certainly possible for the winners – in Canada

those who are the participants in the Rural Canada I part of the new rural economy. The other 90+% of rural inhabitants feel strongly that the environment, consumer safety, health, communities, amenities, and families are not improving. They observe water safety disasters, meat recalls, obesity, dying communities, disfigured countryside, and family breakdown. Trading-down to the lowest global common denominator unarguably contributes to rural devitalization, especially when whole communities are specialized as in the case for forest, fish or wheat-dependent communities.

However, trading-up may also be problematic for rural revitalization by devitalizing SMEs. Carswell et al point out that for the case of global food processing and distribution, trade on a standards basis, may be out-competing SME processors in their domestic markets. The often-rural based processors do not have the scale of operation needed to convert to a standards-driven market. Thus regional food processing, local tastes and diet are drawn into conflict with global conglomerate food processors. This issue is one of the roots of EU/USA/Japan conflict over agricultural and food trade. Carswell's arguments suggest that rural SMEs have little choice but to join the NRE to retool to ISO 14,000-style standards, and apply tactical labelling and new technologies to satisfy local tastes.

## **What is Globalization?**

Globalization is about making global what was local. Globalization is the inexorable process of opening local organization to ever expanding influence by other organizations world-wide. The declining cost of distance enables the process. Full autonomy and sovereignty are less and less practical or even possible to exercise, whether by business, family, volunteer association, ethnicity, market, governance or bureaucracy.

Declining costs of transport and communications drive opportunity for globalization. Seven prominent features define this progression to open boundaries. The first feature is trade liberalization and lower transaction costs, something that reduces protection for domestic production (Noponen et al, 1993). The second feature is a shift in the focus for protection to consumers and the environment, from producers, including farmers. The third is international integration of financial markets. The fourth is extremely rapid international capital flows. The fifth is a growing role for exchange rates to reconcile national differences in productivity and to resolve regional economic crises in the world. The sixth is the growing transnational aspect of mergers and acquisitions. The seventh and last feature is dominance of the global business culture by the major economic nation and new global corporations

Globalization of transaction technology reinforces multinational trade agreements such as the WTO, in integrating markets. High cost producers together with their mercantile sponsors are exposed financially. Those places intensive in the relatively high cost

operations are impacted adversely either from imports or competition in export markets. The meaning of economic restructuring becomes clear when whole regions have to do something else and find their real comparative advantage (Howes and Markusen, 1993). Usually this involves less labour and land intensive activities, deteriorating demographics and pressure on SMEs networked around the constructed advantages, to reorient to other markets. Many people, their institutions, capital assets and land may be immobilized.

The wide scope of globalization can also mobilize resources immobilized by trade. Value-added products are generally more tradable than commodities. However, globalization also exposes local assets to higher opportunity costs for finance, labour and intellectual property. These have to be trumped by ingenuity, more fluid transactions of property rights and achievement of economies of scale.

With globalization, food and social security become increasingly dependent on a nation's economic ability to compete globally over a range of tradable goods, services and capital. Competitiveness in turn is increasingly dependent on global security attained by interlocking and complex geopolitical relationships including managed terrorism.

The new rural economy gains access to global markets for finance, enterprise, technology, transaction services and increasingly over the next decades, immigrant and migrant labour<sup>1</sup>. However, actual profitable access requires that the rural economy have the capacity to compete globally to obtain these factors of production and to organize them with local natural potential and human capabilities.

## **Transaction Services: The Heart of Globalization**

Transaction services are essential for rural and remote economies because of the physical, cultural, social, and economic distance that rural entrepreneurs must overcome to do business. These services are globalizing rapidly because of economies of size from proprietary assets (Fulton et al, 1999; Hayenga and Wisner, 2000). Transaction services facilitate buying and selling and include finance, insurance, brokerage, transport, communication, legal services, accounting and enforcement. Mergers and acquisitions in the transactions sector greatly increase the volume of transactions, and therefore revenue, for very little additional cost. Discriminatory pricing is the rule, combining marginal cost pricing with captive shipper opportunities for territorial monopoly practices. This works against SMEs and small remote economies. The higher costs for rural SMEs are compounded even in free trade areas, for example NAFTA, by volume rules for customs and excise procedures and charges. (Canadian SME survey, 2000).

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<sup>1</sup> However, in general, labour is somewhat of a “fixed factor”.

Standard damages from market concentration arise for all types of enterprise when traders (transaction service companies) collude or merge. The commodity assemblers, Cargill and Continental Grain, are good examples. Hayenga and Wisner (2000) report the results of a study of their merger. Tied selling, price discrimination, reduced pricing transparency and loss of information all along marketing channels impeded economic efficiency in the global sense for this case, while concentrating the benefits from the merger. National competition policy may be made ineffective or insufficient for local markets as national transaction firms scramble to merge using cross-subsidization of global competition by local service charges or off-loading access costs to SMEs. Turvey et al reviewed these kinds of concerns and concluded that in the case of Canadian banks, mergers would not necessarily hurt rural communities (Turvey et al, 1999). They quote the competition Bureau as coming to different conclusions based on different definition of the market structure. Mergers proposed in 1998 were quashed by government. Traders and brokers do not have to be multinationals to exercise monopoly-style outcomes for rural SMEs buying their services.

## **Globalization, mercantilism and rural policy**

Among the least controllable issues for rural SMEs are associated with governments positioning their total economies to be successful globally. Governments must and do position their national economies with competitiveness policies, such as transport and communications infrastructure, to increase balance of payments and sustain positive capital flows. Under the terms of the WTO, governments are increasingly limited to exchange rate interventions and to promotion of business conditions and practices. These heighten the distinction between winners and losers.

Historically mercantilism was used to promote rural and regional economies, in part to offset high transaction costs. Preferential market access, monopolies and entitlements to public resources such as land, forests and fish were set up and protected by the State. This old mercantilism is at the heart of the successive rounds of negotiations leading to both multilateral and bilateral trade agreements. As the cost of distance comes down, mercantile incentives in principle also should be changed. Privileged arrangements with the State are being replaced with State involvement in buying, selling and limiting individual property rights, all of which constrain new entry. Consequently the old economies of whole regions, including farms, fisheries and SMEs are being sidelined wherever entitlements to mercantile privilege are traded off in international agreements. At the same time, new entrants have to negotiate secure bundles of property rights with government before committing equity.

The fundamental difficulty for rural SMEs as part of a national competitiveness and security strategy is that globalization is concentrating the markets in which they must compete. Globalization can bring to the new rural economy access to global markets for

finance, labour, technology and transaction services. However actual profitable access requires that the new SMEs be able to compete globally to obtain these inputs and services to combine with its natural potential and human capacity. Part of this challenge, already acknowledged by Canada's Community Access Program for internet access, is to offset the size bias of IT and deregulate transactions services.

## **Property rights, mobility and uncertainty**

The capacity to self-organize has always been one of the necessary strengths for successful rural SMEs. Self-organization is the rearrangement of uncertainties and risk by moving entitlements and rights around among buyers and sellers (Coase, 1939). However, with inefficient and limited markets for their property rights, or few property rights, the traditional strength for SMEs under uncertainty has been instead pride in craftsmanship and persistence in the face of adversity. These strengths are losing relevance as globalization progresses. Contentment in conformity with traditional rules and general satisfaction with a day's work are giving way in the new formal economy.

Krugman (1993) characterizes trade in this comprehensive process of globalization as strategic. Trade moves private property rights to both immobile assets and their associated mobile assets, to places where they attract a greater return in the form of economic and strategic rents. In the process, trade makes some immobile assets more productive, and therefore more valuable, and idles others for lack of complementary inputs.

Mobility is more likely within SMEs sensitive to globalization, when they reorganize their property rights and change product lines and location. Insensitive SMEs remain in the old rural economy ending up marginalized with their assets immobilized in a localized informal economy. The next higher level of organization, namely local community economies, face new strategic challenges as their social institutions and structures face the ethical and financial fallout of organizational restructuring.

The problem for local rural strategists, whether as municipal leaders or business people, is one of evading uncertainty. Trade constantly moves uncertainty through market channels to the SMEs and communities with the least tradable, least mobile assets, depressing their capitalized value. Sometimes these assets are a whole regional rural economy itself, infrastructure, social capital and SMEs. Investment is impeded by consequent high equity risk premiums.

Rural societies that structure normally tradable rural property rights into untradable bundles with environmental standards, heritage and cultural values are extremely prone to uncertainty from globalization. Societies on the other hand that view property rights purely as individual and tradable, disconnected from common property rights, can out-manoeuvre trade-driven uncertainty more easily. Therein lies the challenge.

Rural SMEs may not only be sensitive to uncertainty from trade through its direct effects on prices and markets in terms of profits and loss. Their fortunes are also sensitive to whether and how common property rights holders exercise their rights as citizens. Asset values and investment for rural SMEs are stronger when citizens are willing to pay for the upkeep of their commonly held assets. Private asset values are devalued when citizens take the route of alienating individual rights through regulation, to protect their common property.

## **Opportunities in Globalization**

The opportunities for SMEs lie in being sensitive to demand-driven markets stimulated by globalization and in larger input supply markets. Demand opportunities arise as trade stimulates the stronger metropolitan economies, both domestic and foreign. Metro-adjacent rural SMEs are particularly well placed in terms of supplying residential habitat, organic and greenhouse products, landscaping, recreation and services to meet a growing diversity of tastes. This diversity in tastes is an outcome of globalization as are the higher disposable consumer incomes stimulated by trade. Durables, such as home furnishings, renovations and decorative artisan products benefit from their income elastic demand.

A second major source of opportunity to improve the competitive advantage of rural SMEs lies in more open inputs markets. Globalization of these markets increase competition in domestic input supply chains, provided that national, prefecture and provincial policies support and enforce competition. Credit financing, insurance and airline travel are examples of globally traded inputs, often on the internet, that allow rural enterprise to shop more widely for lower priced better-designed goods and services. Intermediate goods and services, formally only available from protected metropolitan suppliers may become cheaper with better on-time and backup service because of the trading-up effect of offshore competition, as argued by Carswell et al (1999).

The obstacle to changing the orientation of SMEs toward tradables lies in the associated culture and lifestyle changes for home-grown entrepreneurs. They must embrace demand-induced export-based development and forswear commerce-induced and supply-driven development. New concepts have to be learned at both the policy and enterprise levels for economic and social safety nets because the new uncertainties lie in relationships rather than weather and prices. Strategic tradeoffs are required between new economy jobs around rural amenities and old economy jobs around environmentally challenged industrial factory agriculture and manufacturing.

## **Are SMEs Sensitive Enough to Gain from Globalization?**

This study is premised on the understanding that future performance of rural SMEs as potential engines for rural revitalization lies in their sensitivity to indirect effects

transmitted from global practices. The reasoning is that this kind of sensitivity, though less evident and harder to measure than the direct effects, is a necessary, though not sufficient, for self-organization of the assets of the SME. Sensitivity is not sufficient because global forces, though ubiquitous and imperceptible, are nevertheless powerful givens. They are not easily understood in time to manage their consequences.

Rural enterprises are sensitive to direct effects of prices and markets in terms of profits and loss. But their future performance is related to their sensitivity to indirect effects transmitted from global practices. Sensitivity to indirect effects, even though less evident, is needed for the local rural economy to benefit from trade. The new starts, scaling-up, and business survival needed for job retention and creation are therefore also sensitive to these indirect effects.

1. Sensitivity to pressures from trade. Pressure is brought to bear when others innovate new ways of organizing things. Globalization introduces pressure to change, ready or not. Firms experiencing pressure from global firms, including movement offshore of whole manufacturing processes, may see their asset value eroded faster than they can change, especially if they have glossed over uncertainty to specialize in response to trade opportunity.
2. Sensitive to uncertainty. Uncertainty impedes investment. As comparative advantage shifts, and competitiveness is deconstructed by government as part of multilateral trade commitments, SMEs need to find new ways of sharing uncertainty perhaps through social capital and business partners.
3. Sensitive to new information. Globalization provides access to new technology and information.
4. Sensitive to new standards. Globalization modifies product, labour, and environmental standards and individual rights to demand or exempt adherence.
5. Sensitive to pressure on soft systems of self-organization. Globalization places the rural 'soft systems' or self-organization in competition with other more productive, competitive, and profit-oriented management and administrative business practices. Entrepreneurs' goals are narrowed to match the global priority on shareholders' interest. Joyal says that an uncompetitive rural enterprise culture anaesthetizes the local economy (Senn, 1995).
6. Sensitive to changing values relating private and collective responsibility. Globalization introduces the urban culture and values of the dominant global economies of the day. These redefine the line between collective and individual/private responsibility with implications for business practices.

These six kinds of sensitivity were explored for a sample of SMEs in Japan and in  
| Canada.

## Survey Procedure

Four small and medium sized enterprises (SMEs) were selected in each of the two Japanese sites of Iitate and Awano randomly from the two lists of SMEs. Three SMEs were selected randomly in each of 20 sites in Canada. The Japanese SMEs were all manufacturing enterprises. The Canadian SMEs included commerce and service enterprises as a concession to the funding agency.

The process used for selecting the sites for this study is based on the work of the Canadian Rural Revitalization Foundation's (CRRF) New Rural Economy (NRE) project (Reimer, 2002) The two sites in Japan were selected as representative of lagging and leading towns/villages following an extensive classification exercise.

All census subdivisions (CSDs) in Canada were analysed using factor analysis to group them in five categories:

- exposure to global processes
- market fluctuations
- metropolitan adjacency
- local capabilities
- economic outcomes defining CSDs as leading or lagging.

The 2x2x2x2x2 'sampling grid' of 32 cells contained mutually exclusive lists of all CSDs. The focus for analysis was placed on the 16 leading and 16 lagging sites. A single CSD from each cell was selected at random to represent that type of rural economy. Some trades were made to obtain regional balance. Twenty of these sites were then chosen for this research, based on a variety of factors including research funding and the availability of site researchers to complete the work.

A stratified sampling procedure was used in each Canadian site to select a maximum of four small businesses per site, one from each of four different economic sectors: manufacturing, exporting (to a national or international market), e-commerce (where customers of the business purchase products or services on-line), plus one other business. A total of 56 completed surveys were returned reflecting mainly the absence of some of these business categories in many sites.

Personal interviews were conducted with the SME owner(s) or manager(s), lasting approximately two hours. The questionnaires were exploratory in nature. A mix of qualitative and quantitative closed-ended questions was used. The Japan questionnaire was used first in March 2000. The Canadian version was modified and lengthened to incorporate special interests of the funding agency. Most of the interviewing took place in July 2000. Only the comparative data is used here. The questionnaires were well received in both countries.

## Results

### Characteristics of the SMEs

Awano with three SMEs in the sample is a leading rural economy. Iitate with four is a lagging economy. Iitate in Fukushima Prefecture is an example of rural-remote place, lying half way on a secondary highway linking Fukushima City to the East Coast. Awano is metro-adjacent within the greater Tokyo area of economic influence. The Iitate SMEs are relatively labour intensive averaging 61 employees and US\$ 3.1 million in sales. The Awano SMEs average seven times the sales with only a 30% larger workforce.

*[\*\*survey results section would benefit from presentation of some tables condensing this information\*\*] Yes this is true. However, you will recall that the SME survey was long. The first version was used in Japan, emphasizing sensitivity to globalization and trade issues. The version used in Canada substituted a community focus. Questions about volume of sales and numbers of employees among others were dropped as part of the tradeoffs. Consequently comparable data is limited between the Japan and Canada versions. I don't think it is useful to have two tables, one for Japan and one for Canada, each with different variables.*

The Japanese SMEs producing intermediate goods appear to be faring better under trade liberalization. All have increased sales with liberalization or have held their own. They are actually branch-style plants tied closely within large firms, which have the resources to handle offshore competition, or are part of a keiretsu-style system, a network of privileged markets and upstream control over production. Keiretsu are a looser form of the earlier Zaibatsu System, a loose yet disciplined conglomerate structure of relationships, which internalizes transaction costs and uses transfer pricing to build, expand and protect market shares.

The 56 Canadian SMEs in the sample are independent and generally much smaller family operated businesses focused on a variety of final product/service markets. They include 15 manufacturing, 11 construction and 30 commerce and service enterprises. Almost half the sample, 25 SMEs, sell 50% or more of their output locally. Another 19 sell 50% or more of their output in provincial and national markets, which we define as the domestic market. Sixteen export, with nine exporting 50% or more of their output. Thirteen are importers. Twenty-five SMEs are operated by sole owners, 13 by family partnerships and nine by other partnerships. Most appear to operate in the informal economy.

### Views of trade liberalization

All Japanese respondents expressed views on liberalization. In contrast, ten of the 50 Canadian respondents were not aware of the meaning of liberalization. Their markets have always been liberalized/globalized by the presence of American competitors. Both groups had mixed feelings about their sensitivity. On balance, the Canadians were a bit

more pessimistic, with some feeling that only large corporations benefit and that small and medium sized businesses are vulnerable. Some Japanese were experiencing economic difficulty, feeling greater economic uncertainty. Some respondents in both groups acknowledged greater competition.

Canadians anticipated access to more and larger markets, higher input prices, pressure to adopt new technology and change to business practices, more business, greater input mobility, and cheaper, more abundant consumer goods. Japanese respondents equated liberalization with cost cutting, more convenient deliveries to customers, higher quality workmanship and outputs, and growing demand for compact designs.

Canadian responses don't follow a pattern other than to confirm awareness and sensitivity to potential issues arising from larger markets. On the other hand the Japanese responses tend toward technical solutions for anticipated narrowing margins. Field observation suggests that the Japanese respondents are technical managers of relatively large manufacturing SMEs operating in relatively institutionalized pricing situations. The Canadian SMEs were much smaller operating in active markets on a day-to-day basis.

#### **Sensitivity to pressure from trade**

Rural Canadian SMEs did not feel much pressure from trade. Out of a sample of 54 survey respondents, only 34% have some sales in international markets. Eighteen percent sell over 50% of their products offshore, while 27% of surveyed SMEs imported inputs from another country. More than 80% of the surveyed SMEs feel no effects from trade liberalization. Of those that do, only 1 in 9 also feel more pressure to be competitive. The comparatively relaxed nature of the Canadian responses, with a few exceptions, seems to suggest relative comfort with territorial and exchange rate advantages in markets quite open for some time at the national level following the NAFTA.

The pressure on the Japanese SMEs from liberalization has to be viewed in terms of growing offshore import substitution in their domestic markets. When metropolitan trading companies abandoned Iitate granite producers for cheaper Chinese stone, granite producers went into survival mode. This traditionally supply-driven resource industry is currently getting past the first stages of becoming demand-driven. The clothing assembly factory reported bankruptcy pressure for some years and did in fact subsequently close.

#### **Sensitivity to new information and technology**

Canadian SMEs, as a whole, do not see access to new technology through trade as applicable to their business. Even the eight SMEs exporting more than half their output are at best neutral about greater access to technology associated with trade. These results suggest that they may be operating in niche markets with little competition, or in low-tech markets. Manufacturing SMEs are similarly insensitive to opportunities to access new technology through competition in export or import markets.

On average, the Japanese SMEs are neutral about their access to new technology in the past five years in connection with trade liberalization. All are more aware of new technology, particularly for cost-saving and new products for niche markets. However, only two feel they have better access. Two feel they have less access, while three say access has neither improved nor diminished.

This Japanese evidence is similar to the Canadian evidence, suggesting that rural SMEs in general may not be aware of the technological learning opportunities through trade. This insensitivity also suggests strong overtones of the old rural economy. Barriers such as patents and scale of operations may also limit access. Lack of incentives associated with segmented markets and specialized proprietary assets used to service these markets could also be discouraging access to technology.

### **Sensitivity to standards**

The large majority of Canadian SMEs in the sample say that standards are not applicable to their situation. Only two of the 15 manufacturing and processing SMEs are certified ISO 9001. None are certified 14,001. Similarly very few agree that trade liberalization is promoting certification. All Japanese SMEs are certified or are working toward certification to ISO 9001. None are certified ISO 14,001.

Standards are part of being in the NRE. The Japanese firms are responding to new requirements for competitiveness under liberalization but not to the opportunities in environmental conformity from globalization. The Canadian rural SMEs are insensitive to standards-driven features of either liberalization or globalization.

### **Sensitivity to uncertainty**

Five of the seven Japanese respondents agree that uncertainty has increased in the past five years. Only one disagreed. Each had a different perspective. One noted that uncertainty had limited investment and upgrading, suggesting that uncertainty may be a factor in scaling up. Two observed that uncertainty mainly affects older businessmen who can't adjust, because their mindset is an obstacle to change. Exchange rates were cited as an important feature of uncertainty in Japan.

The large majority of the Canadian SMEs surveyed, 49/56, do not see uncertainty associated with trade liberalization as a significant obstacle to private investment in new or expanding businesses in the community. Three of the seven that do acknowledge uncertainty are manufacturing/processing firms. The remaining two do not feel greater uncertainty. Three of the four exporters that do see uncertainty as an obstacle are concentrated among exporting firms with more than half their markets outside Canada. The remaining six of the nine exporting more than half of their sales do not see uncertainty as an obstacle to investment.

The evidence suggests that globalization does introduce less predictable properties to the rural economy, for SMEs producing into both domestic markets opening to trade and export markets. Nevertheless, most rural SMEs in both countries feel considerable control over outcomes. The results suggest that for rural SMEs, uncertainty from import substitution may be greater than uncertainty found in export markets.

Generally old economy rural SMEs have few ways of passing uncertainty onward. New economy strategies offer innovative contractual arrangements, clusters and networking, and new risk markets as part of retooling. On the other hand, taxation policies favouring interest income over returns to equity are considered an obstacle to risk-taking. Anecdotal evidence from the interviews suggests that labour force restructuring, the usual first stage of adaptation to uncertainty, may actually be contributing to uncertainty from the indirect effects of globalization. Part-time labour was reported to make it difficult to meet ever-tighter just-in-time deadlines in competition.

#### **Soft-system strategies used to face trade liberalization**

All SMEs surveyed are making internal changes as a result of pressure from trade liberalization. The SMEs that are losing sales are also laying off employees. The expanding firms are hiring. The final goods firms are adding new products to access new domestic markets. In particular, counter-cyclical spending on infrastructure by the national government of Japan during the 1990s to stimulate the national economy has provided a market for new stone products. At the same time, final product firms have changed production technology and their market strategy. Three of the four Iitate SMEs have changed management style. Only one reported seeking government assistance.

SMEs in Awano report a slightly different approach. They have switched to cheaper offshore inputs and away from traditional Japanese suppliers. They are implementing labour saving technology and in one case using foreign workers. Other measures include hedging foreign exchange, moving some production offshore and seeking government assistance.

Canadian rural SMEs, feeling little pressure from trade liberalization, report far fewer organizational changes. Of the 15 manufacturing firms, only three reported new strategy to deal specifically with trade effects. Two of these were exporters. They added new products or services, or expanded output, or changed production technology. None changed management style.

These results reflect the very different nature of the two samples of rural SMEs. The Canadian sample of relatively small autonomous firms is oriented mainly to local services markets. Only eight export. Less than a third of the sample, 15 firms are involved in manufacturing/processing. The Japanese sample is made up of much larger manufacturing/processing highly networked firms oriented to the national domestic

market. The exporting Canadian firms voluntarily choose to engage in trade. Trade pressure has been imposed involuntarily by import pressure on the Japanese firms.

Those Canadian firms who do choose to export seem to possess soft systems well suited to their global markets. Those that remain focused locally are not facing competition from trade. Japanese firms coping well and profitably with globalization seem to be substituting the much larger pools of talent in trading companies for problematic internal soft-systems. Those that are not growing or declining are more labour intensive, independent of larger networks and operate with traditional agrarian-style soft systems.

### **Business practices and changing values relating private and collective responsibility (Japanese SMEs only)**

Globalization imposes requirements on firms similar in some ways to the cultural integration inherent in corporate mergers and acquisitions (M&As). Corporate cultures have to merge for successful M&As. Under globalization, business practices linking the SME to its rural community are challenged also to merge with the dominant global business culture. At the time of this survey, globalization features strong influence from the American business culture of individualism, each for herself, scorn for the weak, and winner-take-all competition.

Respondents in this survey expressed frustration about the conflict between their traditional community business cultures, which is quite opposite. Six out of seven Japanese firms surveyed agree, most quite strongly, that American business values are affecting their business life. Community safety nets are under pressure. All stated that they have cut back on gifts. Yet it is clear that with trade liberalization, traditional mutualism within the community is giving way to a tougher more competitive ethos in these rural Japan sites. Four of the seven respondents feel that global values are useful for future business success. Only one saw these values as an obstacle. This could have significant impact on traditional social safety nets and social cohesion at the level of the basic hamlet (ku).

## **Policy Issues Arising**

### **Test of good policy**

Policy change should make at least one individual better off without making any others worse off (The Pareto criterion). Policy is the set of rules of engagement for SMEs. Policy is the expression of governance. The test of good policy making is that entitlements be moved around, including income transfers, so that the economy responds in a timely way to global opportunity without leaving parts of society behind. The problem for rural economies is that too much reliance has been placed on politically easy income transfers and commodity measures to deal with incidence issues in gains and losses.

Small and medium sized enterprises in the NRE are often viewed as the lead business organization for rural economic revitalization strategies. Yet, with globalization and particularly trade liberalization, SME weakness has become a symbol of rural devitalization. This is in spite of decades of investment in business parks and business promotion, and the fact that SMEs represent most of the entrepreneurial talent in a rural community.

The globalization and trade discussion above and the SMEs in the survey raise many policy issues. Several are described briefly here to underline the overriding influence of policy on the sensitivity and responsiveness of rural SMEs to liberalization and globalization.

### **Border measures**

The first policy line of defence as liberalization progresses is market privilege using 'border measures'. Internal trade barriers are particularly problematic. Interprovincial trade barriers in Canada help uphold provincial market prices. Exclusive licensing practices by municipalities protect main street commerce from competition from the informal economy. Preferential credit for first entrants and successful SMEs can turn into barriers to subsequent entry and cronyism. The cost of market privilege is eventually reduced volume, productivity and tradability, all fundamental to responsiveness to globalization. It is a policy disaster for rural SMEs to face liberalization downstream on external borders and not upstream on internal borders (Fullerton, 1995).

### **Competitiveness policy**

Competitiveness policy is the first offensive line on the playing field of globalization. Debate is active on whether rural SMEs are on balance marginalized or revitalized by these policies. Exposure to competition from trade is argued to act as an incentive for SMEs to join the new economy. Rural SMEs tend to be more supply-driven than consumer-driven, being at early and intermediate stages of adding value. Therefore competitiveness policies play out through these markets, aiming to lower costs in the supply-side markets for capital financing, property rights and public services. This fits well the cost preoccupation of artisan technology. But competitiveness policy also removes shields against entry by off-shore global giants such as Walmart whose globalized procurement practices often shut out local SMEs from retail markets.

Hausemann and Rodrik (2002) put forward one possible reason for the devitalization effect on rural SMEs from national competitiveness policy. Costs of self-discovery are high for firms forced to move away from well-understood cost structures, such as when SMEs retool in the new rural economy. SMEs and their communities can only know these new costs and understand the strengths and weaknesses of their rural location in the NRE, when they have made what amount to enterprise-scale experiments.

The individualistic culture of rural SMEs and their wide geographic dispersion slow the communication of this learning relative to urban SMEs. Whatever the pace of global intrusion in rural SME space, it is faster than they can learn and self-organize to be competitive. One could add that the tight ownership structure of many rural SMEs revealed in the Canadian survey may only be suited to building the SME once in a lifetime, unlike publicly owned companies that have institutionalized the learning process.

### **Exchange rates**

The third policy issue exchange rates. Exchange rate policy can materially offset productivity policies, one of the main factors determining rural economic strength. Undervalued exchange rates for commodity exporting countries, such as Canada, while expanding output, may slow productivity growth because there is less of an incentive to change (St. Louis, 1999). Undervalued exchange rates act like export subsidies to discourage value-added SMEs in a natural resource-based economy. Though the effect on productivity is reversed for countries importing undervalued raw commodities, such as Japan, their rural SMEs at the first stage of processing the local raw material are also disadvantaged.

Unstable exchange rates are also an issue. The need to hedge uncertainty from variable exchange rates is an impediment for SMEs considering entry to global markets, especially smaller SMEs. Instability is understood to influence trade volumes although the evidence is mixed. (Hausemann and Rodrik, 2002; Klein, 2000; Langley et al, 2000), The World Trade Organization has placed great weight on exchange rates to equilibrate playing fields in trade. Exchange relationships are determined by global financial markets and capital flows up to a point. Individual governments can and do stabilize changes somewhat through Central Bank currency trading from reserves.

### **Pricing transparency**

The fourth policy issue is the transparency of pricing. This is mainly an issue for value-adding rural entrepreneurs. St. Louis (1999) points out that as global transaction services concentrate through mergers and acquisitions, domestic consumer prices lose their relationship to rural commodities and to first round value-adding activities. Thus rural SMEs may not receive the price signals from consumers, or the consumers from greater rural productivity or efficiency. This situation works against the performance of markets to adjust demand and supply and discover prices. Conglomerate trading companies, a major feature of the Japanese economy, and a feature of global agricultural commodities and chemical inputs trading, are disconnecting urban consumers from rural enterprise and innovation. The granite SMEs of Iitate are examples of disconnect by their former global trading company partners who have cut them off from their cemetery customers.

### **Product definition in trade challenges**

The fifth issue is how products from SMEs are defined for purposes of trade policy. If rural SMEs are to work in global markets, they need to differentiate their products, usually with some joint attribute. Yet problems arise when their products are redefined as perfectly substitutable generics for trade purposes. When they sell in both domestic and foreign markets they may be subject to commodity rules, or worse to trade challenges on matters of dumping, of price discrimination, and the legitimacy of rural investment measures and marketing institutions put in place by governments. Larue et al (1999) provide a typical analysis of what happens when a tradable is treated as a generic rather than a product differentiated by a joint attribute.

Canada attributes joint product value to milk in terms of its geographically dispersed organization of family dairy farms. However, milk is defined as a generic commodity for trade purposes, the joint attribute not being valued by buyers outside Canada. The higher price in Canada relative to the North American (world) price has to be protected by border measures. The clash in this case is between citizens defining the joint attribute and consumers not being willing to pay for it voluntarily through the market.

Many rural SMEs by their nature process generic commodities into differentiated products within generic categories. Un-pasteurized traditional cheeses, gluten-free bread, artisan jams, pea-butter, boutique clothing and hand-crafted furniture are examples. The differentiating attribute could be treated as a joint product, like a room with a view. Joint product status exists when value is attributed to something intrinsic to the product such as the place of origin, the artisan production process, the ownership structure, the link to heritage, or the respect of environmental security. Several values (prices) are attributed every day to visually, chemically, mechanically identical products through segmented markets, or by segmented democratic processes of public choice.

For example, T-shirts embroidered with cowboy motifs in a Hussar Alberta SME, are not just clothing brokered at a border crossing at a price lower to that charged in Canada. The shirts are not joint products in foreign markets with value attributed to the authenticity of wide-open Hussar countryside and cowboy heritage. This value is only attributed in markets at the Calgary Stampede and western rodeos. In fact the shirts may have to be priced lower off-shore, because artisan variation, judged as an imperfection, coupled with discrimination against another county of origin introduces a discount.

### **Lack of competition for transaction services**

The sixth policy issue is also market related. Transaction services can be viewed as natural monopolies because of increasing economies of size. Their propensity not to pass on cost efficiencies is difficult to handle with competition policy because of the problem of cost determination as opposed to determining a violation of rules. Globalization enabled by IT has so transformed the transaction firms that they have become IT firms in

themselves. Information technology has enabled them to develop proprietary rights to their branded way of organizing their services. They are heavily scale biased forming small clusters of high volume firms (Hayanga and Wisner, 2000). These services have an opportunity to discriminate in their markets with monopoly pricing.

The role of SMEs for rural job creation and the transformation of rural economies is limited by upstream and downstream uncompetitive practices for transaction services, especially where global conglomerate traders of packaged financial, brokerage, insurance and transportation services are concerned. This is not just an issue in the trade of 'commodities', which are not the way to strength for rural economies anyway. The sustained high levels of concentration in rural input and output transaction service markets extract rents from SMEs. Lower economic rents bring lower returns to rural investors, including governments and public utilities, which usually have to over-invest in infrastructure. This rent extraction inhibits rural private and collective investment; transforming otherwise bankable projects into venture capital projects.

### **Governance and policy**

Last is interesting insight into the ways changes in governing structures require a new rural policy agenda (Hedley, 1999 and Furtan, 1999). Hedley, and Perdakis and Kerr (1999) observe that citizens in their role as consumers are changing the way policy is made, both at the national level and the global level. Implicit in their arguments is that governance is moving in two directions: One with citizens' consumer and community interests represented through government. And two with citizens' production and wealth creating interests governed through global organizations of firms and markets. Hedley observes, for example, that firms are finding it easier to optimize within one firm in many territories than within many firms in their own territories.

The implication of Hedley's observation is that firms organized as rural SMEs are becoming trapped as sub optimal, facing an uphill battle to cross national borders in competition with transnational business organizations. At the same time, as governance is becoming horizontal (Hedley, 1999), SMEs can't find a policy champion other than perhaps their Member of Parliament or legislative assembly. Rural governing institutions remain as vertical organizations, often with community bases, such as most co-operatives, unable to handle horizontal agendas emerging from restructured governance and globalization. Prescriptive SME policy around community and local resource bases seems in conflict with the emerging horizontality of governance and the global organization of wealth creation. Policy reliance on entrepreneurial SMEs for rural revitalization may be becoming obsolete and at worst dysfunctional.

Furtan underscores the need to focus governance on property rights in line with the types of products and services desired. Rural SMEs usually work with excludable and individual property rights. However citizens' demand for a secure environment and the

expanding horizontal structures of governance, including new NGOs crossing territorial jurisdictions, offer new opportunities for SMEs in rural revitalization. Individual and common property rights are already being rebundled as part of government and business strategy. The policy challenge with revitalization in mind is to find ways that SMEs can deliver environmental security with open access rights, as an explicit fee-for-service enterprise rather than as a joint attribute which may or may not be valued in global markets.

## **Conclusions**

The conclusion from Canadian rural SMEs is a general insensitivity to stimulation from trade liberalization and globalization. They do not feel stressed by competition in domestic, local or export markets. The Canadian SMEs appear comfortably isolated from both trade opportunities and uncertainty, able to choose not to face global competition. This isolation applies to most of the 15 manufacturing SMEs as well as to 32 of the other 41 SMEs in the sample. Few of the sampled rural SMEs report any pressure or sensitivity to the indirect effects of globalization, which could stimulate growth.

Their isolation from export potential seems to be more than a matter of distance. They do not acknowledge greater access to technology as part of the liberal trade environment. They are not embarking on certification in the ISO system, viewing standards as inapplicable to their situation. They have not felt the threat of bankruptcy. They are not aware or do not understand property rights issues. The results suggest that Canadian rural SMEs are at very early stages of joining the NRE.

The second conclusion from examining the Japanese rural SMEs is that when forced to face global competition, successful rural firms learn a totally new management style emphasizing standards for quality and business practices to ward off global competition. They learn that global markets, even accessed indirectly as suppliers of intermediate goods, require upgrading to global standards for quality assurance. Environmental standards are under active discussion. Rural Japanese SMEs demonstrate once again the importance of being connected to other players through technology and a learning culture to organize effectively for globalization. It is difficult for a rural SME to go it alone.

The third conclusion is that established rural SMEs are unlikely to be engines for employment creation, usually first ranked as a desired outcome from rural revitalization. Single primary value-added product lines or final products marketed through brokers or direct sales appear to offer little potential for SME revitalization. The rural SMEs in both samples reported problems growing, unless they are linked in some non-market way as intermediate suppliers to other firms experiencing export growth or growing domestic market shares.

Overall, this study indicates the necessity of a global policy approach if rural revitalization is to be led by SMEs. Trade liberalization appears to be a stimulant to rural SMEs, and a real opportunity when exports are involved. What seems to be missing is an understanding of a role for policy in making the best use of the wide variety of sensitivities needed for rural SMEs to succeed with globalization. A whole new learning culture and management style seems called for on the part of policy analysts and leaders in rural governance, as well as the rural SMEs.

A whole new category of opportunities is being defined by citizens' unorganized priorities for safety, health and the environment. Entry into the NRE requires an appreciation by policy makers of emerging self-governance by citizens through NGOs to organize the demand side of services that seem quite suitable for SMEs. Some change will be led by rural families focused on inventing their own globally competitive organization to enable them to reinvest in their rural lifestyle. Other SMEs will be restored or start up with urban entrepreneurs moving to rural locations. These people will bring SMEs with a more lifestyle-focused bottom line reinforced by connections to global markets and a keen eye for productive rural assets. New rurals are already a feature of the Japanese and Alberta SMEs in the sample.

Whatever the origin of new rural economy SMEs, the results of this exploratory study indicate that sensitivity to the global dimension and attributes of markets is likely the determining factor for driving productivity and investment needed to revitalize the rural SME sector.

There is little or no scope for local rural revitalization of any rural place without a strategy for its relationship and that of its SMEs to globalization.

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