

Entrepreneurship in Focus

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SMEs now play a larger role in trade and FDI relations between Germany and Brazil

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Abstract

Using new statistical data sources, this policy brief highlights a considerable and growing importance of German SMEs for the trade and FDI relations between Brazil and Germany. Although trade volumes and the numbers of involved SMEs have increased, there is still room to develop business opportunities further. Particularly effective are the reduction of tariff and non-tariff trade barriers, e.g., the implementation of free trade agreements and an increased co-operation between trade promotion agencies in both countries.

High tariff profiles restrict market entry into Brazil; also non-tariff barriers still impede trade between Brazil and Germany. Despite this, Germany is the EU's leading exporter of goods to Brazil, with exports totaling EUR 9.5 billion in 2019. When it comes to imports from Brazil, Germany ranks second in the EU – after the Netherlands¹ – with an import volume of EUR 4 billion. In the past, economic analyses and policy discussions regarding trade and FDI developments had to be based on purely macro-economic statistical data which could not highlight the specific contribution of SMEs. Making use of new data sources, this policy brief intends to shed some light – exemplarily – on the importance of SMEs for the bilateral economic relations between Germany and Brazil.

Contribution of SMEs to bilateral trade

With the newly developed TEC-statistics ("Trade in goods statistics by enterprise characteristics"), Eurostat combines two statistical domains which have traditionally been compiled and used separately: business statistics and international trade in goods statistics. Eurostat is now able to provide detailed data for each Member State on its imports and exports by enterprise size and target countries. With regard to Brazil (as with all other countries), the majority of the German trade volume is realized by large enterprises with more than 250 employees: in fact, some 2,200 large companies account for approx. 88 % of German exports to Brazil, while around 1,400 large enterprises come up for approx. 70 % of German imports from Brazil (see table). The number of large businesses engaged in trading has remained largely constant since 2015. Despite fluctuating trade volumes, the entirety of large enterprises always generates a huge positive trade balance with Brazil.

In contrast with that, the SME balance offers a different perspective. Their trade shows a deficit to Germany,

highlighting the importance of Brazilian goods for German SMEs' supply chains and value production. Indeed, in 2019, SME imports accounted for approx. 30 % of all German imports from Brazil. All in all, in 2019 some 3,600 German SMEs exported to Brazil, while some 3,200 SMEs imported from Brazil. Thus, despite the large geographical distance and SMEs' more severely limited resources, an impressive number of German SMEs – significantly higher than the number of large firms – is directly involved in trade activities with Brazil.

GERMAN EXPORTS TO BRAZIL (EUR MILLION)

	Micro	Small	Medium	SME	Large
2015	86	236	735	1.057	8.009
2019	122	246	752	1.120	8.396
RATE (2019/15)	42%	4%	2%	6%	5%

GERMAN IMPORTS FROM BRAZIL (EUR MILLION)

	Micro	Small	Medium	SME	Large
2015	111	193	858	1.163	3.150
2019	324	299	565	1.189	2.820
RATE (2019/15)	192%	55%	-34%	2%	-10%

Source: Eurostat – TEC-statistics.

Furthermore, SMEs show positive dynamics in their trade with Brazil. This is illustrated, e.g., by a strong 9 % increase of the number of SME exporters to Brazil, up from 3,300 in 2015. In the same period, German micro enterprises practically tripled their imports, demonstrating their growing knowledge of the Brazilian market. Hence, in their entirety, SMEs account not only for a sizable portion of Germany's bilateral commerce with Brazil, but they have also seen an increase in both trade volume and the number of enterprises active in bilateral trade.

¹ Trade with Germany is likely underestimated due to the so-called "Rotterdam effect": goods destined for an (unspecified) third country via Rotterdam are generally recorded as Dutch trade.

Scope of German FDI into Brazil

Current data from the United Nations Conference on Trade and Development (UNCTAD) show that German FDI plays a critical role in the Brazilian economy. As South America's biggest country and largest economy, Brazil receives the highest share of German FDI in the region. Indeed, São Paulo is the largest German industrial location outside Germany. All in all, Germans companies operating in Brazil generate some 10% of the country's total industrial GDP. According to data from the *Deutsche Bundesbank*, German FDI to Brazil sums up to EUR 17.7 billion (2020), accounting for 4.2 % of total German foreign investment in the entire American continent and 1.3 % of overall German FDI globally.

But how many SMEs are investors? In contrast to the TEC trade statistics from Eurostat, international FDI statistics do not specify data by enterprise size. However, an indirect – methodology-based – approach might provide some initial clues about the actual importance of SMEs. The Brazilian Central Bank reports a total of 1,028 German enterprises operating in Brazil in 2020. The *Bundesbank*, by contrast, records "only" 649 German companies active in Brazil as of 2020. Differences in data collection methodology and coverage could explain the disparity. In fact, in contrast to its Brazilian counterpart, the German *Bundesbank* covers only those investments that exceed EUR 3 million.

Based on the Brazilian data with their broader FDI coverage, we estimate that more than 350 German enterprises have investments below the threshold of EUR 3 million in Brazil. Among these enterprises, we expect to find a larger number of SMEs. Unofficial data sources point at an even higher number of German production and service facilities in Brazil. Business associations (AHK, BDI) currently estimate their total number at approx. 1,600 and assume a substantial number of SMEs. Furthermore, the number of German SMEs with first-time investments in markets outside Europe has increased over the years, indicating a growing willingness to invest in distant markets, among them Brazil (Abel-Koch/Rohloff, 2017; Kranzusch/Holz 2013).

Conclusion

German SMEs have a considerable and growing importance for the bilateral trade and FDI relations between Brazil and Germany. Not to be forgotten are also the vast indirect contributions by German SMEs to bilateral trade by operating as suppliers to large German export companies. The growth in trade might partly reflect risk diversification strategies of German SMEs. More than ever before, companies have become aware of the manifold economic and political risks which are associated with strong (unilateral) economic dependencies. Since the world economy seems to enter a phase of increasing regionalization and regional economic blocs, the minimization of risks also seems to

imply being present with own production and service facilities in more distant markets such as Brazil.

Even if the announced Free Trade Agreement is not yet in force, the accumulated experience by German enterprises might serve as a foundation for future trade expansion between Germany and Brazil, potentially further increasing the participation of SMEs. Since German firms benefit from specific economic advantages in Brazil such as cultural synergy, a large expat population, and favorable perceptions of Germany and its industries in Brazil, a further increase in trade for SMEs is possible – despite the dominance of large enterprises.

A key goal should be to overcome the main tariff and non-tariff barriers to SME engagement in bilateral trade. Certainly, one effective tool is the proposed EU-Mercosur Free Trade Agreement. Beyond this, the strengthening of new aspects in the current debate, such as sustainability, the Deforestation Act, and due diligence on the value chain can also play a significant role for SME success. Finally, further progress could be achieved by strengthening co-operation between the trade promotion agencies from both countries. This could also include an exchange of experiences and good practice approaches in supporting the internationalization of SMEs.

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