

Executive Summary

Globalisation is a powerful influence on the future competitiveness of enterprises in the world's smallest economies. On the one hand, it offers small states' enterprises access to new technologies, new skills, new markets, new financial sources and hence better outward-oriented growth prospects than ever before. But on the other hand, it exposes them to intensive competition from imports, foreign investment and low-cost developing country enterprises. There is a real prospect that there will be winners and losers among small states and the enterprises within them. The double-edged nature of globalisation seems somewhat daunting, both to policy-makers and to enterprises in small states.

Against this background, this study deals with a pressing economic policy question facing the world's smallest economies: how can small states enhance industrial competitiveness and alleviate economic vulnerabilities associated with small country size? There is a widespread perception that small country size (i.e. economies with 1.5 million people or less) hinders the achievement of industrial competitiveness. This study seeks to address this issue. The transition from vulnerability to competitiveness is at the forefront of current economic policy debates in small states. There is still little sign of consensus about the way forward.

In an attempt to shed some light on these important policy issues, this study addresses four inter-related questions:

- What is the meaning of competitiveness in relation to small states and their enterprises?
- What is the recent industrial competitiveness experience of small states with globalisation and what factors determine success at a cross-country level?
- What kinds of enterprise strategies, policies and institutions have been adopted by small states which have succeeded?
- What principles, actors and measures might underpin the development of future industrial competitiveness policies for other small states?

Competitiveness is often a difficult concept to understand, analyse and apply, even in the context of developed economies, with fully developed institutions, limited market failures and extensive data. These problems are exacerbated when dealing with small states, which typically have underdeveloped institutions and lack available data. Therefore, in order to analyse industrial competitiveness in small states a simple framework has been developed (Chapter 2). This draws on recent literature on technology and innovation in developing countries, and underlines the dynamic links between technology, firms, industries, policies and institutions in developing competitiveness in

small states. It emphasises that competitiveness arises at the level of the firm, but also stresses the importance of national-level factors like a supportive policy framework and the quality of institutions.

To explore the recent performance of small states in relation to competitiveness, a Small States Manufactured Export Competitiveness Index (SSMECI) has been developed to benchmark industrial competitiveness (Chapter 3). To the best of our knowledge, this represents the first attempt to provide a comprehensive picture of the competitiveness performance of small states. It found that the performance of small states varies significantly across geographical regions, income groups and country size classes, and real performance patterns can be observed. Unsurprisingly, Europe was the best performing region, with Malta and Estonia occupying the top two positions in the index. Small states in southern Africa were the next most successful, with Mauritius and the four BLNS states (Botswana, Lesotho, Namibia and Swaziland) all in the top 11 of the index, but performance in the Pacific and West Africa was poor. Even within the small states sample, size was found to be important, with larger small states performing better than micro-states on average. In order to interpret the underlying determinants of competitiveness performance in small states, statistical analysis was used to see which determinants have an influence on SSMECI rankings. This showed that macro fundamentals, such as interest rates, were positive factors, as were external influences such as foreign direct investment (FDI). Diversification of exports was important to good performance, as was a strong base of human capital.

In order to explore the kinds of enterprise strategies, policies and institutions that have been adopted by successful small states, two countries were selected for further study. Both in the top five of the SSMECI, Mauritius (fourth) and Trinidad and Tobago (fifth) are examples of small states that have been successful, despite significantly different initial conditions and paths to success.

Mauritius (Chapter 4) is one of the few small states to have successfully broken into the production of manufactures for export (mainly textiles and garments) and is further attempting to diversify into services exports. In the last 30 years, this small state went from being a poor monocrop producer to an aspiring newly industrialising economy. Traditional economic sectors like sugar exports and up-market tourism laid the foundations for modern Mauritian industrial development by providing a surplus for investment and an international country reputation for producing quality goods and services. The real engine of growth, however, was export-oriented FDI in export processing zones (EPZs), particularly in textiles and garments. Several factors seem to explain why FDI came to Mauritius. These include an outward-looking trade and investment strategy; preferential market access to the EU; cheap and bilingual labour; investment in human capital; political and macroeconomic stability; relatively efficient government; and comprehensive institutional support. Its outward-looking trade and investment strategy emphasised the establishment of public and private EPZs, investment incentives, access

to duty-free raw materials and investor facilitation. With a recent slowing down of FDI, Mauritius has developed a new competitiveness strategy in order to sustain its competitiveness and diversify its economic base away from a dependence on textiles and garments. Among other things, it is attempting to better target foreign investment into the services sector, promote small and medium enterprise (SME) development, upgrade tertiary level technical skills and improve its infrastructure, particularly information and communications technology (ICT). Mauritius' competitiveness experience offers valuable lessons for other small economies.

Trinidad and Tobago (Chapter 5) is today the most industrialised of the Caribbean small states and the highest ranking in the SSMECI index in the Caribbean region. To a large degree this reflects its endowment of natural resources, and the significant oil and natural gas downstream industries that have developed from this resource. However, the reasons for success run deeper than this, and all small states can learn lessons from Trinidad's experience of providing a policy environment which supports competitive growth, of managing natural resources well (whether they be petroleum based or not), and of leveraging from this to diversify the industrial base. After a crisis in the early 1980s caused by over-reliance on oil, a stable, well thought out policy has been the cornerstone of Trinidad's recent success. The macroeconomic fundamental conditions have been well managed. Focus has been put on an outward-orientated trade and investment strategy with well-focused export incentive policies and institutions developed to support enterprise growth and export development, such as the Tourism and Industrial Development Company (TIDCO). Trinidad and Tobago has also made conscious efforts to develop its human resource base and its infrastructure. A case study of an enterprise success story in Trinidad shows that an SME in a non-oil related sector (beverages) can become a world player and be globally competitive in the space of 20 years, despite the 'handicap' of its small state origins.

The cross-country analysis and the case studies of Mauritius and Trinidad and Tobago suggested that a coherent competitiveness strategy is an important ingredient of success in a small state. Six important principles underlie the formulation of such a strategy:

- A focus on evolving comparative advantage;
- Tailoring policy to national circumstances;
- Linkages with regional markets and institutions;
- Combining incentives and supply-side measures;
- Involvement of all major stakeholders;
- Prioritisation of interventions and actions.

A wide range of policy instruments and support measures can be included in a competitiveness strategy in a small state. An example agenda, with 47 initiatives, is provided in

the study for a typical small state (Chapter 6). While detailed measures and support measures need to be country specific, the main strategic thrusts can be identified as follows:

- Maintain credible macroeconomic policies and exchange rate flexibility;
- Persist with outward-oriented trade policies;
- Foster small business start-up and growth;
- Invest in human resources;
- Ensure adequate technological support;
- Encourage and increase inflows of foreign direct investment;
- Improve private sector associations;
- Strengthen public–private sector dialogue and partnerships;
- Promote e-commerce and e-government;
- Improve the quality and coverage of infrastructure.

The process of tailoring competitiveness strategy to a given small state can be guided by a simple road map. An example of a road map is provided in Chapter 6 consisting of four phases, each building on previous efforts: inception review, assessing competitiveness, designing strategy and sustaining competitiveness.

A coherent competitiveness strategy, together with a good implementation plan, is a necessary but not sufficient condition for long-run export success in small states. The economic development record of small states suggests that other factors are required to support even the best-designed competitiveness strategies. These include external factors which originate outside an economy (such as financial crises, natural disasters and terrorism) which are largely outside the scope of policy-making. Another category of factors are internal to a small economy and can be influenced by national policy-making. Many of these issues (political stability, government capabilities and the development of a policy consensus with the private sector and other interested parties) fall under the heading of governance, which is a separate topic that requires further analysis for small states.

Small states face many challenges in the global economy, and size is definitely a constraint. However, despite these challenges, there are success stories among the small states. Rather than concentrating purely on vulnerability, many small states would benefit from a more proactive approach to improving competitiveness through concerted policy action. There are no magic wands in economic development, and achieving success will take years of hard work, but small states that tackle the constraints identified and design and implement a coherent competitiveness strategy appear to have the best chance of long-term success.