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The Economic Dimension: Analysis

5.1 In the past decade the world economy has been transformed by dynamic changes. With the ending of the Cold War, the ideological debate about alternative approaches to economic development has ended with a consensus emerging on the relevance and importance of market forces as determinants of economic performance. The globalisation of production and the liberalisation of trade have increased the challenges facing developing countries. Advances in technology and the increased mobility of capital have improved the prospects for productivity gains and wealth creation. In some cases, new regional arrangements have opened new opportunities in trade and related economic policy areas. Increased interdependence and insistent competitive pressures have become the distinguishing features of the contemporary global economy, determining the position of countries within it and shaping their possibilities for economic development.

5.2 The concern of many small developing states is that they will be disadvantaged in the emerging global economic order and that some will be further marginalised in world trade, investment, commodities and capital markets. This is a real fear every bit as worrying as the threat of intervention in the Cold War. The discussion of security in Chapter 3 drew attention to threats which could significantly narrow the range of policy options available to the state or to private non-governmental entities within the state. Some countries risk such an outcome unless early positive action is taken by them to improve their competitiveness through domestic policy reform and to enhance their prospects for growth through integration into the global economy.

5.3 The focus of this chapter and the following one is on the adjustments small states will need to make to survive globalisation and its related process of regionalisation. They examine the impact globalisation has had upon them and set out the domestic reforms small states will need to implement nationally, as well as the initiatives they will need to take regionally, to maximise opportunities and minimise constraints.

The Effects of Globalisation

5.4 The importance of openness in promoting economic development is one of the more insistent themes that has emerged from an understanding of the processes of globalisation. Many analysts, led by the World Bank, have argued that countries which have integrated into the world economy are better off: trade has grown, flows of private capital have increased, and as a consequence rates of economic growth have risen. Developing countries which have embarked on policy reforms to open their economies to the domestic and international market have had an advantage over those that have not.

5.5 Others, however, argue that globalisation has only benefited a handful of larger countries in East Asia, Latin America and Eastern Europe, and that there are many negative aspects. They claim that countries have lost policy autonomy; domination of transnational corporations has increased; and large scale capital movements, particularly those of a speculative nature, have introduced greater volatility, and thereby contributed to greater instability, in financial markets.

5.6 Such observations, while often merited on both sides, do not address the issue from the point of view of the small state. The handicaps of size and the associated consequences pose additional burdens and challenges which are rarely acknowledged. The World Bank routinely excludes small countries with a population size of less than one million from many of its studies. Its recent report *Global Economic Prospects* (1996), which presents data on the pace of global integration for 93 countries, provides information on only four small countries (Jamaica, Trinidad and Tobago, Botswana and Mauritius). Of these, the World Bank categorises only Mauritius as a successful integrator. Furthermore, the analysis of country situations and characteristics excludes any reference to size as a factor in the ability to integrate.

5.7 Nevertheless, it would appear that a number of other small states – Barbados, Botswana, Cyprus, The Gambia, Guyana, Jamaica, Malta and Trinidad and Tobago – have been successful in integrating into the world economy and that globalisation has made a positive contribution to their economic performance. They have not only expanded their production and export base through diversification, but have experienced expanded capital flows. Their overall growth rates have, on average, improved and are comparable to the favourable rates enjoyed by larger countries. These countries have had favourable external markets largely because of preferential entry to major markets for their goods and/or because of proximity to near by markets for goods and services. Policy reforms have also played a significant role in improving the overall performance.

5.8 However, it can also be argued that the pace of reforms in several of these countries was accelerated precisely because they enjoyed the initial advantages linked with location, assured markets for traditional products, and access to capital, often grant aid, which permitted the implementation of reforms. A large number of small states, especially in Africa and the South Pacific did not have comparable advantages and have found it next to impossible to move very far down the path of integration into the world economy. Because of their size and the structure of their economies, which have a narrow production base, fragile fiscal systems, a high degree of export concentration, limited opportunities for diversification and privatisation of state-owned enterprises, and a relatively undeveloped private sector, the scope for reforms has been limited. These small states in Africa and the South Pacific regions, have been caught in a vicious cycle and have become increasingly marginalised and face threats to living standards in the future.

5.9 It is difficult to state conclusively the role that size has played in this situation as larger countries with similar characteristics have also not performed well and have failed to integrate into the world economy. There is, however, a distinct policy dimension to those that have succeeded in doing so. The impetus for globalisation has come largely from domestic policy reforms mounted by governments, in part driven by the need to undertake structural adjustments. The Bretton Woods organisations have led the way in espousing the need for reforms. These include trade liberalisation through a lowering of tariffs and the removal of non-tariff barriers, including the lifting of quantitative restrictions; exchange rate adjustments with the goal of improving the competitiveness of exports and the attainment of external equilibrium; and fiscal reforms both on the revenue and expenditure side of public finances. Tax reforms have largely focused on introducing greater competitiveness, the elimination of disincentives to investment and enhancement of entrepreneurial activity. Revenue structures have been changed to emphasise taxes on consumption. On the expenditure side cost cutting, removal of subsidies and privatisation of state-owned enterprises have been favoured instruments to attain the overall goal of a reduction of public sector deficits. Taken together, these policies have contributed to the emergence of a greater market-oriented regime while at the same time setting in place greater macroeconomic stability. They have led to greater investment, expanded trade and inward flows of foreign private capital, and generally have helped create a more open economy.

5.10 The following sections examine the trade, financial, technological and communication patterns that impact on small countries, and evaluate the extent to which they have been capable of embarking upon domestic policy reforms. Given the importance attached to the private sector in taking advantage of opportunities presented by such reform the final section examines its role.

Trade

5.11 Most Commonwealth small states can be grouped into four major categories in terms of their export orientation: agriculture and fisheries; petroleum and minerals; tourism and services; and a group that has a mixture of one or more of the above with manufactures as a new element in the production base. As noted earlier, the contribution of exports of goods and services to GDP is high in most of them, with exports accounting for well over 50% of total GDP in the majority of these countries.

5.12 A feature of export patterns is the narrow range of products. Bananas are a major commodity in the exports of several Caribbean countries, accounting for almost 70% in the case of Dominica, 60% in the case of St Lucia, and 42% in the case of St Vincent and the Grenadines. Production is largely by small operators with low acreage, and export is directed to the European Union (EU) with low or non-existent tariffs. Sugar is another mainstay of several Caribbean, Indian Ocean and South Pacific island countries; it accounts for more than 25% of merchandise export earnings for Belize, Fiji, Guyana and Mauritius.

5.13 Textiles and garments are significant export commodities in several Caribbean countries, including Barbados, Belize, Jamaica, St Lucia and Trinidad and Tobago. Textile exports are of importance to Cyprus, Fiji, Mauritius, Tonga and Vanuatu. The exports are destined to the major markets in close proximity, North America in the case of the Caribbean, the European Union (EU) for the Mediterranean countries and Australia-New Zealand for the South Pacific states. Several of the South Pacific and Indian Ocean countries – Maldives, Papua New Guinea, Seychelles and Solomon Islands – have developed their fishery resources and the industry makes a significant contribution to their exports. Petroleum product exports account for almost two-thirds of the exports of Trinidad and Tobago and even more for Brunei. Minerals are a significant item of export in the case of Guyana and Papua New Guinea. Several countries, particularly in the South Pacific, have seen wood and timber-based products emerge as significant export commodities. This is also true in the cases of Belize and Guyana. Diversified manufactures, largely consisting of electronics, are exported from a handful of countries – Barbados, Malta and Mauritius.

5.14 The growth of service exports has largely been in the form of tourism, and offshore banking and financial services. Service exports have become a significant source of income for small island states in the Caribbean and the South Pacific. Cyprus, Maldives, Mauritius and Seychelles have also expanded their tourism industries. As a source of export earnings, tourism now contributes more than the export of primary commodities in several South Pacific states. In the case of Vanuatu, as much as a quarter of the GDP could be attributed to tourism. Kiribati, Solomon Islands and Tonga also have substantial earnings from tourism – between 4% and 7% of GDP. In the Caribbean earnings from tourism amounted to US$ 11.7 billion in 1994.

5.15 Information processing has emerged as a new service sector activity but has not expanded beyond a small number of Caribbean countries to other regions. Barbados, Grenada, Jamaica, St Lucia and Trinidad and Tobago are countries that have an export-based information processing industry. However, the overall contribution of the industry in each of the economies is relatively small. Over the past two decades the Caribbean region has become a leading provider of offshore banking and financial services, taking advantage of the demand for diversified offshore services. In global terms, 74% of the total number of offshore companies registered in island jurisdictions are in the Caribbean – The Bahamas, Cayman Islands and the Netherlands Antilles. Modest developments have also taken place in other regions. In the South Pacific some small states have established offshore banking and related services. In Vanuatu 10% of the GDP is estimated to arise from the exports of such services. Malta and Cyprus also have such facilities with over 22,000 offshore trading entities registered in Cyprus alone.

5.16 Trade by destination has continued to follow traditional patterns and been determined by the preferences accorded by the major trading partners in respect of particular commodity groups. Geographic proximity has also been a factor. The Caribbean states export a significant volume of their output to North America and the EU. Bananas and sugar enjoy preferential access under the Lomé regime established by the EU. The Multi-Fibre Arrangement (MFA) regime, along with the US sponsored Caribbean Basin Initiative (CBI) and Canadian CARIBCAN arrangements have provided several countries with preferential entry for textiles to many markets. In the case of the South Pacific Island States, the South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA) sponsored by Australia and New Zealand has provided preferential treatment to these countries. The Generalised System of Preferences (GSP) has played a role too in providing access in other developed industrial country markets, especially Japan. Some South Pacific states have also benefited under Lomé. In brief, not only has trade flowed to markets where preferences exist, but its growth has been determined by the nature of the preferences extended. While this does more to preserve the past than to promote the future, it must be acknowledged that for many small states commodity exports are the bedrock of the economy and an indispensable base for successful diversification. Proposals to phase out preferences are therefore alarming for many small states without significant compensatory measures being agreed.

Financial markets and capital flows

5.17 It has been claimed that small countries generally have limited access to capital, both from private markets and from multilateral financial institutions such as the World Bank. There is some truth to this contention. In general, private capital markets tend to favour larger countries on creditworthiness grounds and on past lender–borrower relationships. Small countries have no significant track record and are at a disadvantage. Foreign direct investment (FDI) tends to gravitate to countries with a strong track record of political stability, a hospitable environment for FDI, good infrastructure, and an adequate pool of skilled labour. While many of these conditions can be found in some small countries, they are counterbalanced by the size and viability issue. The attractiveness of large markets and readily available domestic joint venture partners are other factors that place large countries at an advantage. Multilateral lending institutions are constrained by portfolio considerations and tend to limit their exposure in small countries. But more critically, the many small countries with relatively high per capita GNP levels, for instance in the Caribbean, are excluded from receiving the International Development Association (IDA) credits because of their income levels. Thus, these states are unable to tap both the private markets and the multilateral sources of capital on concessional terms. They are excessively dependent on bilateral grants for their external capital requirements. Grant aid, in general, is subject to the vagaries of budgetary conditions in the donor countries, thus increasing uncertainties for the recipients. Furthermore, the aid policies of the bilateral donors favour the poorest countries, so designated on the basis of GNP per capita estimates.

5.18 A review of the trends in the inflow of external capital since the late 1970s indicates that all developing countries recorded sizeable inflows. The small states, in the aggregate, shared in these inflows in the late 1970s and the early 1980s and were largely able to cushion the impact of the oil crisis. However, slow adjustment and the general global declines in capital flows in the late 1980s affected small states more severely. In the Caribbean, net external capital inflows declined sharply from US$ 420 million in 1982 to US$ 250 million in 1990. In terms of net transfers, these turned negative in 1990 and continue to remain negative. However, in comparative terms, small states, while badly affected, may have fared no worse than larger countries that were forced into adjustment. Indeed, in one sense they are at an advantage because of the low level of debt and debt service. However, the process of adjustment for several small states has been drawn out and painful. In the absence of a strong macroeconomic environment and with a relatively weak economic base, small countries continue to be more vulnerable to uncertainties about the future flows of external capital flows on a sustained basis.

5.19 The growth in net FDI flows to developing countries, from a level of US$ 24.0 billion in 1990 to US$ 80.1 billion in 1994, may well bypass most small states. Of the total net flow in 1994, only US$ 0.9 billion or a little over 1% went to small countries. What is more significant is that the share of the small countries was a little over 2.6% at US$ 0.62 billion in 1990. Very small states start out with low bargaining power with respect to major external investors. Many transnational corporations have incomes larger than the GNP of these small states. The danger of dependency is enhanced, and the small state may not have the opportunity to benefit from technological innovation because of low participation by local suppliers.

5.20 Global declines in the flow of concessional assistance, both multilateral and bilateral, particularly grant-type assistance, will in the short-term impose additional challenges for many small states. Grants, which have been the mainstay of resource flows, will decline further. In the first place, the pool of concessional resources will shrink as donors curtail contributions to the World Bank's IDA and other concessional funds managed by regional banks. Concurrently, bilateral aid budgets are being curtailed in part driven by domestic budgetary austerity. Bilateral donors have in recent years deliberately introduced policies that tend to direct their aid allocations to the poorest countries where poverty levels are high and to those 'countries in transition' to which high political priorities apply. Taking these various trends into account, the many small states which are also middle income developing states are likely to face reductions in the levels of concessional assistance.

5.21 While this is clearly a matter of concern in the long term, the impact in the short and medium term is likely to be blunted by the difficulties encountered in many small states in preparing project dossiers and accessing concessional assistance. The immediate problem in many of them is less the availability of concessional finance than technical shortages and a lack of initial start-up funds. In so far as these are important constraints on development they require urgent attention, both in terms of demands made by donors to small states in terms of preparing and servicing projects and programmes, and by small states in developing human capacity.

5.22 Small states have had limited access to multilateral loans, in part because of creditworthiness concerns dictated by the desire of the IFIs to maintain overall portfolio profiles that minimise risks. Additionally, some high income small states have been precluded from borrowing from IFI resources because of the policy of graduating countries above a given per capita income level. In the near term, additional countries such as Antigua and Barbuda, St Kitts and Nevis and the Seychelles, are likely to be graduated. In a sense, success in economic performance is likely to penalise these high income countries through exclusion from lending by the IFIs. Such countries, once cut loose by the IFIs, face the challenge of borrowing in capital markets. Small states are handicapped in a number of significant ways. In the eyes of the market lenders, they are judged less creditworthy and face greater difficulties in borrowing, or at the very least are only able to borrow on terms which are unfavourable. Not only are they required to pay interest charges above average market terms, but they also cannot in all circumstances obtain longer maturities.

5.23 Whereas the larger developing countries, which have over the years developed their domestic capital markets, have been able to attract portfolio funds, most small states have been unable to do so. Developing capital markets in small states is a formidable proposition. These states have a limited capacity to promote and operate efficient stock exchanges as there is likely to be only a handful of enterprises that could be floated. While larger countries have strengthened their capital markets through privatisation, the scope for this is far more limited and cannot be a factor in the development of a functioning capital market which would attract external portfolio resources. Under these circumstances, most small states are unlikely to benefit from the global growth in portfolio flows.

5.24 The best prospect for external finance for many small states is represented by tapping into flows of FDI. Although several small states have benefited from the flows of FDI which have contributed to their diversification effort, leading in turn to export growth and income growth, these rewards have flowed in part from several factors. They include: their proximity to large markets and/or well developed transport links; the natural resource base in the form of climatic and geographic advantages that are conducive to the development of tourism; socio-economic political stability; the presence of a human resource base for use in the development of services e.g. tourism, banking and offshore financial services; and a reasonably well developed infrastructure, particularly in telecommunications. Additionally, a hospitable investment climate reflected by openness to trade and investment underpinned by both domestic policies – fiscal, regulatory frameworks – and external policies that commit the country to international agreements on Trade Related Investment Measures (TRIMs) and Trade Related Intellectual

Property Rights (TRIPs) are significant. A competitive environment in terms of labour costs is important, as are investment incentives.

5.25 The challenge for small states is therefore how to tap into the global FDI market. However, this will require the institution of a whole range of policies that impact on the investment environment. While policies do matter and will continue to be a determining factor, there is no absolute guarantee that small states will be successful in a highly competitive environment.

New communications technologies and their impact

5.26 The integration of the world economy and the trend towards globalisation has in part been facilitated by technological advances that have improved communications and information flows. Telecommunications now form an indispensable part of the infrastructure of a modern economy and provide the means to both transmit and process information. Information is fast emerging as an important input into the production process, be it in trading commodities, underpinning a range of financial services, or in the manufacturing process. For small states, particularly those that are remote from the major markets and commercial and financial centres, the communications revolution has created the possibility of reducing traditional barriers and opened up new opportunities. For many small island states, remoteness, smallness and isolation can be overcome and the development of modern telecommunication capacities could become the engine for growth, development and diversification of the economic base.

5.27 The role that telecommunications can play in small states in the various facets of development merits close attention. Communication links between somewhat isolated communities within an archipelago, or even on a single island, are often underdeveloped. Putting in place facilities that permit the exchange and transmission of information can bring about greater cohesiveness and a sense of unity that contributes to a lessening of the threat to security. In the economic context, the ability to transmit information rapidly permits the authorities to provide early warning of approaching cyclones and hurricanes. The facilities in place can also permit speedier dissemination of other relevant information e.g. changes in external prices. In the political and administrative context, they can provide greater efficiency and more effective management of resources and make a contribution to good governance which reduces the security risk while enhancing the prospects for sustainable development.

5.28 The role of telecommunications in promoting tourism can be significant. The industry is highly dependent on contacts with agents and travel services abroad. Telecommunications are also important to visitors who need to be in contact with the outside world. Good external communications are also critical in the context of the offshore banking and financial services industries. The globalisation of capital markets has been made possible by the rapid development of telecommunication and information links. Thus small states that are entering the field will need to be linked into global networks. The availability of efficient information and communication links has the psychological benefits of reducing the sense of isolation as small states begin to feel that they are a part of a global village. For island and archipelagic states, aerial surveillance of EEZs against foreign illegal fishing, using modern communications, is important.

5.29 Many small states have made commendable progress in acquiring telecommunication capacities. The Caribbean has an average of 167 telephone lines per 100 inhabitants and the South Pacific small states 24.6. The Indian Ocean small island states of Mauritius and Seychelles have higher densities than South Africa. The Caribbean states have taken advantage of their telecommunication infrastructure to develop information processing for North American enterprises. The Barbados authorities have identified informatics as one of the areas with great potential for development.

5.30 Estimates prepared by the International Telecommunications Union indicate that small island states invested almost half a billion dollars in 1994 in developing their telecommunication facilities. Revenue earned amounted to almost US$2 billion and accounted for almost 2% of the GDP of these states, and was growing rapidly. The potential exists for further growth and development, but will require the adoption of policies that aim to maximise the contribution of the sector. Apart from creating the appropriate macroeconomic policies and the promotion of new investment, governments will need to address issues of competition amongst providers to ensure that over-capacity is not created. Some regulation of the industry would be necessary to ensure that consumer interests are safeguarded. Given that many small states lie in climatic zones subjected to hurricanes and cyclones, future investment in lines should be in the form of underground facilities in order to protect the investment. Most small states have shortages of skilled telecommunication workers. In the overall programme for human resource development, it would be necessary to assign high priority to the training of workers for employment in this sector.

The role of the private sector

5.31 The private sector in most small states is made up of small and medium sized enterprises. The size of the domestic market is a constraining factor in the growth of enterprises. In addition, in the past public ownership of many businesses has crowded out private enterprise that would have otherwise emerged. The governments of many small states have tended to emphasise the role of public sector-led development. Centrally managed responses to issues of external resource mobilisation and emphasis on social equity issues are other factors that have tended to downplay the role of the private sector. Tax regimes, structured around trade taxes and surcharges, and the dominant role of state-owned marketing boards in both exporting and importing goods, have inhibited the emergence of private businesses. In some instances these boards have enjoyed monopoly rights, thus precluding entry into areas which otherwise would have been occupied by private investors. Many governments of small states play a major role in reviewing and approving investment decisions. While some of these practices are legitimate functions and are in the public interest, poor administrative practices increase the cost of doing business and act as a deterrent to business expansion. The absence of transparency in decision-making processes is an additional barrier. The inherent bias of policies contributes to making some small states less attractive to investors. Foreign investors often are unable to find local joint venture partners.

5.32 In recent years, some progress has been made in changing the business climate. The governments of many small states have begun liberalising the economy. A range of activities are being privatised and efforts are being made to harness the energies of the private sector to become the main engine of growth, through investment and job creation. Changes in the tax and regulatory regimes are having the desired impact in several small states. However, the pace of change is uneven. Some Caribbean and Mediterranean states, along with Mauritius, are moving ahead with policy reforms and have been rewarded with an acceleration in growth. Progress in other regions is slow and their economic performance continues to be sluggish. The role of the Chambers of Commerce and the Manufacturers' Association can be critical in developing positions on specific issues at annual conferences for the exchange of ideas. There needs to be an on-going effort drawing on the experience of existing private sector institutional agencies.

Trends in Regionalisation

5.33 The growth of regionalisation is widely interpreted as a response to globalisation. At its heart is a state-driven project to harness the benefits and minimise the costs of globalisation. Regionalisation is therefore a process feeding the globalisation process, not contradictory to it. It is best seen in the espousal of 'open regionalism' by the three major blocs of the EU, NAFTA and APEC; and the impetus to a 'new regionalism' in the developing world. 'Open regionalism' is based on the principles of free-market capitalism. It has two fundamental characteristics: (1) within a given geographical region obstacles to trade are steadily reduced as at the same time obligations to the WTO are observed i.e. external tariff barriers to the rest of the world are not increased; (2) new opportunities in technology, investment and financial liberalisation are encouraged, regionally and globally, with the goal of improving national, regional and international competitiveness. 'Open regionalism' is both inward and outward looking, seeing the region as an arena in which the agenda of liberalisation can be advanced more speedily and to the benefit of the participating countries than can be done globally. 'New regionalism' in the developing world is similarly imbued with liberal principles. It is also outward looking and it is this feature which distinguishes it from previous experiences of regional integration which were more inward looking and dirigiste in their policies and objectives.

5.34 The promotion of 'open regionalism' and 'new regionalism', alongside globalisation, is of particular importance to many small states. Most of them have preferential trade arrangements with neighbouring countries and with extra-regional groupings which are being eroded and revised in the wake of globalisation. The most important extra-regional grouping, in the sense that it has trade and aid programmes of direct interest to nearly all the Commonwealth small states, is the EU. Cyprus and Malta have association agreements with the EU and both have applied for entry, although Malta has for the moment decided not to proceed. The others, with the exception of the Brunei, Maldives and Nauru, are party to the Lomé Convention which is a comprehensive aid and trade agreement between the 15 members of the EU and 70 countries in Africa, the Caribbean and the Pacific (ACP).

5.35 Other arrangements are more region specific, but what is clear in all of them is that adjustments are having to be made and that old relationships are being revised as well as new organisations being created. In this new world there is a great deal of uncertainty as to whether small states will be able to find a place and voice in new regional arrangements. There is also a question as to whether they will be able to benefit as much as larger states from the opportunities provided. The following section reviews the major regional challenges facing small states.

The Lomé Convention

5.36 The Lomé Convention was first signed in 1975 and it has been periodically re-negotiated since to add new co-operation instruments and to set new priorities in development assistance. The present Convention ends in the year 2000. There is considerable uncertainty about the shape and scope of any future agreement in view of the changes in the world trade regime brought about by the Uruguay Round agreements and the decision of the EU to redefine its external relations to give greater prominence to the common foreign and security goals of member states. The EU is also reviewing its development co-operation policy, including the importance of its preferential trade regimes and the value of its programmes of technical and financial assistance.

5.37 Some of the changes the EU may wish to see in any new agreement with the ACP, or specific regions within it, have been proposed in a Green Paper released by the European Commission in November 1996. Several of the ideas in the Green Paper have already been incorporated in the Lomé Convention. These include a greater emphasis on structured political dialogue, stricter conditionality on aid, increased emphasis on the private sector and other non-governmental organisations (NGOs) in delivering development, and new requirements for developing countries to respect human rights, good governance and the rule of law. Other ideas are relatively new and include a phased end to non-reciprocal trade preferences, emphasis on improving the competitiveness of developing countries to enable them to fully engage with the global economy, a focus on poverty reduction in the delivery of aid programmes, and a greater awareness of differentiation among the ACP in respect of the need for trading preference, the reliance on aid and geographic location. This last element has raised the possibility of region specific agreements which would be part of a new Convention or be separately concluded with the Caribbean, the South Pacific and the African countries, thereby spelling the end of the ACP as a group and of the Convention as it has developed to date.

5.38 The response of the ACP to many of these proposals is likely to be negative. They have already indicated a preference to stay together and to preserve as many benefits from the present Convention as possible. In respect of the Commonwealth small states this means maintaining the protocols in sugar, bananas and beef. There is also a desire to maintain preferential access to the EU market and the distinctive development assistance programme administered by the European Commission. Other areas of common interest include the special programmes for island developing countries, land-locked countries and the least developed countries. Finally, the institutional arrangements in the Convention provide an unparalleled opportunity for Commonwealth small states to engage in dialogue and develop common positions with nine other small developing states who are not members of the Commonwealth but are party to the Lomé Convention.

The Caribbean

5.39 The major regional organisation is the Caribbean Community (CARICOM) which was created in 1973. It includes all the Commonwealth Caribbean small states plus Montserrat and Suriname. Recently Haiti has been accepted for membership. It established a common market for the purposes of trade and economic co-operation, defined various functional areas for co-operation, and provided for the co-ordination of foreign policies among member states. The Common Market has survived but it has not proved to be a dynamic instrument for development and has attracted much criticism on this account. Major proposals for change in the early 1990s, as well as fears of marginalisation from the global economy, have recently led to renewed impetus to achieve a single market and economy. While this is now set for 1999 the question of the further development of CARICOM depends on a number of factors including political will and external developments such as the proposed Free Trade Area of the Americas (FTAA). There is also the special position of the smaller Eastern Caribbean countries, grouped in the sub-regional Organisation of Eastern Caribbean States (OECS), to consider. Their interests regarding trading arrangements are likely to be different from the larger Caribbean countries.

5.40 A new regional organisation, the Association of Caribbean States (ACS), was established in July 1994. It arose from a proposal for a basin-wide regional organisation to take account of rapid changes in the Americas which were creating areas of common interest between all the Caribbean states (including non-independent territories) and states on the littoral. The present membership of 25 includes all the independent Caribbean states plus those in Central America and the Group of Three (Colombia, Mexico and Venezuela). The ACS is defined as 'an organisation for consultation, co-operation and concerted action'. It has identified some areas for action, including trade liberalisation, tourism and transport, but it has yet to project a distinctive presence in the region. There are many reasons for this including historically based and contemporary obstacles to closer co-operation between CARICOM and Latin American countries. However, what is clear is that the ACS is expected to play a role complementary to that of CARICOM, not to be an alternative or substitute for it. In this sense its function is to project a larger presence for the Caribbean than they might otherwise be able to achieve.

5.41 The small states in the Caribbean are party to the Lomé Convention. This has provided significant trade advantages to the Caribbean as well as being a source of financial and technical assistance. The Caribbean, along with other ACP states, is currently engaged in a debate on what future arrangements will govern its relations with the EU after 2000. The Caribbean position is to retain as many of the advantages from the present Convention as possible, particularly in respect of trade and the protocols for sugar and bananas. The EU is more open as to future arrangements. It is not possible at present to determine the likely course or outcome of negotiations. It is expected, however, that the EU will continue to maintain an interest in the region. The question is how broadly this will be cast. Among the options trailed for future arrangements is a wider regional agreement to include the states of Central America. Another is a free trade area. Whatever transpires it is likely that the Caribbean will find that any new arrangement is not as beneficial in trade or in aid.

5.42 'Open regionalism' is most unsettling for the Caribbean in its relationship with the US. The US has initiated a regionalist project in the Americas built around the construction of a hemispheric free trade alliance. To date the most important elements have been the establishment of the NAFTA and the proposal to create a FTAA by 2005. The potential for the Caribbean to be disadvantaged by these developments is very high. To begin with the establishment of NAFTA has eroded the non-reciprocal trade preferences the Caribbean receives from the US under the CBI. It also threatens investment diversion to Mexico. The attempts by the Caribbean to offset this through achieving parity with NAFTA have been stalled. They have also been complicated by the decision taken at the Summit of the Americas to initiate an FTAA in a relatively short timescale. The amount of preparatory work and negotiation to achieve this object will be immense. There are 26 regional and sub-regional free trade agreements to accommodate and while many of them do not directly involve the Caribbean, it has to be mindful of what is being decided elsewhere. It also has to define its own approach to the FTAA. A common approach is yet to emerge although one is being sought. The problem here will be similar to the one facing it regarding Lomé, but whereas negotiations with the EU are more structured and more known (as to both timetable and content) those for a FTAA are not, with the prospect that common positions will be more difficult to find.

The South Pacific

5.43 The South Pacific Forum (SPF), to which all the South Pacific small states belong, was formed in 1971. The SPF meets annually to consider a range of topics, including issues of development and regional co-operation. In 1995 the SPF adopted a Vision Statement and a Plan of Action setting out the way the South Pacific could adapt to the changing regional and international environment. Among the policy measures recommended were domestic reforms to improve competitiveness; trade reform, including reduction of tariff and non-tariff barriers consistent with the principles of the WTO; adoption and implementation of the investment principles agreed to by APEC as a means to attract investment from the Pacific Rim countries; closer regional co-operation in shipping and civil aviation; and the joint promotion of tourism. They also agreed to review existing patterns of trade, investment and other aspects of regional economic relations with a view to broadening, deepening and diversifying regional economic co-operation. This marked a renewal of interest in regional economic integration which had been a theme of early Forum activity but which was not taken up or developed in any purposeful way.

5.44 The South Pacific benefits from the Lomé Convention. The EU is a major aid donor to the region and instruments such as Stabex have provided valuable additional assistance. The Sugar Protocol is also vital to Fiji. However, the major extra-regional economic association is SPARTECA, concluded with Australia and New Zealand in 1980. This provides non-reciprocal duty free and unrestricted access to their markets for most raw products and for manufactured goods meeting a 50% or less rule of origin requirement. Although this has provided some benefits, the emerging view is that SPARTECA has not been particularly successful and that it has contributed to the development of uncompetitive industries in the islands. Accordingly, proposals have recently been trailed to establish an alternative Economic Association, the main aim of which is to provide a competitive investment environment. The Economic Association would encompass agreements on trade in goods and services; movement of private capital; movement of labour; and technical assistance. It would also be conditional in the sense that South Pacific members would pledge themselves to undertake reforms as set out in the 1995 SPF meeting in return for continuing economic assistance.

The Indian Ocean

5.45 Until very recently there has been very little development of a specific regional agenda for the Indian Ocean. The Indian Ocean Commission (IOC) was formed in 1982 and includes Comoros, Mauritius and the Seychelles. It outlined four areas of co-operation including economic and commercial activities. Some committees have been established and action has been taken on tuna fisheries, transport and tourism, but very little has been achieved by way of regional integration. In 1995, Mauritius hosted a meeting which resulted in the creation of the Indian Ocean Rim Association for Regional Co-operation (IORARC). The recently adopted Charter of the organisation focuses on trade facilitation, promotion and liberalisation; investment promotion; scientific and technological exchanges; tourism; development of infrastructure and human resources; and movement of people and service providers on a non-discriminatory basis. It is not intended that it should develop into a trade bloc, although the opportunities for preferential trade agreements among its members are enhanced.

5.46 The Maldives is a member of the South Asian Association for Regional Cooperation (SAARC). In 1993 a South Asian preferential trade agreement was signed which gives 'special and favourable treatment' to the least developed member countries. Mauritius and the Seychelles are in the Lomé Convention. Mauritius, in particular, has gained considerable advantage from Lomé through the Sugar Protocol and more particularly from the preferential treatment accorded exports of clothing to the EU.

Africa

5.47 Botswana, Lesotho and Swaziland were founding members of the Southern African Development Co-ordination Conference (SADCC) which was established in 1980. The original impetus was to provide a development framework avoiding entanglement with apartheid South Africa. That has now clearly changed. In 1992 a decision was taken to transform SADCC into the Southern African Development Community (SADC) and South Africa joined in 1994. Namibia and Mauritius are also members. SADC has become the major vehicle for regional integration in the region with a substantial sectoral programme and broad political and social aims as well as economic objectives. In 1996 a decision was taken to establish a free trade area among the twelve member states within eight years.

5.48 All the above, except for Botswana, are also members of the Common Market for Eastern and Southern Africa (COMESA) in which South Africa has observer status. South Africa's full entry into COMESA, which is a preferential trade area with plans for conversion into a common market by the year 2000, has wide ranging implications for the other members, most of whom are either small states or less developed countries, due to enormous disparities of wealth and power between South Africa and the others. There is also the problem of overlapping membership between SADC and COMESA which could lead to confusion and duplication of effort. A previous proposal to merge with SADC failed to gain support.

5.49 The Gambia is a member of the Economic Community of West African States (ECOWAS), established in 1975. ECOWAS sought to develop an ambitious programme of economic and social integration leading to the adoption of a customs union in 1990. This has not been realised and the future of ECOWAS has been put in some doubt by other proposals for West African integration.

5.50 The Lomé Convention is an important source of assistance for all the small African states. Under Title IV Botswana, Lesotho and Swaziland are classed as land-locked states which allows for special treatment to be accorded to them. The Gambia and Lesotho are also classified as least developed ACP states which provides additional support. The same classification is extended to Kiribati, Samoa, Solomon Islands, Tuvalu and Vanuatu. Specific provision also applies to island states and covers the Caribbean, the Indian Ocean and the South Pacific.

The Mediterranean

5.51 Cyprus and Malta signed association agreements with the EU in the early 1970s. These have brought substantial benefits to both countries, including greater market access and inflows of FDI which have supported diversification and development. These benefits, however, have been eroded by several recent developments including the establishment of the Single European Market, EU enlargement and the proliferation of similar agreements concluded by the EU with other neighbouring countries. The competitive advantage which both countries enjoyed was being lost to others, including Mediterranean regions within the EU which were able to claim substantial structural funds from the EU for economic development.

5.52 The decision to apply for full membership of the EU was taken on both political and economic grounds. Difficulties, however, have arisen for both countries which make early membership uncertain. In the case of Cyprus it stems from the continuing Turkish occupation of part of the country and a claim by Turkish Cypriots for permanent division of the island unless Turkey joins the EU at the same time. In the case of Malta, the new government elected in 1996 considered that Malta's economy had not developed adequately to take on the full burden of membership. The two sides are now expected to negotiate a new relationship short of full membership.

Small States and Regionalisation

5.53 Attempts at economic integration amongst developing countries in the past have centred around the promotion of free trade areas, import substitution at a regional level, and collective self-reliance. These attempts fell short of initial expectations. Intra-regional trade experienced slow growth; joint plans for industrialisation amongst groups of countries in a region failed, in part because of the relatively small size of markets and low levels of economic development; and political and economic policy differences slowed or destroyed attempts at joint action to implement sectoral programming on a regional scale or to control FDI. Trade liberalisation was either blocked or new tariff and non-tariff barriers erected. These negative experiences with attempts at regional integration among developing countries have not precluded new attempts at regional co-operation. The various sub-regional agreements point to a new attempt to co-operate. A feature of the 'new regionalism' is that while trade remains the core and central factor, agreements take fuller account of the prospects for co-operation in non-trade related areas, with a particular focus on the need to attract FDI. There is also a somewhat more realistic evaluation of opportunities and limits. The process of structural adjustment mounted by many countries has created more open and export-oriented and competitive economies. Successful outward and market-oriented policies have permitted countries to take advantage of regional demand for goods and services. In addition, the strengthening of the private sector and somewhat closer co-operation in the development of infrastructure have supported an environment in which new opportunities for trade have emerged.

5.54 The challenge posed by 'open regionalism' is beginning to be met by small states through the 'new regionalism'. However, two sets of factors, additional to domestic reform, are necessary to ensure that small states make a successful transition to new forms of regionalism. First a more innovative approach to regional co-operation amongst small states in a sub-region will be an essential element in the development strategies they adopt. Joint approaches to marketing, promotion of investment, procurement, infrastructure development, exploitation of EEZ resources, and the use of technology merit closer attention than has been the case in the past. Second, they need assurances from the international community that assistance and support will be forthcoming during the period of transition. The trade preferences now extended to them will need to be extended beyond the time horizon now contemplated. The IFIs will need to be more sympathetic to their need for finance by relaxing stringent rules of access to concessional resources and graduation. The major bilateral donors will need to maintain flows of concessional bilateral assistance while these states adjust. Such concessional assistance will need to be directed towards the strengthening of infrastructure, development of the human resource base, and support for protection of the environment.

5.55 The approach small states adopt will clearly depend on levels of development and the wider regional environment in which they are located. The problems are most acute for the Caribbean which will have to simultaneously deal with the US, the EU and with Latin America. The choices elsewhere are more limited but no less pressing. But what is clear is that the architecture of the new regional associations is likely to be radically different from that which is now, or until recently has been, in place.

Assessment

5.56 This chapter has evaluated the economic problems facing small countries and the adjustments which they will have to make to integrate into the global economy. The overall evidence is mixed. While some small states have indeed been successful in realising benefits from globalisation there are many small states that have not. It cannot be categorically concluded that size has been the determining factor given the fact that several small states followed their larger neighbours in integrating into the global economy. There is, however, some evidence to indicate that countries that embarked on domestic reforms were more successful. This leads to a view that policy rather than size has played a critical role. In this sense small countries appear to face the same set of choices as larger countries. This said, there is nevertheless a case that can be made in favour of the proposition that small states face handicaps that constrain them from embracing a full programme of reforms because of size.

5.57 At the same time, small countries, even though constrained, have little choice but to adopt a programme of reforms. The reform process must be gradual and pragmatic and take account of the prevailing circumstances. External support by way of access to concessional financial and meaningful transition arrangements must be in place to cushion the cost of reforms. Regional agreements will help to improve the competitiveness of many small states though their immediate effect is likely to be limited. However, there is no alternative to the implementation of reforms. Failure to act will marginalise small states and increase their vulnerability.