

**Small economies and their development in the Multilateral Trade System:  
Correlation between economic and political environment and trade performance of  
small economies.**

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## **Abstract**

At the heart of this study is the topic of small economies in the Multilateral Trade System (MTS). The study examines the World Trade Organisation's (WTO) legal framework and policy objectives in order to develop a comprehensive definition of small economies as a group of WTO members with specific needs. Particular attention is given to the determination of the specific characteristics of small economies, as well as the issues and constraints they are facing in the MTS.

The study explores solutions proposed in order to tackle the constraints to the effective integration of small economies in the MTS, with specific reference to the policy reasoning of small economies. More importantly, the study explores the impact of the size factor, which is certainly not only a burden on the growth and development perspectives of the considered entity, but which may also become an advantage and promotes the trade performance of a small economy.

Hypotheses are then made relating to the relevance of the economic and political environments in the determination of a successful (or not) integration, and participation, of a small economy in the MTS. A crucial argument developed is that the differences observed between countries sharing similar characteristics of smallness, vulnerability and remoteness/landlockedness, illustrates the fact that what ultimately matters is the interplay of factors related to the economic and political environments, the effect of which is to promote or constrain (depending on the case) successful integration of the small economy in the MTS.

November 2007

## **Keywords**

Committee on Trade and Development

Developed Countries

Developing Countries

Economic environment

Political environment

Least Developed Countries

Multilateral Trade System

Small economies

Small and vulnerable economy

Trade performance

World Trade Organisation



## Declaration

I declare that *Small economies and their development in the Multilateral Trade System: Correlation between economic and political environment and trade performance of small economies* is my work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged with complete references.

Galani Tiemeni Thierry



Signed

November 2007

“In the language of boxing, we would be in the featherweight class. In the WTO however, we are expected not only to contend with the world heavyweight economies but also to be proud of that suicidal fate as an expression of our equality.”

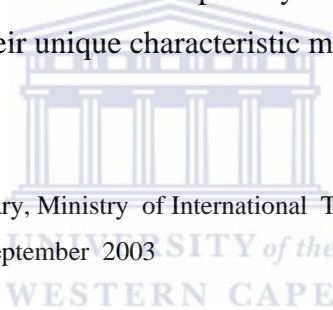
Honorable Terence Sam Condor

St Kitts and Nevis Deputy Prime Minister and Minister of Trade and Industry, Third Ministerial Conference, Seattle, 2 December 1999

“If the liberalization process is to contribute to poverty alleviation and not poverty creation in small economies, their unique characteristic must be recognized and addressed in the WTO.”

Mr. Horatio Versailles

St Kitts and Nevis Permanent Secretary, Ministry of International Trade and CARICOM Affairs, Fifth Ministerial Conference, Cancun, 13 September 2003



## Abbreviations and Acronyms

AITIC.....	Agency for International Trade Information and Cooperation
AOSIS.....	Alliance of Small Island States
CTD.....	Committee on Trade and Development
FDI.....	Foreign Direct Investment
GATT.....	General Agreement on Trade and Tariffs
GATS.....	General Agreement on Trade in Services
FAO.....	Food and Agriculture Organization of the United Nations
LDC.....	Least Developed Country
MTS.....	Multilateral Trade System
NAMA.....	Market Access for Non-Agricultural Products
NGO.....	Non Governmental Organisation
SDT.....	Special and Differential Treatment
SIDS.....	Small Island and Developing State
SPM.....	Sanitary and Phytosanitary Measures
SVE.....	Small and Vulnerable Economy
TBT.....	Technical Barriers to Trade
TRIPS.....	Agreement on Trade-related Aspect of Intellectual Property Rights
UN.....	United Nations
UNCTAD.....	United Nations Conference on Trade and Development
WTO.....	World Trade Organisation

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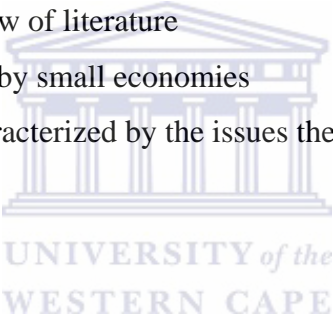
I finally say thank you to Professor Darcy Dutoit, Social Law Project, Faculty of Law, UWC, who first taught me writing and research techniques, and who helped me develop confidence in myself. Without your guidance and support, I would not have completed this course.



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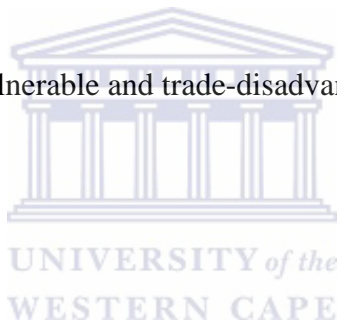
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## Chapter One: Introduction

### 1-1 World Trade Organization and integration of disadvantaged countries

In today's global economy, trade is becoming a matter that is increasingly involving more and more international parties. Public and private international entities are major actors in the global system of offer and exchange. Rules and practices of international trade are then highly monitored by all stakeholders of the international community since the outcome of the Multilateral Trade System (MTS) is likely to impact on the existence of any persons, and public or private entities

It is common sense to link international trade and international relations since the outcomes of both systems are tightly related and interdependent.

It is then understandable why the MTS is being prioritized over bilateral and even regional trade systems. Unlike both bilateral and regional trade, the MTS involves multiple countries, concerned with common trade issues and working together in order to build a global system of exchange from which all countries will benefit<sup>1</sup>. In fact, it is all about evading the inevitable inconvenience of a system exclusively based on bilateral and regional agreements, which are likely to generate discrimination, unfair treatment, argument and even conflict between countries.<sup>2</sup>

In order to achieve this purpose, has been developed, since the end of World War 2 and the launching of the General Agreement on Tariffs and Trade (GATT) and the more recent establishment of the World Trade Organisation (WTO), an international trading system based on agreements negotiated between member countries and applicable to all signatory states.

The system is based on the principles of transparency, reciprocity and non-discrimination between countries in international trade; it also provides safety valves to countries with a good reason to restrict trade; and, more importantly, the commitments assumed by members are binding and enforceable.<sup>3</sup>

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<sup>1</sup> For a detailed summary of the objectives of the MTS as organised by the WTO, see Chapter One of *Understanding the WTO*, 3 ed October (2005) WTO Publications

<sup>2</sup> See the WTO Pamphlet, *10 benefits of the WTO trading system*, WTO Publications

<sup>3</sup> For an overview of the basics principle of the WTO see Chapter One, *Understanding the WTO* See note 1 above

With such principles, a system like that is supposed to be efficient and profitable to all the countries involved in international trade. However, it is being enjoyed mostly by the world's most powerful countries that can afford the cost of the implementation of these rules, whilst, on the other hand many countries are still disadvantaged because of their lesser position in the MTS.

## **1-2 Small economies in the Multilateral Trade System**

Small economies are countries of a relatively small economic size, and they are not always able to impact on the evolution of the MTS, which is, according to the facts, driven by the world's powerful economies even if it is regulated through consensus. The MTS in its founding principles and mechanism is supposed to advance and promote a collective development of all participating countries. In fact,

“the trading system managed in the WTO is a huge and frequently confusing enterprise in which a large and complex set of rules governs the way that governments [...] interact.”<sup>4</sup>

Nevertheless, this complex set of rules does not necessarily develop an approach aimed at facilitating the effective participation of all the parties to international trade. One of the main weaknesses of the MTS may be the inefficient mechanism of integration of disadvantaged countries, such as small and vulnerable economies (SVEs).

Besides the least developed or developing countries in the WTO, there is in fact a category of disadvantaged countries which are struggling to meet the requirements of WTO adherence or participation, and are therefore failing to benefit from the outcomes of international trade.

Consequently, they are marginalized<sup>5</sup> in the MTS, and even suffer severe economic crises because of the rules and practices of the WTO.<sup>6</sup> As small size is the principal characteristic of these countries, this physical disadvantage generates trade and non-trade

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<sup>4</sup> Peter Gallagher, Patrick Low, Andrew L. Stoler, *Managing the challenge of the WTO participation*, 2005, Cambridge University Press, p1

<sup>5</sup> See Terence Sam Condor in a Statement at the Seattle Ministerial Conference, 2 Dec 1999 “The WTO Agreements...have only served to further marginalise many small and vulnerable economies.”

See also Horatio Versailles in a Statement at the Cancun Conference, 13 Sept 2003“...growing marginalisation of small vulnerable island developing economies as the multilateral trading system has not responded to the needs of these economies.” Op cit

related constraints on their participation in the MTS.

According to the authors of *Managing the challenge of the WTO participation* quoted above, the smallness criterion may inherently constitute a constraint to trade:

“What we found was that these economies face many of the same problems and opportunities as other economies, but have fewer resources to manage them and face greater penalties if things go wrong.”<sup>7</sup>

In fact, difficult situations faced by SVEs are merely the consequence of uncontrollable natural and geographic factors, such as, smallness, remoteness, enclavement, and the effects of natural disasters.

Moreover, what needs also to be considered is the fact that these economies' vulnerability is exacerbated by the fact that natural and geographic constraints are intertwined to trade related constraints, such as, *inter alia*, the size of the market or the dependence on one or a few export products. This difficult situation is then emphasized by the non-recognition within the WTO of their specificities, hence the absence of any precise definition or any particular classification of SVEs as well as the absence of any particular advantages or favourable treatment aimed to relieve them of some of these constraints. Ultimately, situation of SVEs in the MTS is worsened by the fact that they are often subjected to follow the dictate of powerful economies.<sup>8</sup>

The first imperative for a MTS purporting to support the integration of SVEs must be to acknowledge the existence of a group of countries sharing particular characteristics and facing the same issues. Thus, it must address unavoidable issues of the definition and precise characterization of small economies.

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<sup>6</sup> Horatio Versailles “...of 21 Small Island Developing States, 18 have negative balance of trade and the United Nations in a publication titled ‘*Making Global Trade Work for People*’ has documented that some 67 developing countries have suffered loss of market share, contraction of manufacturing capacity and increase in unemployment as a result of the liberation process.” See note 5

<sup>7</sup> See note 4 , p25

<sup>8</sup> Honorable Clement J Rohee, ‘Multilateralism at the crossroad’, Contribution to the annual WTO Symposium, Geneva, May 24-25, 2004, p2: “As a representative of small Caribbean developing countries I am very concerned with trends that will subject rules to the dictates of power with the end result being that the poor and weak will be the natural losers. This vision is indeed scary as it means that these countries will be forced to accept rules not in conformity with their development and which in many instances serve to hinder such development.”

### 1-3 The WTO and the concept of small economies:

The concept of “small economy”, in the WTO legal framework is an uncertain one because it has not officially been given a precise definition. When accessing the WTO website and browsing through the WTO glossary and terminology database, it is surprising that no definition of a small economy or any other relevant concept is available.

Such elusiveness might be confusing if we do not keep in mind the fact that the issue of the recognition of the particularities of the small economies is an actual and ongoing matter in the WTO.

In fact, a positive and comprehensive official definition of small economies will ultimately depend on the culmination of ongoing negotiations within the Multilateral Trade System.

Walter Goode proposes a definition of the notion of small economy as:

“A WTO work programme established at the Doha Ministerial Conference which aims at the fuller integration of small, vulnerable economies into the multilateral trading system”<sup>9</sup>.

Dealing with the similar notion of “Small Islands Developing States” (SIDSs), Goode defines it as:

“a group of forty-one countries and territories recognized by the United Nations as having unique problems in achieving sustainable development. The Alliance of Small Island States (AOSIS) operates within the group as a lobby and negotiating group, but not all AOSIS members are part of SIDS. AOSIS pays attention especially to the vulnerability of SIDS to the effect of climate change”.<sup>10</sup>

The search for a comprehensive and explicit definition of small economies will not easily bear fruit as there is no substantial explanation of what a small economy is or is not, nor what can or cannot be labelled as a small economy. .

On the other hand, to come up with such a definition is important with regard to both its substance and its consequences. A comprehensive definition of small economies is

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<sup>9</sup> Walter Goode, *Dictionary of trade policy term*, 4ed (2003), Cambridge University Press, p318

<sup>10</sup> Goode (see note 9 above), p318

necessary for an exhaustive listing of the issues and constraints faced by such economies, as the addressing and recognition of those issues require the acknowledgment of the very existence of an entity or entities with specific characteristics and particularities.

Therefore, solutions proposed in an attempt to remedy SVE issues cannot be effective until there is a precise designation of entities with specific criteria for whose advantage the measures are taken.

This fact has been acknowledged within the WTO framework, as is apparent from the *Briefing Notes* of the Cancun Ministerial Conference: “There is currently no definition in the WTO of what a ‘small economy’ is. Some members have argued that a definition is necessary before any commitment is made. Other members do not want to embark on such an exercise.”<sup>11</sup>

This work considering small economies will commence with an attempt to formulate an academic definition of the term “small economy” through an analysis of its specific characteristics. This will be followed by summing up the different issues and constraints faced by the small economies. Then particular requests made and the policy reasoning will be considered, as well as the solutions proposed within the framework of the MTS will be examined.

More importantly, the relationship between trade and development is going to be considered in order to assess the trade relevance of the political and economic environments of a given entity. The question is: Can the economic and political environment corrupt or promote the trade opportunities of a country with trade potential? Furthermore, what are the impacts of the smallness criterion on the trade performance of SVEs?

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<sup>11</sup> cf wto website [http://www.wto.org/english/thewto\\_e/minist\\_e/min03\\_e/brief\\_e/brief16\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min03_e/brief_e/brief16_e.htm)



## **Chapter 2: Definition, Characteristics, Issues and Constraints of SVEs**

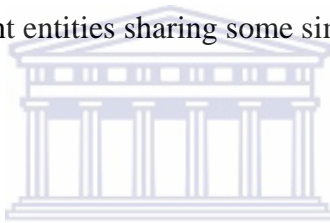
### **2-1 Summary of terminology:**

It is significant to note that when dealing with the issue of small economies, one is confronted by a multitude of terms employed. Does this abundance of terminology imply a more precise and effective technical comprehension of the concept of small economies?

Does it rather show vagueness in the definition of the concept which illustrates the absence of a consensually approved understanding of the SVE issue? Before any attempt at reaching a definition of a small economy, it is important to first aim for a precise differentiation between the broad ranges of terms used.

According to the context and the objectives of the definition, the criteria considered, or just the research field, we may note the use of any of the following terms.

These expressions may all refer to the general notion of 'small economy', but are always describing substantially different entities sharing some similarities in terms of the principal criterion of smallness.



#### **2-1-1 Small state:**

Let us first consider a small state, which is easily confused with small economy. A small economy in the WTO glossary does not basically refer to a sovereign political entity, but is defined by the geographic and economic aspects of a WTO member. Then a "small state" differs from a small economy because, in essence, what is principally considered is the political aspect of the entity. A small state is a political entity or government, a sovereign country, which is characterised by its remarkably small size. Finally, it may also be important to note, in the words of Tulloch, "The concept of 'small economy' as distinct from 'small state' reflects [...] the fact that not all members of the WTO are states"<sup>12</sup>

#### **2-1-2 Small economies and small and vulnerable economies:**

These two concepts are very close in definition and refer to the same situation of a particularly small economic entity with enough political autonomy such to be able to

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<sup>12</sup> -Peter Tulloch ,Director ,Development Division, WTO, Geneva; 'Small economy: the current status of events in the WTO' .Background Paper for Small States Forum,Prague,25september 2000,p1

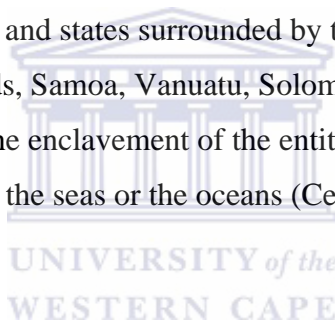
become a WTO member. These notions then refer to countries “characterised by the dual constraints of small economic size and vulnerability”.<sup>13</sup>

The two terms are the ones mostly used in the WTO vocabulary, as they are the simplest expressions to define economic entities characterised by an exceptional small size, and therefore an increased fragility and vulnerability in the Multilateral Trade System.

### **2-1-3 Small Islands and Landlocked Countries: Small Pacific States and Pacific Island Countries:**

Even if describing the same situation of a small economic entity in the MTS, these notions specifically bring a geographic criterion into the characterisation of the small economy.

These are small economies with a specific geographical position: Pacific island and Pacific state refer to the islands and states surrounded by the Pacific Ocean (Fiji, Guam, Kiribati, Maldives, Cook Islands, Samoa, Vanuatu, Solomon Islands, *etc*). Another geographic criterion is one of the enclavement of the entity considered in the middle of a continent without any access to the seas or the oceans (Central African Republic, Zambia, Mongolia, etc...)



### **2-1-4 Landlocked Developing Country, Small Island Developing State, Small Developing Economy, and Small and Relatively Less Developed Countries:**

The particularity of these terms is the introduction of the notion of development in the definition of the small economy. The effect is the assimilation of small economies to the group of Developing Countries or Least Developed Countries (LDC) since they are similar because they share a lot in common in terms of characteristics and issues faced.

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<sup>13</sup> Extract of the online article ‘small economies seek attention, special treatment’ ,BRIDGES, Weekly Trade News Digest, Volume 8 , Number 38, 10 November 2004, Available at <http://www.ictsd.org/weekly/04-11-10/index.htm>

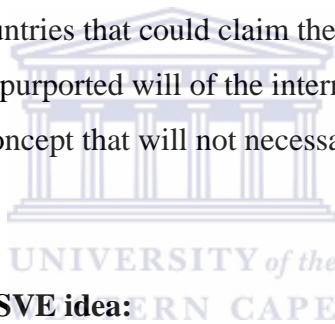
However, these definitions have the negative effect of reducing the scope of the small economy to the developing countries, and this can be a serious matter of debate since not all the small economies can be classified as a LDC or a Developing Country.

Let us now consider both the question of the appropriateness of a definition of SVE and the willingness of the Multilateral Trade System stakeholders to effectively come up with a consensual recognition of the SVE situation.

## **2-2 Necessity of an appropriate definition of SVE:**

How can we interpret the actual lack of a consensual definition of the notion of SVE within the WTO? Does it illustrate an inherent difficulty to reach a comprehensive definition, which will logically and ultimately combine in a uniform acceptance of the miscellaneous categories of countries that could claim the etiquette of SVEs?

Does it reflect the political and purported will of the international trade community not to agree to any definition of the concept that will not necessarily satisfy the expectations of all the countries involved?



### **2-2-1 Appropriateness of the SVE idea:**

#### **2-2-1-1 Difficulties of an appropriate definition: variety of claims**

Basically, it is not easy to reach an exact and unarguable definition of SVE. First because of the huge variety of different entities that will fall within the definition.

As we will see below, small economies are not only of many different forms, but also they sometimes are so different in their situation that one will try in vain to establish a single set of criteria that will describe all these different entities.<sup>14</sup>

Also, 'small economies' does not *a priori* refer to an exact economic or geographical criterion; so, many countries already classified as an advantaged LDC or Developing

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<sup>14</sup> Note by the Secretariat Committee on Trade and Development, 'Small economies: A literature Review' WT/COMTD/SE/W/4, 23 July 2002, (02-4066), Para 51-52 "Drawing a conclusion on what "small state" means is not easy. As shown in the previous sections, there is no unanimity on what the most relevant characteristics of small economies are, nor on which variables are the most appropriate to measure country size and what cut-off points should be used. Conclusions in the empirical literature tend to be somewhat contradictory and inconclusive in a number of important points. Each small economy is unique."

Country could technically be able to benefit from a favourable treatment primarily supposed to be for the benefit of small economies.

### **2-2-1-2 Urgency for a definition:**

What follows is the recognition of the urgency to precisely determine the exact nature of any state that could benefit from the advantages that are supposed to be enjoyed by SVEs. In fact, a claim of the SVEs is, for example, the need for them to be allowed special measures, deadlines and obligations relating to the implementation of the WTO rules. SVEs also requested a regime of special and differential treatment that will particularly address the trade constraints they are facing within the WTO.

This shows the importance of a consensus around the definition of SVE in order to further the objective of integration of all economies into the MTS and promotion of free and fair trade.<sup>15</sup>

However, we will now see that not all WTO members are likely to agree to the effectiveness of a precise definition of SVE.



### **2-2-2 Pros and cons of a definition and classification of SVE**

Within the WTO, the main issue is about the linkage between the definition of the notion of SVE and the creation of a new category of member. The hypothesis for the creation of a new category of WTO member, namely the small economies category, is criticised by some WTO members, particularly LDCs and Developing Countries, which consider that this may deprive them of some of their previous advantages.

#### **2-2-2-1 Distinction between small economies and other disadvantaged countries**

There are some major issues in the WTO relative to the possibility of precisely distinguishing small economies from other WTO members.

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<sup>15</sup> Philippe Hein, 'Small island developing States: origin of the category and definition issues'; in *Is a special treatment of small island developing States possible?* United Nations, New York and Geneva, 2004, UNCTAD/LDC/2004/1, p15: "Some of the skepticism and lack of concrete action stems from the absence of a definition for the SIDS category. No programme can be meaningful, operational and monitorable if it is not clear what specific countries are being considered".

The first controversy is the matter of the difficulty in distinguishing between: (a) small economies, (b) LDCs and (c) developing countries. All have made a request for special treatment in the MTS and they share a number of common characteristics, difficulties and constraints. There is also an identity of interest on similar issues within the WTO.

Notwithstanding these similarities, it is, however, certain that:

- Not all the small economies are developing countries. For example, St. Kitts and Nevis or Liechtenstein, which are small economies, are not developing countries at all.
- Developing countries are not necessarily small economies. Let take the example of the Democratic Republic of Congo, Nigeria or Sudan, which are either Least Developed or Developing Countries, but not small economies at all.

The fact of the matter is surely that most of the small economies are developing countries. Thus, it cannot be denied that does not constitute an easy task to define a set of preferential treatments designated for the small economy, because of the community of problems between “small” and other developing countries.

Peter Tulloch notes:

“It should be pointed out that most of the issues raised by the group of "small" economies [...] are also of concern to many other developing countries.[...] Many of the areas of direct concern to small economies in the preparation for negotiations are therefore also important to other developing countries.”<sup>16</sup>

Then the first challenge for the policies makers of the MTS is not about taking measures, but about the necessity to be able to clarify which member countries could request the application of these measures, and on which basis. Tulloch comments as follows:

“For example, the consequences for developing countries of increasing support levels in developed markets, the issue of Net Food-Importing Developing Countries, the special place of agriculture in developing countries and the perceived need for flexibility in protection by certain

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<sup>16</sup> Tulloch (see note 12 above) pp2-3

developing countries have also been raised by others in the mandated negotiations on agriculture (see for example, the proposal to the June 2000 Special Session of the Committee on Agriculture by 11 developing countries<sup>17</sup> and the statement by India at the same meeting<sup>18</sup>). Secondly, implementation of the Agreement on Textiles and Clothing is a major item in the ongoing "implementation" discussion, (and an area where developing countries' views themselves differ as between those competitive suppliers that can benefit from liberalization, and those less competitive suppliers for which the maintenance of quotas gives a certain, protection). Again, we can expect that if or when negotiations on industrial tariff liberalization get under way, the basis, scope and depth of tariff cuts and bindings to be made by developing countries and of "special and differential treatment" in this regard will become a major issue. Lastly, in regard to subsidies, the proposal had been made before Seattle that the criteria for applying the "de minimis" level should apply not only to LDCs and developing countries whose GDP per capita was under US\$1,000, but also to the lower- and middle-income developing countries as defined by the World Bank. Many of the areas of direct concern to small economies in the preparation for negotiations are therefore also important to other developing countries."<sup>19</sup>

### **2-2-2-2 Issues about a new category of states**

Another matter of controversy in the WTO relates to the possible creation of a subcategory of members, designated for small economies.

Here also the same concern regarding the appropriateness of such a new category prevails. The creation of this category could in fact generate more problems than it will solve, because of the difficulty of designating the countries that will fall within it:

“The Doha Declaration expressly states that a sub-category is not to be created of small economies, but several WTO Members who are landlocked, small islands, and/or geographically isolated have argued that they have particular problems such as distance and transportation requirements and vulnerability that need to be specifically addressed by WTO rules.”<sup>20</sup>

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<sup>17</sup> G/AG/NG/W/13, 23 June 2000

<sup>18</sup> G/AG/NG/W/33, 13 July 2000

<sup>19</sup> Tulloch (see note 12 above) pp2-3

<sup>20</sup> BRIDGES, Weekly Trade New Digest, volume8, number 38, 10 October 2004, (see note 13 above) p1

First, there is no precise line distinguishing between small and other developing countries. Secondly, a new subcategory could allow some developed but small countries to enjoy special treatment, which is actually needed more by other developing countries, which are not necessarily small but are struggling to benefit from international trade.

Small economies are aware of this situation and are not directing their requests to the possibility that the WTO will create a new category of members. In fact, the main objection to such a category came from other developing countries that are concerned by a differentiation, which could lead to discrimination amongst Third World countries. This is in addition to the fact that these countries are actually supposed to stand together against the domination of the world's powerful economies.<sup>21</sup>

In an attempt to further the objective of defining small economies, our task now is to summarise the pertinent characteristics, issues and constraints that could determine a positive definition of the concept.

### **2-3 Characteristics of SVEs and issues faced in the MTS**

It is a difficult task to establish an exhaustive listing of the different criteria for characterization of the small economy. First of all, because of the similarities between small economies and other categories of countries, the link between smallness and vulnerability is not obvious, and has been subject to many authorial controversies, as we will see further below.

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<sup>21</sup> -Extract of the online article 'Members largely favourable to new approach on small economies' problems' BRIDGES, Weekly Trade New Digest, volume9, number 35, 19 October 2005, p1, at <http://www.ictsd.org/weekly/05-10-19/index.htm>

**"Small economies: we are not seeking to create new category**

Sources indicate that a handful of delegations including Peru complained that the proposal would introduce differentiation among developing countries in the WTO, a longstanding objection of many developing country WTO Members.

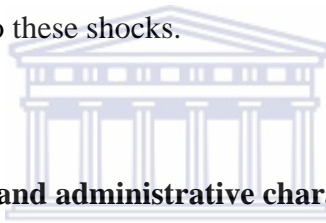
The proponents of the approach, as in earlier submissions (WT/COMTD/SE/W/12 and W/13), denied that they were seeking to create any such new categories, or to take anything away from other developing countries. Acknowledged that no single problem they faced was unique to small and vulnerable economies, they argued that they were simply seeking the sort of variable treatment among developing countries that already exists in the WTO Agreements and the July Package. Certain WTO subsidies obligations, they noted, do not kick in for developing countries until their per capita annual gross national income surpasses USD 1000. The July Package calls for "differential treatment" for net food-importing developing countries."

Our approach will then consist of recording elements of smallness and vulnerability, which inherently constitute constraints on the full participation of the considered entity in international trade.

### **2-3-1 Natural and geographic characteristics**

The first element in this category relates to the natural and geographic situation of these countries. Smallness and vulnerability are intertwined merely because of their impact as a constraint on trade. Other characteristics in this respect are:

- The small geographic size, small population and limited human resources;
- The remoteness, enclavement, physical isolation and geographical distance to the main markets;
- The vulnerability to external and exogenous shocks, including natural disasters, and a limited adjustment capacity to these shocks.



### **2-3-2 Economic, institutional and administrative characteristics**

The trade performance of SVEs is compromised by the following constraints:

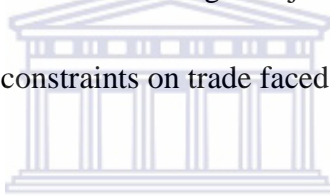
- The population is generally small, and therefore their markets are of a reduced size.
- The limited size of the domestic market reduces the scope for exploitation of economies of scale.
- The resource base is narrow, fragile, and prone to disruption by natural disasters.
- They are generally characterised by high access costs, high reliance on transit states for access to the sea, high dependency on their neighbors for supplying their domestic market;
- There is a shortfall in institutional and administrative capacity



### **2-3-3 Characteristics related to trade performance and development:**

- The limited diversification of their export structure, both in relation to the range of products, and concentration on a few markets.
- They typically depend for foreign exchange on a small range of primary product exports.
- Lack of adequate market access opportunities for their exports, and, in some cases, low levels of production, insufficient supply and low competitiveness.
- They generally have limited local capital for productive investment.
- In short, their base for revenue generation is narrow.
- Agriculture constitutes the backbone of many small economies, providing the main source of livelihood for the population and being a major export earner.

Finally, one can summarise the constraints on trade faced by SVEs as related to the followings elements:



“High access costs, high reliance on transit states for access to the sea; high dependency on their neighbors for supplying their domestic market; competition from transit states on similar exports; dependence on a narrow range of exports; deficiency in competitiveness; lack of attractiveness for foreign direct investment (FDI), etc.”<sup>22</sup>

### **2-3-4 Issues and characteristics as recorded by SVE**

Small economies themselves have proposed a list of their specific characteristics, which reflect the majors issues they are facing:

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<sup>22</sup> AITIC's *Information Brief No2*; November 2004, 'Small and vulnerable economies :the specific problems of landlocked developing countries';p1

“Indicative List of Specific Characteristics and Problems:

1. Physical isolation, geographical dispersal and distance from the main markets. Many are Small Islands or landlocked developing countries.
2. Insignificant participation in the multilateral trading system and a minimal share of total world trade.
3. Small, fragmented and highly imperfect markets.
4. In general, very open economies.
5. Domestic markets with imperfect and highly polarized structures: either a multitude of small and micro enterprises, or cartels/monopolies.
6. Minimal or no export diversification: concentration of exports on very few products (especially commodities, traditional products and low value added goods).
7. Low supply of export services.
8. Dependence upon very few export markets.
9. Inadequate Infrastructure.
10. High degree of vulnerability.
11. Low competitiveness.
12. Low levels of productivity and insufficient supply.
13. Economic rigidity with high adjustment costs.
14. Inability to sustain diversified productions.
15. Considerable difficulties to attract foreign investment.
16. Lack of adequate market access opportunities to place their few export products.
17. High transport and transit costs.”<sup>23</sup>

#### **2-4 An attempt at defining a SVE**

After the summary of the main characteristics which differentiate between SVE and all other categories of countries, the challenge now is to come up with a concise definition reflecting the quintessence of the idea of SVEs.

First of all, we should look at how different authors considered the appropriate meaning to be given to the notion. Interest will then be given to finding out the criteria proposed by some small economies themselves as properly defining their situation.

##### **2-4-1 Authors definitions: review of literature**

It is relevant to note that, as in the case of the MTS, there is no consensus between authors about the main aspect of the small economy situation that should be used as the central point of a definition.

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<sup>23</sup> *Work programme on small economies: an assessment of the progress to date*; Committee on Trade and Development WTO, WT/COMTD/SE/W/20; 9 February 2006, (06-0562). p3

In a note by the Secretariat of the Committee of Trade and Development, on 23 July 2002, there was a review of the main aspect of the typical definition proposed by different authors on the question:

“Small country issues have been analysed in the literature for more than four decades now (de Vries, 1973, Kuznets, 1960, Scitovsky, 1960) are among the first works on the topic), but there is still no general agreement on what "small" means. Several different measures of size and thresholds have been proposed. An appropriate definition of smallness should take into account a variety of factors including population, per capita income and income distribution (Srinivasan, 1986). Indeed, a very poor country can have a large population but still be a small market because of its limited demand potential.

In spite of this, the proxy that has been most widely used in the literature as a measure of country size is population. Some have proposed 1.5 million people as a threshold (Commonwealth Secretariat – World Bank Joint Task Force, 2000), others 5 million or even more (Streeten, 1993, Collier and Dollar, 1999, Brautigam and Woolcock, 2001), and still others something in between (Armstrong et al, 1998).

Of the 207 countries listed in the World Bank's 2002, World Development Indicators, 63 have a population of less than 1.5 million and 97 of less than or equal to 5 million. Thirty-six of these are island states and nine landlocked countries. Table A1 in the appendix lists countries with populations of less than 5 million. Of the 49 countries classified by the United Nations as least-developed (LDCs) in 2001, 13 have a population below 1.5 million people, 19 below 5 million and 11 are either landlocked or island countries (small or very small). However, small countries are not necessarily poor countries. If we take the list of small countries proposed by the Commonwealth Secretariat and World Bank Joint Task Force on small states (April 2000)<sup>24</sup>, only seven countries out of 45 have a per capita GNP below US\$760 (the threshold for a country to be considered low income according to the World Bank Atlas method) and only 14 are also classified as LDCs (Table A2).

Davenport (2001) proposes an alternative definition of smallness which has to do with trade flows. Small states, despite their high degree of openness, usually represent a very small share of world trade. In the author's view, instead of considering plain demographic criteria or building up vulnerability indexes to select small states, one could simply set a threshold share of world trade and consider as small all the countries that have an export share lower

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<sup>24</sup> The Commonwealth Secretariat, World Bank Joint Task Force report considers countries with a population of less than 1.5 million eligible for official aid, including one transition economy (Estonia) and developing countries, as listed in the *List of Aid Recipients Used for 1997 and 1998 Flows* issued by the OECD Development Assistance Committee. A few larger states (Jamaica, Lesotho, Namibia and Papua New Guinea) are also included because they share many of the characteristics of small states.

than the cut-off level.<sup>25</sup> The de minimis principle can be applied either on aggregate trade flows or on a sectoral basis to take into account countries that have a small aggregate trade share but are particularly relevant producers of a specific good. Others (Encontre, 1999) have proposed restricting attention to small island states. These countries, being small and remote, share similar characteristics and needs.

Whatever the criteria used to define small states, any list would include countries that are heterogeneous in some respects and can be easily criticized, since the analysis of common characteristics turns out to be difficult. Due to the considerable diversity among small states, it is hard to find that "one" aspect of smallness that is essential in the characterisation of small economies and in distinguishing them from large states. In these circumstances, it is not surprising that a unified view on small states is still missing."<sup>26</sup>

#### **2-4-2 Proposed SVE definition by small economies**

In order to constitute a unified block of countries, with same aspiration, within the MTS, groupings of small economies have also proposed specific and objective factors that should be taken into consideration when trying to identify small economies.

In fact, these are common factors shared by small economies, and are relative to their trade performance. Basically, it is about differentiating SVEs from others countries using the criterion of their percentage participation in international trade transactions. This could then lead to classification in the SVE group of only those countries with a particularly low percentage share of international trade.

For example, in a 26 July 2006 communication by a delegation of small economies<sup>27</sup> in a dedicated session of the WTO Committee on Trade and Development, the criteria for

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<sup>25</sup> One possibility considered by Davenport is to set the limit share at 0.03 percent of world trade, which was the former threshold used by the WTO to set the minimum level of WTO budgetary contributions. According to the author, selecting the countries by this criterion would also imply that granting special and differential treatment would have negligible trade diversion and trade creation effects. One third of the 59 WTO Members with a population of less than 5 million people have been requested to pay the current minimum contribution rate of 0.015 percent to the WTO 2002 budget.

<sup>26</sup> *Small economies: A literature review*, Note by the Secretariat Committee on Trade and Development. At WT/COMTD/SE/W/4, 23 July 2002, (02-4066)

<sup>27</sup> Communication from Antigua and Barbuda, Barbados, Bolivia, Cuba, Dominica, Dominican Republic, El Salvador, Fiji, Grenada, Guatemala, Honduras, Jamaica, Mauritius, Mongolia, Nicaragua, Papua New

defining countries that should benefit from special and different treatment as negotiated between the parties, was proposed as follows:

“countries whose average share for the period 1999-2004 (a) of world merchandise trade does not exceed 0.16 percent and (b) of world NAMA trade does not exceed 0.10 per cent and (c) of world agricultural trade does not exceed 0.40 per cent should be identified as SVEs”<sup>28</sup>

In order to give a wider application to this definition, these countries insisted that because “the vulnerability that characterises them affects their trade performance in the non-agricultural and agricultural sectors [then]... the same criteria should prevail in both negotiating areas and [they]... fully endorses the use of the criteria submitted in the NAMA Negotiating Group for the agriculture negotiations.”<sup>29</sup>

This communication also contained greater precision about the necessary distinction between small economies and other disadvantaged countries within the WTO:

“The criteria for the identification of potential developing country beneficiaries of this proposal in the NAMA negotiations, excluding LDCs, countries in transition and paragraph 6 countries, would apply to the remaining countries:

- whose share of world merchandise trade does not exceed 0.16 per cent;
- whose share of world NAMA trade does not exceed 0.10 per cent; and
- whose share of world agricultural trade does not exceed 0.40 per cent”<sup>30</sup>

### **2-4-3 Conclusion: SVEs are characterized by the issues they are addressing in the MTS**

The main characteristics that may be used to precisely define SVEs are all relevant to issues and constraints faced by their participation in the MTS.

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Guinea, Paraguay, Solomon Islands, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines and Trinidad and Tobago.

<sup>28</sup> World Trade Organization, Committee on Trade and Development, Dedicated Session, 26 July 2006, *Small Economies Work Programme, The monitoring role of the Committee on Trade and Development in Dedicated Session*, at WT/COMTD/SE/W/21/Rev.1,

<sup>29</sup> Ibid

<sup>30</sup> Ibid

In fact, SVEs are typically entities presenting natural, geographical and economic specificities which may be inherent constraints on trade.

Furthermore, these countries generally

“suffer from a lack of adequate financial, technical and administrative capacities to implement all proposed trade facilitation measures at the national level.”<sup>31</sup>

This increases their disadvantage as participants in the MTS, because of the difficult implementation of its rules: “It should be noted that for SVEs the unit costs of adopting some measures are higher and therefore may limit the ability of SVEs to reap the full benefits of implementation.”<sup>32</sup>

It is then understandable why these countries strongly insist on the urgent need for the determination of the special and differential treatment that could allow them to fully participate in international trade.



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<sup>31</sup> Ibid

<sup>32</sup> Ibid

### Chapter 3: SVEs and Development Perspectives within the WTO

SVEs' perspectives of integration and development within the MTS are tightly related to the effective response that could be given to the constraints on trade they are facing. In fact, the backbone of the policy reasoning of these countries is the idea that their effective participation in the MTS is inherently compromised by the non-recognition of their specific characteristics. Emphasis is also placed on the particularly high cost of their participation in the regulation of international trade, and the further difficulties faced in terms of the effective implementation of these rules.<sup>33</sup>

Because of the importance of trade, specifically as a tool for development, these economies often have to deal with the dilemma of the choice between the difficult and onerous implementation of trade rules and principles, and a more prejudicial avoidance of an effective participation in the MTS.

As explained by Dr Richard Bernal:

“Despite the costs and difficulties involved in participating in multilateral trade negotiations, there are [...] compelling reasons why small states must remain engaged in the multilateral trading system and participate as fully as possible in the current and future negotiations in the World Trade Organization (WTO)”<sup>34</sup>

The option from the small economies perspective is to participate in the MTS and strive to try to have their issues and characteristics taken into consideration and addressed.

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<sup>33</sup> Dr Richard Bernal, ‘Small developing economies and the multilateral trading system, A Caribbean perspective’, Caribbean Regional Negotiating Machinery, Studies and Technical Paper, available at [www.crn.org/documents/studies/staff%20papers/CFM\\_Bernal.pdf](http://www.crn.org/documents/studies/staff%20papers/CFM_Bernal.pdf), p1 : “Small developing countries often find the costs of participating in the negotiation and adjudication of rules in the multilateral trading system very onerous. Indeed, many governments in small or developing countries regard the cost as prohibitive [...]”

<sup>34</sup> R. Bernal (See note 34 above) p2 “• The importance of international trade to small economies; • Their vulnerability to external developments; • The distinct and sometimes unique nature of their interests; • The enhancement of negotiating leverage; and • Protection of their rights.”

The typical position of these economies, in their intervention before the WTO, relates to the necessity for the world trade community to reach a consensus on a particular set of measures purported to circumvent the constraints to trade faced by SVEs.

The objective in fact is to “fully integrate” these economies in the MTS because “As small, vulnerable economies (SVEs)... [They] suffer from a severe lack of adequate financial, technical, and administrative capacities to fulfill their obligations”<sup>35</sup>

Our aim in this chapter will be, first, to summarise the different policies reasoning, and requests of the SVEs. This will be followed by an analysis of the MTS response to these propositions, and an assessment of the different actions engaged by the WTO in order to accommodate SVEs.

### **3-1- Request and policies reasoning of small economies**

Initially, the first step in the trade strategies of SVEs has been to “combine their resources and form common entities”<sup>36</sup>. In fact, because “these countries have no alternative but to be involved, given the paramount importance of international trade to their economies”<sup>37</sup>, it is then important for them to be regrouped in order to achieve greater consistency during the negotiating process, and be able to contribute their own views on the policies and principles of international trade.

Generally, in their different communications to the Committee on Trade and Development (CTD), groups of SVEs will emphasise on the urgency of a set of Special and Differential Treatment rules aimed at containing the trade-related constraints to the development they are facing. These will also be specifying general trade policy requests as well as particular measures and changes they are expecting in some specific fields.

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<sup>35</sup> As claimed by groups of SVEs in different communication before the Committee of Trade and Development, cf inter alia followings WTO archives WT/COMTD/SE/W/15, WT/COMTD/SE/W/16/Rev.1

<sup>36</sup> R. Bernal, (see note 34 above), p1.

<sup>37</sup>R. Bernal, (see note 34 above) ,p4



### 3-1-1 General policies request

From the small economies' perspectives the WTO should consider as a priority, the adoption of a set of dispositions for the purpose of integrating marginalised economies. The main aim is to circumvent the natural disadvantages faced by these countries, by introducing preferential dispositions in multilateral agreements.

For instance, in a Communication at the Seattle Ministerial Conference, a group of small economies requested the following proposals to be considered by the WTO during coming negotiating rounds:

- “(a) For transitional trade preferences for "countries historically dependent on trade preferences for their principal trading partners";
- (b) For longer transitional periods for trade liberalization by small economies;
- (c) For the adoption of concrete measures to address food security in small, net food-importing developing countries;
- (d) For assistance with modernization of sectors on which countries are heavily reliant (such as textiles and garments);
- (e) Flexible arrangements for the establishment of regional trade agreements which comprise small economies; and
- (f) Higher thresholds for the non-actionable application of export subsidies by small economies.”<sup>38</sup>

### 3-1-2 Specific policy requests relating to particular trade agreements

**(TRIPS, NAMA, GATS, GATT, TBT, SPM, etc)**

At the Seattle Ministerial Conference, another approach of SVEs was to make specific policy requests concerning particular fields of interest. For instance, in another paper presented by Mauritius and Jamaica, the request was:

- “In respect of agriculture, international measures to assist small economies whenever they are adversely affected on account of any natural disaster; assistance for diversification into products that have higher value-added; rapid implementation of the Decision on Least-Developed and Net Food-Importing Developing Countries; priority consideration to market access for small economies' agricultural products; technical and financial assistance to improve agricultural productivity; and a mechanism to provide concessional facilities when food prices exceed a particular ceiling or food production falls below a certain level;

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<sup>38</sup> -Peter Tulloch,(see note 12 above) ,p1

- Technical and financial assistance to small developing countries to help them adjust to the integration of textiles and clothing into WTO rules and the phasing out of the provisions of the Agreement on Textiles and Clothing;
- More favorable provisions in respect of tariff cuts and bindings to be made by small economies;
- Raising of the de minimis level for actionable subsidies in respect of small economies; and
- In respect of services, priority to removal of barriers in sectors of export interest to developing countries; incentives to improve access of small economies to technology, distribution channels and information networks, particularly via electronic commerce; and capacity building measures for the services sectors.”<sup>39</sup>

Further requests were submitted to the CTD by groups of SVE containing proposals for measures to be taken in particular fields, such as:

- Technical Barriers to Trade - WT/COMTD/SE/W/15 (18 October 2005).
- Sanitary and Phytosanitary Measures - WT/COMTD/SE/W/16 (18 October 2005).
- Intellectual Property Rights - WT/COMTD/SE/W/18 (18 October 2005).
- Accession to the WTO - WT/COMTD/SE/W/17 (18 October 2005).

-NAMA

-Market Access

-Rules

These communications are revised from time to time and circulated at the request of the concerned SVE<sup>40</sup> during dedicated sessions of the CTD on the Work Programme on Small Economies.

### **3-1-3 Special and Differential Treatment (SDT) request**

The WTO legal framework has a set of rules that allow selected developing countries to gain some benefit in terms of advantageous trade dispositions in different agreements.

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<sup>39</sup> Tulloch, (see note 12 above),p2

<sup>40</sup> Communication from Antigua and Barbuda, Barbados, Cuba, Dominica, Fiji, Grenada, Jamaica, Mauritius, Papua New Guinea, Solomon Islands, St. Kitts and Nevis, St. Vincent and the Grenadines.

One of the main purposes of SVE policy reasoning, if not the principal one, is the request for a set of rules specifically designed to address the major trade and non-trade related constraints on their full integration and participation in the MTS.

T. S. Condor summarises some of the necessary measures that need to be taken to the advantage of the small economies:

“A regime of special and differential measures should include

- (a) Continuation of preferential arrangements;
- (b) Permit developed and more advanced developing countries to extend duty free treatment on a non-reciprocal basis to LDCs and vulnerable small economies;
- (c) Take account of the special interest of small economies in agreements such as Technical Barriers to Trade, Anti-dumping, subsidies, and safeguard agreements;
- (d) Require lower levels of commitments by small economies, most notably with respect to tariff bindings given the significant revenue implications;
- (e) Allow greater flexibility in transition periods for implementation of WTO Agreements given the cost and loss of revenue;
- (f) Greater coherence in the process, including, the removal of the GNP per capita Criterion for determining eligibility to concessionary funds, soft loans and grants by small vulnerable island states; and
- (g) Provide improved technical co-operation and assistance for capacity building.”<sup>41</sup>

The question remains: What have been the nature, the extent and the efficiency of the WTO response to these requests? What solutions have been proposed by the MTS? And what actions have been taken so far?

### **3-2- Solutions offered by the multilateral trade system**

#### **3-2-1 Policies reasoning/proposition from WTO/MTS**

Various solutions have been considered by the WTO in an attempt to effectively tackle the obstacles and barriers encountered by SVEs in the MTS

During different WTO ministerial conferences, WTO seminars on small economies as well as Dedicated Sessions of the CTD, various approaches to resolve the problems have been considered. The objective has been the effective containment of the marginalization of these disadvantaged countries.

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<sup>41</sup> TS Condor (see note 5 above),p2

On 21 October 2000, at a WTO seminar on small economies held at Geneva, WTO members and observers discussed the following potential solutions:

*“More open markets:* While openness to trade may sometimes exacerbate vulnerability, such openness also affords the opportunity to develop global industries, beyond the limited local market, and can also be a motor for growth and development.

*Internal reforms and policy measures:* There was a broad agreement that internal reforms and policy measures, such as sound macroeconomic management and the resolution of civil conflicts, are critical in addressing the problems of the small economies and in determining their participation in international trade and the global economy.

*New technologies:* Small economies must take advantage of technological developments.

*Diversification of exports:* Diversification of production and trade is desirable but difficult to achieve, as it often requires a significant amount of investment and training.

*Increased market access:* Internal reforms and policy measures must be complemented by international endeavors. For example, exports of small economies often face high tariff rates and non-tariff barriers in foreign markets. There is a need for enhanced, secure, and predictable market access for exports of interest to small and vulnerable economies.

*Regional agreements:* Regional cooperation among small economies can help them overcome certain difficulties through the pooling together of their resources, including in international trade negotiations, at the bilateral, regional, and multilateral levels. However, regional organizations cannot fully represent all the interests of member state<sup>42</sup>

### **3-2-2 Measures already taken in addressing the small economies challenge:**

The first observation to be made here is the fact that the WTO has not as yet done much in terms of giving effective answers to the SVEs' requests.

Since the Doha Round (and even before) the stakeholders of the MTS have repeatedly ascertained the urgency for policies to be conceived, and for action to be taken, in order

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<sup>42</sup> - Text available in the WTO Website at [http://www.wto.org/English/tratop\\_e/devel\\_e/smalecosum\\_e.htm](http://www.wto.org/English/tratop_e/devel_e/smalecosum_e.htm)

to relieve these economies from the constraints on trade and development that they are encountering.

These developments have resulted in the continual promotion in WTO official documents of the objective of a “fuller integration of small, vulnerable economies into the multilateral trading system”<sup>43</sup>; but to date this has served only as policy background to administrative and procedural activities, without any concrete implementation of the original and manifested purposes and intentions.

In paragraph 35, the Doha Declaration mandates the General Council to examine the issue, and to make recommendations as to the type of trade related measures that could improve the integration of small economies.

The General Council then instructed the CTD to hold dedicated sessions on small economies, the first of which took place in April 2002.

The General Council also agreed that the question of small economies would be a standing agenda item.

In 2005, the Hong Kong Ministerial Declaration included paragraph 41 on small economies, which again had only the goal of manifesting the concern of the MTS players on this issue. The paragraph reads as follows:

“We reaffirm our commitment to the Work Programme on Small Economies and urge Members to adopt specific measures that would facilitate the fuller integration of small, vulnerable economies into the multilateral trading system, without creating a sub-category of WTO Members. We take note of the report of the Committee on Trade and Development in Dedicated Session on the Work Programme on Small Economies to the General Council and agree to the recommendations on future work. We instruct the Committee on Trade and Development, under the overall responsibility of the General Council, to continue the work in the Dedicated Session and to monitor progress of the small economies’ proposals in the negotiating and other bodies, with the aim of providing responses to the trade-related issues of small economies as soon as possible but no later than 31 December 2006. We instruct the General

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<sup>43</sup> See the Work Programme on Small Economies, in the Ministerial Declaration at the Doha WTO Ministerial Conference 2001, WT/MIN(01)/DEC/1, 20 November 2001

Council to report on progress and action taken, together with any further recommendations as appropriate, to our next Session.”<sup>44</sup>

### **3-3- An appraisal of the WTO response to the SVE issues**

It is basically noticeable that the subject of small economies is the matter of difficult and complicated ongoing negotiations within the WTO framework. We will now focus on an assessment of the pertinence and efficiency of the actions so far conceived and deployed in order to ameliorate the trade performance, and ultimately the development of SVEs. In fact, a question that logically begs an answer is: is the WTO approach aimed at addressing the real and pertinent issues faced by SVEs. Furthermore, are comprehensive and effective actions being taken in order to tackle these issues?

From a small economy perspective, these solutions are obviously limited because the real issues are not addressed, and the answers given are non-exhaustive.

#### **3-3-1 Are effective and comprehensive actions being engaged?**

The typical criticism of the WTO relates to the obvious lack of concrete actions being effectively engaged in order to resolve these issues. In fact, except for the officially manifested intention to develop a concerted strategy that will definitely implement the policy of full integration of SVEs, no efficient set of measures directly addressing these issues has been deployed as yet. Small economies are still waiting for the MTS to be really concerned, take a step further than merely a simple proposal, and practically implement effective and comprehensive solutions to the SVE issue.

#### **3-3-2 Are SVE pertinent issues addressed?**

Issues faced by the small economies in the MTS are not only trade related, or with a direct impact on trade. In fact, there is a miscellaneous set of problems SVEs are dealing with, and which can affect their trade performance. What then are the constraints that must be given priority by the MTS and the international community?

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<sup>44</sup> Doha Work Programme, Ministerial Declaration adopted 18 December 2005, WT/MIN(05)/DEC Available at [http://www.wto.org/english/thewto\\_e/minist\\_e/min05\\_e/final\\_text\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min05_e/final_text_e.htm)

In fact, before looking for trade related answers to the small economies question, it is first necessary to sort out the pertinent issues faced by those countries, and which are relevant to:

- the lack of financial capacity needed for an effective participation in the WTO;
- the lack of capacity and competence in terms of qualified human resource;
- the lack of coherent and comprehensive economic policies nationally developed by most of these countries;
- the vulnerability to external market influence by multinational companies and even some developed countries;
- corruption as a constraint on fair international trade;
- the political environment of international trade, nationally and internationally;
- the economic structure of most of these countries; characterised by poverty and underdevelopment; and
- the transit issue

### **3-3-3 Need for concerted action by all stakeholders of the MTS and by SVEs themselves**

Ultimately then, and considering the variety of origins of the SVE constraints to trade and development, the question arises as to whether the WTO is the appropriate organ to effectively take measures to improve the trade performance of these countries.

In fact, the conjunction between trade and development could also be met, possibly, by other kinds of action employed and implemented, through collaboration between all the stakeholders within the international community.

In short, it is obvious to see that the WTO is not the only forum where the small economies problem can be discussed. There is a need for active cooperation between the WTO and international organisation, such as the United Nations, the FAO, the World Bank, the International Monetary Fund, the UNCTAD, and others, in order to define a concerted approach to the issue, develop a comprehensive policy, and then implement effective actions purported to promote the development of SVEs.

The ultimate concern of any interested parties will now relate to the form that the fruits of this international co-operative effort should take. The typical outcomes of such concerted action could comprehensively integrate into one set of measures:

- the promotion of regionalisation;
- the regrouping of small economies in lobbies acting in the MTS;
- bilateral negotiations between SVEs and others trade partners;
- technical and financial assistance for these economies in need;
- capacity building in these economies;
- the financing of infrastructures; and
- foreign investment purported to boost the development of host countries.

Anyway, whatever the actions engaged, one must keep in mind the fact that smallness is not necessarily to be equated to underdevelopment; or even negative trade performance. In fact, some authors have even argued that, indeed, the smallness of an economy may be enjoyed as an advantage, and could promote better benefit from the MTS. We will now engage in a comparative analysis of how countries sharing the same characteristic of smallness have dealt with the issue of vulnerability, in different economic and political environments, and with different outcomes.



## Chapter 4 Relevance of the economic and political environment on the trade performance and development of small economies.

After an attempt at defining the concept of small economies, one may proceed to focus on observing the trends and uniqueness in the trade performance of various SVEs as a result of their particular political and economic situations.

How do small economies perform in term of participation in world trade? What are the decisive factors for the success or failure of a small economy to integrate into the MTS and realize its growth and development? Moreover, what is the effective impact of the SVE's characteristics, namely, smallness, remoteness/landlockedness and vulnerability on its trade performance? Is smallness "ugly"<sup>45</sup> or "beautiful"?<sup>46</sup> These questions have been at the center of many discussions. The specific outcome of such a preoccupation is the highlighting of the differences in trade performance, growth and development levels, between small economies.

A major concern comes from the differentiation between economies sharing same constraints but realizing different performance. Thus, the hypothesis of the interplay of other factors in the determination of the successful participation of any economy in the MTS can be considered, even though similar issues that relate to the inherent characteristics of SVE confront them.

Accordingly, our approach will entail:

-First, the analysis of the effective impact of the size criterion on the trade performance of an economy. This will lead us, *inter alia*, to try to answer the following question, as summarise by Enrico Spolaore:

“What are the costs and benefits associated with smaller or larger size? What are the economic and political consequences from being ‘small’? In particular,

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<sup>45</sup> Refers to the expression used by Enrico Spolaore in his article ‘Is small really so ugly?’ (2004) 3, *World Trade Review*, p1

<sup>46</sup> Refers to the expression used by Eckhaus, R. in his article “Is it Beautiful to be Small, or is it a Burden?” (1997) 22, *Journal of Eastern Caribbean Studies*, pp.1-30.

are small states at an economic disadvantage because of the limited size of their domestic markets?”<sup>47</sup>

-Secondly, we are going to consider an analysis of different factors, which are decisive in their impact, on the trade performance of small economies. These factors generally encompass the economic and political environment of the given economy.

-Finally, we are going to attempt to figure out what the crucial policies, actions and practices are, that should be implemented because of their significant impact on the positive development of small economies.

#### **4-1 Is smallness an advantage or an inconvenience?**

About the relevance of the size criterion, one may argue that the size of an economy is not the determining factor of its trade performance; nor is it a pertinent element that could definitely impact on the efficiency of policies, measures, actions and practices implemented with the aim to promote development and integration into the MTS.

That is, for instance, the view of Jose Antonio Ocampo, who considers that new technologies and globalization have mitigated the importance of the size of an economy:

“Globalisation certainly poses new questions as to the relation between size and development. On the one hand, globalisation is making all countries smaller relative to the relevant (world) market. By reducing the transaction costs associated with distance, new technologies have reinforced this process. The relative importance of large national markets has thus declined, and even larger economies are increasingly dependent on external conditions. [...] But size has certainly not become an irrelevant factor in the current phase of globalisation. In this regard, it can be argued that small economies have both advantages and disadvantages [...]”<sup>48</sup>

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<sup>47</sup> Spolaore (see note 45 above) p2

<sup>48</sup> ‘Small Economies in the Face of Globalisation’; Third William G. Demas Memorial Lecture at the Caribbean Development Bank; Delivered by José Antonio Ocampo, Executive Secretary, Economic Commission for Latin American and the Caribbean (ECLAC); Cayman Islands, 14 May 2002, p2

Indeed, it is simple to realize that inherent characteristics of small economies are likely to generate trade-related constraints, and undeniably impose a “burden”<sup>49</sup> on the growth, development and trade performance of the considered entity. However, smallness is not to be considered merely as an inconvenience, because small size is also prone to generate some advantages for the concerned economy, thus the following observation of Marion Jansen:

“The reason for the attention devoted to small states is to be found in the general belief that, due to some particular characteristics, small countries are particularly vulnerable and can be more easily hurt in the process of globalization. Yet there is no unanimity of opinion among researchers on this point. Some have argued that being small in a "macro" world is a drawback. Small states for instance cannot enjoy economies of scale both in production and in public administration. They tend to be particularly vulnerable to natural disasters and economic shocks. According to other studies, smallness is an asset in a changing and dynamic world. Small countries can respond quickly and easily to the adjustments required by a changing international economy. The decision-making process can be faster and more flexible when the country's population is less heterogeneous. Although there seems to be no agreement on whether or not "small is beautiful", there is some agreement in the literature when it comes to common characteristics of small states.”<sup>50</sup>

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#### **4-1-1 Smallness as an inconvenience**

The typical inconvenience associated with the characteristics of small economies is the inherent negative effect of the threefold constituted by smallness, vulnerability, and remoteness/landlockedness on the trade capacity of SVEs.

In fact, emphasis is placed on the necessity for the MTS to allow these countries a preferential treatment, as per the principle “unequal partner, unequal treatment”; especially because without such favourable measures, SVEs are not likely to successfully integrate into and participate in the MTS.

Carlos Fontin on this subject makes the following comment:

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<sup>49</sup> Eckhaus (see note 46 above)

<sup>50</sup> Marion Jansen, *Income volatility in small and developing economies: export concentration matters*, ERSD World Trade Organization, Geneva, Switzerland, p5

“Globalization offers small island developing States (SIDS) valuable economic opportunities in the same way as it does with other countries. However, because of their intrinsic disadvantages, most SIDS will be unable to seize these opportunities unless certain special measures to compensate their disadvantages are granted to them by their development partners.”<sup>51</sup>

As a trade disadvantage, smallness negatively impacts at the macroeconomic level, by compromising the economy of scale, and imposing “less diversification and macroeconomic policy autonomy”<sup>52</sup>

In fact, J. A. Ocampo emphasizes the fact that small economies are extremely disadvantaged at the economies of scale level because of the interplay between factors related to their characteristics.

“The essential factor in this regard is scale economies, both internal and external to firms. Thus, to the extent that small economic size implies that economies of scale and scope cannot be attained, higher production costs and an unfavourable competitive position will result.”<sup>53</sup>

In addition, there is a remarkable impact of the size on the market structure, employment and adjustment costs, in small economies:

“Smallness also determines production and market structures. Being mainly composed of small firms, the domain of viable production alternatives is naturally more limited in small economies. Small firms are also financially weak and tend to be viewed by financial agents as more risky borrowers. They are thus more vulnerable to shocks than larger enterprises, including those which compete with them in international markets. On the market side, high unit costs and small market size naturally tend to create monopoly situations.

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<sup>51</sup> Carlos Fortin; Officer-in-charge of UNCTAD, in the ‘Foreword’ to *Is a special treatment of small island developing States possible?* United Nations, New York and Geneva, 2004, UNCTAD/LDC/2004/1 ;

<sup>52</sup> Ocampo (see note 48 above) p2

<sup>53</sup> Ocampo (see note 48 above) p3

The size of labour markets matters too, and has adverse consequences for both suppliers and demanders. Because the pool of human capital is naturally limited, firms must compete for scarce labour skills and may have difficulty in finding the full range of skills they require in the labour market. On the other hand, specialised workers have very few employment alternatives”<sup>54</sup>

Finally, it is to be noted that smaller countries are consistently more vulnerable to external shocks than larger ones. This also constitutes an important setback to trade because this vulnerability, which is attributable to “interrelated geographic (country size and location), demographic and economic factors”<sup>55</sup>, has the general effect of limiting the trade capacities of small economies.

#### **4-1-2 Smallness as an advantage**

Smallness is considered as an advantage because of the potential sociological and political advantages in terms of “achieving greater social cohesion”.

In fact, J.A Ocampo considers this an important benefit especially if we bear in mind the relevance of social cohesion as a “determinant of the investment climate and economic growth”<sup>56</sup>

At the level of the benefits related to the market structure, openness, which is also a main element of the characteristics of small economies „save for the case of landlocked and extremely remote countries, have the effect of empowering both producers and consumers of trade in goods and services.

A report by the Commonwealth Secretariat/World Bank Joint Task Force on Small States highlights the benefits associated with trade as follows:

“While most small states produce a relatively narrow range of goods and services, they consume a wide range of them and, as a result, they have high trade to GDP ratios.

The high degree of openness brings real benefits that accrue from trade—consumers in small states are able to obtain a greater variety of goods at lower costs than if their choices were confined to domestically produced goods while producers in small states can sell on the world market—provided they have effective market access—earning more than if they were confined to meeting limited domestic demand.

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<sup>54</sup> Ocampo (see note 48 above) ,p3

<sup>55</sup> Ocampo (see note 48 above) ,p7

<sup>56</sup> Ocampo (see note 48 above) ,p2

Participation in the world market also helps to channel new ideas and information about opportunities to firms and consumers in small states[...]  
Openness to trade also means that small countries have a larger stake in a stable, rule based, world trade environment than their small share of world trade would indicate. The terms of trade of small countries—the price of their exports (which tend to be concentrated in a relatively narrow range of goods and services) relative to the price of their imports (which tend to cover a broad range of goods and services)—are not significantly more volatile than those of other developing countries.”<sup>57</sup>

Finally, the positive relevance of small size as a trade advantage is also experienced at the micro-economic level; thus the comment of J.A Ocampo:

“Small market size also has some microeconomic advantages, especially when it comes to diseconomies of scale associated with transaction costs. The smallness of the population involved promotes better information for economic partners (suppliers or customers) and thus reduces risks associated with information asymmetries and moral hazard. Reputation and peer pressure to behave according to established ethical standards is a partial substitute for regulation and law enforcement. *Ceteris paribus*, smallness also favours better social cohesion and facilitates the relationship between the state and its citizens: almost by definition, public policy is decentralised in a small democratic state and there is no great distance between policy makers and policy takers. Nevertheless, these advantages materialise only when governance conditions are guaranteed.”<sup>58</sup>

#### **4-2 Trade performance of small economies depends on the interplay of a combination of factors with an effective impact on the trade outcomes of the countries’s economic characteristics**

Different hypotheses may be developed from the above examination of conflicting views on the size of an economy as a determining factor of its trade performance (or non-performance).

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<sup>57</sup> Report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States , ‘Small States : Meeting challenges in the global economy’, April 2000; p9

<sup>58</sup> Ocampo (see note 48 above) p3-4

The most relevant of these hypotheses are related to the necessary interference of other factors with a direct trade related incidence on the development of the concerned economy.

In fact, the interplay of diverse pertinent factors relative to the economic and political environments characteristic of each SVE may explain the differences in the situation of economies sharing the same size-related constraints. The importance of the economic and political environment is significant, as it is remarkable how small economies differ in their level of development as a result of a differentiation in their integration into and participation in the MTS.<sup>59</sup>

When assessing the reasons for the success, or failure, of a small economy to fully integrate into, and gain benefits from, the MTS, an analysis of SVE sharing similar trade outcomes, intertwined with a comparison with SVEs presenting different trade performances and growth level, will highlight significant elements that need to be taken into consideration as booster to trade, growth and development.

#### **4-2-1 Different elements of the economic environment may determine the trade performance of a small economy:**

The trade performance of small economies is likely to depend on the positive or negative impact of the interplay of different factors relative to their specific economic environment. The following elements constitute the significant features of this economic environment, and may interact in order to boost or constrain the trade activities of the concerned entity.

##### **a- Infrastructures:**

As demonstrated in different studies, trade performance of an economy is generally influenced by the availability of basic infrastructures, which are necessary for the

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<sup>59</sup>Report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States, (see note 57above), at p i: “The incomes and stages of development of these states vary widely, from very poor African countries such as Guinea-Bissau (with per capita GNP of \$160) to wealthy countries such as Brunei, Cyprus, Malta, and Qatar (with per capita GNP of more than \$9,000).”

growth of the local economy. Infrastructure of good quality also promotes the deployment of effective trade links between a small economy and foreign trade partners. It is worth noting that the lack of good infrastructure always constitutes an inevitable constraint on trade especially in small economies whose integration into the MTS depends on the effectiveness of the trade flow, both inwards and outwards. This hypothesis has been confirmed by the results of a study by researchers of the Economic Research and Statistics Division of the WTO:

“This paper explores the role that quality of infrastructure has on a country's trade performance, estimating a gravity model that incorporates bilateral tariffs and a number of indicators for the quality of infrastructure. The paper looks at the impact of the quality of infrastructure (road, airport, port and telecommunication, and the time required for customs clearance) on total bilateral trade and on trade in the automotive, clothing and textile sectors[.....]The results can be summarised in four main findings: (i) bilateral tariffs, generally neglected in gravity regression of bilateral flows, have a significant negative impact on trade; (ii) quality of infrastructure is an important determinant of trade performance; (iii) port efficiency appears to have the largest impact on trade among all indicators of infrastructure; (iv) timeliness and access to telecommunication are relatively more important for export competitiveness in the clothing and automotive sector respectively.”<sup>60</sup>

Certainly, this paper does not directly address the issue of the infrastructure in small economies; however, the results of the study are particularly relevant to the case of most small economies because their vulnerability is even more emphasized by the limitation of infrastructure and the impact of natural disasters on those available. Thus, the pertinence for small economies of this conclusive remark by the authors of the above mentioned study:

“It is, however, likely that better infrastructure and lower transport costs first and foremost increase the total volume of trade, while the distance is as important as before for the distribution of (a larger volume) trade on individual trading partners.

These findings have important policy implications for least developed countries. If improvements in the quality of infrastructure in these countries

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<sup>60</sup> Hildegunn Kyvik Nordås and Roberta Piermartini, *Infrastructures and Trade*, World Trade Organization; Economic Research and Statistics Division; Staff Working Paper ERSD-2004-04 ;August, 2004; p1



lags behind the development in more developed countries, their share of world trade is likely to continue to decline.”<sup>61</sup>

#### **b- Natural resources**

Industrial production is limited in small economies because of the lack of a diverse and abundant reserve of natural resources able to supply the industrialization process.

#### **c- Human resources**

The lack of human resources is an issue for most SVEs and entails not only the absence of a labour force, but also the lack of skilled labour.

Another important aspect to be mentioned here, is the need in SVEs of expertise in terms of availability of qualified and suitable personnel for the purposes of the determination, the implementation, and management, of coherent economic and trade policies.

#### **d- The currency and the balance of payments**

A strong, stable and viable currency is a crucial element for a positive trade performance. The viability of a currency is, however, tightly related to the balance of payments of the concerned economy. Balance of payments also depend on the industrial activities and exports of the country.

#### **e- The attractiveness to foreign investment**

Foreign investment plays an important role in the development of host countries. This role is even more emphasized in small economies where the inflow of FDI may contribute to the integration of the host country into the MTS.

There is an evident lack of interest on the part of international investors to invest in most small economies, this may be explained by the risk associated with the constraints on trade present in these countries:

“As with commercial borrowing and other financial flows, an analysis of FDI flows in the last two decades shows that small states are at a disadvantage in attracting FDI relative to other developing countries. Even when they have good policies and other characteristics (such as good human resource development indicators), small states are rated to be significantly more—28 percent more risky. To some extent, this may reflect greater underlying

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<sup>61</sup> Ibid ,p 18

riskiness of their economies. It may also reflect the weaker incentives that risk rating agencies and investors have to do their homework and learn about opportunities in small states.”<sup>62</sup>

In fact, the reluctance of international investors to invest in small economies also explains the difference in growth levels and trade performance between on one hand small economies receiving capital inflow from FDI, and on the other hand small economies still struggling to attract some foreign investors:

“Foreign direct investment brings not only capital but is often critical in linking the more isolated small states to developments abroad. Foreign firms can be an important source of know-how for improving private sector capacity overall and of information on new technologies and market opportunities. As the data in Table 5 show, some small states received substantial inflows of FDI in the late 1990s. Total flows of FDI to small states averaged about \$2.1 billion annually in 1996-98, some 15 percent above the official development assistance and aid flows, but with a very different distribution among the regions and countries. Nearly 80 percent of the FDI received by small states went to just seven countries (Bahamas, Botswana, Estonia, Equatorial Guinea, Guyana, Malta, and Trinidad and Tobago).”<sup>63</sup>

#### **f- The impact of disaster on the trade capacities of small economies**

The industrial structure of small economies which are victims of natural disasters is characterized by a high level of vulnerability, the instability of infrastructure and the overall limitation of the economic means of production. This is because of the negative impacts of natural disasters.

This has the effect of creating an unfavorable economic environment, thus the limitation of trade activities.

“The impact of a large disaster on international trade can be transmitted either directly or indirectly. Direct impacts on exports can occur due to the human losses and injuries (affecting companies' human resources) and the destruction and damage of physical capital and equipment in the export sector.

Damage to public infrastructure, such as roads, bridges, railways and telecommunication systems, can cause disruption to the export supply chain. In the case of imports, while similar direct channels can have an adverse effect on

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<sup>62</sup> Report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States, (see note 57above), p15

<sup>63</sup>Ibid

it, most of the impact of a disaster is likely to be transmitted indirectly through a reduction in aggregate economic activity (GDP).”<sup>64</sup>

#### **4-2-2 Different elements of the political environment that may determine the trade performance of a small economy:**

The quality of the political and institutional environment also plays an important role in the trade performance of an economy. For instance, the following features of a small economy’s political environment may have a direct trade effect:

##### **a- The quality of institutional structure**

For any individual involved in international trade activities, cross-border trade is generally associated with risk and uncertainty, because of the involvement of parties operating in different institutional environments with different jurisdictions, the usage of foreign languages and currencies, and the distance between trade partners. Thus, the decision to perform trade activities inside another country is generally dependant on the trust and confidence of the foreign counterpart in the quality of the institutions of the host country.

In fact, a recent study by researchers of the Economic Research and Statistics Division of the WTO has shown that “the quality of institutions has a positive and significant impact on a country’s level of openness”.<sup>65</sup>

By offering more security and reliability to private and public parties trading into its jurisdiction a good, institutional structure has the effect of increasing the volume of trade flow:

“Institutions set the rules for the interaction between private actors and for the interaction between public and private actors. Well functioning institutions

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<sup>64</sup> Martin Gassebner , Alexander Keck and Robert Teh , *The impact of disasters on international trade*, World Trade Organization; Economic Research and Statistics Division; Staff Working Paper ERSD-2006-04 March 2006; p3

<sup>65</sup> Marion Jansen and Hildegunn Kyvik Nordås, *Institutions, trade policy and trade flows*, World Trade Organization Economic Research and Statistics Division; Staff Working Paper; ERSD-2004-02 ; April, 2004, p1

therefore reduce the level of uncertainty inherent to this interaction and as a result reduce transaction costs. High quality institutions are therefore expected to have a positive effect on economic activity in general and on international trade in particular.”<sup>66</sup>

As envisaged in this theory, the definition of ‘institution’ entails the following indices, as set out by Kaufmann *et al*<sup>67</sup>:

- The “Government Effectiveness”, which is a measure of the “quality of government input”, that encompasses : the quality of public service provision; the quality of the bureaucracy; the competence of civil servants; the independence of the civil service from political pressures; and the credibility of the government's commitment to policies.<sup>68</sup>

-The “Rule of Law”, which not only entails an assessment of the confidence of individuals in the public order, but also their level of respect of, and submission to, the rules of the society. The indicators implemented include the “perceptions of the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts”.<sup>69</sup>

-The “Control of Corruption”, which measures the perception of corruption, “conventionally defined as the exercise of public power for private gain”, and its impact on the transparent and effective functioning of the institution.<sup>70</sup>

Finally, it can be noted that the interplay of all the above mentioned indicators has the ultimate effect of creating a political and institutional environment that will determine the trade performance of the concerned country. Thus, the following comments emphasised by Marion Jansen *et al.*:

“Domestic institutions, both in the home and the foreign country, can thus be expected to affect a country’s choice of trading partners and, as a consequence, the overall pattern of bilateral trade. At the same time, we would

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<sup>66</sup> Marion Jansen and Hildegunn Kyvik Nordås ,(see note 65 above) p3-4

<sup>67</sup> Kaufman, D., A. Kray and P. Zoido-Lobaton, *Governance matters II: Updated Indicators for 2000-01*, (2002), World Bank Policy Research Working Paper 2772.

<sup>68</sup> Kaufman, D., A. Kray and P. Zoido-Lobaton,(see note 67 above) p9

<sup>69</sup> Kaufman, D., A. Kray and P. Zoido-Lobaton,(see note 67 above) p9

<sup>70</sup> Kaufman, D., A. Kray and P. Zoido-Lobaton,(see note 67 above) p9

expect domestic institutions to affect a country's overall level of openness, in the sense that countries with better institutions trade more. Inefficient institutions represent a cost factor for domestic exporters and thus lower their international competitiveness with negative repercussions on export flows. Transaction costs due to inefficient institutions also raise the final consumer price of imported goods with negative repercussions on a country's import flows. Last but not least we would expect that institutions affect the effectiveness of trade policy. Even if a country lowers its trade barriers, outsiders may be reluctant to trade with that country if, for instance, they do not believe contracts can be enforced or are not sure whether payments will be made."<sup>71</sup>

#### **b- The administration**

This entails the level of efficiency and organization, and the expertise in trade policies of the administration, which may have an impact, either negative or positive, on the trade performance of the concerned entity.

#### **c-Political stability and democracy**

These elements play an important role in the determination of the trade performance of a country because they have a direct impact on the economy of the relevant entity.

The level of democracy is also relevant and generally determines how the available natural resources of the countries are managed. Thus, the need in countries with limited natural resources, such as small economies, of a coherent and development-oriented management of available resources.

This can be illustrated by the example of the Equatorial Guinea, a small economy with a pertinent trade potential due to its massive capacity for oil production along with its accessibility via the Atlantic Ocean. It however, has a limited trade performance and development level.

#### **d- Lack of coherent trade policies**

The development and implementation of appropriate and coherent trade policies at the national level is a condition for successful participation in international trade.

Small economies are generally characterized by a lack of expertise, and an inefficient organization, of the stakeholders of the trade community at the national level. This

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<sup>71</sup> Marion Jansen and Hildegunn Kyvik Nordås ,(see note 65 above) ,p4

generally explains the sometimes naïve attitude of trade authorities of small economies when confronted with policies considerations,, leading to trade engagements not always tailored for the growth and development of the local economy. This has been illustrated by the significant mistakes made by Mongolian authorities during the negotiation of their WTO accession, which had the effect of burdening local industries with trade commitments without any appropriate reciprocal advantage.<sup>72</sup>

#### **e- Lobbies and NGOs networking**

The role played by industrial lobbies and NGOs, in the trade policy process, is also important. Lobbying and NGO networking are especially important in small economies where these actions could lead to the definition of a coherent trade strategy much needed in order to tackle the setbacks to trade faced by the country.

#### **f- Bilateral and regional exchanges and co-operation**

The importance of regionalisation for small economies is summarised in the following extract from a speech on "Small Economies in a Globalised World: A European Perspective" by the then European Union Trade Commissioner, Pascal Lamy, who said:

“But sound domestic policies will not be enough, in particular for small island economies. Regional integration is unavoidable for alleviating the natural handicaps of smallness and vulnerability. Regional integration will enlarge the production base, allow for more rational exploitation of resources, improve specialisation and above all increase attractiveness for investment. Regional integration is, of course, not easy. It requires creative policies and new institutions. It requires a common vision for the appropriate pooling of sovereignty, the definition of solidarity mechanisms, the building of markets”<sup>73</sup>

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<sup>72</sup> Damedin Tsogtbaatar, ‘Mongolia’s WTO Accession: Expectations and Realities of WTO Membership’, Case Study 29 in *Managing the challenges of WTO participation*

<sup>73</sup> Speech by EU Trade Commissioner Pascal Lamy at Sandals Hotel on "Small Economies in a Globalised World: A European Perspective";St. Lucia; 1 March 2003, p2

## **Chapter 5 Conclusion and recommendations**

At the end of our journey through the small economies' situation within the MTS, one of our key findings relates to the effective interaction between the principal characteristics of SVEs, namely smallness, remoteness and vulnerability, and their trade performance. Since these characteristics do not necessarily constitute constraints on trade performance for each and every small economy, there is a need to consider the impact of other determinant factors of trade performance, growth and development.

### **5-1 SVE characteristics are not inherent disadvantages and constraints on trade**

Small economies are certainly characterised by a combination of factors, which may induce trade vulnerability thus difficult integration into, and participation in, the MTS. These characteristics, however, need not be considered merely as disadvantages and impediment to trade, since they may also become real trade advantages.

In fact, smallness may be an advantage or an impediment, depending on how the economic and political environments interplay in order to promote or hinder trade performance of any small economy.

The evidence of different levels of trade performance, thus growth and development, between small economies facing the same issues and sharing the same characteristics, shows how the national, economic and political environment may have impact on the economic performance of a small economy. These factors may therefore contribute to boost development and promote in- and outward trade flow.

It would therefore be appropriate to go over such examples of success stories in countries where smallness does not mean trade vulnerability or underdevelopment.

### **5-2 Ireland, an example of a small but successful economy**

Ireland is nowadays one of the most stable and best performing economies of the European Union, although it is a small state experiencing most of the issues faced by small economies.

Irish economic growth, and the development thereof, has been realised through a long process of adaptation of the economic and political environments to the development

goals of the country, taking into account the necessity to overcome the drawbacks to trade that they face. The achievement of this objective is the result of a long process developed in co-operation with the UK and within the framework of the EU.

Mr. Bertie Ahern, T. D., in a speech at the Annual Conference of the Confederation of British Industry in Islington on Monday 27 November 2006, acknowledged the pivotal role the bilateral cooperation with the UK has played in the performance of Ireland's economy. In fact, Ireland has benefited from this "special economic relationship"<sup>74</sup> in order to expand its trade activities. The one to one link of the Irish pound to British Sterling has also provided Ireland with the much-needed element of stability, hence its improved trade performance.<sup>75</sup>

Generally, as remarked by Bertie Ahern, Ireland's boom is the result of the successful combination of different factors of the economic and political environments, including<sup>76</sup>:

- the pertinence and coherence of policies, what Bertie Ahern defines as "A mix of mutually consistent policies, covering areas like taxation, incomes, investment, education and skills"<sup>77</sup>;
- an actively engaged workforce, and industrial relation stability;
- a focus on the promotion of research and development activities;
- heavy investment in competitiveness, which involves "an unparalleled level of investment in developing our infrastructure and our education and training services"<sup>78</sup>;
- a good corporate tax environment; and
- a very accessible political and administrative system, geared to respond quickly to business needs and concerns thus an effective "ease of doing business"<sup>79</sup>.

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<sup>74</sup> Speech by the Taoiseach, Mr. Bertie Ahern, T. D., at the Annual Conference of the Confederation of British Industry in Islington on Monday 27 November, 2006 at 4.45pm.,p1

<sup>75</sup> John Kelly, 'The Irish Pound: From Origins to EMU' (2003) 89 *Quarterly Bulletin Spring*, p2 :  
"A theme running through the history of the Irish pound is a search for stability — stability in financial conditions and stability in prices. In the first instance, this stability was provided by a fixed one-for-one link to sterling, with the credibility of the new currency being ensured by a full backing with sterling assets in a currency board. The sterling link also provided a stable environment for trade, which was almost exclusively with the UK in the early years and was relatively slow to diversify in subsequent decades."

<sup>76</sup> Mr. Bertie Ahern (See note 74 above), p2

<sup>77</sup> Mr. Bertie Ahern (See note 74 above), p2

<sup>78</sup> Mr. Bertie Ahern (See note 74 above), p2

<sup>79</sup> Mr. Bertie Ahern (See note 74 above), p2



The relevance of Ireland's economic and political environment in its exceptional trade performance have also been commented on by Franck Barry, who emphasises the quality of the infrastructure and the human resources, but also the efficiency of the political and institutional system:

“The World Bank's 1997 *World Development Report*, for example, signified an important shift in thinking about the role of the state in economic development. It built on analyses of the positive role played by East Asian bureaucracies in the region's spectacular industrialisation and on a number of emerging studies that employed cross-national data sets to show how growth was related to various measures of quality of government. [...]

Ireland is very far in advance of most developing nations in this regard – with a well-developed interlocking system of parliamentary, judiciary and press scrutiny, clear lines of responsibility and accountability, EU oversight, an independent Competition Authority, a series of independent regulators and a meritocratic civil service [...]

The *World Competitiveness Yearbook* discussed earlier assesses some 60 countries with respect to various competitiveness factors, including quality of governance, human capital development, infrastructure and technological environment. Ireland ranks among the top quartile with regard to most of the criteria for government efficiency and human capital. [...]<sup>80</sup>

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### **5-3 Characteristics of small, vulnerable and trade disadvantaged economies**

Different studies have shown how the combination of an unfavourable political and economic environment and the inherent characteristics of SVEs, have the effect of constraining the trade performance of the considered entity.

Analysing the Malawian trade experience, Tony Kandiero of the University of Pretoria makes the following comment:

“In general, Malawi faces severe trade and economic problems, including declining commodity prices, weak infrastructure, lack of technology, high cost of inputs, lack of

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<sup>80</sup> Frank Barry, 'Future Irish Growth: Opportunities, Catalysts, Constraints', (2005) *Quarterly Economic Commentary*, p49-51

access to financing, weak institutional and human capacity, high external debt — all of these have a major impact on trade performance.”<sup>81</sup>

This remark can easily be extended to most of the Third World SVEs, which are generally struggling to integrate into, participate in and benefit from, the MTS. Moreover, this is understandable if we bear in mind the general low level of development of these countries in terms of economic infrastructure, human capacity and expertise, and institutional quality.

#### **5-4 Recommendations**

Though a Small Island and Developing State, Mauritius is, however, a small economy which is positively performing in terms of integration into, and participation in the MTS. This encouraging example of the Mauritian booming economy shows how the evolution and adaptation of the economic and political environments in order to meet the trade and development goals of a small economy may contribute in the improvement of its trade performance and growth indices.

The Mauritian policy-makers had early on decided to quickly develop and implement coherent policies of promoting trade, with a particular focus on specific sectors, such as tourism, while developing infrastructures and trade policies intended to improve its trade performance, both regionally and internationally. This has been done in concert with different national, regional and international stakeholders of the trade community<sup>82</sup>, and has led to consistent positive progress in terms of growth and development.

The Mauritian example in fact reveals how a multipurpose approach is needed to counter the constraints faced, which therefore addresses both the direct trade-related aspect of the SVE vulnerability as well as the improvement of the economic and political

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<sup>81</sup> Tony Kandiero, ‘Malawi in the Multilateral Trading System’; Case study 26 in *Managing the challenge of the WTO participation*, p4

<sup>82</sup> See, for example, Report of the UN Secretary-General on the *Mauritius Strategy for the Further Implementation of the Programme of Action for the Sustainable Development of Small Island Developing States*; United Nation General Assembly; 6<sup>th</sup> Session, Agenda item 52-b, 3 October 2005

environments of the considered entity.<sup>83</sup> This imposes the necessity for a concerted action between the all the role players of the international community, and particularly the WTO, the International Monetary Fund, the World Bank, the FAO, the UN and the UNCTAD, and the OECD...etc



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<sup>83</sup> See also Andrew L. Stoler; Executive Director, Institute for International Business, Economics and Law, University of Adelaide : 'Mauritius: Co-operation in an Economy Evolving for the Future'; in *Managing the challenge of the WTO participation*

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