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The trade environment and small countries

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Introduction

With rapid changes taking place in the global trading environment, there has been concern within several international arenas and academia about the future of small developing countries (SDCs). Although the discussion relating to the effects of country size on economic growth and development began in the early 1960s with the publication of Kuznets' (1960) article and Demas' (1965) monograph, there has been a recent flurry of writings on small developing countries in the context of the new global order. For example, the World Bank in collaboration with the Commonwealth Secretariat (2000) undertook a major study of small states and their ability to meet the challenges of a changing global economic environment. Kennes (2000) and Salvatore *et al.* (2001) have also analyzed the challenges and opportunities facing small countries in the global marketplace. The Commonwealth Secretariat had previously arranged two expert panels to examine the vulnerability of small states in a global society and also the future of small states in overcoming their vulnerability (see Commonwealth Secretariat, 1985, 1997).

The ongoing interest in 'small' countries stems from a number of factors. First, these countries make up a significant proportion of the membership of international organisations such as the United Nations (UN) and the World Trade Organisation (WTO). Although there are different views relating to the criteria for determining the size of a country, in this commentary, a country with a population of 10 million or less is regarded as being 'small'. Some commentators have used alternative classifications such as 'small', 'very small' and 'micro' using various population demarcation lines. The large number of small developing countries in these organisations gives them a significant degree of voting and hence bargaining power. Second, with limited natural and human resources and relatively small domestic markets, questions have been raised about the 'viability' and 'vulnerability' of these SDCs. The early discussion on small countries focused on their 'viability', as many of them became politically independent. In recent years, the emphasis has been placed on their 'vulnerability' (economic, social and environmental) as these countries experienced severe natural and man-made shocks (e.g., hurricanes, oil price increases). Third, these SDCs are largely dependent on external economic activities for their survival – imports and exports,

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capital inflows, skilled labour and aid. The economic structures of SDCs are largely undiversified, with several of them being dependent on one or two main areas of activity (bananas, sugar, tourism, minerals) to generate growth and employment.

The changes in the global trading environment magnify the problems faced by SDCs. With the growing integration of global markets for commodities and factors of production, the focus on trade liberalisation, the recent developments in information and communications technology (ICT) and the changing geopolitical relationships between countries with the end of the cold war, SDCs have to rethink their economic management and development strategies. In effect, they have to engage in some degree of strategic repositioning within the global economy. For small countries with limited resources this is not an easy task as the options are somewhat limited. The two main papers in this issue examine the challenges faced by small developing counties and provide some possible options for dealing with these challenges. This commentary examines some of the issues raised by the authors.

The WTO and the poorest countries

Mattoo and Subramanian (M&S) examine the challenge posed for the WTO by the large number of small, developing member countries. From a list of 73 small and poor countries in 2000, 49 (67.1 %) are members, 12 (16.4 %) had accession in progress, 3 (4 % had observer status, while 9 (12.3 %) were not members. The small and poor members of the WTO identified in their article constituted about 40 % of the total membership of the WTO in 2000. When other small developing countries are added to the list, the membership is over 50 %. Several of these small, poor members are amongst the least developed countries of Africa. Since the WTO is not a development assistance institution, like the World Bank, membership by the countries in the WTO is based on the premise that the gains from trading in the new international environment would promote growth and development in the developing world.

M&S observe that, while the movement towards free trade in the world economy reflects a Pareto optimality (efficiency) outcome, there are significant distributional challenges associated with the process. Indeed, the world-wide protests associated with globalisation and trade liberalisation, especially by non-governmental organisations, partly reflect the inequities associated with the process. Since trading arrangements take place in an imperfect 'second-best' world, sustainable compensation systems must be designed for small poor countries to adequately benefit from the new trading arrangements.

The WTO was created in 1995 as a successor to the General Agreement on Tariffs and Trade (GATT), which was a treaty arrangement among 23 large 'developed' Western market economies signed in 1947 after World War II (Deardoff and Stern, 2002). The WTO's operations are much broader than those

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of the GATT and incorporate both large and small developed and developing member states. Such a heterogeneous body, which fashions international trade policy largely by 'consensus', can be difficult to manage. Like all clubs, all members must abide by the rules, although some members can seek to change the rules once they have the necessary support. In joining the club, members must seek to ensure that the benefits of membership outweigh the costs. For small, poor countries, these concerns are critical to their development, as the costs of WTO membership are high and the benefits are somewhat tenuous. Although the benefits of trade would not change their size of country (as measured by population) it can transform a poor country into a non-poor country. As M&S correctly point out the costs of meeting the obligations of WTO membership are significant for small, poor countries (e.g., TRIPs, customs valuation); hence, the call for special and differential treatment by small poor and non-poor member states. Although it can be argued that joining the WTO is a 'fait accompli', for small states operating in the new global trading environment, they need to establish bases of power and influence within the WTO in order to realise significant development benefits. The issue therefore becomes a game-theoretic one, as coalitions of countries with common interests are formed. Such a coalition among small states (poor and non-poor) has been pushing for special and differential treatment in the context of trade-promoting development.

M&S acknowledge that, while small, poor countries account for an extremely small percentage of world trade, there are some benefits to be gained from the new trading order. However, these countries have to manoeuvre around the legal and economic difficulties posed by the new trading requirements as envisaged in the Doha round. While countries have their own specific needs and requirements, M&S have identified five possibilities for accommodating small poor country interests within the Doha round, which is perceived to have a developmental focus.

They conclude that 'desirable outcomes are infeasible and feasible areas are less desirable' on the part of small poor countries. They argue that the 'first best' scenario for small poor countries is: financial and technical assistance and non-preferential access options with a movement towards greater liberalisation. This is akin to the standard policy measure emerging from welfare economics. They however recognise that in an imperfect world where political negotiations are critical, a game theoretic approach to multilateral trade negotiations is needed. A feasible outcome for small poor countries would therefore involve further preferential access and relief from costly obligations. While M&S seek to categorize the five options into 'first best' and 'second best', the reality of the political economy of international trading negotiations can see alternative groupings. For example, several small poor (and non-poor) countries would need technical and financial assistance to restructure their economies and relief from costly obligations primarily because they are poor and do not have the necessary resources. In many respects, the small markets of these countries are not attractive enough to

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be a bother to major players in the trading system. As pointed out earlier, these countries are peripheral to the system, hence granting special privileges (if agreed by all members of the club) would not create any significant economic dislocation.

Business cost in small remote economies

Winters and Martins (W&M) have undertaken the Herculean task of establishing the transactions cost of doing business with small remote economies. Although it has been long recognised that these costs are high, little empirical work has been available to verify the claim. Given the nature of the data available on these cost elements, W&M have engaged in 'statistical gymnastics' to show that, while small countries may have a comparative advantage in certain commodities, 'the combination of diseconomies of small scale and high costs of transactions with the rest of the world prevent small remote countries from generating competitive exports or attracting significant amount of foreign investment'. Using cost data from a number of countries for mid-2002, W&M regressed various components of costs on a number of variables reflecting size, remoteness and level of development. They found evidence to support the view that being small and remote increases the costs of transacting. These costs relate to air and sea freight, labour and utilities. The cost disadvantages are very high for very small and micro economies.

While W&M are very creative in dealing with the data and econometric issues, their general results are reinforced if we add the costs of delays and general tardiness of the transaction process. In addition, the small volume of business emerging from small countries further raises the costs of transacting. As in M&S, geography does matter for small economies as the distance variable is positive and highly significant in the air and sea freight costs regression equations. It would have been useful to add a regional dummy variable to determine if the distance factor was more prominent in the Pacific compared with the Caribbean. The quality of the facilities in small economies also influences the costs of transacting. For example, inadequate port facilities or the shortage of skilled manpower can raise the transactions costs for small economies.

As in the article by M&S, the options for small remote countries are limited. W&M note that tourism development and information technology services development are possible. Small remote countries would however need external financial and technical assistance to help develop these areas. It is imperative that these small countries promote such activities in order to avoid the growth of illegal activities taking root in these countries. It is clear that small countries would need to adopt a gradualistic approach to liberalisation, given the high costs of adjustment. In addition, some form of strategic alliance would be needed. The ability to use the mode 4 component of the GATS can assist small countries through remittances and skills transfer.

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Conclusion

The articles by M&S and W&M highlight the main challenges faced by small, remote and poor countries operating in the new global trading environment. There is a sense of pessimism emerging from both articles, which can result in these countries remaining on the periphery of international economic activity. It is therefore imperative that the economic and political managers and leaders of these small economies take stock of their situation and develop measures to adequately face the realities of the new global environment. This would require 'strategic development planning'. Some of the elements of the planning framework are identified in both articles.

Small counties would need to identify economic activities which can maximize economic welfare. In some small countries, tourism, information services and cultural services have been identified as key economic sectors of the future, given the problems with agriculture and, to a lesser extent, manufacturing. These countries also need to forge strategic alliances with other small and large countries in order to fully exploit the new trading arrangement. These alliances can be in the form of economic integration, joint private sector investment ventures or international associations (see Downes, 2001). These alliances can also help small economies to pool resources and coordinate activities to achieve gains from international trade. For example, the countries in the Caribbean have established a Regional Negotiating Machinery in order to negotiate on behalf of all members. This collective approach to negotiating trade policy measures enhances bargaining power. Given the small claims which small, poor and remote countries make on the international system, they can lobby the international institutions to provide financial and technical assistance to help with their special development problems: viability, vulnerability, volatility and sustainability. These countries need to develop their physical infrastructure and human resources (skills and attitudes) in order to meet the demands of the new world order. The granting of 'special and differential treatment' in the WTO and FTAA should give small countries the breathing space to allow them to restructure their economies. For example, such treatment can be linked to a strategic development planning process as mooted in the FTAA negotiations. The articles in the issue provide the empirical data and the analytical framework for small economies to start the process of examining feasible and sustainable development options to cope with the new global environment.

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