

**Special  
Characteristics  
and Development  
Challenges of  
Small States**

# Integrating Small States in a Fast-Changing Global Economy<sup>1</sup>

---

Shahid Javed Burki

Let me spend a few minutes on providing the audience with some information on the reasons that led to the establishment of a joint World Bank/Commonwealth Task Force on Small States. I will then provide a brief overview of the work that has already been done by the Task Force. I will also set out what I think has emerged from the papers prepared, and will pose a few questions for us to keep in mind during this meeting in St. Lucia.

## The establishment of the Task Force

The Commonwealth's interest in helping with the development of small states goes back a long time. The Commonwealth Secretariat has done some pioneering work in understanding the economic and social characteristics which distinguish small states. We at the World Bank have also been concerned with the development problems of small states. In the late 1970s, for instance, the Bank proposed a small state bias in allocating International Development Association (IDA) resources – a proposal that was accepted by the IDA deputies in negotiating the fifth replenishment.

It is not surprising, therefore, that when a delegation headed by Prime Minister Owen Arthur visited the World Bank on 10 July last year, his proposal for establishing a joint World Bank/Commonwealth Secretariat Task Force on Small States was quickly accepted by our president, James Wolfensohn. Prime Minister Arthur spoke in particular about three problems faced by small states: (i) economic vulnerability; (ii) a sharp decline in official development assistance; and (iii) increasing pressures as a result of the rapidly evolving global trading system under the aegis of the World Trade Organisation (WTO).

## The progress made by the Task Force

The Task Force met for the first time in Washington in October 1998 under the joint chairmanship of Sir Humphrey Maud and myself. At this meeting, we decided to organise an advisory group drawn from people

---

<sup>1</sup>This paper was presented as opening remarks at the Commonwealth Secretariat/World Bank Joint Task Force on Small States conference held in St. Lucia in February 1999.

who have special expertise in small states, as well as international institutions to which the small states must look for help. It was also decided to commission a series of papers that would assist in the work of the Task Force. The terms of reference of these papers were discussed at the second meeting of the Task Force held in London in December 1998. Following the London Meeting, I visited Geneva to discuss the work of the Task Force with senior officials from WTO and UNCTAD.

Following the St. Lucia deliberations, it is our intention to write a short paper, which will be presented to the Development Committee at its April meeting. Further discussions will be held during the summer with a number of international institutions before this report is finalised for submission to the Commonwealth ministers and to the Development Committee in the autumn.

## The emerging theme

The background papers prepared for this conference serve as a useful background for our deliberations. I identified at least eight conclusions or threads:

- ◆ The economic work done by the World Bank staff suggests that small states have a higher per capita income and higher volatility of income than large states. This does not suggest that small size does not pose a disadvantage. Small size implies high per capita costs of providing public goods and limits the possibility of exploiting economies of scale within the domestic economy. This disadvantage has been compensated by the advantages of greater trade openness in small states.
- ◆ The paper by the Commonwealth Secretariat suggests that the advantages from trade enjoyed by small states may have resulted in part from the preferential access given to them under various arrangements. There is a problem, however. The evolving trading system threatens to erode the preferences that have worked in favour of small states. These states are now vulnerable to the adverse consequences of trade opening as this new trading system evolves.
- ◆ The paper on vulnerability establishes convincingly that in looking at small states we have to look beyond conventional indices of development such as GNP/GDP measurements. A vulnerability index of this type developed in the paper should guide the international community in two ways: GNP-based thresholds need to be reinforced by a vulnerability index to establish access to official finance by small states. And, in applying trading rules, the international community must take cognizance of the vulnerability of small states.

- ◆ A theme that runs through most of the papers prepared for this conference, sometimes explicitly and at other times implicitly, is that developing countries, including small states, must take full advantage of the rapid globalisation of trade and finance. They cannot opt out of the system nor expect long-term preferential support from the industrial world. However, as the current debate on the banana regime demonstrates, it would be both imprudent and irresponsible to force adjustments on small states without recognising that there are larger costs associated with making this transition. One of the unexplored areas from the perspective of small states is the cost of transition – how long it should last and how it should be met. I hope that this conference will help us to find some answers to these important questions.
- ◆ An example of the globalisation of finance and of how small states would benefit from it is provided in the World Bank paper on disaster insurance. It suggests that rapid developments in global finance have made it possible to think in terms of developing new instruments that would bring together the public and private sectors to cope with natural disasters, to which small states are especially vulnerable. The purpose of this financial instrument engineering is to spread risks, reduce the volatility in risk premiums and improve disaster management. The World Bank is working on identifying its role in this important area.
- ◆ I hope that one product of the work done by the Task Force will be to challenge other international institutions of great consequence for the small states to develop responses similar to those being worked upon in the World Bank. These responses should not only address the problem of transition to which I have already referred. They should also take cognizance of the special circumstances of small states.
- ◆ It would be helpful to recognise that ultimately it is the strength of domestic policies that counts in promoting development. This is the main conclusion of another World Bank paper. While the paper recognises that, for a variety of reasons, foreign aid does not reward those who have followed good policies, I would like to suggest that the future may well be different. There has been a precipitous decline in the level of aid in recent years. On average, 21 OECD (Organisation of Economic Co-operation and Development) countries devoted 0.22 per cent of their GNP to development assistance in 1997, down from 0.25 per cent a year earlier. Total overseas aid dropped from \$55 billion in 1996 to \$48 billion in 1997. Aid from the G-7 group of big, rich countries has dropped by almost 30 per cent in real terms since 1992. The USA now donates less than 0.1 per cent of its GNP. Small states must therefore rely increasingly on a combination of their savings and

private external flows – foreign savings – to finance development. How this could be done in a credible way is suggested in the country studies prepared for the Task Force on Cyprus and Mauritius.

- ◆ Although official development assistance is likely to be less of a factor in financing development in developing countries, one of the World Bank papers suggests that IDA flows can influence perceptions of risk on the part of the sources of private external flows. Official development flows, good domestic policies and flow of foreign savings are the elements of a virtuous cycle that we should set in motion in the small states. How this could be done is our other question, and one that I would like to pose to the participants in this conference.

## Conclusion

I do not know how much agreement we will be able to find on these eight threads. I have simply presented them this morning to provoke discussion.

Furthermore, as I stated earlier, states have to stay fully involved in the process of globalisation and become full partners in the global financial and trading system. At the same time, however, there will be a period of time during which this transition will take place. This transition period will require the adoption of prudent policies. It will also need support from the international community. This task will have to be done on a case-by-case basis and on a country-by-country basis. How long this period of transition should last, what kind of policies should be adopted by countries making the transition, how the effort to change can be supported by the international community – these are some of the questions we should ask ourselves during our deliberations.

An example of the approach to the problem of transition is the Bank's very flexible approach towards graduation – graduation from both IDA and IBRD (International Bank for Reconstruction and Development). As a result of these discussions and the work of the Task Force, I hope we can persuade other organisations to be equally flexible in the application of their policies.

There is a great deal of ground to be covered today and tomorrow. But, with common understanding and goodwill, we can cover the ground quickly without stumbling. It is in this spirit that my colleagues from the World Bank and I are participating in this discussion.