Globalisation and Small Developing Economies: Challenges and Opportunities[1]

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Opportunities from globalisation

Globalisation is a multi-dimensional process, which is transforming at a rapid rate and in a profound way all aspects of national and global activities and interactions. Inherent in this process of restructuring the global economy, and concomitantly national economies, is the decline or demise of some industries and products and the simultaneous creation of opportunities for new products and services. These changes are being driven by rapid technological change and innovation, and are being facilitated by corporate integration through mergers and strategic alliances. The elimination and reduction of national barriers to the global movement of goods, services, capital, technology and certain types of labour is an integral part of globalisation. As a seamless global economy emerges, it establishes the dominance of the global market. The existence of a global market provides a highly intensive level of competition requiring continuous innovation and improvements in efficiency to supply both new and existing products and services. This process of globalisation is continually creating opportunities for exports which are globally competitive in cost and quality. Small developing countries can take advantage of many of these opportunities; however, their size and level of development pose challenges to taking advantage of these opportunities.

The restructuring of developed economies and profound technological changes in telecommunications and information technology provide significant new opportunities for small, developing countries. Tourism and services, including financial services, are among the most rapidly growing sectors of the world economy and have become important growth sectors in many small developing countries. The high cost of health care in developed countries and the aging of their populations open up possibilities in offshore health care, health tourism and retirement communities. These developments will occur rapidly as the health care industry experiences

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the merger and consolidation of health care providers in developed countries as a prelude to the globalisation of this sector. Given cost differentials, a significant part of health care will shift from developed countries to overseas facilities in developing countries, particularly those in close proximity to developed countries. Small, developing countries with modern telecommunications and educated populations are well placed to capitalise on the enormous growth of informatics and entertainment. There will also be opportunities for manufacturing in brand name special products, for example Jamaica Blue Mountain coffee, individualised products and small high-value aspects of international production processes. Production for niche markets which may be too small to interest large corporations is a possibility, especially if these products are maintained by innovation or a well-established reputation.

Commonwealth Secretariat/World Bank Report

The Interim Report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States is titled *Small States: Meeting the Challenges in the Global Economy*. The report correctly points out that globalisation brings opportunities as well as threats, and that part of the development challenge is to exploit these opportunities successfully. This raises two questions. Firstly, what should small, developing economies do to achieve survival, growth and development? Secondly, what, if anything, should be done at the multilateral level to complement, facilitate and support the efforts of small developing economies?

Unfortunately, the report provides very little guidance on these questions because it emphasises the platitudes of conventional economic policy despite recognising that small developing countries have distinctive characteristics. The conviction that conventional policy prescription, if properly implemented, will be adequate to secure the economic future of small developing economies precludes the need for action at the multilateral level. Hence the report is bereft of useful suggestions about actions to be taken at the multilateral level. Symptomatic of these deficiencies is the emphasis on the conclusion that, generally, good domestic policies are as essential to successful development in small states as elsewhere. Without good policies, external support will not be effective. While this is true, this proposition neglects the fact that the converse is equally important, that good policies and external assistance are both indeed necessary but not sufficient conditions. Sound domestic development policies can only come to fruition in small, highly open economies if they are complemented by a conducive external environment. For example, export diversification and promotion are effective if complemented by access to external markets; for example, CBI apparel exports critically depend on

access to the US market. Hence, national economic policies and a complementary external environment are two interrelated determinants of a successful response by small developing economies to the challenges and opportunities of globalisation.

Difficulties in responding to globalisation

The opportunities provided by globalisation can only be realised if countries pursue appropriate internal economic policies. The specific package of policy measures must be designed bearing in mind the specifics of each economy. In the case of small developing countries there are challenging obstacles and rigidities, which are peculiar to this type of economy. Among the most important difficulties are the structure and operation of markets and the small size of economic entities.

Structure and operation of small markets

The small size of markets in small developing economies results in market structures which are characterised by substantial imperfections. These derive from the limited number of participants; in many cases there are monopolies and oligopolies. Even where there are a large number of producers or traders, one or a few firms effectively dominate the operation of markets both in the financial as well as the real sector. This type of market situation has several implications.

Resource use, allocation and mobilisation

The narrowness of the market, i.e. the limited number of participants and/or the dominance of one institution, reduces the efficiency with which resources are allocated and leads to distortions in resource use.

The lack of market-driven competition leads to inefficiency and higher costs, as firms are not driven by the dynamics of competition to optimise efficiency and introduce new technology and improved production systems. A firm's international competitiveness depends on its capacity to continually innovate in production techniques and products. The national market conditions in which the company operates are a significant variable in its drive to develop its competitive advantages.

The small size and skewed structure of the market inhibits the ability of small developing economies to garner resources from external sources, in particular private foreign investment. Investors are often unaware of or do not find small developing economies worthwhile as investment locations because of the limited size of the national market. Even investment for export tends to be biased in favour of larger economies, even if they are low income and less developed.

The high import content of production and consumption, the undiversified economic structure and the lack of competitive markets in small economies mean that there are rigidities in resource allocation. This makes the adjustment process more difficult, and of necessity slower than the adjustment process in larger more developed economies.

Lack of global competitiveness

Production costs in small developing countries tend to be higher for many economic activities than those prevailing in the global marketplace. This lack of global competitiveness increases import demand and reduces exports.

Small economies have severe constraints on the amount and variety of the factors of production because of their limited land area, GDP and size of population. These constraints limit the achievement of economies of scale for a wide range of products and lead to high unit costs of production. Small economies tend to have a narrower range of domestic and export production because of the small size of the market and the limited range of resources. Small market size also tends to cause high costs because there is often a lack of competition. In fact, in many instances, the market can only support a single producer, i.e. a monopoly.

Small economies pay higher transportation costs because of the relatively small volume of cargo, small cargo units and the need for bulk breaking. In fact, small economies spend more on transportation and freight costs as a percentage of exports than large countries. The figure for Brazil, Canada and the USA averages less than 4 per cent, whereas it is over 30 per cent for Antigua, Barbados, St. Kitts-Nevis and the Bahamas. Caribbean countries pay far more for transportation for their imports than the world average of 5.4 per cent – in Suriname as much as 18.5 per cent. Among the contributing factors are the small size of vessels, small scale of cargoes and the lack of equivalent return cargo.

The efficient operation of firms is also constrained by the high cost of infrastructure that is related to indivisibilities of public administration structures and functions which every country, no matter how small, has to provide. The cost of physical infrastructure tends to be high in small developing countries, imposing additional constraints on efficient production and distribution.

Small size of firms

It is firms, not countries, that conduct international economic transactions. Nationally owned firms from small countries are small both by global standards and in comparison with firms in large economies and

multinational corporations owned by or based in large countries. Except for a few sectors where economies of scale are not a significant factor, size makes a significant difference in a firm's ability to survive and compete in the global marketplace. Small firms are at a disadvantage because they cannot realise economies of scale, are not attractive business partners, and cannot spend significant funds on marketing, market intelligence, and research and development near par. In fact, Wal-Mart, the largest employer in the USA, has a staff complement of 675,000 compared to the Caribbean's top employer, Lascelles Demercado of Jamaica, which employs 6,800 staff. Total sales at the largest US corporation, General Motors, are 328 times those of Neal & Massey of Trinidad and Tobago, its Caribbean counterpart.

Trade theory as explained in textbooks assumes that international trade takes place between countries in an environment of perfect competition, and that trade occurs because of differences in comparative advantage which in turn derive from differences in resource endowment or technology. In this model all firms are price-takers, where each firm is too small to influence price in the world market and international trade occurs because of differences between countries, but the size of a country does not matter. However, when taking into account economies of scale, the size of a country and the size of a firm become important considerations. Very large firms, such as multinational corporations (MNCs), operate internationally in ways very different from small firms. Most of the trade of MNCs is intra-firm trade, rather than the traditional arms-length international trade conducted by smaller firms. It is estimated that intra-firm trade accounts for 50 per cent of the trade of the USA and is also significant in developing countries. The small size of firms in small developing economies has several implications, including:

- **Economies of scale and scope**
  Small firms in small economies, especially in small developing economies, are at a major disadvantage compared to large firms. Small firms can attain neither internal economies of scale (where unit cost is influenced by the size of firm) nor external economies of scale (where unit cost depends on the size of the industry, but not necessarily on the size of any one firm). Small firms in small developing countries have severe difficulties in attaining economies of scope, i.e. economies obtained by a firm using its existing resources, skills and technologies to create new products and/or services for export. Exposure to global competition requires small firms to invest heavily just to survive in their national market and more so in order to export. Larger firms are better able to generate new products and sources from existing organisation and networks.

- **Retarded market-driven competitiveness**
  Small developing economies and their small markets are unlikely to foster the competitive dynamic necessary for firms (including export sectors) to achieve competitive global competitiveness. The attainment of competitive advantage is more likely to occur when the economy is large enough to sustain clusters of industries connected through vertical and horizontal relationships and where there is a network of related and supporting industries. A firm working together with world-class local suppliers can benefit from cross-fertilization opportunities. Related industries can also be an important source of innovations and provide strategic alliances and joint ventures.

Constricted economic management

A limited national market and the small size of economic entities have adverse implications for stabilisation, adjustment and transformation because these structural features reduce the efficacy of conventional policy measures and narrow the range of policy options.

Stabilisation policy must be designed specifically for small developing countries taking cognizance of the structure of markets and the nature of their operations. The uncompetitive nature of these markets, particularly where monopolies and oligopolies exist, and the limited number and type of institutions, make resource utilisation and allocation more problematic than in large developed economies. These types of market situations are characterised by rigidities, which make the adjustment process more time-consuming and which diminish the efficacy of conventional policy measures such as open market operations and recalibration of economy-wide prices such as the exchange rate. Furthermore, structural adjustment, like stabilisation, is a more difficult process in small developing economies because the inherent rigidities in the structure and operation of markets complicate the process of resource reallocation. The nature of these small markets also restricts the ability of private sector entities and the government to mobilise additional resources, both within these economies and from external sources.

Small developing economies have structural features that need to be changed if they are to cope with the rapid and profound changes associated with globalisation. Adjustment will not suffice to enable these economies to cope with changes in the global economy, since adjustment implies marginal and incremental modification to an economic structure which is fundamentally sound and conducive to sustainable economic growth. Economic transformation goes beyond the resource utilisation, reallocation and mobilisation intrinsic in stabilisation and structural

adjustment to incorporate resource creation over the medium to long term. Transformation in the current and future global economy will entail the ability of small developing economies to facilitate the rapid and frictionless international mobility of goods, services, finance, capital and technology which is the essence of a seamless global economy.

The challenge in this context is how to formulate and implement economic policy that permits small developing countries to respond to globalisation in a way that ensures sustainable economic development.

National policy response – strategic global repositioning

The changes involved in globalisation are so profound that the implications for small developing countries cannot be addressed only by having sound conventional economic policy. While this is necessary, the response is a developmental issue rather than an issue of economic management. An appropriate response by small developing economies to globalisation is a development strategy that is best described as strategic global repositioning (SGR). Strategic global repositioning is a process of repositioning a country in the global economy and world affairs by implementing a strategic medium- to long-term plan formulated from continuous dialogue between the public sector, private sector, academic community and the social sector. It involves proactive structural and institutional transformation (not adjustment) focused on improvement and diversification of exports and international economic and political relations. Achieving SGR therefore requires changes in both internal and external relations. The external relations are of paramount importance because of the highly open and vulnerable nature of these small developing economies.

Strategic global repositioning begins with a change of mind, outlook and attitude. The prerequisite for such change is a recognition of the need for new ideas and a willingness to abandon the traditional mindset. This will be incumbent on governments as well as the business sector. An integral part of strategic global repositioning will be export diversification encompassing the development of new exports, for example informatics, as well as improving competitiveness and productivity in existing export sectors. Some foreign exchange earning sectors, such as tourism, will have to undertake a continual process of adjusting their product mix to shifting demands, for example increased travel by older and retired people. Traditional export commodities may not be viable and face the choice of being phased out or used as inputs in higher valued added goods such as rum. The experience of Antigua's transition from an economy based on sugar to one in which tourism is the core activity is encouraging. This is

a very real prospect for economies heavily dependent on the export of bananas, such as St. Lucia, St. Vincent and Dominica.

The only certainty in tomorrow's global economy is change, and change at an exponential rate, which makes speedy decision-making and implementation an essential aspect of life in the future. The ability to discern changes, to adopt and adapt to new technology, and to reorganise rapidly will ultimately determine the capacity to respond. Firms, governments and individuals must get accustomed to a lack of permanence and recognise that this presents challenges and opportunities. The countries that achieve economic development practice 'proactive adjustment' by adjusting rapidly in anticipation of global changes in demand and technology. Defensive and reactive adjustment, which aims to preserve industries or to retain aspects of production which are uncompetitive, is self-defeating. In the short run, reactive adjustment reduces competitiveness of exports and increase prices of domestic goods. In the long run, entrepreneurs will find ways to import cheaper alternatives and will relocate inefficient production to other countries in order to retain international competitiveness.

Today, there is only one market, the global market, from which no country is isolated. Since all firms in small economies are small by global standards, their survival even in national markets will increasingly depend on strategic corporate alliances and 'constellations'. Companies have to be flexible, responsive, competitive, innovative, efficient and customer focused. The traditional hierarchical and pyramid-shaped organisation of corporations is too cumbersome and slow to respond effectively. This has prompted a process of 're-engineering', which entails the fundamental rethinking and radical design of business processes to achieve dramatic improvements in critical, contemporary measures of performance, such as cost, quality, service and speed. The fragmentation of transnational production processes into separate stages being undertaken in different countries and strategic corporate alliances have made it possible for networks of small firms to overcome the limitations of size and compete effectively against large corporations. Small firms can ensure their survival and profitability in the global economy by: (a) specialising in a single aspect of production or distribution; (b) capitalising on specific market niches where economies of scale are not a determinant of competitiveness; (c) flexible manufacturing specialisation; (d) concentrating on the economies of speed, which are now more important than the economies of scale; and (e) initiating strategic corporate alliances which make it possible for networks of small firms to overcome the limitations of size.

Increasingly, the world economy will be dominated by knowledge-based industries, especially services, making the quality of human capital a

critical factor. The productivity of labour (workers and managers) will have to be upgraded, and this means improvement in the quantity and quality of education. The importance of this is illustrated by the experience of the East Asian countries, where the expansion and transformation of education and training during the last three decades has been a key factor in their economic growth. Making the workforce more knowledgeable and productive involves better education both within the individual enterprise and in the society as a whole. Firms need to put more emphasis on vocational training and on-the-job education. The new technology of learning can help, for example multimedia training enables workers to learn faster and in more detail, particularly those workers who are functionally illiterate. In many developing countries, much of their human capital resides outside their borders. Every effort must be made to repatriate skilled nationals, as this is the quickest way to improve the quality of the workforce. Incentives and special programmes must be established to induce overseas nationals with professional skills to return home.

Globalisation involves continuous innovation and technological change. Firms in small developing countries cannot afford the enormous costs of research and development but they can realise opportunities in the global marketplace by the transfer and adaptation of knowledge. The capacity for absorption of knowledge and new technology requires the development of an appropriate national educational institutional infrastructure. Education will have to become the priority of governments, with an emphasis on increasing the scientific and technological component of education and the devotion of more resources to secondary and university level training. Much of the university level education will have to be undertaken overseas; the substantial cost involved, particularly for study at institutions in developed countries, is a significant impediment to the efforts of small developing countries to expand institutional capacity and research.

Multilateral policy response – special and differential treatment

The global economic environment must be complementary to the internal economic policies of small developing economies in order to ensure their growth, development and resilience. An integral part of the global economic situation will be the principles on which multilateral, regional and bilateral trade agreements are based. The appropriate principle is that of special and differential treatment which was widely recognised when the General Agreement on Tariffs and Trade (GATT) was established. This took the form of preferential access to developed country markets

through tariff preferences and exemptions from GATT rules. In 1965, the special status of developing countries in the multilateral trading system was established with the adoption of a new Part IV of the GATT, which embodied what was termed 'special and differential treatment'. Subsequently, the principle of special and differential treatment in the form of long-term, or transitional, non-reciprocity was embodied in several integration arrangements in the Western hemisphere. It is included in the Lomé Convention Caribbean Basin Initiative, CARIBCAN, the Andean Trade Preferences Act, the CARICOM, CARICOM–Venezuela Agreement and CARICOM–Columbia Agreement.

The design of measures to address the concerns and interests of small developing economies should not be limited to measures which avoid putting small economies at a disadvantage, but should be proactive in promoting the growth and development of smaller economies. For example, Article IV of the General Agreement on Trade in Services (GATS) specifies measures aimed at increasing the participation of developing countries in the global trade in services through specific commitments in relation to strengthening their domestic services and their efficiency, capacity and competitiveness. It also requires developed member countries to facilitate the access of developing country service suppliers to information related to market access.

Special and differential treatment of small developing economies includes:

- **Appropriate obligations**
  Smaller economies should be allowed to undertake commitments to the extent consistent with their adjustment capacity, development, financial and trade needs, and their administrative and institutional capabilities for implementation. These concessions should be negotiated on an issue-by-issue basis and, where appropriate, on a product-by-product basis. Small developing economies should also be permitted some exemptions. This would not only address the question of disparities, but also avoid situations where small, developing economies, despite their best efforts, are not able to meet certain requirements and timetables. For example if, as is likely, export subsidies are outlawed, smaller economies should be exempted from this requirement. Where complete exemptions are not feasible, *de minimus* provisions would be helpful.

- **Asymmetrically phased implementation timetables**
  Given the small size of firms in smaller economies, and the small scale of production and limited size of the market, export sectors will require a longer period of adjustment than larger firms and larger, more developed, economies. Hence, there must be asymmetrically phased

implementation of rules and disciplines, permitting a longer adjustment period for smaller economies. For example in agricultural trade, and in particular in food items, smaller economies should be allowed the flexibility to implement their commitments to reducing protection and domestic support over a longer period than the implementation period prescribed for larger economies.

Both larger and smaller economies should commit to best endeavors in implementation of special and differential treatment. Larger economies should, whenever possible, provide measures and accept timetables which provide easement to smaller economies. For example, careful regard should be given by developed countries to the peculiar situation of smaller economies when considering the imposition of anti-dumping duties. Larger, more developed economies should be required to explore the possibility of constructive remedies before imposing duties where these would affect the essential interests of smaller economies. Where flexibility is provided, there should be some criteria to assess the extent to which smaller economies are making adequate efforts. For example, when smaller economies have achieved 'export competitiveness' in a given product they should be expected to phase out concessions over an extended period.

◆ **Balance of payments adjustment mechanisms**

Small economies are highly open economies and are therefore more susceptible to balance of payments problems. This is particularly the case for small developing countries where balance of payments deficits tend to be persistent because of their structural origins. Trade agreements should include balance of payment provisions such as those provided in Articles XII and XIII of the GATT. While all members may avail themselves of the right to resort to these provisions under the circumstances prescribed, small developing economies, because of their vulnerability to balance of payments problems, should be permitted additional facilities to enable them to maintain sufficient flexibility in their tariff structure and schedule of liberalisation to permit the establishment, stabilisation or rehabilitation of a particular industry, and to apply quantitative restrictions for balance of payments purposes which take full account of the high inelasticity of demand for imports and import surges.

◆ **Technical assistance for capacity-building**

Small developing countries will have to improve their capacity to mediate the encounter with the global marketplace. Technical assistance for capacity-building should aim to:

- contribute to efforts by small economies to undertake structural, institutional and legislative adjustment;
- promote the development of adequate institutional capacity, including training, to improve their handling of negotiations and implementation of international trade agreements;
- assist small economies in fulfilling their obligations under the various international agreements, in particular, commitments under the WTO;
- ensure that small developing countries can overcome: (a) their limited capability to make use of the dispute settlement mechanism because of their inadequate expertise and institutional capacity to implement panel findings; and (b) the high cost and administrative difficulties of using the mechanism.

Financing

Strategic global repositioning, like structural adjustment, requires financing from both public and private sector sources. While facing the difficulties of lack of visibility and small market size, private sector investment needs can be met in part from inflows of private foreign investment. This is a realistic possibility given the enormous financial resources available in global capital markets, but it requires macroeconomic policies that provide stability and a business environment conducive to investment. Mobilising private capital is constrained by the fact that even with impeccable policies, small developing countries are perceived by private investors as more risky than large developing countries. Governments will have to upgrade and expand infrastructure and institutional capacity in a manner, and at a pace, which complements and supports private sector activity. Public sector investment on a scale necessary for successful strategic global repositioning may be beyond the capacity of governments to garner sufficient resources through local borrowing and taxation. Raising additional funds from external sources will be critical, particularly development financing. However, the financing needed for strategic global repositioning cannot be adequately met either by project-oriented bilateral development assistance or by structural adjustment lending by multilateral financial institutions, as neither is designed for this purpose. A new kind of long-term development financing facility should be explored to facilitate programmes of strategic global repositioning in small developing economies.

Multilateral financial institutions and bilateral development assistance agencies have focused almost exclusively on per capita income as a

criterion for classifying developing countries. This has resulted in the graduation from concessionary lending of many small developing countries. This is unfortunate since concessionary resources can increase public sector investment, help in attracting foreign direct investment and speed up the reallocation of resources. Lending criteria must be extended to include vulnerability and the constrained adjustment capacity which are characteristic of small developing economies, enabling them to become eligible for concessionary funds.

Concluding remarks

The Commonwealth Secretariat/World Bank Report does not adequately address the issue of how small developing countries can cope with globalisation in a way which facilitates reduced vulnerability, structural transformation and sustained economic development. The report advocates sound economic policies as the basis for an effective response to globalisation. However, internal economic management and reform is a necessary, but not sufficient, condition; it must be a part of a broader development strategy of strategic global repositioning. An integral aspect of this process is increased investment in infrastructure, productive capacity, institutional reform and education. Private investment, both national and foreign, must be supported by public sector investment. A substantial increase in the short run will require an infusion of resources from external sources. Strategic global repositioning must be complemented by action at the multilateral level, which must include special and differential treatment. Strategic global repositioning and special and differential treatment are complementary and integral aspects of a strategy to promote a successful response by small developing countries to the profound changes inherent in globalisation.