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The Constraints Faced by Small States: A Review

To set the context for the analysis presented in this study, we begin by presenting a review of the literature on small states in the global trading system, drawing out why trade negotiations are so important to small states and how the well-known economic and political structural constraints that they face in the international system define the framework within which small states must manoeuvre.

(a) Smallness, vulnerability and trade

A wide-ranging literature details the unique set of economic incentives and constraints faced by small states, as well as a series of development challenges that combine to influence their interests in trade negotiations. These can be summarised under the following four headings:

Trade dependence: The small size of the domestic economy and limited options for production diversification within their economies leads most small states to rely very heavily on trade and on highly concentrated export baskets.[5] This reliance on traded goods often leads to high levels of dependence on tariffs as a source of government revenue. At least five of the nine Organisation of Eastern Caribbean States (OECS) members, for instance, depend on tariffs for over half of their government revenue.[6] Such dependence makes the outcomes of trade negotiations highly relevant to small states, and at the same time increases the economic and political sensitivity of adjusting to liberalisation.[7] Where tariff revenue is important, states are likely to act to safeguard these revenue sources during negotiations.

Cost disadvantages: To avoid continued marginalisation, small states recognise the need to diversify away from primary commodity dependence.[8] However, this can be a challenge as smaller and more remote countries often face higher costs of trading,[9] which can diminish or eliminate the potential gains from trade for small states. Winters and Martins (2004) argue, for instance, that '[t]here may be some very small economies that face such great absolute disadvantages that exporting at world prices is either impossible or generates factor incomes that are too low to subsist'.[10] In this situation, they argue that preferential market access is central to the economic survival of small states. Others, including Page and Kleen (2005), note that changes in global economic opportunities mean that higher production costs may not always be a significant factor. In the services sector, for instance, domestic production scale is less important and opportunities for diversification are different.[11] Many small states have moved to bolster their services sectors, and are now highly reliant on exports of services, particularly on the temporary movement of workers and the remittances they provide. In Tonga, for example, 41 per cent of GDP is derived from remittances.[12] In trade negotiations, small states have an interest both in preserving preferences and in increasing market access in new areas, such as through new commitments that would better facilitate the temporary movement of natural persons.

Vulnerability to policy decisions of major trading partners: High reliance on a small number of exports and relatively few markets renders small countries vulnerable to unilateral policies on the part of trading partners that adversely impact trade, including the use of export subsidies. In addition, they can also be vulnerable to changes in the trade policies of major trading partners. For instance, as many small states rely heavily on trading arrangements that provide them with preferential market access, changes to these schemes can be very disruptive to producers (Box 3).

Development challenges: While some small states, such as Mauritius and Barbados, have been relatively successful in boosting growth and reducing poverty, others, such as Tonga and Comoros, face significant development challenges and relatively high levels of poverty. These poorer small states have a range of weaknesses in their domestic economies and their firms are often uncompetitive. As a result, they express an interest in securing policy flexibility to support less competitive sectors and stimulate economic transformation, and acquiring financial assistance to address supply-side constraints.

The constraints highlighted in the existing literature are keenly felt by government officials and trade negotiators in small states. In interviews with 35 government officials from small states conducted for this study, negotiators detailed their main objectives in negotiations. Negotiators placed the greatest emphasis on protecting flexibility in their own national trade policies, expanding market access and maintaining trade preferences. Key secondary interests were receiving assistance to overcome supply-side constraints and improving their participation in international trade negotiations (Box 4).

(b) Smallness and trade negotiations

Although trade negotiations are particularly important to small states, their small size contributes to a series of barriers to participating and influencing the outcomes of negotiations. This structural constraint heavily circumscribes the space within which they must manoeuvre. The existing literature points to six possible reasons for this.

Resources: Institutional capacity in trade ministries is severely constrained in small economies. Small population size tends to reduce the scope for specialisation of expertise within governments and small countries generally have fewer people in every profession.[13] The scale of government budgets and the quantity of human resources are also a significant binding constraint across small states, especially for the very smallest countries, and arise across the full range of issues on which governments engage in international negotiations and have legal obligations that involve administrative action at the national level. Even those small states, like Barbados and Mauritius, which have

Box 3. Vulnerability to trade policies of major trading partners: Examples from case studies

For the cotton-producing countries of West Africa, subsidies in the USA, Europe and China have had an adverse effect on their economies. Cotton is the main employment source and exports for several West and Central African countries and contributes between 5 and 10 per cent of their national GDPs. Between 1997 and 2002, the world price of cotton halved, in part due to subsidies to cotton producers in powerful states. World Bank studies found that the full elimination of these cotton subsidies would raise the international price of cotton by 12.9 per cent, thus giving a boost to economic welfare of US$147 per year in sub-Saharan Africa.

Whereas the case of cotton highlights how some small states are vulnerable to adverse policies in more powerful countries, the cases of St Lucia and Mauritius illustrate how the welfare of small states can be vulnerable to changes in trade policies (in these cases, changes to unilateral trade preferences). St Lucia and Mauritius benefited for many years from favourable trade preferences on bananas, sugar and apparel. In each case, their export sectors proved vulnerable when the schemes were modified. Notably, the political dynamics of a 'pro-trade' fight against subsidies differ from those of the fight to retain the benefits of trade preferences, which has proven difficult in the context of a broader push for the liberalisation of trade, particularly in the WTO system.

Changes to the European system of banana preferences in 1992 were a major contributor to a precipitous decline in St Lucia's banana industry. Banana exports fell from a peak of 132,000 tonnes in 1992 to 30,000 tonnes in 2005. As banana farming was the main source of national employment, decline of the industry has led to significant social dislocation, as well as increased unemployment and crime. An estimated 29 per cent of St Lucia's population currently lives below the poverty line.

In Mauritius, manufacturing is the largest sector, accounting for 20.1 per cent of GDP, the bulk of which is in textiles and apparel. The termination of the WTO Multi-Fibre Arrangement in 2005 had a series of adverse economic impacts due to the preference erosion that resulted. This prompted the relocation of textile and apparel companies and a dramatic reduction in exports from 57 per cent of total goods exports in 2001 to 36 per cent in 2006. Employment fell from 77,000 in 2001 to 55,311 in 2007.

Sources: St Lucia: WTO (2007), *OECS Trade Policy Review*, WTO Document WT/TPR/S/190 and St Lucia country profile on www.fco.gov.uk. Benin: Anderson, K *et al.*, 2006. Mauritius: WTO (2008), *Mauritius Trade Policy Review*, WTO Document WT/TPR/S/198.

allocated resources in ways that provide excellent administrative capacity on trade, individual officials tend to be responsible for bigger portfolios than their counterparts in larger countries. These challenges are magnified by the fact that alongside the expanding

Box 4. Research findings: The interests of small states in trade negotiations

Policy flexibility: For 22 of the 35 negotiators and ambassadors interviewed, the need to retain policy flexibility was a priority, particularly to support weak domestic industries and to retain customs revenue.

Market access: For 15 respondents, increased market access was a clear priority, including for niche products and for services, particularly temporary movement of people.

Preservation of preferences: Eight respondents emphasised the need to preserve existing trade preferences

Aid for trade: There was also significant emphasis on aid for trade, with eight respondents seeking to use negotiations to increase such assistance to address supply-side constraints.

Participation: Finally, ten respondents described ‘participating’ in the global system as an important objective in its own right. Small states are often marginalised in decision-making and merely being present in the room ensures some degree of recognition of their interests. Others explained that participation enables small states to understand the negotiations and outcomes, which helps them to implement rules in their domestic economy in harmony with those agreed internationally, and to be aware of the flexibilities they can use.

Source: Interviews with trade negotiators, June–September 2008 (see Annex 4).

scope of World Trade Organization (WTO) negotiations, there has been a proliferation of bilateral and regional negotiations that demand additional institutional capacity.[14] Importantly, distinct from the issue of the quantity of resources is their quality. The quality of institutions and human resources varies among small states and is a factor that can be strongly influenced by government policies. Differences in the level of human development between states are also an important contributing factor; skilled officials can be more easily cultivated in small states with higher levels of health, education and overall wealth.

Economic size: Market size presents obvious political challenges for small states in trade negotiations, as it means they may have little to offer by way of market access concessions and thus have limited negotiating power and leverage.[15]

Power asymmetries: Powerful states have a series of tools that they can use in trade negotiations to persuade weaker states to adopt certain positions. These include threats of withdrawing preferential trade access; pressure on officials in national capitals; calling for the removal of unfavourable negotiators from influential positions; divide-and-rule tactics such as deploying middle-income countries to convince low-income countries to change their positions; and the use of technical assistance to pressure developing countries to sign agreements.[16] A number of studies observe that power asymmetries are often more pronounced in bilateral North-South negotiations than in the multilateral negotiations at the WTO, especially where smaller developing countries are also dependent on the more powerful state for aid.[17] The challenge of power asymmetries is particularly pronounced in the EU-ACP negotiations, where a complex web of structural, political, institutional and economic asymmetries severely constrains the negotiations.[18] In the multilateral context, power asymmetries at the WTO negotiating table are somewhat mitigated by the opportunities for small states to forge alliances with larger developing countries. By contrast, bilateral negotiations with the USA often isolate small states from possible alliances with larger allies.

Rules and procedures: It is widely argued that small states should favour and support multilateral trade negotiations, where more formal negotiating processes and the potential for collective action among weaker countries offer greater potential to mitigate and manage power asymmetries.[19] Davis (2003) notes that the consensus-based procedures of WTO decision-making formally empower all participants by giving them potential veto power, which allows even smaller states to exert more influence on agenda setting and negotiation outcomes.[20] However, powerful states still generally dominate agenda-setting and the conclusion of trade rounds.[21] The procedures and rules relating to WTO accession pose particular challenges for small states, which have to accept rules that others have negotiated and more recent entrants often find themselves worse off than countries that are already members.[22]

Enforcement capacity: The existence of a dispute settlement mechanism in the WTO is in principle a major benefit to small states as it provides an objective judicial mechanism that is ostensibly divorced from power politics. However, the use of the WTO's dispute settlement system has been dominated by a limited number of larger developing countries.[23] As of mid-2009, Antigua and Barbuda was the only small state to have been a complainant in a WTO dispute, and Trinidad and Tobago was the only small state to have been a respondent.[24] The most commonly cited constraints are the significant human and financial costs of mounting a case, and limited government and private sector capacity to identify violations of WTO rules and potential cases that could be pursued, as well as political fears of the repercussions of mounting cases against powerful trading partners. A further constraint is that small states may be unable to effectively enforce rulings that are in their favour, as Antigua and Barbuda discovered in its recent dispute with the USA over internet gambling.[25] However, it has also been observed that there is an additional, more central, explanation for the limited use of the dispute settlement system by many of the smaller developing countries, namely that the trade preferences of greatest importance to them are often provided outside the framework of the WTO and these cannot be enforced by its dispute settlement mechanism.[26] As a result, the smallest and least powerful players have much less security and predictability with respect to trade rules than other players in the trading system.[27]

Norms and ideas: The discourse and ideas surrounding trade negotiations are important factors in legitimating the importance of some issues and interests over others. Larger countries have tended to have more influence in this area, which then gives them additional leverage in negotiations.[28] Principles, norms and ideas can, however, also be a powerful source of leverage for small states in trade negotiations. The principle of 'special and differential treatment', for instance, has assisted some small states to articulate and advance their trade priorities. However, there is no accepted norm in international trade negotiations for differentiating countries on the basis of smallness or vulnerability.

The existing literature might lead one to the conclusion that small states face so many structural constraints that 'no amount of negotiating will make a difference'.[29] This study tests this view. The research undertaken seeks to develop and strengthen a much smaller body of scholarship which examines under what conditions weaker states may be able to enhance their influence. The work of Odell (2000; 2001; 2006) and Page (2005), for example, suggests that interactions during negotiations can shape the interests of all parties and how they exercise power. This suggests there may be opportunities, even for small states, to achieve gains.[30] Page shows that over time developing countries have become more active and influential participants in WTO negotiations and their negotiating positions have become better informed and more sophisticated. In the Doha Round, for instance, even the least active negotiators from among the least developed countries (LDCs) contributed positions and participated in coalition meetings, particularly of the Africa group and Least Developed Countries group.[31]

Understanding with better precision how and why small states are constrained, and how these states perceive the constraints within which they work, has an immediate relevance and importance to debates and policies about aid for trade. As part of the development concerns which rose to prominence in the Doha Development Agenda discussions, developed countries committed to greater provision of aid for trade. Of the US$25 billion contributed in 2007, US$685 million was allocated to support 'trade policy and regulation', which aims to improve the ability of developing countries to formulate trade policy, participate in negotiations and implement trade rules. The EU and the USA are the largest contributors of this form of support, committing 60 per cent of the funds, and the Africa region was the largest recipient, allocated a third of funding.[32]

Our examination of the kinds of assistance provided for trade policy and regulation suggests that donors place great emphasis on improving the technical capacity of smaller, weaker states. The assumption underpinning such efforts is that small states are mainly constrained by insufficient technical capacities and institutional weaknesses in areas such as trade policy formulation, trade negotiations and negotiating techniques; weak technical capacity of governments to design and implement trade rules and regulations, linked to a lack of expertise on trade policy; and weak mechanisms for consulting the private sector and civil society in trade negotiations.

The following chapters build on the existing scholarship by probing in greater depth the constraints that prevent small states from effectively 'manoeuvring at the margins' and maximising their influence in trade negotiations. In doing so, it marks the first attempt to systematically analyse the views of representatives from diverse small states on the constraints they face in negotiations. Having identified a series of constraints, the study reflects on the implications of these findings for capacity building initiatives.