



## **The World Today**

### **The International Economic Policy Challenges of Small Developing States**

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What is the single most critical characteristic of CARICOM member states, for the purposes of international economic policy? We are all small developing states, compelled to confront a number of interactive structural challenges that necessarily affect our potentials to formulate, choose and implement international economic policy effectively. Resource limitations can limit opportunities to achieve economies of scale, while high population densities increase the pressure on productive capacity, and threaten overuse of water supplies, agricultural land, and road transport systems, as well as air pollution.

Project and programme management skills relevant to transport and communications infrastructure are often insufficient, and government services tend to be provided at high unit costs. In turn, limited institutional capacities, and domestic markets that may be too small to provide significant economies of scale, can make export competitiveness a problem, worsened by high freight rates and shipping routes that are incompatible with trade potentials. For example, it can cost more to ship a 20 foot container from Belize to Trinidad or Grenada, than from Belize to Taiwan. Meanwhile, airline routes, costs and capacity can also contribute to the challenges to be considered – for instance, air travel between the relatively near islands of Trinidad and Martinique or Guadeloupe can consume many wearying hours.

Then again, high levels of migration, particularly among groups such as accountants, teachers, nurses and medical doctors, can both burden local training facilities, and force the import of expensive foreign expertise. The challenges of small developing states continue to multiply. For instance, partly because of relatively small size, and partly consequent upon their vulnerability to natural and environmental disasters – a vulnerability which is particularly widely appreciated just now, in the middle of the hurricane season – such countries are classified as high-risk, so that insurance and reinsurance can readily become exorbitantly expensive, with negative

consequences for investment, production costs, government revenues, and infrastructure.

The national incomes of some small developing countries are significantly augmented by migrant remittances, as in the case of Jamaica, where related inflows can be larger than those generated by tourism, the country's largest foreign exchange earner, but these revenue flows can be variable, as a result of factors such as recession in migrant host countries. Within developing countries in general, government revenues amounted to an average of only 27% of GDP in 2004, compared with 44% in advanced post-industrial countries, mainly as a result of relatively inefficient tax and customs systems, and larger informal economies. As a result, debt tends to be much more significant within developing than in OECD economies, in relation to tax revenues.

In addition, interest payments tend to be almost twice as high, as a share of GDP, and much more volatile, given the prevalence of short-term debt. One method of evaluating the sustainability of a developing country's public debt is the projected path of debt-GDP, if the government holds their primary budget balances (excluding interest payments) at existing levels. In fact, the current budget positions of most developing countries imply rising debt ratios. In proportion to the size of their economies, almost all of CARICOM's independent countries are among the 30 most heavily indebted developing countries in the world. Seven CARICOM member countries are in the top ten of the world's most debt-burdened states, with external public debt much larger than Gross Domestic Product.

Within the context of the macro-economic challenges briefly reviewed above, small developing state governments have been pressured to adopt what has been termed the "Washington Consensus." This neoconservative approach to economic policy projects economic growth driven by fiscal discipline, reoriented and limited public spending, tax reform, financial market liberalization, unified and competitive exchange rates, trade liberalization, openness to foreign direct investment, privatization, deregulation, and secure property rights. It views development as a result of market efficiency, with scant concern for market failures, and rejects the case for 'special and differential treatment' in international trade advocated by small developing states.

To be sure, the economic experience of Caribbean small developing states, during the past decade, has been that fiscal reform can create incentives for private sector activity, and that export diversification can help to reduce trade dependence, while economy-wide consensus on wage restraint can safeguard competitiveness. At the same time, high interest rates and unclear

exchange rate policies can inhibit investment and growth, weaken national fiscal positions, and undermine the health of the financial sector.

Let us focus for a moment upon investment policy. The potential benefits of investment liberalization include economic growth, technology transfer, employment creation, improved products and services, and enhanced managerial efficiency. But there is abundant evidence that investment liberalization may not lead to actual foreign investment. Further, when foreign direct investment is directed towards natural resource exploitation and capital intensive industries, such as oil and liquefied natural gas, there may be little opportunity for technology and skill transfer, and job creation for host country citizens, especially at senior management levels.

In addition, the bulk of direct foreign investment flows tends to be associated with cross-border mergers and acquisitions. Turning to portfolio investment, which are essentially speculative, and can be readily withdrawn, such inflows may be associated with interest and exchange rate instability, as in Mexico, Turkey and Thailand, during the 1990s. In fact, the benefits of foreign investment are sector-specific, and depend upon the commitment of the investor, together with related environmental, industrial relations, national security and financial factors.

Within CARICOM, foreign direct investment (FDI) is highly concentrated – Jamaica, together with Trinidad and Tobago, accounts for over 70% of FDI inflows into the region. However, total CARICOM FDI inflows are less than 10% of those targeting Mexico and Central America – yet another challenge, given the development needs of the region. There may be some basis for an analogy between the small developing countries of CARICOM and the West Indies cricket team, in recent years – beset by interactive problems, requiring effective leadership and management, and gallantly striving to improve performance under pressure, in the face of tremendous odds.