

I. Introduction

The report presents a new empirical study of small and very small economies. It is based on especially collected data and addresses, for the first time, we believe the additional costs entailed in conducting business in small economies.

Much of the previous work on small economies has focused upon the economic and environmental vulnerability of these countries. It has explored macroeconomic variables and demonstrated clearly that there is a close correlation between vulnerability and size. There has also, however, been a substantial body of research over the years which has shown that there appears to be no correlation between smallness and GDP per capita, or growth in GDP per capita. Most of this work has ignored the problems posed by the extremely poor GDP and growth data in many of the small countries. It has also been based on historical data, ignoring the question of small countries are likely to be able to respond to the changes brought by globalisation and the ability of small countries to respond to present and future changes in the global trading system. For small states the issue is not past performance but rather a consideration of whether they are well positioned, given the globalisation of trade, to capitalise and achieve growth rates similar to those achieved in the past.

To address these issues the UNCTAD and the Trade Division of the Commonwealth Secretariat commissioned the authors to undertake a study of the operating costs confronting the private sector in small economies and to determine whether these act as a fundamental impediment to trade and investment. Small countries have generally argued that because of the interaction of diseconomies of small scale, high costs for imported inputs, the cost of isolation and remoteness, and the costs of physical dispersion, they have not been able to attract investment in a globalised market. The study aims to determine whether the private sector in small countries is fundamentally disadvantaged in its preparations for globalisation because its costs are higher than in large ones. It has also investigated briefly whether any detectable cost structure disadvantages are the result of poor economic management or of fundamental structural characteristics. Finally, it has briefly speculated what type of policy interventions the international community might devise to assist those countries that face high costs structures by virtue of their inherent structural characteristics.

The focus of the study is explicitly on small trading economies and their ability to generate competitive exports as their current sources of the foreign exchange earnings – aid and preferential exports – are eroded, and as they are urged by economic orthodoxy and international organisations to embrace the global economy.

As a teacher of international trade theory, one of us has spent many hours patiently explaining to students that every country in the world has a comparative advantage in something; that, by definition, there must be some good in which every country is, relatively speaking, least inefficient. This report does not challenge the logic of that proposition, but it does explore the possibility that “least inefficient” does not translate into competitive exports and operational comparative advantage. The argument is that the

transactions costs of trade and the unavoidable diseconomies of small scale in non-tradables sectors may make production for the world market so costly that it does not generate acceptable, or even perhaps subsistence, levels of income. This is not a new argument but the report advances it substantively by subjecting it to formal testing with an extensive and newly collected dataset.

For the study the Commonwealth Secretariat commissioned surveys of business costs in 92 countries – 54 surveyed by the Economist Intelligence Unit (mostly medium-sized and large countries) and 40 (mostly small) countries in Africa, the Caribbean and the Pacific surveyed by local organisations (Kenya and Zimbabwe were surveyed twice). We have coded, reviewed and cleaned these data under the headings of transport costs, utilities, labour and land and presented them in a convenient form – see Sections II and III. We then summarise the data and calculate simple descriptive and inferential statistics to measure the extent to which small economies suffer cost disadvantages. It is substantial. We also consider crudely whether small countries' higher costs can be attributed to the poor management of certain standard policies such as tariffs and taxes. They cannot. In section V we summarise the overall effects of the cost disadvantages by considering the costs of production in three potential key exports sectors – electronic assembly, clothing and tourism. The conclusion is that at very low size, the cost disadvantages are crushing, but that they dissipate fairly quickly as size increases. Section VII concludes that economic smallness presents significant policy challenges, but that what is required is not protection against the rest of the world (which effectively makes small economies smaller), but proactive policies from the international community. Without them small economies are likely to become progressively less attractive locations as the world economy globalises, which may eventually set up strong migratory pressures.