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CURRENT TRENDS IN THE SOCIO-ECONOMIC DEVELOPMENT OF SMALL ISLAND DEVELOPING COUNTRIES

Jackson Karunasekera

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* Jackson Karunasekera is Chief Economics Officer at the Commonwealth Secretariat, London.

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CURRENT TRENDS IN THE SOCIO-ECONOMIC DEVELOPMENT[1] OF SMALL ISLAND DEVELOPING COUNTRIES

1. Introduction

Taken as a whole, the economic performance of small states (defined here as those with populations of less than five million) has over the years been a good one. The GNP per capita of 34 of them grew at an overall annual average rate of over one per cent during the period 1980-91, more than twice that of developing countries as a whole. Their overall income (GDP per capita) is also well above the developing country average. But such figures can be deceptive, and for a variety of reasons the economies of small states are often fragile and show few of the linkages necessary for sustainable development. There are a variety of reasons for this. The small size of their domestic markets and resulting difficulty in generating scale economies mean a high degree of openness and vulnerability to external economic events; their narrow resource base encourages specialisation in a few products; their history has led to dependence on a few markets, accentuated by preferential trade agreements; their particular circumstances have resulted to reliance on concessional external financial flows; and their small populations have meant high per capita costs of providing government services, and shortages of certain skills. The impact of these characteristics on development can at times be pernicious and, therefore, some have called for the economies concerned to be treated as a special case of current development paradigms.

Against such a background this paper examines the recent economic and social developments of selected Commonwealth small island developing countries, with particular attention to those in the Caribbean and Mediterranean.

2. Overview of Economic Trends

The twelve economies of the Commonwealth Caribbean[2] grew as a whole at an average rate of 2.7 per cent a year during 1980-1991. This exceeded the population growth rate, and the per capita GNP of the region grew on average by 1.2 per cent a year. However, there were considerable variations in performance (see table 1). For instance, in Guyana and Trinidad and Tobago

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1. Prepared by Jackson Karunasekera, Chief Economics Officer, Commonwealth Secretariat. The views expressed are those of the author and not necessarily those of the Secretariat. Thanks are due to Ian Thomas, Assistant Director, Commonwealth Secretariat for his comments on a previous draft. However, the author is responsible for any errors and omissions.

2. Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Kitts & Nevis, St. Lucia, St. Vincent & the Grenadines, and Trinidad & Tobago.

real GNP declined on average during 1980-91, while in Barbados and Jamaica it recorded only modest growth. Since 1988, GNP growth in the Bahamas has been slackening and in 1991 it became negative. In recent years, economic activity has also decelerated in Dominica, Grenada and St. Lucia.

To stimulate the economy and rectify fundamental imbalances, some of these countries have recently adopted structural adjustment policies. As a result, Guyana and Trinidad and Tobago reversed the deterioration of their economies. In **Guyana**, real GNP was estimated to have expanded by 6.1 per cent in 1991 turning around the contraction of the preceding three years. A strong export supply response, resulting partly from currency depreciation, and partly from the liberalisation of the economy, contributed to the growth of the economy. However, inflation is high (about 90 per cent in 1991) and constraining demand is a major problem.

Jamaica has intensified its programme of tight monetary and fiscal policies. The aim is to reduce excess liquidity in the economy and to restrain aggregate demand. Most of the productive sectors of the economy responded quite positively. For instance, the area planted to bananas was enlarged, resulting in a 20 per cent increase in production between 1990 and 1991; sugar production rose by 7 per cent over the same period; and manufacturing was reported to be buoyant. All contributed to an improved merchandise trade balance, and increased GDP. Recently, however, the picture has become rather more mixed, with some of the export sectors adversely affected by weak overseas demand.

The eight year decline of real GDP in **Trinidad and Tobago** was reversed in 1991 as GDP grew by 1.8 per cent, following an expansion of the manufacturing and distribution sectors, (agricultural activity contracted by 6.7 per cent). However, the upturn exposed the continuing structural weaknesses in the economy as evident by the re-emergence of an external deficit. The uncertain nature of the recovery was highlighted by the need for recourse to severely contractionary monetary policy in the latter part of the year. Achievement of sustainable growth will require, among other things, eliminating fiscal imbalances, implementing an exchange rate policy that stimulates non-oil exports, an incentive framework conducive to efficient resource allocation, eliminating regulatory impediments to the development of the private sector, and undertaking an appropriate public investment programme without recourse to net borrowing from the Central Bank.

The foreign exchange difficulties facing the **Barbados** economy deepened during 1991 as output in the export sectors remained depressed. As a result, foreign exchange earnings did not keep pace with the demand for imports of goods and services. With the continued decline in sugar and manufacturing activity during the past decade, tourism has been the main foreign exchange earner. But value-added in tourism declined by 5.8 per cent in 1991 and 9.8 per cent in 1990, largely as a result of the weakness in the North American and European economies. In an effort to correct the foreign exchange deficiency, the Government implemented an eighteen-months stabilisation programme during the fourth quarter of 1991. This sought to reduce imports through contracting the fiscal deficit and tightening private sector credit. It is intended to pave the way for a structural adjustment programme to strengthen the island's capacity to produce more exportables and achieve sustainable economic recovery.

In 1991, economic growth slowed down in the **OECS** countries as a group reflecting, for the most part, a 4 per cent contraction in agriculture. Banana production fell by over 18 per cent largely due to unusually dry weather. Attempts by some producers to reduce production in the European winter, when export prices are low, and to increase it during the summer, when prices are higher, appear largely to have been unsuccessful. The performance of manufactures, particularly export products such as garments and electronic components, was sluggish due to the recession in the US. Tourism expanded rapidly, with stop-over visitors rising by 6 per cent in 1991 despite unfavourable economic conditions in the tourists' home countries. This performance compares very favourably with an estimated 2 per cent increase for the Caribbean region as a whole.

It is difficult to estimate the underlying sources of growth of output in the Caribbean countries during the period reviewed. But it is believed that the contribution of capital has been almost twice that of labour. Technology, which is embodied in both capital and labour, played an increasingly important role. This suggests that despite the shift in the structure of production from agriculture to services in many of these countries, the mode of production has been more capital-using than labour-using. If these patterns continue, it will be difficult to reduce the current high level of unemployment.

In **Cyprus**, GDP grew by 7 per cent in 1992 but recently growth projected for 1993 was revised downwards from 4.5 per cent to 1 to 2 per cent. The problems are attributed to developments on the external account, with the strong Cyprus pound contributing to a sharp decline in tourism and a downturn in manufacturing export orders.

The economy of **Malta** continued to expand in 1992, albeit at a decelerating pace. Real GDP is estimated to have increased by 4.7 per cent during 1992, compared with 6 per cent in 1991. In that year when economic growth was due mainly to rising consumer expenditure, but in 1992 it was mostly export-led. Another source of growth was government consumption. Following a poor year in 1991 because of the Gulf war, tourism grew by 12 per cent in 1992, and arrivals exceeded one million; manufacturing output registered a 21 per cent increase but employment in that sector fell by 1.6 per cent.

3. **Trade**

Most of the merchandise exports of Commonwealth small states are linked to preferential trade agreements. In the Caribbean these are vital for the sugar, bananas and garments sectors and, therefore, for some of the countries' economic development.

Though these agreements tend to distort global trade patterns, they contribute significantly to the domestic income, employment and export earnings of the beneficiary countries. However, because the benefits of preferences can be eroded by unilateral action on the part of preference giving countries or by liberalisation of protected markets, Caribbean countries are concerned that the GATT multilateral trade negotiations under the Uruguay Round or the US-Canada-Mexico free trade agreement will severely disrupt their export markets.

The preferences Caribbean countries receive on their sugar exports to the European Community (EC) and United States, whereby they obtain the same high internal prices paid to EC/US beet farmers, are particularly valuable in the light of the low prices on the world market. (In some years, the guaranteed price on the EC quota market has been almost double the free market price.) Currently there is great concern that the forthcoming review of the EC sugar regime may result in a price reduction, and ACP governments have called on the EC to protect the incomes of sugar farmers in their countries by adopting measures comparable to any direct income support granted for EC farmers.

There is also concern on whether US sugar import quotas for Caribbean producers will be adversely affected by the North American Free Trade Agreement, which allows Mexico to increase its sugar exports to the US.

In both cases there are in addition doubts on whether the EC and US arrangements will be compatible with a GATT Agreement based on the Draft Final Act. Overall, it is likely that there will be an erosion of preferences. This will place increasing pressure on Caribbean sugar producers to improve their productivity through better management and labour practices and enhanced technology.

Banana exports from Commonwealth Caribbean countries are particularly vulnerable to the Single European Market and to a consequent change in UK import policy. It remains to be seen whether the expected Latin American challenge in GATT to the new EC banana import regime which comes into force on 1 July will be sustained. The new regime comprises a tariff of 100 ECU/tonne on EC imports of up to two million tonnes from Latin American countries and of 850 ECU/tonne on imports above that amount.[1] African, Caribbean and Pacific (ACP) countries' bananas will have tariff-free access up to a level reflecting the highest export of each ACP country in any one year up to and including 1990. Higher imports may be allowed from ACP countries already committed to a programme of production expansion. EC compensation will be available to Community producers based on the difference between previous income and average production income in each year. EC support will also be available for

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1. The 100 ECU/tonne and 850 ECU/tonne tariffs are equivalent to 20.6 per cent and 176 per cent rate, respectively, in 1990 prices.

measures to improve product quality, development of banana marketing structures and diversification out of bananas.

The 807 arrangements under which garments are exported to the US appear to be the most secure and least vulnerable of the region's preferential trading arrangements. They are long standing exemptions which give direct benefits to US cloth producers as well as to garment manufacturers in the Caribbean. However, because they are widely accessible beyond the region, it is vital for Caribbean garment producers to be very competitive. Moreover, the value of the 807 and super 807 arrangements may be eroded by a liberalisation of the MFA in the context of the Uruguay Round.

Because trade preferences are likely to be eroded over time and may be phased-out altogether, Caribbean exporters need to become more efficient to compete in a rapidly changing world environment. As small economies, their long-term interest lies in the development of a more liberalised trading system in which countries abide by multilaterally agreed rules. Appropriate policy reforms are vital; but export competitiveness will also require the development of new product lines and an entrepreneurial spirit. Despite an incentive structure conducive for the development of the private sector, this sector in many Caribbean countries is still very small and sometimes confined almost entirely to trading and distributive activities. Development of a business culture can take many years to materialise, and there is a strong case for examining policies appropriate for developing the private sector. This can raise complex issues which need to be discussed openly.

Among 'invisible' exports, Caribbean countries' earnings from tourism doubled (in nominal dollar terms) between 1978 and 1983 and again between 1983 and 1990 (see chart 1). Tourism is a major source of foreign exchange and employment for many of these countries. In some of them it contributes more than 10 per cent of GDP, over 20 per cent of employment and 60 per cent of export earnings (including invisibles). Because a strong performance by the tourism sector is a pre-requisite for the sustained development of these countries, efforts to improve the sector's productivity need to continue.

Because of buoyant re-exports, merchandise exports from Cyprus rose by 6.5 per cent in 1992, but domestic exports declined. Agricultural exports fell because of unfavourable weather which affected most agricultural crops, including potatoes which account for over half of agricultural export earnings. Exports of manufactures fell because of the declining competitiveness of garments, footwear and leather goods which account for about half of manufactured exports. The merchandise trade deficit was offset by rising earnings from shipping and tourism; earnings from the latter are believed to have trebled in 1992.

By contrast, in Malta stronger merchandise export growth in 1992 led to a fall of nearly 5 per cent in the deficit on merchandise trade. Exports of manufactures rose by over 27 per cent with the largest increase being recorded in the electrical machinery sub-sector. Three-fifths of the country's exports consist of machinery and transport equipment. Traditional exports, such as clothing, continued to decline due to a deterioration in competitiveness.

4. **Financial Flows**

Over the years, external financing enabled many developing countries, including those in the Caribbean, to accelerate economic growth through sustained increases in investment and in domestic consumption. Generally, those countries following import substituting policies, including Guyana, Jamaica, and Trinidad and Tobago, experienced a deterioration in their economies, with a rise in external debts and decline in productivity. From the early 1980s these difficulties were exacerbated by external shocks relating to demand, prices and interest rates. Certain other Caribbean countries were insulated to some extent from this adverse international economic environment until the mid-1980s because of the importance to their economies of major export commodities covered by preferential trade agreements and the highly concessionary nature of external financing available to them.

Net capital flows to Commonwealth Caribbean countries (shown in Table 2) doubled to over US$1.3 bn between 1980 and 1983, declined by over three-fifths in 1984 but recovered to a peak of $1.9 bn in 1988. Thereafter, they dropped by about three-fifths between 1988 and 1991. The volatility of these totals mainly reflects the instability in private flows, of which the Bahamas has been the major recipient. But even when the latter are excluded from the total, the trend is similar, though the volatility is less pronounced. Net transfers to the region, on the other hand, have been negative since 1986 (except for 1988 - see Table 3) because of the debt servicing requirements incurred by Barbados, Jamaica and Trinidad and Tobago. This is perverse in view of the amount of external financing needed to support their structural adjustment programmes.

Net capital flows to Cyprus during January-September 1992 amounted to $260 million compared with $93 million in the corresponding period of 1991. Long-term loans to Cyprus grew sharply and, as a result, inflows exceeded outflows by $125 million. Short-term capital inflows decreased moderately resulting in a net total of $58 million. External public debt rose from $1,685 million in 1991 to $1,816 million in 1992 (27 per of GDP) and debt servicing corresponded to about 10 per cent of exports.

Net capital flows to Malta rose from $133 million to $216 million in 1992, a result of increased private borrowing from international capital markets. Net financial inflows from offshore activities also rose.

5. **Review of Social Conditions**

Caribbean peoples have done well from the way in which their national incomes have been used: their human development ranking, according to UNDP, is far ahead of their per capita income ranking. In fact human development indicators such as life expectancy at birth and educational attainment are in Barbados and the Bahamas comparable to those of developed countries. They reflect a deliberate policy to combat poverty. Caribbean countries on average devote about 8 per cent of their GDP to the social sectors. Most countries have safety net arrangements to protect vulnerable groups.

However, during the 1980s, stagnant or declining real incomes, higher unemployment and a reduced volume and quality of social services all contributed to growing pockets of poverty in Guyana, Jamaica, and Trinidad and Tobago. While there are conceptual difficulties in estimating the number of poor because they are not a homogeneous group across countries, some surveys have reported that in Jamaica over two-fifths of the population have incomes below the poverty line and that the incidence of poverty is much higher in rural areas. Other reports estimate that about two-thirds of the population in Guyana and about a fifth in Trinidad and Tobago live below the poverty line.

The most important factors impacting on poverty are inadequate property rights; inaccessibility to basic services such as health, water and sanitation; the incidence of low productivity; unemployment; and low educational attainment. Changes in economic policies such as cuts in social services resulting from structural adjustment programmes and alterations in the external environment (e.g reduction of sugar quotas in leading markets) can also exert an adverse impact upon the standard of living, especially in the long run.

Inadequate property rights available to small farmers are a major cause of rural poverty. In Jamaica, St. Kitts and Nevis, and Guyana, the state owns large sugar cane or banana plantations. Land distribution is reported to be inequitable in Jamaica, Belize and OECS countries. In some countries, most of the land used by small farmers is in hilly areas, parcels are relatively small, and productivity is thought to be low which is partly due to non-existent or rudimentary agricultural extension services.

In the 1980s, the economic decline in some Caribbean countries contributed to inadequate recurrent budgetary expenditure on the social sectors and to deteriorating health and nutrition, particularly among children. In Guyana, the leading cause of death among infants was reported to be malnutrition. In many areas of Trinidad and Tobago, about a fifth of children attending health clinics were reported to be suffering from malnutrition. Generally, the principal causes of death among infants in the region are nutritional deficiencies, diarrhoea diseases and acute respiratory infections.

Unemployment is another important cause of poverty. The average open unemployment in 1990/91 in the Caribbean was around 20 per cent of the labour force, while in some countries such as Grenada, and St. Vincent and the Grenadines it was estimated at over 30 per cent. Throughout the region unemployment among females was considerably higher than among males. In Barbados and Jamaica, it was twice as high. In most of the countries, unemployment was highest among young people who in Trinidad and Tobago accounted for about 40 per cent of the total unemployed.

During the 1960s and 1970s, all Commonwealth Caribbean countries made rapid progress in extending education. But during the 1980s, budgetary constraints meant that a number of them, including Barbados, Guyana and Jamaica, experienced an erosion of their educational standards and systems as well as a lowering of educational coverage and access. In Jamaica it was reported that about 30 per cent of primary school leavers were functionally illiterate. This problem is thought to have been particularly severe among boys in rural areas. A major dimension of the problem is its association with a growing number of 'street children', especially in Jamaica, Trinidad and Tobago, and some OECS countries.

To combat the growing pockets of poverty in the region, governments need to improve human resource development and the condition of the poor through policies which promote sustainable economic growth, maintain budgetary resources for social sectors including safety net arrangements for vulnerable groups, tap non-governmental organisations for undertaking poverty alleviation projects, and involve the private sector in the provision of social services. Donor assistance is a necessary adjunct in most cases.

The per capita income and social indicators of both Cyprus and Malta are very close to those of other European countries. As a result of safety net arrangements to safeguard the vulnerable groups, there is no discernible evidence of poverty. The unemployment levels are very low and, in 1992, the rates were 1.8 per cent in Cyprus and 3.9 per cent in Malta. However, in both countries there is scope for improving the status of women, particularly in education.

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Table 1
Growth of Gross Domestic Product in Selected Commonwealth Small States
(per cent change values at 1980 prices)

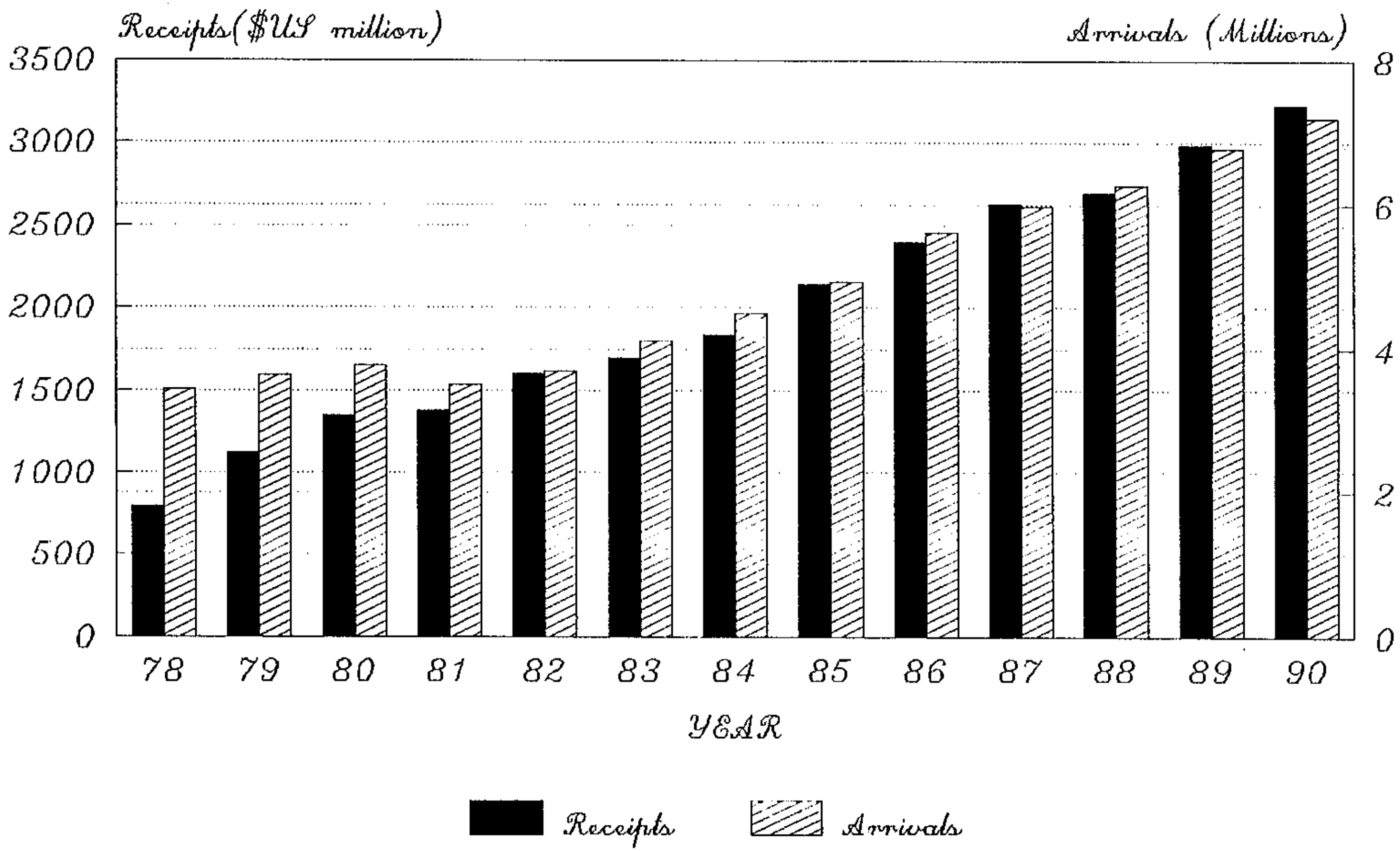
	1985	1986	1987	1988	1989	1990	1991	1992[a]	GNP Real Growth 1980-1991
Antigua and Barbuda	8.7	9.7	9.1	7.7	5.2	2.7	..	..	4.4
Bahamas	13.5	3.6	4.9	2.3	2.0	1.0	-2.0	1.0	3.3
Barbados	0.9	5.2	2.6	3.5	3.6	-3.3	-3.3	-2.5	1.6
Belize	0.3	4.5	12.9	10.0	14.2	7.6	4.8	..	5.3
Dominica	1.6	6.8	6.8	8.0	-1.2	6.6	2.1	2.0	4.4
Grenada	5.0	5.4	6.0	5.3	5.7	5.3	3.1	0.5	4.9
Guyana	1.1	0.3	0.8	-2.6	-4.9	-3.0	6.0	3.0	-3.8
Jamaica	-5.4	2.2	6.7	1.1	6.3	3.8	1.9	1.5	1.0
St Kitts and Nevis	5.7	6.1	7.4	9.8	6.7	3.1	6.8	..	4.5
St Lucia	9.1	5.0	0.5	9.2	5.4	5.6	1.8	..	4.8
St Vincent and the Grenadines	7.1	5.9	5.7	7.4	7.1	7.0	4.6	10.0	6.1
Trinidad and Tobago	-4.3	-2.2	-4.6	-3.3	-0.5	2.2	1.8	0.0	-3.9
Group average	..	..	..	..	..	..	..	..	2.7
Cyprus	4.7	3.8	7.0	8.6	8.3	6.5	1.0	7.0*	6.0
Malta	2.6	4.0	4.2	6.7	8.0	5.9	6.0	4.7	3.5

a Preliminary Estimates; .. not available; * GDP growth for 1993 was recently revised downwards to 1 to 2 per cent.

Sources: GDP data of Caribbean countries are from ECLAC and GNP estimates from the World Bank. The data for Cyprus and Malta are mainly from national sources.

CHART 1

Commonwealth Caribbean Countries—Tourism



Source: Based on IBRD data.

Table 2
Total Net Disbursements of External Capital from All Sources
to selected Commonwealth Small States (mn US$)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Antigua and Barbuda	6.5	14.5	6.4	3.7	-3.9	22.7	45.5	28.1	9.9	33.2	6.4	3.1
Bahamas	71.6	244.8	250.7	830.3	-103.1	521.5	874.4	1,064.2	1,344.4	953.8	193.1	115.5
Barbados	23.1	38.0	48.6	34.0	-1.7	28.0	39.6	-15.3	58.8	14.2	-0.3	-15.3
Belize	17.9	11.9	13.3	20.7	26.5	29.1	19.1	23.6	33.6	33.9	35.5	30.1
Dominica	17.4	21.3	20.4	10.3	29.0	35.9	40.4	38.8	4.9	45.5	30.8	18.3
Grenada	3.7	6.6	-1.7	18.5	30.7	33.1	27.9	21.5	21.7	7.6	20.9	16.1
Guyana	39.3	86.0	59.9	34.1	23.4	35.4	26.5	41.0	36.8	59.1	223.9	214.4
Jamaica	277.1	233.2	355.6	311.2	354.0	219.3	69.2	239.7	344.1	419.1	300.5	203.2
St Kitts and Nevis	6.2	4.2	3.4	3.2	-2.6	4.7	5.3	10.9	8.8	25.9	7.2	8.2
St Lucia	9.7	13.5	9.7	8.3	5.4	7.1	11.8	15.3	25.3	30.0	16.9	23.6
St Vincent and the Grenadines	10.7	9.2	7.8	5.1	4.2	7.8	12.5	13.4	16.1	15.6	14.3	30.6
Trinidad and Tobago	92.8	48.9	45.6	66.5	146.3	-317.8	9.4	57.3	-20.1	73.8	-73.8	-85.5
Cyprus	67.4	120.9	39.4	42.1	23.2	178.4	177.5	96.4	196.0	246.2	321.8	419.1
Malta	60.3	100.0	366.5	57.7	11.3	20.8	19.1	22.6	8.8	43.2	97.6	215.8
(a) Total (excl. Cyprus & Malta)	576.0	732.1	816.7	1,345.9	508.2	626.4	1,181.6	1,538.5	1,884.3	1,841.7	775.4	663.1
(b) Total Caribbean excl. Bahamas	504.4	487.3	566.0	515.6	611.3	105.3	307.2	474.3	539.9	887.9	582.3	547.6
Private Flows to Caribbean (12)	23.4	274.7	346.3	807.7	18.4	89.6	638.5	1,044.4	1,398.2	1,059.5	-13.9	-114.9
Private flows Cyprus	10.1	70.2	0.4	11.7	-9.5	72.7	58.7	-52.7	121.4	171.7	279.1	347.4

a Private flows to Malta are not indicated in the source given below.

Source: Compiled from OECD, Geographical Distribution of Financial Flows, Various Issues.

Table 3
Net External Capital Transfers to Selected Commonwealth
Small States (mn US$)

	1985	1986	1987	1988	1989	1990	1991
Barbados	30.0	26.0	-45.0	60.0	-60.0	-34.0	-61.0
Belize	12.5	2.8	11.7	20.1	24.1	16.8	16.2
Dominica	15.5	5.4	16.3	15.2	18.9	13.7	10.1
Grenada	14.9	12.4	25.5	23.5	18.7	22.0	12.1
Guyana	46.0	47.0	33.0	25.0	44.0	68.0	127.0
Jamaica	105.0	-212.0	-57.0	-163.0	-42.0	-199.0	59.0
St Kitts and Nevis	11.4	10.5	13.1	26.4	34.5	48.7	51.6
St Lucia	19.9	25.1	36.7	32.6	32.3	15.7	54.1
St Vincent and the Grenadines	3.5	8.6	10.9	11.2	7.0	5.6	6.2
Trinidad and Tobago	-237.0	-99.0	-333.0	-41.0	-136.0	-348.0	-286.0
Total (10)	21.7	-173.2	-287.8	10.0	-58.5	-390.5	-10.7
Cyprus	78.0	113.0	-4.0	-55.0	94.0	18.0	-24.0
Malta	-1.4	-23.1	-9.8	13.5	5.8	48.2	18.6

Source: World Bank, World Debt Tables, Various Issues