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Small States Forum

Toward an Outward-Oriented Development Strategy for Small States: Issues, Opportunities, and Resilience Building

A Review of the Small States Agenda Proposed in the Commonwealth/World Bank Joint Task Force Report of April 2000

by Lino Briguglio, Bishnodat Persaud, and Richard Stern

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TOWARD AN OUTWARD-ORIENTED DEVELOPMENT STRATEGY FOR SMALL STATES: ISSUES, OPPORTUNITIES, AND RESILIENCE BUILDING

A REVIEW OF THE SMALL STATES AGENDA PROPOSED IN THE COMMONWEALTH/WORLD BANK JOINT TASK FORCE REPORT OF APRIL 2000

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Acronyms and Abbreviations

ACP	African, Caribbean, and Pacific
AGOA	African Growth and Opportunity Act
AIDS	Acquired immune deficiency syndrome
CARIBCAN	Caribbean/Canada Trade Agreement
CARICOM	Caribbean Community
CHOGM	Commonwealth Heads of Government Meeting
CMA	Common Monetary Area
CPIA	Country Policy and Institutional Assessment
CRNM	Caribbean Regional Negotiating Machinery
CSME	Caribbean single market and economy
EBA	Everything but Arms
ECCB	Eastern Caribbean Central Bank
ECTEL	Eastern Caribbean Telecommunication Authority
ESMAP	Energy Sector Management Assistance Program
EDF	Export development fund
EDT	External debt, total
EEZ	Exclusive economic zone
EU	European Union
FATF	Financial Action Task Force
FDI	Foreign direct investment
FSAP	Financial Sector Assessment Program
FSF	Financial Stability Forum
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNI	Gross national income
GSP	Generalized System of Preferences
HIPC	Heavily-indebted poor country
HIV	Human immunodeficiency virus
IPCC	Intergovernmental Panel on Climate Change
ITIO	International Trade and Investment Organisation
MDG	Millennium development goal
MFA	Multi-fibre arrangement
NGO	Nongovernmental organization
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OECS	Organization of Eastern Caribbean States
PAHO	Pan American Health Organization
PIC	Pacific islands countries
SACU	Southern African Customs Union
SDT	Special and differential treatment
SIDS	Small island developing states
SME	small and medium enterprises
UNCTAD	UN Conference on Trade and Development
UC-SIS	University Consortium – Small Island Studies
VAT	Value-added tax
WSSD	World Summit on Sustainable Development
WTO	World Trade Organization

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A REVIEW OF THE SMALL STATES AGENDA PROPOSED IN THE COMMONWEALTH/WORLD BANK JOINT TASK FORCE REPORT OF APRIL 2000

EXECUTIVE SUMMARY

1. The 2004 annual Small States Forum and Commonwealth Finance Ministers Meeting called for a review of the 2000 report of the Commonwealth/World Bank Joint Task Force that had been presented to the Development Committee and to the Commonwealth Heads of Government, to assess whether its analysis and agenda remain relevant, to identify significant small states' issues and opportunities that have emerged since 2000, and to suggest additions to and/or deletions from the agenda in light of recent developments. This report, which responds to that request, was discussed in draft form at the 2005 Small States Forum and the Commonwealth Finance Ministers meeting which preceded it. During these discussions, Ministers requested that the Commonwealth Secretariat undertake additional consultations with member governments before resubmitting the conclusions of the report to the 2006 Commonwealth Finance Ministers Meeting and the 2006 Small States Forum. Such consultations were held from May through July 2006. This report reflects these discussions.

2. ***Post-2000 Experience of Small States.*** Notwithstanding the significant variations among small states, the following findings are broadly applicable to the experience of small states over the last five years (a) average GDP growth rates have declined relative to larger low- and middle-income states; (b) income and export volatility remains high; (c) the importance of the service sector (particularly tourism) has risen while that of agriculture and merchandise exports has declined; (d) remittances and foreign direct investment remain more important to small states than to their larger counterparts; and (e) the debt burden has grown, particularly for Caribbean small states.

3. ***Enduring Characteristics/Emerging Challenges.*** This report finds that the characteristics identified by the 2000 report as having important implications for the development of small states—including remoteness and insularity, susceptibility to natural disasters, limited institutional capacity, limited diversification, and a high degree of openness—remain pertinent today. However, new challenges have emerged for small states in the recent past, including faster than anticipated preference erosion for traditional exports and the related and pressing need to diversify into new economic activities; a rapid rise in the debt burden for many small states; increased environmental susceptibilities; rising concerns with respect to youth unemployment, security and crime; and the HIV/AIDS pandemic.

4. ***Small State and Donor Responses.*** The response to enduring and new challenges by small states and the development community presents a mixed picture. On the

positive side, some small states have implemented aggressive economic reform programs; improved the investment climate and created an environment conducive to private sector development; upgraded their governance systems; expanded regional cooperation in the regulation and provision of banking, finance, telecommunications, education, and air traffic control services; and developed effective responses to HIV/AIDS. Less success has been achieved in articulating and implementing natural disaster mitigation and insurance measures. In many small states, progress in adjustment and fiscal reform has been disappointing and governance remains very weak. On the donor side, too, the picture is mixed. For example, although some progress has been achieved in strengthening the voice of small states in the WTO, much remains to be done to strengthen small states representation in international negotiations; similarly, while per capita aid allocations to the small states remain high relative to other developing countries, and progress has been achieved in harmonizing donor procedures and interactions with small states, overall aid flows to these countries have declined, and more radical steps are needed to reduce the aid management burden on small states.

5. ***Conclusions and Recommendations.*** Taken together, the above challenges suggest that efforts to prolong reliance on preferences do not have promising or productive prospects. Instead, small states should shift their attention to designing and implementing aggressive outward-looking export based development strategies. Indeed, for preference-dependent small states, nothing less than a repositioning of their economies is required. This entails increased emphasis on efforts to exploit and create comparative and competitive advantage in the service sectors, including tourism, finance, insurance, health, education, internet services, and e-commerce, while at the same time not neglecting scope for competitiveness in other sectors, including agriculture and niche markets. By their nature, the service sectors are less vulnerable to the high transport and other infrastructure costs faced by many remote small states, and, in contrast to traditional commodity exports, have robust long-term market prospects. However, scale disadvantages, especially for the very small states, remain significant, and will require special attention.

6. The success of the small states in implementing such an outward-oriented approach will be critically dependent on accelerating the reform process—including the creation of a conducive investment climate; empowering and improving the quality, health and safety of their human resources; enhancing regional cooperation; building environmental and other resilience mechanisms specifically designed to offset their unique vulnerabilities; and improving the quality of international assistance designed to support these efforts. The critical elements of such an updated and revised strategy are summarized below. In this respect, it is important to emphasize, that small states are heterogeneous. All recommendations are not appropriate for all small states.

Increasing competitiveness and improving the investment climate

7. Improving the investment climate requires a move away from specific incentives and greater focus on such measures as securing property rights, simplifying the tax regime, enacting appropriate competition legislation, providing an adequate physical infrastructure, enhancing education and health infrastructure, and improving governance.

The increase in the indebtedness of many small states that has occurred since the publication of the 2000 report, coupled with the reality that traditional preferences to the small states are eroding faster than originally anticipated, further highlights the importance of urgently enacting these reform programs. Furthermore, small states cannot remain outside the framework of international trade rules if they are to successfully follow an outward-looking development strategy and have full access to opportunities to expand their trade in tourism, finance, and other services. Tax reform and tax administration remain key areas of weakness in many small states. The exception includes Barbados which has undertaken wide ranging tax reform. Reductions in public expenditure to correct fiscal imbalances, together with the identification of new revenue sources, are also required in many instances.

8. Innovative efforts to secure public sector efficiency gains, including more outsourcing, are also required. Given the limited possibilities of many small state governments for reaping the benefits of economies of scale, this will be a major challenge. In this connection, the last five years has seen an increasing recognition of the central importance of good governance and capacity building to enhance overall competitiveness. While the average performance of small states with respect to governance is roughly similar to that of their larger counterparts, some of them have demonstrably suffered from weak and unstable political institutions as well as corruption. It is critical that governments of small states give priority to these matters.

9. Ensuring that the small states exploit the considerable potential of their diaspora communities is essential to the success of private sector development. These overseas communities have considerable potential to provide the needed finance, entrepreneurship, and markets.

Empowering and improving the quality, health and safety of the small states human resources

10. Though small states in general have more highly educated populations relative to the larger low- and middle-income developing countries, it is essential that they invest in and further improve the quality of their educational systems, if they are to exploit effectively the current and emerging service opportunities. Countries benefiting from the migration of educated and trained people from small states are encouraged both to provide increased support for human resource development in small states and to develop more open immigration policies for both skilled and unskilled workers.

11. Crime and security have emerged as major issues facing many small states. Not only are the social and economic costs of this crisis very high, but crime rates severely undermine the prospects for developing a successful and vibrant outward-oriented development strategy. It is critical that small states, with the active assistance of the international community, give priority to solving these problems.

12. The devastating social and economic costs of the global HIV/AIDS pandemic are not unique to small states. However, some of the African small states have the highest incidence rates in the world and the Caribbean small states are the most seriously affected

countries in the Western hemisphere. The long-term impacts on health, economic growth, and the public finances will be severe. It is vital that small states and the donor community attach the highest priority to aggressively combating this disease.

The imperative for regional cooperation

13. Given their small size, individual small states will inevitably be unable to deliver all the necessary government policy, regulatory and service functions required of a modern state and to service the needs of a vibrant private sector. It is therefore vital that the small states put increased emphasis on regional cooperation and aggressively seek to replicate the success of their pioneering regional regulatory innovations, such as those in the telecommunications and financial sectors in the eastern Caribbean. Other opportunities for developing and intensifying regional cooperation, be it with other small states or with larger neighboring states, include health and disease control, higher education, secondary school examinations, environmental protection, fisheries protection, regulation and enforcement, air traffic control, utility regulation, procurement of regional air and shipping services, preparing model legislation, cross-border crime prevention, international negotiations, foreign representation, and cultural and investment promotions. Enhanced regional cooperation is needed not only to better provide for domestic needs, but also to increase engagement with a globalizing world.

Building environmental and other resilience mechanisms to offset the unique vulnerabilities of small states

14. Many small states remain particularly vulnerable to environmental problems that threaten their sustainable development—such as rising sea levels resulting from climate change, cyclones, destruction of coral reefs, and inappropriate exploitation of natural resources. Many small states need to strengthen their mechanisms, institutions, and local stakeholder partnerships designed to protect and manage the environment. Moreover, the experience of the first years of the millennium has shown that small states remain highly vulnerable to natural disasters and exogenous shocks. It is therefore disappointing to note that until recently little progress had been made in developing the necessary insurance mechanisms for both private and public assets. The World Bank, together with CARICOM, is presently developing a Caribbean Catastrophe Risk Insurance Facility. It is hoped that it can quickly become operational and that similar mechanisms can be developed for other regions. Given the high returns to mitigation measures, it is vital that small states quickly institute the needed practices and building codes.

15. The impracticability of developing affordable long-term commodity risk insurance products, combined with the decline in the importance of commodity exports for most small states, would indicate that the development of such insurance mechanisms is not now a priority issue.

The role of the international community

16. The small states as a whole are well-aided relative to their larger counterparts. However, there has been a declining trend since the mid-1990's, particularly in the Caribbean and Africa, which was only reversed in 2004. In an era of anticipated increases in aid flows, it is important that additional ODA be made available to those countries that have embarked on the needed repositioning and outward looking strategies. There is also a strong case for extending such transition assistance to those lower middle income small states that have high incidences of poverty and are falling short in reaching their MDGs. The case for increasing aid volumes is strengthened by the adverse effects of declining resource transfers associated with preference erosion. Since the 2000 report, many of the major donors have taken steps to streamline their systems and procedures with a view to reducing their administrative and institutional burden on the small states. While these initiatives are a welcome development, it is apparent that more radical steps are necessary. These could include increased donor specialization, innovative country cooperation approaches where one donor would be selected to manage the aid program for all aid givers, and increased efforts to build and retain the needed specialized small states expertise within the development agencies.

17. It is recommended that at the 2006 Small States Forum, participants consider the possibility of setting up a permanent small states network in close collaboration with the World Bank and the Commonwealth Secretariat, with the aim strengthening cooperation between small states, sharing good practice between these states and providing continuity between one session of the Small States Forum and another. In this connection it is important to emphasize that such a network would not substitute for ongoing programs of the World Bank or other donors; rather it would attempt complement their activities and increase their overall effectiveness and responsiveness to small states needs.

Toward an Outward-Oriented Development Strategy for Small States: Issues, Opportunities, and Resilience Building

A Review of the Small States Agenda Proposed in the Commonwealth/World Bank Joint Task Force Report of April 2000

Introduction

1. The Commonwealth/World Bank Joint Task Force on Small States presented its final report to the Development Committee in April 2000[1] and to the Commonwealth Heads of Government in 2002. The report identified a focused small states agenda aimed at (a) tackling economic volatility, vulnerability, and natural disasters; (b) strengthening public and private sector capacity; (c) dealing with issues of transition to the changing global trade regime; and (d) examining new opportunities and addressing challenges arising from globalization. The Development Committee welcomed the report and supported the World Bank's and IMF's proposals for their future work programs on the issues of small states.

2. As part of this new partnership between the international community and small states, an annual Small States Forum was established to provide an opportunity for senior representatives of the small states and key external stakeholders to assess progress on the small states agenda and set priorities for future work. The annual Small States Forum, which is held during the occasion of the World Bank/IMF Annual Meetings, has now met five times (the 2001 meeting was cancelled in the aftermath of September 11). At the 2004 Forum and Commonwealth Finance Ministers Meeting, it was agreed that a review of the 2000 report should be prepared for the 2005 Forum[2] to determine whether the analysis and agenda set out in the original report remain relevant and to identify any new issues and opportunities for the small states that require the attention of the global development community.

3. This review, which responds to the above request, was discussed in draft form at the 2005 Forum. In preparing that draft the authors benefited from extensive consultations with the staff of the Commonwealth Secretariat, the World Bank, the WTO, UNCTAD, the IMF, the Asian Development Bank, the Organization of Caribbean States, the African Development Bank, the Caribbean Development Bank, the Indian Ocean

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1 *Small States: Meeting Challenges in the Global Economy*, Commonwealth Secretariat/World Bank Joint Task Force report, April 2000, accessible at www.worldbank.org/smallstates. The report addressed the challenges of 45 developing and transition World Bank member countries, most with populations of less than 1.5 million people.

2 The 2005 Small States Forum was held in tandem with the World Bank Group/IMF Annual Meetings, on September 24-25, 2005, at the World Bank headquarters in Washington, DC. For more information, see www.worldbank.org/smallstates.

Commission, the High Commissioners of the Commonwealth Small States based in London, the World Bank Executive Directors for the small states, the CRNM, the Permanent Missions of the Small States in Geneva, the Pacific Forum Island Countries Office in Geneva, the OECS Geneva Office, participants at the March 2005 Malta conference on vulnerability and resilience of small states, and many others. During the discussions on the report at the 2005 Forum and the Commonwealth Finance Ministers meeting which preceded it, Ministers, while agreeing with the analysis contained therein, requested that the Commonwealth Secretariat undertake additional and more widespread consultations with member governments before resubmitting the conclusions of the report to the 2006 Commonwealth Finance Ministers Meeting and the 2006 Small States Forum.

4. In the intervening period, and in response to the above request, the authors of the report and the Commonwealth Secretariat solicited and received additional written comments from several of the small states. Between May and July 2006 extensive consultations were held with most of the Pacific and Asian small states (during the Annual Meetings of the Asian Development Bank held in Hyderabad), the High Commissions of the Commonwealth Small States based in London, the Permanent Missions of the Small States in Geneva, the Pacific Forum Island Countries Office in Geneva, the OECS Geneva Office, and the Permanent Missions of the Small States to the UN in New York. In addition, visits to several small states governments in southern Africa and the Caribbean took place in June and July 2006. In the Caribbean, consultations were also held with Prime Ministers Owen Arthur and Denzil Douglas of Barbados and St. Kitts and Nevis respectively. These consultations are summarized in the Annex to this report.

5. The authors would like to express their appreciation for the constructive feedback and guidance received during the extensive consultation process. They have tried to reflect the feedback in the report; however the views expressed in this document are, the authors' own and any errors and omissions are their responsibility.

6. After briefly summarizing the overall economic and social performance of small states since 2000, this report assesses the response of the states and the international community to the agenda identified in the April 2000 Joint Task Force report, and attempts to determine whether its analysis and agenda remain relevant. The report then goes on to highlight some important issues and opportunities that have emerged since 2000 and recommends a revised agenda with priority action items for small states and their development partners.

How Have the Small States Performed Since 2000?

7. Though there are significant differences between individual small states, their economic performance relative to the rest of the developing world appears to have slipped somewhat in recent years. The average GDP growth rate for all small states from 1990 through 2005 (Table 1) was 3.5 percent, compared to 4.2 percent for the low- and middle-income countries and 5.0 percent for the low-income countries. While the root causes of this disappointing performance are not entirely clear (and some of the underlying data should be treated with caution), it is apparent that, reflecting their

openness to the international economy, small states were adversely affected by the slow-down in growth in industrialized countries, the aftermath of September 11, 2001, and some shifts in policies affecting their exports (especially the faster than anticipated erosion of trade preferences).

Table 1. ***Small States' Growth Has Been Disappointing***

	Recent growth in GDP (%)							Average annual growth
	1999	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*1990-2005*
African small states	3.6	3.9	3.5	3.9	4.4	4.2	3.3	**4.3**
Africa (excluding Equatorial Guinea)	*2.0*	*4.1*	*3.6*	*3.1*	*3.7*	*3.8*	*3.3*	***3.8***
Pacific and Asian small states	4.3	3.7	4.1	4.4	5.9	5.0	5.2	**4.3**
Pacific and Asia (excluding Bahrain)	*4.3*	*0.9*	*3.3*	*2.7*	*3.6*	*4.4*	*2.0*	***3.0***
Caribbean small states	3.4	3.6	1.6	3.3	7.2	4.0	4.2	**2.8**
All small states	**3.6**	**4.3**	**3.1**	**3.7**	**5.0**	**4.3**	**..**	***3.5***
All developing countries	3.2	5.3	3.2	3.6	5.4	7.2	6.5	**4.2**
All low-income	5.6	3.9	4.7	3.5	7.0	7.4	7.5	**5.0**
All lower-middle-income	4.0	5.9	4.8	5.9	6.0	7.6	6.9	**5.4**

Source: Table A1.

8. Despite the unimpressive GDP growth rate, per capita income growth in the Caribbean small states has remained fairly modest over the last decade, reflecting remittances and low population growth rates. However, average growth has slowed in each decade since the 1970s, the gap between rich and poor states in the region continues to widen, and total factor productivity appears to have stagnated. The African small states have on average performed relatively better than other countries in the region, even when data for Equatorial Guinea (a resource-rich economy) are excluded. Mauritius and Cape Verde have been able to maintain high rates of growth. Small states in the Pacific region have experienced sluggish growth, consistent with longer-run trends. Only in Samoa and Tonga have per capita incomes kept pace with income-level comparators, while countries such as the Marshall Islands, Micronesia, Palau, Solomon Islands, and Vanuatu all saw falls in per capita income over the 1998 to 2002 period. In part, this trend reflects the high fertility rates that continue to prevail in the Pacific islands countries (PIC). Around 40 percent of the PIC population is below 15 years of age and another 20 percent is between 15 and 24. This expanding youth bulge is exerting significant pressure throughout the PIC societies. In south Asia, Bhutan and Maldives have both continued to register strong economic growth and social progress.

9. Although there are significant differences among countries, volatility of production and incomes has continued to be a grim reality for many of the small states. The impact of the aftermath of September 11, 2001, was particularly severe, especially in the Caribbean (reflecting the region's reliance on tourism). In recent years, a number of small states have been also negatively impacted by competitive pressures from lower-priced tourist destinations, oil price increases, and eroding trade preferences. For example, Lesotho's export sector remains very vulnerable to outside shocks and competition. The country exports only 21 products; it lost competitive export shares for

about three-quarters of its major clothing products during the late 1990s, primarily to NAFTA countries, and it is likely to lose more market share to East Asian exporters now that the multi-fiber arrangement has been phased out.

10. The determinants of export and income volatility in small states are diverse, but these countries' exceptional vulnerability to natural disasters (addressed in paragraphs 96-101 below), terms of trade shocks and macroeconomic instability (in some cases arising from inappropriate macroeconomic policies such as ill-timed fluctuations in public consumption and credit to the private sector), appear to be the main agents. In the Caribbean, the higher per-capita-income countries tend to be less volatile. The impact of natural disasters has tended to be higher in those countries that are more dependent on agricultural production. For example, the volatility of per capita income in Dominica declined substantially as the share of agriculture in GDP declined from about 40 percent in the 1970s to a current figure of less than 20 percent. Virtually all small economies have been impacted by terms of trade shocks, including those stemming from oil-price fluctuations, such as Gabon and Trinidad and Tobago.

11. The service sector is assuming an increasingly important role in the small states. This is particularly the case in those small states that have performed well in recent years (e.g., The Bahamas, Barbados, Cape Verde, Estonia, the Maldives, Malta, and Mauritius). In part, this reflects the rapid growth in tourism. For example, the share of tourism in total export receipts has risen to over 50 percent in the Maldives, Sao Tome and Principe, and several Caribbean countries. Tourism's net contribution in Mauritius has doubled from 4.5 per cent of GDP in the late 1980s to a current figure of 8 per cent. The average share of tourism in export receipts for the small states in Africa now stands at about 20 percent, while the figures for Asia and the Caribbean are 45 percent and 30 percent, respectively. The comparable figure for all low- and middle-income developing countries is about 7.5 percent. On average, the service sector now accounts for about 65 percent of GDP in the Caribbean; much higher than the average (45 percent) for developing countries in general. The share of agriculture value added has dropped to just over 11 percent for the Caribbean as a whole.

12. Reflecting this trend, the share of small states in total world merchandise exports has continued its general decline. In 2003, the small states' proportion of global merchandise exports stood at 2.73 percent, compared to 3.97 percent in 1990 and 3.21 percent in 2000. In most small states, and in small states on average, merchandise exports as a share of GDP has stagnated. This contrasts to the overall trend for all developing countries where the share of merchandize exports in GDP had doubled over the last 15 years (Table 2, Table A2). Only those small states with significant natural resource endowments have countered this trend. Given the inherent disadvantages that most small states face with respect to penetrating markets and their relatively high transport, infrastructure, and labor costs, these developments are not surprising. They highlight the importance of developing economic activities (including exports) that are based on human capital and are thus less location sensitive and easier to integrate with the global economy.

Table 2. ***Merchandise Exports Performance Continues to Lag***
(merchandise exports as % of GDP)

	1990	*2001*	*2002*	*2003*	*2004*	*2005*
African small states	26	36	35	34	37	44
Pacific and Asian small states	29	19	19	20	20	21
Caribbean small states	36	22	20	23	26	26
All small states	**30**	**27**	**27**	**27**	**29**	**32**
Memo items:						
All developing countries	16	24	25	27	29	31
All low-income	11	15	15	16	18	19
All lower-middle-income	16	22	24	26	29	31

Source: Table A2.

13. Remittances remain a key source of income for small states. Such remittances averaged 3.4 percent of GNI for the small states in 2000-04, compared to 1.8 percent for all developing countries (Table 3). Remittances are particularly important in the Caribbean small states, where they amount to about 7 percent of GNI. There are some very noticeable differences in longer-term trends with respect to these transfers. For example, from 1990 to 2003 the average annual growth rate in remittances was a negative 1.0 percent for the African small states, whereas the rates for the Asia and the Caribbean small states were 5.4 percent and 13.5 percent, respectively. The high growth rate in the Caribbean reflects that region's significant migration: its diaspora in the United States alone now accounts for almost 3 million people of a total Caribbean population of around 25 million. Remittances also are a prominent source of income for several African countries such as Cape Verde and the Comoros.

Table 3. ***Remittances Are Important and Growing***
(Remittances and compensation of employees, received, as % of GNI)

	2000	*2001*	*2002*	*2003*	*2004*
African small states	3.2	3.1	3.1	2.8	2.5
Pacific and Asian small states	3.7	5.9	4.6	3.9	3.4
Caribbean small states	5.2	5.8	6.6	7.0	7.0
All small states	**3.1**	**3.5**	**3.5**	**3.4**	**3.5**
Memo items:					
All developing countries	1.5	1.6	1.9	2.0	2.0
All low-income	3.0	3.3	3.9	4.1	3.8
All lower-middle-income	1.5	1.7	1.9	2.1	2.1

Source: Table A3.

14. Foreign direct investment (FDI) remains vitally important to many small states. FDI per capita in the small states averaged US$220 in the first five years of this decade; this compares with an average of about US$34 for all developing countries (Table 4). Among small states, the oil exporters (such as Bahrain, Brunei, Equatorial Guinea, Qatar, and Trinidad and Tobago) received relatively large amounts of FDI. Indeed, if data for Equatorial Guinea are excluded, the per capita figures for Africa drop to an average of about US$54; however, this still compares favorably with larger African countries. There are, however, wide variations in FDI flows to individual small states (see Table A4). In general, the Caribbean is an attractive destination for FDI whereas the Pacific countries

have not attracted significant flows. The reasons for these disparities are discussed further in the section on private sector development.

Table 4. ***Foreign Direct Investment Is Important for Small States*** *(US$ per capita)*

	2000	*2001*	*2002*	*2003*	*2004*
African small states	58	90	88	186	190
excluding Equatorial Guinea	*51*	*14*	*65*	*77*	*63*
Pacific and Asian small states	25	22	13	17	8
Caribbean small states	294	317	290	353	391
excluding Trinidad and Tobago	*229*	*226*	*201*	*279*	*288*
All small states	**164**	**195**	**180**	**267**	**290**
Memo items:					
All developing countries	**34**	**35**	**31**	**31**	**40**
All low-income	**5**	**6**	**7**	**6**	**7**
All lower-middle-income	**38**	**38**	**38**	**39**	**44**

Source: Table A4.

15. The external debt of many of the small states appears to have grown rapidly since the 2000 report was published (Table 5). The ratio of external public and publicly guaranteed debt to GNI for 31 of the small states for which data are available grew from 81 percent in 2000 to 84 percent in 2004. This is much higher than an average of about 18 percent for all low-income countries, a ratio that has declined over the last decade. More than half the small states in Table A5 have external indebtedness that exceeds 50 percent of GNI, and only five of the 31 small states have a level of indebtedness below the low-income average. The increased indebtedness of the smaller Caribbean states is particularly worrisome. In the OECS, debt almost doubled between 1997 and 2003. Belize has now joined Guyana in indebtedness that exceeds 100 percent of GNI. This deterioration has placed seven Caribbean countries among the 10 most indebted countries in the world.[3] A number of small states, namely Comoros, The Gambia, Guinea Bissau, Guyana, and Sao Tome and Principe, are classified as Heavily-indebted Poor Countries (HIPC).

Table 5. ***Small States Have Become More Heavily Indebted***
(External public and publicly guaranteed debt outstanding and disbursed, as % of GNI)

	2000	*2001*	*2002*	*2003*	*2004*
African small states	128	127	134	125	124
Pacific and Asian small states	37	39	46	47	43
Caribbean small states	57	64	71	73	71
All small states	**81**	**83**	**88**	**86**	**84**
Memo items					
All developing countries	**23**	**22**	**22**	**21**	**18**
All low-income	**35**	**33**	**33**	**31**	**28**
All lower-middle-income	**20**	**19**	**19**	**17**	**15**

Source: Table A5.

[3] Sahay, R. (2005). *Stabilization, Debt, and Fiscal Policy in the Caribbean.* IMF Working Paper WP/05/26.

16. The reasons for the increasing debt burden are not entirely clear, but declining resource transfers, overly ambitious investment programs, persistent public sector deficits (currently averaging an alarming 6 percent of GDP in the Caribbean), natural disasters, weak macroeconomic management, the global downturn early in the decade (exacerbated by excessive countercyclical spending), the impact of compliance with post-9/11 security requirements and standards (especially in the Caribbean), and slow progress in deepening the tax base appear to be the most important contributory factors. The net result of this increased debt burden is to make the small states as a group even more vulnerable to such events as hurricanes, earthquakes, future rises in global interest rates, and other exogenous economic shocks. It also threatens to erode the impressive social development gains made by many of the small states.

17. Progress towards the millennium development goals (MDGs) is summarized in Table 6. The overall picture appears to be mixed, though there are significant gaps in data coverage. The performance of the African small states has been generally disappointing: as shown in Table A6, all but Botswana, Mauritius, Namibia, and the Seychelles are falling seriously off target. Progress has been more encouraging in both the Pacific and Caribbean regions, particularly in enrollment in primary education and gender equality and the empowerment of women—but reductions in child and maternal mortality and improvements in access to safe water and basic sanitation are proving to be more elusive. It is far from clear whether the majority of small states will achieve the MDG targets. Finally, the high and growing prevalence of HIV/AIDS, particularly in the African and Caribbean small states, threatens to reverse past gains in health indicators, with grave consequences for overall growth and development.

Table 6. ***Progress Toward the Millennium Development Goals in the Small States***

	Malnutrition	*Primary ed*	*Gender*	*Child mortality*	*Births*	*Water*
African States						
Achieved	0	3	6	0	2	2
On track	1	1	0	0	2	3
Off track	0	0	2	7	3	0
Seriously off track	3	8	2	7	2	0
No data	10	2	4	0	5	9
Pacific and Asian States						
Achieved	0	9	9	0	7	3
On track	2	2	0	4	1	1
Off track	0	0	2	8	2	1
Seriously off track	0	0	0	3	2	4
No data	13	4	4	0	3	6
Caribbean States						
Achieved	0	7	10	0	9	3
On track	1	1	0	1	1	0
Off track	1	0	0	6	0	0
Seriously off track	0	2	0	5	0	2
No data	11	3	3	1	3	8
All Small States						
Achieved	0	19	25	0	18	8
On track	4	4	0	5	4	4
Off track	1	0	4	21	5	1
Seriously off track	3	10	2	15	4	6
No data	34	9	11	1	11	23
Total	**42**	**42**	**42**	**42**	**42**	**42**

Source: Table A5.

Does the 2000 Task Force Agenda Remain Relevant?

18. While some small states have made significant economic progress in the five years since the report of the Task Force was published, the issues highlighted in that document remain valid. The report emphasized the following characteristics of small states as having important implications for their development:

- **Remoteness and insularity.** *Of the 45 small states, 34 are islands, a number of which are located far from major markets and some of which are widely dispersed multi-island micro-states*. The disadvantages associated with remoteness remain a reality; however, it is important to note that the increasing reliance of small states on the service sector, which is less sensitive to transport costs than traditional merchandize and agricultural exports, has the potential to at least mitigate some of these inherent disadvantages.
- **Susceptibility to natural disasters.** *Most small states are in regions frequently affected by adverse climatic and other natural events which, in contrast to larger states, typically impact the entire population and economy when they occur*. As recent events have demonstrated (e.g., the 2004 Indian Ocean Tsunami and the destruction of the Grenadian economy) the extreme vulnerability of small states to such events remains a grim reality.
- **Limited institutional capacity.** *Sovereignty necessitates certain fixed costs of providing public services, including policy formulation, regulatory activities, education, social services, justice, security, and foreign affairs. Indivisibilities in the provision of these public goods mean that small states face higher costs per person unless ways can be found to pool such costs, for example on a regional basis*. The challenge of providing the sophisticated government services required of a modern state remains a daunting one. However, as discussed below, the recent past has seen several very interesting regional regulatory and other initiatives. Moreover, the prospect of outsourcing some government functions holds considerable promise to provide some offset to the inherent inability of small states to reap economies of scale in providing such services.
- ***Limited diversification.*** *Because of their narrow resource base and small domestic markets, many small states are necessarily undiversified in their production and exports. Capacity in the private sector is also limited, posing difficulties when faced with a need to respond to changing external circumstances.* Limited diversification remains the reality for small states. Moreover, the rapid market changes that characterize the modern global economy make it even more important that the small states increase their flexibility to respond to changing circumstances.
- ***Openness.*** *Small economies tend to rely heavily on external trade and foreign investment to overcome their inherent scale and resource limitations. While small economies can benefit from outside competition and ideas, they are vulnerable to external economic and environmental shocks, especially when the domestic economy is undiversified.* Openness

continues to be a fact of life for the small states; indeed the loss of preferential treatment in some key commodity and merchandise markets in the recent past has left small states even more vulnerable to the global economy.

- ***Access to external capital**. Access to global capital markets is important for small states, and is one way to compensate for adverse shocks and income volatility. But the evidence is that private markets tend to see small states as being more risky than larger states, so that spreads are higher and market access more difficult.* Despite these inherent disadvantages, the flow of FDI has remained relatively high in many small states.
- **Poverty.** *There is some evidence that poverty levels are higher, and income distribution more uneven, in smaller than in large states*. While robust data are not readily available, the current high levels of unemployment that characterize many small states have undoubtedly had a negative impact on both the incidence of poverty and income distribution.

19. The challenges posed by these characteristics remain central concerns for small country policymakers. A number of issues have emerged since the 2000 report was published, which fall into four broad, partially overlapping areas (i) economic policies for transition toward a service and knowledge-based development paradigm (including private sector development and financial sector issues); (ii) governance and security; (iii) vulnerabilities (including HIV/AIDS, environment, and disaster prevention); and (iv) the heightened need for regional and other forms of cooperation. These issues are summarized in the paragraphs that follow. In this respect it is important to emphasize that while many of the core challenges faced by small states are similar, they are also characterized by a wide heterogeneity. It is therefore important to recognize that, *not all* recommendations are appropriate or feasible for *all* small states.

20. Related to the above and during the consultation process, several of the landlocked small states noted that they shared many of the above characteristics e.g., limited institutional capacity, limited diversification, and poverty, with the developing small island economies. However, they also stressed that they faced some unique challenges e.g., high costs of transit through their neighbors, and suggested that both the 2000 Task Force report and the consultants review had perhaps "neglected" the problems of the landlocked small economies relative to those facing the small island developing states. In a similar vein, some of the "micro-states" felt that their special challenges were often neglected.

Trade: Adjusting to a Changing Global Regime and Representation Issues

21. The 2000 report recognized the particular difficulties facing small states arising from the erosion of the trade preferences they had been enjoying for decades. The problems arose not only from reduced preference margins through progressive international trade liberalization and the proliferation of regional trade arrangements, but also from a decline of special preference regimes of which various selected small states have availed themselves for products such as sugar, bananas, beef, rum, and rice.

22. At the time of completion of the 2000 report, the post-Lome arrangements between the EU and the African, Caribbean, and Pacific (ACP) countries had just been concluded and the framework for future EU/ACP trade relations set. Provisions were made for the negotiation of new WTO compatible trading arrangements which are expected to replace the non-reciprocal trade preferences currently applied by the EU to ACP member countries by January 2008. This also includes a review of the special arrangements for bananas, sugar, and rice.

23. The European Commission has now put forward proposals for revised trading regimes for sugar and bananas. On bananas, the tariff-rate-quota (TRQ) system was abolished and replaced in January 2006 by a single tariff. A preferential duty-free quota has been maintained for the ACP. The continuation of zero tariffs on ACP suppliers would allow some preferential treatment to continue but even this lower preference faces a threat in the near future from WTO rules. Discussions on the actual tariff level that might eventually be applied to MFN supplies are currently inconclusive, with the Caribbean suppliers pressing for the maintenance of current tariffs on non-ACP suppliers and Latin American exporters challenging the current level in the WTO. Preference margins have also been reduced for canned tuna exports to the EU from Pacific and Indian Ocean island countries. In addition, reform of the EU's Common Agricultural Policy threatens Caribbean rice exporters and beef exporters from small southern African states. Manufactures exports have also been affected through wider global liberalization, though the process of erosion is less rapid. In the case of the important category of textiles and clothing, however, the ending of quotas under the GATT Multi-Fibre Arrangement (MFA) from January 2005 has opened up world trade in textiles and garments to fiercer international competition. Preference margins remain significant for small states and others benefiting from preferential arrangements, including the Cotonou Agreement, the Africa Growth and Opportunity Act, GSP schemes, and the Caribbean Basin Economic Recovery Act; however, the liberalization process has been disruptive, as indicated by the very sharp rise in Chinese exports in the short period since the ending of the MFA.

24. The 2000 report expressed the view that, over time, successful reforms will enhance welfare. It recognized that both time and resources will be needed to change the structure of small states to respond to the new trading environment. It thus focused attention on domestic macroeconomic, structural, and social policies required to bring about adjustment. Given the increasing pace of globalization and the continuing erosion of special preferences, the need for such domestic policy adjustments has become even more critical. It is thus important that the structural change efforts of the small economies continue to be pursued with vigor; indeed, in many cases they should be substantially strengthened. Barbados and Mauritius are examples of countries taking bold action, including in the latter's case efforts to restructure its large sugar industry (see para. 31). Given that efforts to prolong preferences are unlikely to be productive, there needs to be an aggressive emphasis on developing those exports, principally services and niche commodities and manufactures, which can help small states gain a competitive advantage. It must be also recognized, that for many of these economies, the emergence of alternative activities will not be rapid or easy, and that they will need special support over a long period.

25. It should be emphasized that preference erosion is proceeding more deeply and quickly than envisaged in the post-Lome arrangements. The recent suspension of the Doha negotiations may give some respite, in that preference erosion relating to MFN liberalization may be prolonged; however the adjustment problem remains both urgent and significant. A Commonwealth Secretariat study estimated that the annual value of agricultural preferences for the three most protected products—sugar, bananas, and beef—was US$536 million, with sugar responsible for by far the largest portion of this.[4] The potential loss of income transfers from these agricultural products was US$402 million, with welfare losses of US$318 million among the most dependent economies, which were mainly small states with a large involvement in the preferential sugar market. Losses of export revenues from sugar were estimated at between US$350 million and US$447 million.

26. While shifts in competitiveness often occur and are a normal, indeed essential, part of robust economic development, these shifts can be socially disruptive and require ameliorative action. The donor community has provided important transitional support. However, the severity of the adjustment problems posed by the extent and rapid nature of preference erosion calls for additional measures, particularly for those most seriously affected. The shift from a commodity- or manufacturing-based economy (where few small states can expect to compete) to one based on vigorous private sector development and the creation of comparative advantage in service and niche industries face major challenges. These challenges are discussed in further detail in the sections that follow.

27. The 2000 report called for external financial and policy support to help small states make the necessary transition without incurring excessive social costs. Five types of external support were identified as being particularly helpful—agreement on transition periods, provision of financial assistance, action to remove barriers to small states' exports (including agricultural exports), support that addressed capacity and vulnerability problems, and support for participation in the WTO and international trade discussions.

28. Developed countries involved in special preference schemes that are now being phased out have contributed to the present predicament of their preference-dependent partners. Many such schemes, such as the EU/ACP Sugar Protocol, were of a long-term/indefinite nature and thus carried obligations to respect the interest of trading partners in any change. The EU has not neglected these obligations and has offered adjustment assistance under the EDF in the preference arrangements already affected, such as those on bananas, rice, and rum. However, a more comprehensive approach to increase ODA flows to small states that are implementing aggressive reform policies and programs is warranted (see the section on aid below). The transition process could be helped also if improved market access is granted in other areas, where small countries face trade barriers.

29. The European Union's schemes of adjustment assistance in relation to bananas have included the Special System of Assistance, introduced in 1994, offering financial

[4] R. Grynberg and S. Silva, "Preference-Dependent Economies and Multilateral Liberalisation: Impacts and Options," Draft Paper, Commonwealth Secretariat, October 2004.

and technical assistance and income support for the industry. In 1999, a new program was established—the Special Framework of Assistance—which abandoned the income support component, continued to emphasize productivity improvement but also included a new component, namely diversification. This last aspect deserves still greater emphasis, especially for those countries, which will never be internationally competitive. The focus should be on improving the climate for entrepreneurship and identifying market-friendly means to mitigate the inherent competitive disadvantages associated with smallness.

30. In the case of rum and rice, the focus in the European Union's assistance schemes was on improving productivity and competitiveness. This was well-directed, since for the producing countries involved, international competitiveness was within reach and what was needed was support to develop competitiveness and resilience as preference was withdrawn, which has already happened in the case of rum. Adjustment assistance for sugar is contemplated when current guarantees are withdrawn. Specific proposals have been put forward only for 2006, with the offer of 40 million Euros for all ACP suppliers, and there is promise of further assistance. In some countries, productivity improvement will need to be an important component; in several others, diversification will have to be emphasized and projects will have to be on a broader basis than only the sugar industry.

31. The proposed changes in the sugar preferences were not unexpected, and beneficiary countries should have already begun to take the necessary adjustment actions. Mauritius is one of the most vulnerable countries in the world to the unwinding of the Sugar Protocol. Preparations began for the inevitable more than a decade ago. Dependence on sugar had been steadily declining in any case as exports of manufactures and services grew, but the Sugar Sector Strategic Plan introduced in 2001 squarely addressed an urgent need to downsize and restructure the sector – consolidating 17 mills into eleven, diversifying output into ethanol and electricity cogeneration, and raising efficiency by derocking and irrigation. A second phase, recently approved, will take the least efficient fields out of production, double electricity production and scale up ethanol output to 30 million liters. Notably, Mauritius will need to import molasses to produce that much ethanol and a "molasses hub" with an energy port is planned in the south of the island. Following on a long tradition of consensus building, the planning and implementation is being done in close consultation with stakeholders. The Mauritius model is being studied by other countries, including Fiji.

32. Many small states are in the process of negotiating Economic Partnership Agreements (EPA) with the EU. These agreements were launched in 2002, under the Cotonou Agreement, with the main objectives of promoting sustainable development of the ACP States and their smooth and gradual integration in the world market, while at the same time supporting regional integration. Some small states fear that with the freeing of trade, ACP firms will find it very difficult to compete with EU firms and that government revenue in these countries will experience shortfalls as import duties are decreased. For this reason, the small states are demanding that the EPAs should have a clear development dimension and should take account of the socio-economic impact of trade liberalisation and should ease supply-side constraints. EPAs should also be conducive to

increase investment flows between Europe and ACP countries and encourage diversification in these economies.

33. The costs of negotiating, implementing, and administering the provisions of the WTO are particularly burdensome on small states, e.g., dealing with technically and administratively demanding agreements such as those on Sanitary and Phytosanitary Measures, Technical Barriers to Trade, Anti-dumping and Countervailing Measures, and Rules and Procedures for the Settlement of Disputes. Under-representation in international negotiations in the past has meant inadequate reflection of the interests of small states in some agreements. This is compounded by the institutional gaps existing in many developing countries in understanding the changing trading environment, formulating appropriate policy and effectively negotiating to secure their trading interests at negotiating fora. Some donors are currently funding joint regional representation offices in Geneva while others are providing advisory as well as human resources to assist the missions. In addition, technical assistance is also being provided in tandem to address the institutional gaps which exists in their respective trade administrations.

34. The Doha Development Agenda mandate on the establishment of a Work Program for Small Economies was largely achieved through the collaborative efforts of a number of WTO Small States and this is quite an achievement for countries that have largely been marginalized since the GATT. Nevertheless, the challenge lies in politically agreeing on SVEs that should be accorded special and differential treatment under the program without the creation of a new sub-category of countries. The other challenge lies in ensuring that the final outcome of the Round delivers effective, meaningful and operational responses to the trade-related problems of small economies.

35. The development of the Work Program on Small Economies has largely been carried out by the WTO's Committee on Trade and Development Dedicated Sessions (CTD-DS) which has, since the Hong Kong Ministerial, assumed a monitoring and supervisory role over progress of the Small Economies proposal tabled in the relevant negotiating and other bodies, i.e., Rules, Agriculture, NonAgricultural Market Access (NAMA), etc. While WTO Small States have been tabling Agreement specific proposals to the relevant negotiating bodies, other logistical proposals have also been tabled in tandem to the CTD, i.e., Sanitary & PhytoSanitary (SPS), Technical Barriers to Trade (TBT), Trade-Related aspects of Intellectual Property Rights (TRIPS) Accession. One can state that work on the establishment of a Work Program of Small Economies has progressed and agreement specific proposals tabled identifying their interests and concerns have been reflected in the Hong Kong Ministerial Declaration. The most important achievement to date on this initiative is that it has raised the level of awareness amongst WTO members on the characteristics and genuine problems faced by small economies in integrating to the multilateral trading system.

36. An issue that often emerges in trade negotiations relates to "policy space" for small states argued mainly on the premise that the cumulative effect of their inherent characteristics and problems further marginalizes rather than fully integrates them into the multilateral trading system. This is, in part, due to the fact that 'effective market access' created through the removal of internal barriers to trade do not necessarily result

in effective access for small states exports into developed country markets. The volatility of international prices for products exported by small states and inherent low levels of competitiveness are some important factors which causes such inhibitions. The request for appropriate "policy space" is associated with the realization that small states strict adherence to WTO disciplines may, to some extent, limit their room for policy maneuver. Although small states recognize the potential gains from trade liberalization, some compromise needs to be sought to introduce a degree of flexibility, such as for example derogations from certain subsidies disciplines to allow small states to provide incentives for attracting FDI to compensate for the high cost of doing business in small economies and appropriate provisions negotiated on Special Products (SP) and Special Safeguard mechanisms (SSM) for the development of their agricultural sector. The challenge will be to introduce some flexibility while at the same time not hollowing out the rule based trading system, which has significant potential benefits for developing countries. It should also be emphasized that the achievement of sustainable competitiveness requires that any subsidies be clearly time bound.

37. Aid for Trade (AfT) has featured prominently in the international trade agenda in the run-up to the Hong Kong WTO Ministerial meeting and thereafter. AfT is intended to enhance the trading capacity of developing countries and to provide them with trade-related assistance to mitigate the detrimental effects of trade reforms arising from the implementation of their liberalization commitments. AfT is not meant to replace traditional ODA or development assistance associated with the Doha Round, but is seen as a valuable complement to existing aid arrangements. AfT should also complement the core market access issues at the centre of the Doha Development Round. It should focus on the placement of resources into increasing the value-added of exports, diversification, and attraction of foreign direct investment to generate jobs and exports. It should also focus private sector development by facilitating the improvement of the business environment for exporters. Although the beneficiaries would be mostly LDCs, of which some are small states, non-LDC small states should also benefit given that many of these stand to lose from preference erosion.

38. Early consideration should also be given to providing transitional arrangements for small states graduating from least developed status. Small states have a special interest in increased access for temporary workers through Mode IV under the GATS (see also para. 52). In addition, continuing attention is needed to making accession of small states to the WTO easier. Much more could be done by existing WTO members, which agree on accession proceedings on a case-by-case basis and by consensus, to simplify and make conditions less onerous. Small states in the process of accession should be allowed appropriate transitional periods and some flexibility in relation to special and differential provisions already available in the WTO. Weak representation in the WTO remains an issue for small states. Given their size and other priorities, it is just not feasible for most small member states to be represented in Geneva or to individually develop the required trade policy capacity. Expanded technical support has been provided through the WTO, UNCTAD, the Commonwealth Secretariat and other donors and NGOs. Thirty-two Members and Observers do not have diplomatic missions in Geneva. Governments and observers without representation at the WTO now stay abreast of WTO work and negotiations through electronic newsletters which they receive regularly from the WTO and

by attending Geneva Week events, an occasion where representatives from small states are brought to Geneva twice a year to attend WTO meetings and receive in-depth briefings on the state-of-play in the Doha Round of trade negotiations. Since 2002, Geneva week events have been financed through the WTO's regular, annual budget.

39. These developments, positive as they are, would have a better impact if small states are more effectively represented in WTO committees. Through the initiative of the Commonwealth Secretariat and with financial support from the EU's EDF, help has been provided to the Pacific Islands Forum states and members of the OECS to set up joint representation for each group in Geneva. A Pacific Office representing 14 Pacific states with its own accommodation is now in operation. It has observer status in the relevant WTO Committees, but actual representation takes place through the existing three members. An OECS mission has also been established. It has been provided with accommodation by the Agency for International Trade, Information and Cooperation (AITIC), established by the Swiss Government, to facilitate representation and provide technical support for less-advantaged countries. AITIC is now supported by additional donors and has capacity to assist other member and observer small states without a resident mission in Geneva, for some of whom affordability and cost/benefit considerations would remain a long-term constraint. The OECS is seeking observer status. The Commonwealth is also exploring the viability of a similar joint mission for African non-resident members and observers. The Caribbean Regional Negotiating Machinery (CRNM) -an organ of CARICOM- has also played an important role in international negotiations and thus helped to improve the representation of its member states. It has a presence in Geneva. It is a regional mechanism, which has bolstered negotiating capacity in the Caribbean and is an example that other regions could emulate. Donor countries should do more individually or collaboratively, directly or through organizations such as the Commonwealth Secretariat, to support the strengthening of small country representation in Geneva. The possibility of supporting shared representation, which the Commonwealth Secretariat has pioneered and promoted, is a promising way forward.

Domestic Policies, Economic Management, and Public Finance

40. The 2000 report highlighted the issues that small states needed to address if they were to adapt and transform their economies in response to the changed global trading environment. The global economy is changing even faster than the 2000 report envisaged, particularly with respect to preference erosion, and small states are confronted with difficult adjustment problems in the context of declining aid. But it is disappointing to note that, in many small states, adaptation and reform have not proceeded systematically and adequately.

41. The recommendations of the 2000 report remain largely relevant, particularly in their emphases on attracting private investment and providing the complementary public investment in infrastructure, education, and institutional reform. The report stressed the importance of a stable macro-economy, low average tariffs and tariff dispersion, well-established property rights, effective governance and the rule of law, and high levels of investment in education and health. It also stressed the need for clear signals in policies on trade and regulations and adjustment. It recognized that transition will take time but

that governments needed to give a clear message that change will occur and will not be postponed indefinitely. Recognizing that small states tend to depend heavily on import tariffs for revenues, it called for fiscal reform and the use of other options such as VAT, sales tax, and a low flat tax on imports. It pointed to examples of countries that have successfully adopted VAT.

42. With few exceptions, fiscal reform is not an area where significant progress has been achieved since the Task Force reported. Tax reform and tax administration remain areas of weakness in many small states. Some small states have traditionally avoided income and corporate taxes as part of a policy to encourage offshore financial services. Their reliance on import taxes is therefore large, and there is a reluctance to change. Part of the problem is the often mistaken view that reducing the reliance on import duties necessarily means resorting to direct taxes. Although there is resistance to such changes, they are both necessary and urgent. In this connection, it is important to note that several of the more successful small states have, as part of their outward oriented development strategies, substantially shifted their taxation base towards broad based consumption taxes and direct income taxes. Malta and Barbados are good examples of the successful implementation of VAT.

43. Small states cannot continue to remain outside the framework of international trade rules if they are to have full access to opportunities to expand their trade in financial, tourism, and other services. Within this framework, efforts must continue to improve the regulatory environment, especially in the financial sector, and to develop a non-restrictive work-permit regime for importing scarce skills and a similar regime on the right of foreign ventures to operate in the service and other sectors.

44. Because of small local and regional markets, it is important that small states continue to emphasize an export orientation. Regional economic arrangements can assist in opening up product, service, and factor markets and in improving access to capital and skills. In the Caribbean, progress is being made in regionalizing financial services and making them more efficient and competitive. After considerable effort, CARICOM is nearing its goal of establishing a single market and economy. This is welcome progress but, because of limited opportunities even in a fully integrated regional market, these efforts should be seen as a step towards global market integration. It is important that they do not detract from seeking opportunities in world markets.

45. Unsustainable levels of deficits and debt require urgent remedial actions. Volatility and a proneness to natural disasters further undermine macroeconomic stability. High debt servicing increases public expenditure, makes deficits harder to reduce, and reduces a government's room to maneuver in response to exogenous shocks. Furthermore, high levels of government expenditure, excessive borrowing, and associated high interest rates add to the unsuitable environment for private investment. The additional expenditures required for security and public safety as well as to comply with international standards and regulations (often related to international circumstances and needs) have also contributed to undermining fiscal stability.

46. It is important to emphasize that reductions in public expenditure must not be achieved by cuts in vital services. What is needed are innovative efforts to secure public sector efficiency gains. Some of the available options are highlighted elsewhere in this report: more outsourcing; greater use of user charges; greater reliance on tuition fees and student loan schemes at the tertiary level (while maintaining the access of the poor); achievement of a better balance between public and private sector wage levels; a reduction of public service employment; improvements in the privatization process to avoid failures and being saddled with contingent liabilities; and greater selectivity in the use of subsidies.

Towards a Service- and Knowledge-Based Development Paradigm

47. As noted earlier, a number of small states are increasingly becoming knowledge- and service-based economies. Not only does this development help to mitigate their high transportation costs, it also exploits the small states' potential competitive advantage in developing and exporting services based on their human capital. Moreover, the higher middle income small economies, such as Barbados and Mauritius, must increasingly rely on raising productivity and moving to higher value added, more skill intensive activities, if they are to maintain their impressive growth performance. The experience of some small states indicates that there is a wide and expanding spectrum of opportunities. Some countries are expanding into eco-tourism and health tourism (health services plus tourism) and in offshore financial services. The Maldives has developed a highly successful tourism industry based on its natural resources and targeted at upscale tourist market. A few small economies, for example Bermuda and the Cayman Islands, have been very successful in deepening the financial services sector to include a wide variety of products—fund management, trust services, ship registry, different types of insurance services, and so forth. This not only widens employment and business opportunities, it also makes the financial sector more resilient and sustainable and less open to charges of promoting harmful tax competition. Additional potential service exports include, the provision of higher and professional education, such as residential training of doctors and nurses (70 percent of the international medical graduates entering the US between 1984-2004 have been from Caribbean offshore medical schools), elective surgery (often coupled with tourism to recuperate), niche tourism, and the offshore provision of internet, computer, e-commerce and software services. ICT is already providing a platform for exports e.g., call centers in the Caribbean, and there are considerable opportunities for additional value added in this sector, including the provision of "government outsourcing services" (see the section on governance and capacity building below). Beyond the encouragement of investment in these service activities, small states should take an active interest in the ongoing negotiations in the WTO on services and seek to remove any restrictions that stand in the way of expanding their trade in services and be prepared to make reasonable offers in order to secure movement. Movement of natural persons under Mode IV is among the areas, where small states have a strong interest as indicated in paragraph 49 below.

48. Education is an important requisite for the building of a vibrant services sector. The level of education of the population of small states tends to be relatively high. The small states also possess many first-rate educational and medical institutions. In those small states where the education infrastructure is inadequate, this deficiency need not be an

insurmountable problem. The very smallness of their education sector can make it relatively easy to introduce the needed changes and upgrades (though unit costs per student will typically remain higher than in larger education systems). By further enhancing the capacity of schools and universities, supporting overseas study programs for their nationals (where it is not economic to provide domestic specialized training) and improving the business environment, many small states can hope to replicate the successes of such countries as the Bahamas, Barbados, Bermuda, the Cayman Islands, Malta, Mauritius, and Singapore. The significant costs of providing higher education will have to be recovered through appropriate measures, such as tuition fees and associated loan repayment schemes from graduates; otherwise small states will not be able to afford these costs. The donor community can play a key role in both strengthening the relevant training and educational institutions as well as in establishing the associated repayment programs.

49. Given the wide variety of potential service-based exports that can be generated and the strong demand base for such products in the developed world, a human resource service-based strategy has the potential to build reliance and reduce vulnerability, as well as to substantially increase income. The experience of countries such as Singapore shows that such services can become increasingly sophisticated and contribute progressively higher value-added as the human resource base deepens and grows. Such a service based strategy is not of course without risks. The demands on the human resource base will be significant; the benefits of the new information and communications technologies, which are essential to overcome "remoteness and insularity" will have to be captured; the "digital divide" must be bridged. The large countries, such as India and China, will be formidable competitors, particularly ICT; however, the pioneering small states have demonstrated that niche service strategies can succeed.

50. Such a strategy requires a significant investment in education as well as a coherent and supportive investment climate, including a modern communications structure (see the subsequent discussion on private sector development). It also implies that the declining quality of the education systems in some of the small states should be reversed as a matter of priority. Many small states are already spending significant resources on education and training but the quality of school graduates is often disappointing. The reasons are not entirely clear, and vary across countries, but accountability, efficiency, school management, teacher training and motivation, community involvement, and educational culture appear to be key quality determinants. Increased involvement of the private sector in tertiary education would also appear to be critical if the needed volumes of knowledge workers are to be produced. There is also considerable potential for regional and international cooperation among small states to achieve the necessary efficiency improvements, such as cooperation through the recently launched Small Island States University Consortium(UC-SIS) involving the Universities of Malta, Mauritius, West Indies, and the Virgin Islands.

51. One by-product of such a strategy will be an increase in emigration of high-level manpower. However, the potential to add to the "brain drain" should not be seen as a deterrent to such an approach. As noted elsewhere in this report, the diaspora is a major source of remittances (itself a return on investment in their education) and investment. Moreover, as Singapore and the Maldives have demonstrated, bonding systems designed

to recover the costs of education for those emigrants who choose to leave permanently can work effectively. However, it should also be noted that the repayment performance of similar schemes in the Caribbean has been disappointing. It is important to better understand the reasons for these differences with a view to developing appropriate remedial prescriptions. Given that the developed countries are and will remain major beneficiaries of high-level emigration from the small states, there is a compelling justification for them to increase their financing of the related education and training schemes. Moreover, developed countries should also be expected to allow the freer movement of temporary workers, both to alleviate their own shortages of skilled and unskilled manpower and to contribute to increased remittance flows.

52. Healthcare workers offer a particular opportunity for freer movement of temporary workers. In many OECD countries, demographic changes are causing severe shortages of nurses. For the Caribbean, a recently agreed pilot project points the way forward. It addresses the needs of the developed countries as well as the high social and economic cost of emigration of scarce health care professionals from developing countries. It establishes a system for the temporary movement of nurses from the Caribbean and provides technical and other support for Caribbean nursing schools and public nursing systems to upgrade capacity to supply nurses for local and overseas needs, as well as accreditation for regional nursing examinations. The approach seeks to achieve increased market access in developed countries under Mode IV of the WTO General Agreement on Trade in Services (GATS) while at the same time providing development assistance to improve training capacity and offering opportunities for the export of training services. This is a mutually beneficial initiative for both developed and developing countries.

53. More generally, it is important that developed countries develop more open immigration policies which favor the small states and expand the provision of seasonal work permits for unskilled workers. Such policies have the potential for significant mutual benefits. During the consultation process, several governments highlighted their concerns with respect to this issue. Specifically they noted that the gestation period and pay-off to investments in education, particularly higher education, would inevitably be long. Accessing developed country labor markets, particularly during the transition, was thus critically important. Other governments stressed the importance of such international labor mobility in helping them to make the necessary structural adjustments as workers were displaced from previously protected crops such as sugar and bananas.

Private Sector Development

54. The 2000 report highlighted the importance of developing and maintaining sound economic and public sector investment policies designed to increase private sector investment and employment. In particular, it emphasized the importance of investing in infrastructure, education, and health, ensuring economic stability, establishing low average tariffs, maintaining sound and predictable regulatory environments, ensuring property rights, and promoting effective governance and the rule of law.

55. Private sector development is a particular challenge for small states. Domestic markets are small, unit costs of production are typically high, there are limited opportunities for specialization of skills, and many of these economies are remote from major markets. Reflecting these realties, most firms are also small. Typically, such firms cannot realize economies of scale, have difficulty in attracting partners, and cannot spend significant funds on marketing, research, and development. Moreover, small firms in small states are often monopolies or oligopolies in the local market without the advantage of the spur of competition. Small states thus face huge competitive challenges. Given the high costs of transportation, and the lack of diverse economic and physical infrastructures, such economies will not be suitable locations for industry unless they have specific advantages that allow them to charge higher prices than their competitors, e.g., opportunities for eco-tourism. However, precisely because of their small size, modest levels of investment can have a relatively major impact on employment and income generation.

56. For most small economies, investment in small and medium enterprises (SMEs) in the export sector, including tourism and other services as well as niche markets (such as horticulture, exotic fruits and spices and customized manufacturing), offers the best chance of rapidly creating jobs, increasing national income, and widening the tax base. In this connection, it is important that special attention be paid to marketing and branding. External markets are large enough to absorb new output without any fall in price and the new activity enlarges the domestic market for non-traded goods and services. Simultaneously, the enhanced skills required by most exporting SMEs will likely result in improved skill levels more generally by putting pressure on standards and capacities of local training institutions.

57. Resource endowments and opportunities differ among countries. Agriculture remains a substantial sector in some small states, supplying both domestic and export markets. Improvements such as the wider use of irrigation and chemical and organic inputs, planting better varieties and better access to know-how and credit, could all help to increase productivity and food security and protect the country-side, and could be an important part of any poverty reduction strategy. While international agricultural liberalization is causing problems for preference-dependent crops, it will on the other hand, open-up opportunities for other products such as cotton and beef for southern African small states. There are other export opportunities, which are already being exploited such as spices, vegetables, cut flowers and high quality coffee and cocoa. A particular problem requiring urgent attention, especially in the Pacific and Southern Africa, is insecure land tenure systems, which are detrimental to long-term agricultural improvement. It prolongs low productivity subsistence agriculture, discourages cash crop production, and causes food insecurity to persist even when land is not in short supply.

58. In the case of manufacturing, some small states have developed significant exports, based on preferences provided by AGOA, the Cotonou Agreement, the Caribbean Basin Economic Recovery Act, the Caribbean/Canada Trade Agreement (CARIBCAN), and GSP schemes. Many of these exports e.g., textiles and garments, are also suffering from preference erosion, but for some products, preference margins may remain significant for some time, allowing scope for continuing production and even

possibly developing competitiveness. There are also cases of internationally competitive manufacturing, often resource based, some of which are of a significant enough size, not to be deemed niche activities. Examples are rum, canned tuna, canned fruits and fruit juices, wood-pulp and other wood products, handicraft and furniture.

59. In the case of forestry and fisheries, these depend on resource endowment and both have a manufacturing component. These resources could make substantial economic contributions. Tuna and canned tuna production in the Pacific and in the Maldives and wood pulp in Swaziland are examples. Both cases call for good management as there are already serious depletion problems e.g., tuna in the Indian Ocean and forestry in the Solomon Islands.

60. There is now a long history of small states enacting special programs and incentives designed to promote private sector development and encourage FDI. Given the limited size of the domestic market, such efforts have typically been targeted at export industries. Incentives have included tax holidays, exemptions and concessions from import duties, and discretionary licensing. However, the overall impact of such measures on private sector development has been decidedly mixed. Some countries have been highly successful in attracting foreign investment (e.g., Barbados, Malta, Mauritius, and, more recently, the Maldives) whereas others (e.g., Guyana, some Eastern Caribbean states, and the Pacific Islands) have had little response. The reasons for this disparate performance lie largely in deficiencies in the investment climate in specific countries rather than the special incentives themselves. Such deficiencies typically include fragile governance structures and political instability, insecure property rights, high cost and unreliability of infrastructure services, an under-educated labor force, unnecessarily complicated tax systems, and overly regulated business environments that are invariably associated with too much red tape, weak judicial systems, excessive discretion in the granting of incentives, non-transparency, and corruption. In this connection it is also important to emphasize that local investors require the same conducive framework if they are to realize their own potential to contribute to development. Indeed, they may be more vulnerable than foreign companies to deficiencies in the investment climate because they are inevitably smaller than their foreign counterparts and may thus have less influence on key decision makers.

61. Since the finalization of the 2000 report, it has become apparent that appropriate competition policy and legislation can play both a key role in ensuring a level playing field and promoting a conducive investment climate. Competition law, backed by appropriate enforcement arrangements, can help to create a more predictable and transparent economic environment and support the development of economic entities that can compete in an increasingly challenging global market place. For example, the new smaller members of the European Union (Cyprus, Estonia, Latvia, Lithuania, Malta, and Slovenia) have had to integrate the principles of competition set out in the EU treaties into their own national legislation. This, in turn, has improved consumer protection, reduced restrictive practices, and constrained governments from supporting inefficient industries.

62. Achieving the requisite competitiveness and a conducive investment climate poses special challenges for small states. Their size may enable quick decision-making and responsiveness, but this has to be offset against the higher costs associated with

insularity, dependence on imports, small and undiversified financial sectors, inability to reap economies of scale, high costs of regulation, and so forth. However, as highlighted in this report, many small states have successfully built competitiveness in key industries by systematically improving macro and fiscal management, removing protection, strengthening their financial systems (often in cooperation with their neighbors), providing the needed infrastructure, improving governance, and, most important, upgrading their human resources. In this connection, the importance of the social aspects of reform programs needs to be emphasized. The support of all key groups of civil society is essential to success, particularly in small economies. For example, the success of reforms in Barbados in the 1980s was at least in part a result of a widespread acceptance of the need for cooperation, austerity, and sacrifice by all segments of society, which was itself a result of extensive consultations with all key stakeholders.

63. A conducive investment climate is also likely to have a major impact on attracting investment from the diaspora. As noted earlier in this report, most small states have significant emigrant populations that maintain close relations with their homelands. The ratio of the diaspora to the local population in small states is typically far higher than that for large states. These groups often have significant savings, bankable credit ratings, professional and technical know-how, overseas networks and market connections, entrepreneurial talent, and the necessary commitment to succeed. Their ability to identify niche markets, transfer technology, and respond to rapidly changing demand trends is particularly valuable. The diaspora has made a major contribution to the success of export industries in such countries as Mauritius, Fiji, and several Caribbean states. As emigration continues to increase and the size of these overseas communities relative to the local populations grows even larger, the potential importance of this valuable source of investment should not be underestimated. It is critical that small states fully exploit this potential engine of private sector development. During the consultation process, several small states mentioned that they have, or are, developing a comprehensive set of "diaspora friendly" policies, e.g., Dominica, designed to fully utilize their talents and resources. These policies typically include an enhanced role for the overseas missions/embassies of the small states. For example, some missions have organized targeted exchanges between the diaspora and the local private sectors on measures designed to increase investment opportunities.

64. Potential niche export markets include exotic plant products or "out-of-season" fruits and vegetables, horticultural products, customized manufactured goods, live fish, eco-tourism, residential tertiary education targeted at overseas students, and medical treatment services for foreign patients. Many small states are already pursuing such opportunities. For example within the last decade Fiji has successfully exploited a source of exceptionally pure water. The bottling company's exports now amount to about US$40 million a year, and may soon exceed revenues from gold production, fisheries, and the sugar industry. The required investments to exploit these opportunities are often modest, yet they can have a major impact on employment and income-generation in a small state.

65. Adequate infrastructure services are critical to attracting investment. Investors typically rate the quality of infrastructure as being of utmost importance to their

investment decisions. Obstacles such as unreliable and expensive electric power and water, inefficient port systems, and deficient and expensive telecommunications compound the geographical isolation that typifies many small states, and they can be fatal to robust private sector development. The success of service and knowledge industries, where many small states have, or can gain, long-term comparative advantage and competitiveness, is critically dependent on the availability of state-of-the-art telecommunication facilities.

66. While there is considerable potential for these infrastructure bottlenecks to be alleviated through public/private partnerships, many small states lack the necessary policy and regulatory capacity to facilitate such investments. Given the limited size of such countries, it is often neither practical, nor cost effective, to develop dedicated regulatory institutions for each state. In this connection, there is considerable potential for regional cooperation. The liberalization of the telecommunications sector in the Eastern Caribbean and the successful establishment of the Eastern Caribbean Telecommunication Authority (ECTEL) is an exciting cooperative model. The increase in network capacity and competition generated by these reforms has led to a considerable drop in prices for most services; the costs of calls to the US have been reduced by more than 70 percent, and service quality has shown a marked improvement. There is clearly considerable potential to replicate such regional cooperative models in other parts of the world—sharing capacity and arrangements among small states or with larger neighboring countries, and taking advantage of existing regional blocks—and in other sectors, such as in power, water, air traffic management, and the financial sector. The last is particularly important as small financial systems are prone to a lack of competition and an incompleteness arising from the high set-up costs of some financial services and markets; furthermore, financial regulation is similarly prone to high establishment and maintenance costs. The Eastern Caribbean Central Bank (ECCB) is good example of regional cooperation. The ECCB has played a key role in developing the financial sector of the OECS countries primarily through the maintenance of monetary stability, protection of the safety and soundness of the local banking institutions, and capital market development.

Financial Sector Development and Regulation

67. The provision of international financial services is already a significant activity in many small states. The availability of qualified professionals, the relative absence of scale economies, and the erosion of "remote location" disadvantages as a result of improved information and communication technologies, give the financial sector significant potential for further growth. Its association with tourism, especially long-stay tourism, and retiree schemes is also beneficial in this regard. Initially assisted by the enactment of "tax advantages," many small states have developed vibrant financial sectors (e.g., Bahamas, Barbados, Bermuda, the Cayman Islands, the Channel Islands, Dubai and Mauritius). The fact that some small states, like Cyprus and Malta, are now expanding financial services on an onshore basis confirms these possibilities for small states.

68. Since the publication of the 2000 Report, much activity has taken place in connection with the financial regulatory environment of small states. New international

standards and regulations have been enacted and monitoring and supervisory systems are being strengthened. Key areas of attention have included money-laundering, terrorist financing, narco-trafficking, the OECD harmful tax initiative, financial regulations in the GATS, regulatory standards and supervision by the multilateral financial institutions and the Bank for International Settlements. While many of these reforms are essential for a robust global financial system, they impose especially onerous burdens on small states. In some cases they relate more to the problems and interests of larger countries and are biased against small countries. The net result is that the process has not been smooth; improvements are needed if the small states are to be more effectively integrated into the international financial and security system.

69. When the 2000 report was being prepared, small states that were offshore financial centers felt severely threatened by unilateral actions, taken by the Financial Stability Forum (FSF) and instigated by the major industrial countries, that sought to impose regulations and standards. Actions to combat money-laundering and financing of terrorism (after September 11, 2001) were also initiated, by the Financial Action Task Force (FATF) set up under the auspices of the OECD. While this process is still problematic in terms of the administrative burdens imposed on small states, significant progress in improving regulatory processes has been achieved. There has also been improvement in international representation, including that of small states; however, OECD control remains strong and the role of small states remains largely consultative. It is critical that the donor community maintain its technical assistance programs to help small states meet the administrative and institutional demands of these reform efforts and view more positively the scope for well-regulated and supervised international services to contribute to economic diversification and development.

70. The OECD Harmful Tax Initiative posed a major threat to offshore financial centers. The small offshore centers reacted sharply as 41 of them were initially targeted for listing as uncooperative unless they agreed to engage in exchange of information and take a number of other measures demanded by the OECD. However, it is encouraging to note that there is now less insistence that tax competition is harmful, and with the establishment of a Global Forum on Taxation (on which there are non-OECD members as well as small states), the whole process has become more consultative and less unilateral. Blacklisting has been downplayed, although the threat against some centers remains. Issues of exchange of information and transparency are actively discussed, and small states have been successful in bringing to the fore the matter over which they had great concern—discrimination and the need for a level playing field. The atmosphere has become better for dealing with legitimate concerns over regulatory matters, but the influence of small states on standard-setting remains negligible. The establishment of the International Trade and Investment Organisation (ITIO) has been a welcome development. It is striving to improve the voice of small states in the international system and it deserves wider support. A major problem remains the ability of small states to undertake costly information exchange obligations; in this connection, it is recommended that, since developed countries have a much larger interest in such cooperation, appropriate incentives should be provided.

71. Beyond these regulatory and supervisory requirements, there are those required under the UN Conventions on Transnational Organised Crimes and the Suppression of the Financing of Terrorism and the Bank for International Settlements Core Principles and its New Capital Accord. The issue is not whether small offshore financial centers need to comply. Their improved regulation and supervision is an integral element of the smooth functioning, stability and security of an increasingly integrated global financial system and is needed for their beneficial participation in that system. It is therefore largely a question of costs and capacity and the assistance needed to meet these requirements. The New Capital Accord (Basle 2) underlines a shift in emphasis from compliance with rules (Basle 1) to standards based on market valuations of risk. For developing countries adopting Basle 2 is optional. Most small states would therefore want to avoid its more onerous requirements. This would, however, come at a cost since larger capital requirements would make local banks in small states less competitive and it would impede the entry of their branches in high income countries, which would require meeting the advanced Basle standards.

72. This progress on consultation has increased small states' confidence that they can re-invigorate efforts to expand their export of financial services. It is important that donors maintain their support for these endeavors. The IMF and the World Bank have completed regulatory assessments for several small states under the Financial Sector Assessment Program (FSAP); these involve monitoring of compliance with standards, including those set by the Basle committee on bank supervision. Some small states have also benefited from the Financial Sector Reform and Strengthening Initiative launched in 2002 by the World Bank and IMF and several bilateral aid agencies in support of capacity building efforts as a follow-up to the FSAP. If small states are to realize their potential to export financial services, there is also a clear need to aggressively explore ways to reduce the cost of the required regulatory and supervisory systems. In this connection, the Eastern Caribbean regional cooperation, through the ECCB, is an innovative model that could be used to inform establishment of shared, multi-country regulatory and supervisory systems in other areas of the world. It is also apparent that it may be possible to "outsource" key supervisory functions. Finally, there is a need to develop local banking structures and products that can support domestic businesses, particularly SMEs that continue to be largely ignored by the formal financial sector.

Governance and Capacity Building

73. The 2000 report emphasized the problems posed by expenditure indivisibilities of certain public services, such as regulatory activities, tax administration, education, health and social welfare, judicial systems, foreign relations, and security. In contrast to larger countries, the costs of providing these essential government services have to be borne by a small population base. For example, Malta has a population equivalent to about 1/150 of that of the United Kingdom; if the Maltese government were organized proportionally, many departments would employ less than one person! Moreover, the report rightly noted that small country size requires that ministerial portfolios must be multifaceted if the public sector is to be confined within reasonable limits. This combination of issues inevitably places a heavy burden on administrators and personnel; a challenge that has become particularly onerous in an age when state-of-the-art policies and systems for the

delivery of public services are evolving rapidly. The ambitious development agenda proposed in this report will also strain this limited government capacity even further.

74. The limited institutional capacity of small states is further stretched in those countries that face difficult internal transport logistics, such as the landlocked African countries and the multi-island states of the Pacific. Indeed, it is doubtful that some small states, such as the Pacific islands, even have the capacity to fully implement their obligations arising from their international agreements and membership of international organizations. In addition, because of the small size of the domestic market, monopolies tend to be more prevalent in small economies and, as a result, the role of government in the economy tends to be more pervasive than in other states. This often leads to political involvement in the provision of utilities, creating possibilities for political patronage and corruption. These problems are inherent to small states, no matter how much public reform is undertaken. This is not of course an argument against public sector reform. On the contrary, these realities make it more important and more urgent for small states to improve efficiency in the delivery of public services. The 2000 report also highlighted the fact that the costs of poor governance in a small society are very large, given the difficulty in recovering from the consequences of inappropriate policies and practices sustained over a long period of time. Effective measures to build public sector capacity remain a critical requirement for the small states.

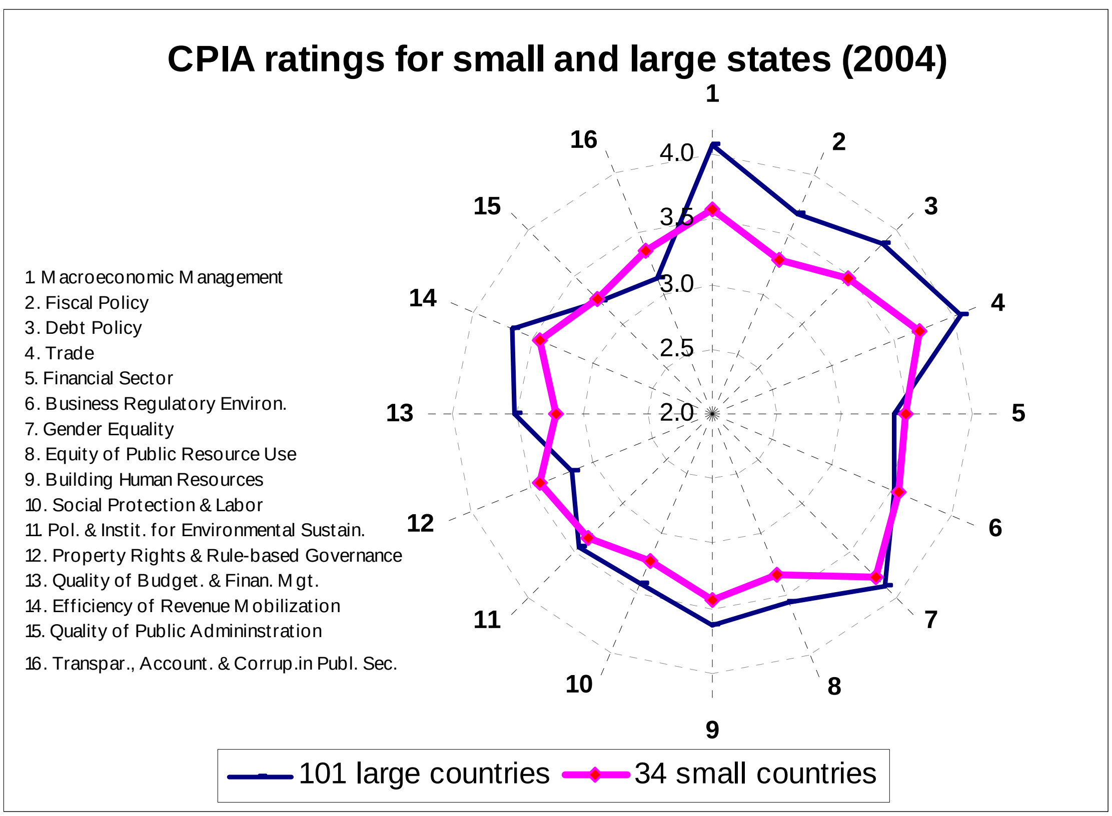
75. In recent years, there has been increasing recognition of the central importance of good governance and capacity building for equitable and rapid development. Indeed, it is interesting to note that during the consultation process several senior government officials highlighted governance as the most important determinant of development. If governments fail to protect freedom and human rights, to provide effective public services that meet basic human needs, and to respond equitably to the requirements of each section of society, crime, conflict, chronic ill health, poor education, and persistent poverty are the inevitable result. Recent research shows a strong link between improvements in the way states govern themselves and development results, whether in terms of income per capita, child mortality, or illiteracy. The implications of weak governance, civil unrest, and lost economic opportunities are readily apparent. For example, the 2004 report by the Asian Development Bank on "Governance in the Pacific: Focus for Action 2005-2009" concludes that nearly all Pacific island countries face serious challenges in all areas of governance; a finding confirmed by the governments themselves during the consultation process. Equally apparent is the positive development impact of sustained good governance in such countries as the Bahamas, Barbados, Botswana, the Maldives, Malta, Mauritius, and Singapore.

76. Strong and honest leadership can have an immediate and major impact in small countries precisely because of their limited size. Equally, the very familiarity of their populations, coupled with personal, family, and tribal rivalries and/or traditional political and cultural systems can result in partiality in government decisions and render it difficult to generate the necessary consensus and cohesion for sustainable improvements in governance. The Asian Development Bank report cited above notes that modern and traditional systems of governance coexist uneasily. Whereas the former advocates individual merit, neutrality, equal participation, and the rights of the individual and the

nuclear family, the latter demands priority and loyalty for kin and community, consensual and consultative values within the "chief/big men" traditional hierarchy, and traditionally defined roles for men and women.

77. The Country Policy and Institutional Assessments (CPIA) developed by the World Bank provide a good proxy to measure countries' overall performance in relation to governance issues. Both small and large states are included in the annual CPIA Bank-wide exercise that examines and evaluates the quality of borrowing countries' policy and institutional frameworks in terms of their ability to foster sustainable growth and reduce poverty. Countries with good policies and institutions are likely to use development assistance effectively. In performing the assessments, World Bank country economists and sector specialists review indicators of performance in four clusters: economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions. The World Bank discusses the detailed results for all criteria in these four clusters with each borrowing country's authorities. These discussions are opportunities to identify areas for action to meet development challenges. The results of this exercise for small and large states are summarized in Figure 1. Significantly, small states' overall policy and institutional performance has been at least as strong as that of larger countries. However, given that there are significant differences in performance across small states and because the "development" returns to improved governance are significant, it is important that small states continue to attach priority to addressing such issues.

Figure 1. ***Country Policy and Institutional Assessments of Small States***



78. An effective public sector reform effort requires close consultation with employees unions, the business community, and civil society more generally to build the necessary stakeholder support; the Maltese Council for Social and Economic Development and the tripartite approach to economic reform in Barbados, involving the Government, private sector and labor are good examples of such best practice. Equally important is the need to enlist the support of senior civil servants and to explore public/private partnerships that may generate innovative solutions for the provision of public services, such as outsourcing options that are discussed below. Improving the quality and availability of data will also provide better evidence on which to base policies, encourage participation in their development, and allow results to be quantified and measured.

79. While foreign donors have a key role to play in such reform processes, it is important to emphasize that attempts by the donor community to impose good governance from the outside have typically failed. Training programs and the use of outside consultants have also been largely ineffective. Country ownership and the commitment of local stakeholders are essential. However, the very success of several of the small states in improving governance shows that, despite the acknowledged challenges and vested interests, improvements in economic growth and welfare can be generated very quickly, if and when, the necessary degree of ownership materializes.

80. In some small states, including the Pacific and some of the Caribbean states, government capacity has also been adversely affected by the loss of senior staff with key managerial and technical skills to outward migration. Some times these migrations are caused by political factors and social unrest, e.g., the Fiji Islands in 1997 and 2000; in other cases they relate to perceptions of better opportunities in the developed world. It may not be possible for small states to effectively use the services of key public sector specialists full time. The solution to this set of problems lies in improving local and regional opportunities, particularly in the private sector.

81. Recognizing the practical difficulties of a small country effectively delivering all the services required by the citizens of a modern state, several governments have taken important steps to establish and strengthen regional institutions charged with key regulatory functions, such as the Eastern Caribbean Central Bank, the Eastern Caribbean Telecommunications Authority, and the regionally managed air traffic control systems in the Pacific. It is important that such regional initiatives be further developed and exploited by small states. They will be particularly critical if small states are to follow the human resource-based development strategies proposed in this report. The successful export of services requires sophisticated and modern financial, telecommunications, and education services which, for the vast majority of small states, can only be effectively delivered and supervised within the context of meaningful regional cooperation. Both the small states and the international community are encouraged to continue to explore and develop such regional options.

82. The emerging opportunities for outsourcing of government services have significant potential for improving both the governance and the public sector capacity of small states. Information technology coupled with outsourcing government functions can

transform the quality and transparency of government. Technology can reduce the time and effort required to register and start a business, and can thereby promote entrepreneurial behavior; it can improve tax and customs collection and fairness, and streamline government procurement; and it has the potential to improve security through reduced fraud in driver's license, ID cards, or passport issuance. A coherent and determined government outsourcing strategy has the potential to (i) improve citizen service quality and government accountability, (ii) improve national security, (iii) increase transparency and reduce corruption, (iv) increase government revenues, (v) increase regional or global competitive advantages, (vi) jumpstart the information and communication technology (ICT) and business services industry in the country, and (vii) reduce budgetary pressures. The potential for outsourcing government services may be particularly promising in the Pacific islands where the degree of isolation and the limited possibilities for reaping the benefits of economies of scale are particularly significant.

83. It is important to emphasize that such outsourcing does not imply any loss of the policy functions of government. Indeed, by contracting out selected service obligations small state governments are better able to focus their scarce high-level manpower on their core policy role. Not only does such an outsourcing strategy have the potential to allow small states to provide the full range of government services but the knowledge gained by specialized firms providing such functions can become the basis of a vibrant service export industry.

84. Related to the above, it is encouraging to note that there was widespread agreement, with only a few exceptions, that there were additional and major opportunities for the outsourcing of government services. Examples included revenue collection (already outsourced to independent revenue authorities in several small states), land registration, port administration, customs supervision, social security administration, and the issue of passports and business and divers licenses. In a related matter, several senior officials highlighted the importance of promoting e-government as part of any strategy designed to improve the efficiency of government service delivery. They also rightly emphasized that successful e-government units also had the potential to provide "outsourcing services" to other states (large and small).

85. Measures designed to strengthen civil society, are a critical part of any effort to upgrade governance. A strong civil society can act as an important watchdog and as a disincentive to corrupt practices; it can also help to ensure that the interests of less influential groups are represented. During the consultation process, several government officials and NGOs from all regions highlighted this issue. They emphasized that an effective civil society was particularly critical for small states given the limited size of government. Empowering civil society, to increase the accountability and responsiveness of the state, as well to help tackle key development challenges e.g., education, HIV/AIDS and crime, was in their view a high priority. Many small states e.g., Botswana and Lesotho have developed comprehensive programs designed to promote the role of civil society.

Security and Crime

86. Crime, drug trafficking, and youth unemployment have become major issues in many small states. The repatriation of offenders and the emergence of international criminal networks have compounded these problems. The Caribbean has been particularly impacted by these developments, but other regions, including the Pacific, are also being affected. Not only do these developments impose severe costs on the small economies (public security expenditures in Jamaica are now equal more than 50 percent of the education and 150 percent of the health budgets), but they also discourage private investment and tourism. Persistent youth unemployment also has the potential to severely undermine social cohesion and create a "lost generation," which in turn becomes a permanent burden on society.

87. Crime and security concerns have a negative impact on foreign and domestic investment, and raise the cost of doing business. They also erode the development of human and social capital on which the long-term competitiveness and income growth of the small states ultimately depends. Equally, crime necessitates a diversion of scarce public resources away from productive uses that have a potentially much higher impact on social development and growth, to areas such as police and justice. For example in recent years Jamaica's budgetary expenditure on health grew at an annual rate of 20-25 percent in nominal terms whereas those for national security and justice grew by more than 60 percent per year. Similarly, for private citizens it diverts resources away from productive expenditures such as education, to spending on private security. The direct annual cost of crime in Jamaica is currently estimated to amount to 3.7 percent of GDP. Given that small states are all competing in a highly open global economy, they cannot pass on the costs of crime through higher prices; crime is thus a tax on profits, which in turn reduces opportunities for investment and expansion. The growing alienation of the youth and unemployed from formal and informal institutions also serves to undermine the authority of governance systems, which are themselves already weak in many of the small states (see below).

88. The causes of crime, drug related violence and delinquency are, at least in part, rooted in the disappointing economic growth performance of some of the small states, most notably in the Caribbean and the Pacific, the proximity of many of these countries to the drug shipment areas, and failures in the educational systems. The declining importance of the manufacturing sector and the volatility of the tourism sector may have also contributed. The high population growth rate in the Pacific and the related challenge of providing adequate and meaningful jobs may have also been significant causal factors. For example, only 25-30 percent of school leavers in Vanuatu and Tonga can expect to find employment in the formal sector. These problems have often been compounded by failures on the part of families, governments, and societies to provide adequate support for young people to grow into responsible and productive adults. Youth unemployment rates in such countries as Barbados, Trinidad and Tobago, and St. Lucia are particularly high; indeed St. Lucia has the highest rate of such unemployment in the Americas. Similarly, youth unemployment rates are in excess of 40 percent in Timor-Leste, 30 percent in Tonga and 45 percent in the Solomon Islands; youth unemployment rates in the Pacific islands are typically double the rate of adult male unemployment. These

pressures in turn translate into high incidences of sexual and physical abuse, early sexual initiation (which helps to explain why the Caribbean has a high incidence of HIV/AIDS), and high incidences of youth rage and violence and drug abuse.

89. Given the high social costs of these problems and their ability to undermine the long-term competitiveness, welfare, and development of small states, it is essential that their solution be given highest priority by these countries and the donor community. The issues are complex and the appropriate remedies are inevitably multifaceted. A balanced approach is needed that addresses both economic and social factors, reduces inequality (especially inequality that is not derived from differential effort and performance), improves educational achievement (not just enrolment), ensures fair and effective law enforcement, and increased regional cooperation. Measures designed to improve the availability of productive and meaningful jobs will be equally important. In this connection, it is also important that donors collectively examine their own assistance programs relating to crime prevention and the promotion of security, with a view to ensuring that a full range of appropriate products is available to their small state clients.

HIV/AIDS

90. The devastating social and economic costs of the global HIV/AIDS pandemic are not unique to the small states. However, many small states are among those countries most seriously affected. Along with the larger states in the Africa region, the African small states have experienced a rapid increase in the prevalence of HIV/AIDS. It is estimated that about 37 percent of the adult population (15-49 years) of Botswana is now living with HIV/AIDS; the comparable figures for Namibia, Lesotho, and Swaziland are 21 percent, 23 percent, and 35 percent, respectively. These are the highest rates of adult prevalence in the world. While the rates for the Caribbean are significantly lower, between 2 percent-3 percent of the same cohorts, HIV is spreading fast. Of the 12 countries with the highest prevalence in the Latin America and Caribbean region, nine are in the Caribbean. In the Bahamas, Barbados, and Guyana, the HIV/AIDS epidemic has already spread to the general population; in other Caribbean countries the disease is still confined to the high-risk groups. If current trends are not reversed, a rapid growth in the incidence of HIV/AIDS in the region will be inevitable. Prevalence rates are low in the Pacific—less than 0.4 percent of the population—but a high risk factor for the spread of HIV is the high incidence of sexually transmitted infections. In Samoa and Vanuatu, more than 40 percent of pregnant women have been found to be so affected.

91. The long-term impact of these developments is significant. For example, Swaziland's population is now projected to be about 1.6 million in 2015 compared to just over 2 million in the absence of HIV/AIDS. The equivalent projections for Botswana are for a population of 1.7 million in 2015 compared to 2.7 million. The impact on the future labor force will be even more dramatic. Life expectancy in Swaziland has already declined from about 60 years to about 38 years over the last decade as a direct consequence of the pandemic. In the English speaking Caribbean, AIDS is now the largest cause of death among young men between the ages of 15 and 44. Apart from directly reducing life expectancy, and over time the size of the labor force, AIDS also

affects the dynamics of skill accumulation. It tends to kill prime-age adults, many of whom are skilled and at the peak of their economic activity.

92. The economic cost of HIV/AIDS is equally devastating. The cost of one year of medical treatment for a person with AIDS can exceed two to three times the per capita GDP of many of the small states. In a country with an HIV prevalence of 15 percent, the estimated budgetary cost of the disease (lower revenues and increased expenditures) could rise from a current level of 2.5 percent of GDP today to 6 percent by 2010. The social systems of the African small states have already become over burdened by the disease, and the health and education gains of the poor have been reversed. Recent World Bank research indicates that as long as the prevalence of HIV remains below about 5 percent, per capita growth is minimally affected. When prevalence reaches 8 percent the annual cost in per capita growth is about 0.4 percentage points. The World Bank currently projects that the presence of AIDS in Botswana will reduce the average GDP growth rate from 4.7 percent to 2.2 percent. This is particularly tragic for a small state that has been a model of good governance and is prudently managing its natural resource endowment for the benefit of present and future generations.

93. If the small states that are threatened by HIV/AIDS are unable to reverse the pandemic, the prospects for the successful implementation of the export-oriented development strategies advocated in this report could be seriously undermined. Such knowledge/services strategies are critically dependent on training and maintaining a highly skilled labor force capable of competing in the global market place.

94. Since 2002, global funding for HIV/AIDS has trebled. A major initiative has been the establishment of the Global Fund to Fight HIV/AIDS, Tuberculosis, and Malaria. It is of the utmost importance that the most seriously affected small states utilize this support and aggressively promote and fund programs designed to prevent the spread of AIDS and to ameliorate its impact. This includes providing clear leadership by the most senior government ministers (Botswana's leaders have provided an exemplary model), the scaling up of prevention and surveillance activities at national and community levels (including awareness programs, and making condoms, counseling, and testing readily available), ensuring safe blood supplies, and reducing mother-to-child transmission, scaling up care activities for those infected (including the provision of retroviral drugs), and strengthening regional responses. The latter are particularly important for those small states (most of them) that lack the necessary capacity to respond comprehensively and adequately to the epidemic. In this connection, a major initiative in the Caribbean was the establishment in 2001 under the umbrella of CARICOM of the Pan-Caribbean Partnership against HIV/AIDS (PANCAP) to better coordinate and reinforce national action. Its membership spans the wider Caribbean and includes 29 countries and a total of 70 partners involving both Governments and non-Governmental organizations. PANCAP has raised the profile of HIV/AIDS in the regional agenda and has helped to secure a fourfold increase in bilateral and international support for programs, which have shifted the emphasis to a more comprehensive view of HIV/AIDS as an economic development issue as well as a health and social issue. It is encouraging to note that some of these programs are beginning to have an impact. For example, in the Bahamas and Barbados, there have been significant reductions in the

number of reported cases, in prevalence among pregnant women, in mother-to-child transmissions, and in the number of AIDS deaths. There is also preliminary data which shows that, in some small states the overall incidence rate, albeit high, may have stabilized e.g., Swaziland and Namibia. It is vital that the international community maintain and expand even further its financial, technical, and institutional support efforts.

Environment and Sustainable Development

95. Small states, especially the island ones, face major environmental problems that pose serious constraints to their development. This reality has been recognized in the Barbados Programme of Action (1994), which set out a series of actions to be taken by the national governments and the international donor community towards the sustainable development of small island developing states (SIDS).

96. Since the publication of the 2000 report, there were two international meetings of major interest to small states: the World Summit on Sustainable Development (WSSD) and the Mauritius International Meeting. In both these meetings, environmental concerns of small states featured prominently. The Plan of Implementation of the WSSD dedicates a whole section (VII) to the sustainable development of small island developing states, whereas the Mauritius Declaration was entirely dedicated to the problems of such states. In both documents, the need for integrated action was highlighted, and both emphasized the need for institutional strengthening and capacity building.

97. A major problem faced by many small island states, identified by the 2000 report, related to their susceptibility to extreme events such as cyclones, hurricanes, and tsunamis. This problem has not only remained relevant, but there are indications that it has become more serious. The impact on small island states is exacerbated as a result of the relatively high ratio of coastal area to the land mass and the relatively large population that lives close to the coasts.

98. Most small island states experience major environmental problems associated with waste generation and marine pollution mainly because of their relatively high population densities. The small territorial size of most small states leads to intense land use competition, which in turn results in deforestation and land degradation. During the consultation process, several governments also rightly emphasized that scarce water resources are becoming a critical issue for many small states; they felt that much more attention will have to be paid to this issue in the future.

99. Climate change and variability are likely to have a much higher impact on SIDS than on larger territories, even though the former contribute very little to greenhouse gases. The Intergovernmental Panel on Climate Change (IPCC) Third Assessment Report on Impacts, Adaptation and Vulnerability (2001) shows clearly and convincingly that small island states will face severe economic, environmental, health, and cultural impacts as a result of sea level rise, especially in low-lying countries such as the Maldives, where large areas of land are likely to be inundated. Adaptation to climate change is therefore a critical challenge facing SIDS; however, they face severe resource and capacity constraints in meeting it.

100. Another major problem faced by SIDS relates to the advancing destruction of coral reefs, an immensely valuable marine resource with regard to fisheries and tourism, which are central to their economic development.

101. Many SIDS located in the Pacific and Indian Oceans have vast ocean resources under their jurisdiction within their Exclusive Economic Zones (EEZs), but they lack the capacity to manage and exploit the sustainable development of these resources. SIDS require capacity and expertise to meet their national and international responsibilities for management of their EEZs. Their international responsibilities and obligations, which are embodied in a number of international conventions, often require expensive ocean management and monitoring capacity. As noted elsewhere in this report, executing the requirements of Agenda 21 and other international conventions are proportionately higher per capita than for larger territories. It is therefore important that the international community extend sufficient support to the small states to enable them to effectively discharge their international obligations.

102. Small states face similar institutional challenges with regard to their capacity to develop, promote, and support integrated policies relating to the environment, water, and energy and to adaptation to climate change. In this connection, there is often, a lack of coherence in environmental policies and approach across ministries in small states, despite their small size. It is therefore important for those small states that have not already done so to set up national commissions for sustainable development to ensure the necessary consistency, and for the international community to further strengthen its capacity-building support for the environment. Small states should also promote and strengthen partnerships of key stakeholders to better inform decision-making and implementation of sustainable development policies.

Managing Natural Resource Endowments

103. Smallness does not necessarily mean poor resource endowment. It does, however, often mean a narrow endowment, usually oil or one other mineral resource. Among the small states so endowed are Botswana, Equatorial Guinea, Gabon, Guyana, Sao Tome and Principe, Suriname, Timor-Leste, and Trinidad and Tobago. But natural resources are not confined to minerals. As noted above, many island and coastal small states have attracted tourism development because of pleasant climates and beautiful natural environments. It is important that these valuable assets be managed well, for the benefit of current and future generations.

104. Ensuring that these resources are used for sustainable long-term development is particularly critical at a time when oil and primary commodities are commanding high prices. However, these surpluses often hinder development and result in civil strife and corruption as powerful interest groups attempt to capture the rents. Some of the small states have been particularly vulnerable to such pressures. It is vital that the revenues from depleting natural resources be used for physical and human capital formation. Botswana, with its strong governance, has set an impressive example in this connection. If primary commodity surpluses cannot be productively used in the short and medium term, investment and trust funds are an important option. Kuwait has utilized such

instruments well. In addition, Timor-Leste is about to adopt a "best-practice" legislative framework for petroleum production, taxation and revenue management, which will, if effectively implemented, safeguard petroleum revenues for current and future generations.

105. Management of environmental resources to ensure optimal tourism development is an important issue for many small states. This implies making careful trade-offs between high-end eco-tourism and mass market approaches that can result in heavy environmental pressures. It also requires a special premium and emphasis on preserving these fragile environments for the benefit of future generations. In this connection, greater use could be made of user charges and other economic instruments to protect against misuse or overuse of fragile tourism amenities.

106. Substantial institutional strengthening will also be required if the small island states are to realize the large potential resource gains from the extended EEZ. Management here has both economic and security dimensions. It requires regional collaboration and partnership with both island and developed states, as is the case in some Pacific islands, for effective surveillance and economic exploitation.

Disaster Insurance and Risk Management

107. Reflecting the unique vulnerability of small states to natural disasters, the 2000 report highlighted the critical importance of both disaster mitigation measures and the development of catastrophe insurance tailored to the special needs of small states.

108. Events since 2000 have only served to further highlight the dangers posed by natural catastrophes to small states. Hurricane Ivan devastated Grenada, decimating the housing stock and causing US$900 million of damage (equivalent to 200 percent of GDP). The cost of the recent earthquake in Dominica amounted to more than 33 percent of GDP, while the cost to the Maldives of the December 2004 tsunami equaled more than 65 percent of its GDP. It is important to emphasize that relatively low-cost mitigation measures, e.g., hazard mapping, enactment and enforcement of building codes, and disaster information mechanisms, can avoid significant loss of life, considerably reduce infrastructure damage, and lower insurance costs. For example, only two schools in Grenada escaped damage from Ivan. These were built with assistance from the World Bank, with rigorous attention paid to hurricane-proof standards. During the 2004 cyclone Heta, Samoa is estimated to have saved up to US$165 million in damages because of the adoption of hazard management procedures. It is thus disappointing that progress in implementing the needed mitigation measures in many small states has been less than adequate in the last five years. It is important that such actions be given more prominence by the small states and the donor community.

109. Progress in developing natural disaster insurance mechanisms has also been disappointing. The design of such schemes, which can be purchased by small states at affordable costs, poses significant challenges owing to the unique nature of the risks associated with natural disasters. The 2000 report pointed out that natural disaster insurance can provide some relief in the event of a catastrophe but that the cost of

insurance for such risks tends to involve 'over-pricing' to compensate providers for the inherent uncertainty and the risks of insolvency if the probability is miscalculated. It also indicated that there needed to be a more optimal spreading of such risks, including integration into international markets that are better able to absorb the large economic and financial risks. It concluded that more work would be needed to find new ways to "ensure adequate financing for post-disaster rehabilitation and reconstruction and improve incentives for the private sector to enter the natural disaster market at premiums that would be attractive to small states."

110. The recent disasters have provoked a renewed urgency on the part of the most seriously affected small states to develop appropriate insurance facilities. For example, the CARICOM governments are now interested in developing a comprehensive risk management approach that will allow the efficient sharing of insurable and uninsurable risks among the public and private sectors, the international insurance industry, the credit and capital market, and the "self-insured" population. The leveraging of scarce capital to diversify and better spread risks and to significantly increase the efficiency of risk-transfer mechanisms would require a substantial risk-pooling mechanism, which the CARICOM countries are committed to developing. Such a mechanism has the potential to improve the leverage of limited domestic capital while exploiting the best terms for reinsurance protection, through shared risk diversification and faster accumulation of domestic insurance reserves. The 2005 draft of this report recommended that the international financial institutions consider developing financial products designed to support and catalyze such schemes.

111. It is encouraging to note that in January 2006, with grant funding from the Government of Japan, the World Bank initiated preparatory studies for the establishment of Caribbean Catastrophe Risk Insurance Facility. The Facility has now been established and an Operations Manager appointed. The Facility will allow CARICOM member governments to purchase coverage, akin to a business continuity insurance, that would provide them with early cash payments after the occurrence of a major disaster, thus enabling them to overcome the traditional liquidity crunch that follows such an event. Details, including the desired levels of coverage and prices, are currently being discussed with the potential beneficiary states. It is intended that donors will contribute towards the initial capitalization of the Facility. The Facility will contract additional risk cover through (multi-year) reinsurance or through other financial coverage instruments e.g., catastrophe bonds. It is important that the donor community support this initiative and that it be replicated/extended to small states in other regions of the world.

112. It is also important that the interest of the small states and donors in disaster mitigation and recovery mechanisms be maintained. The needed mitigation measures are generally well known and can be implemented at comparatively small costs. The key is to provide the necessary level of government leadership and commitment to ensure that they are in fact implemented.

113. Reflecting the vulnerability of some of the small states to commodity risks, the 2000 report highlighted the importance of fully exploiting hedging instruments in the international financial markets to help offset temporary price fluctuations. It also

emphasized the importance of exploring other possibilities for sustainable and effective ways to assist developing countries in better managing the risks associated with commodity price fluctuations, including the possibility of introducing crop insurance schemes. However, little progress has been made on such initiatives in the intervening five years. The major problem appears to be that the financial cost of such long-term risk management instruments is prohibitive. The continuing long-term decline in the importance of commodity exports for most small states also makes this issue less critical than it once was. It is therefore recommended that commodity risk insurance be taken off the immediate agenda.

Regional Cooperation

114. The period since the 2000 report has seen an increased interest in regional cooperation by small states. Regional trade liberalization and other forms of economic cooperation have long characterized the Caribbean region, and, in recent years, the Pacific islands have sought greater economic integration to add to a well-developed system of cooperation in other areas, specifically through the Pacific Plan for Strengthening Regional Cooperation and Integration, approved in October 2005. These cooperative initiatives initially focused on freer trade and the promotion of mutual political interests, but the institutional arrangements they spawned have provided the basis for other joint activities. For example, in the Caribbean a free trade area, and later a customs union, led to current efforts to create a single market and economy (CSME). In the context of the current proliferation of free trade areas, this has been a prudent decision for the Caribbean. The move to a CSME illustrates the importance of preparing the Caribbean countries for the harsher competitive environment that they must face as the world moves towards an increasingly open international trading system. In this connection, it is prudent to emphasize the potential negative effects of regional trade arrangements for small states, and the need to exercise caution in embarking on such initiatives. Such risks include, trade diversion, the administrative burden of multiple negotiations and the cost of compliance with different rules and standards.

115. Given that trade flows between neighboring small island states are and will always be quite limited, the success of regional cooperation will ultimately have to be judged by its impact on the overall competitiveness of its members relative to the rest of the world. In this connection, the CSME has initiated, in a limited way, the freer movement of people. It is very important that such initiatives be accelerated. Success in the new global economy requires highly educated and flexible labor markets in which key skills can be deployed on a just-in-time basis. The easing of regional employment restrictions across small states can result in the better utilization of scarce skills, alleviate sectoral labor shortage (e.g., skilled construction workers), and provide high-level professional opportunities. The latter can also help to reduce pressures to emigrate. Some progress is also being made in freeing up the movement of capital and trade in services and making it easier to establish businesses in neighboring countries. Cross-border stock trading is being encouraged and cross-border business takeovers and amalgamations are being made easier. The success of the outward-oriented strategy advocated in this report will critically depend on the widening and deepening of such initiatives. For example, progress in the Caribbean is likely to be faster with the removal

of exchange control, where it still exists, and by further tax and regulatory harmonization and the removal of remaining restrictions on foreign ownership.

116. As mentioned elsewhere in this report, increased regional cooperation among small states and with their larger neighbors, will be essential, both to counter the limited ability to reap economies of scale in delivering vital government, central banking, and regulatory services and to achieve the degree of competitiveness necessary to succeed in a global economy. Without a partial ceding of sovereignty to such regional bodies, the full benefits of the outward oriented development strategies proposed in this paper will not be achieved. In this connection, it will also be important to resist the temptation, and to avoid the costs, of creating "national" bodies to supervise and oversee these regional institutions. The successes of the Eastern Caribbean Central Bank and the Eastern Caribbean Telecommunications Authority have already been described. The Caribbean Development Bank, which has made a major contribution to the development of the region, has also developed a special understanding of the needs of small economies. Similarly, the small states in southern Africa (in cooperation with South Africa) have participated successfully in a customs union (SACU) and common monetary (CMA) and financial regulatory arrangements. Additional and promising opportunities for regional cooperation (some of which are already used by several small states) include health and disease control, higher education, secondary school examinations, environmental protection, fisheries regulation and enforcement, air traffic control, utility regulation, procurement of regional air and shipping services, preparing model legislation, cross-border crime prevention, international negotiations, foreign representation, and cultural promotion. It is important that such options be aggressively pursued by small states. This, in turn, will require a major effort by the international community to support the necessary capacity building in these vital areas.

117. During the consultation process, the landlocked African states noted their agreement with the need to explore further economic integration with their larger neighbors as well to exploit the potential for additional outsourcing of key regulatory functions to the same countries. However, they emphasized their inherently weak bargaining position and the tendency of larger countries to ignore, or neglect, the special concerns of their smaller neighbors e.g., provision of efficient transport links and other infrastructure services and in their trade negotiations with the rest of the world. They noted that the international community, including the small states acting together, has a key role to play in ensuring their interests are protected.

Aid, Aid Management, and Harmonization

118. As a group, small states have received considerable aid relative to their population size: US$178 per capita per annum on average in 2001-02, compared to US$11 received by low-income countries. In most small states, the bulk of aid is from bilateral donors, with multilateral donors playing a significantly smaller role than in larger countries. At the same time, because of their high dependence on aid flows, small states can be particularly hard-hit by declining aid. Official development assistance and official aid to small states fell, from a peak of US$2.5 billion in 1994 to less than US$2.0 billion annually in 1998-2002. Aid flows to small states recovered in 2004 but have still to

reach the levels of the mid-1990's (see Figure 2). The decline affected small states in all regions except Europe, but was most pronounced and persistent in Africa and the Caribbean (see Figure 3 and Table A7). Given the challenges faced by small states as result of the withdrawal of trade preferences, their need to promote the private sector and invest in human development and services, and taking into account the resumption in recent years of increases in global aid flows, it is important that aid flows to small states that are committed to a rigorous development agenda be increased. The responsibility for such a development agenda must fall to the small states themselves, but in view of capacity limitations, donors would need to facilitate the reform and adjustment process.

Figure 2. Start of recovery of ODA to small states

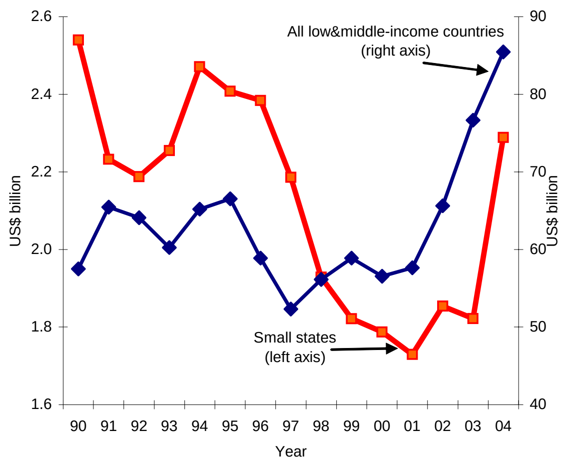
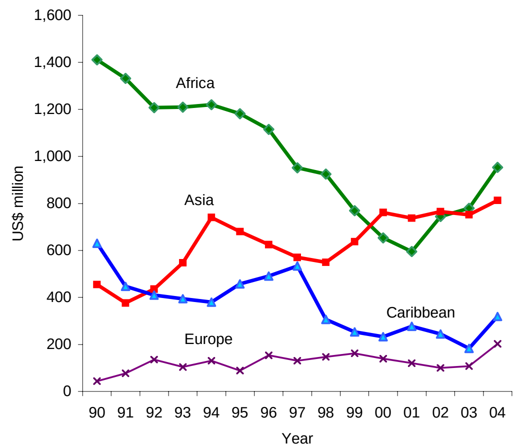


Figure 3. Trends in ODA to small states by region



Based on OECD/DAC data.

119. The 2000 report rightly noted the limited institutional capacity of small states to manage aid and the high costs of individual donor requirements, differing disbursement procedures, and so forth. The donor community was urged to adapt their instruments to suit small states, coordinate their efforts in a country-led framework, and avoid burdening the implementation capacity of small states.

120. During the intervening period many, if not all, all members of the aid community have taken steps to respond. Some donors have specialized and focused their efforts on their respective comparative strengths; for example in the Pacific island states, the bulk of the World Bank's activities have concentrated on the provision of advisory services, while the bilateral donors have focused on budget support and project financing with a high degree of country specialization by individual aid givers. The World Bank has also experimented with "regional" loans and credits in the Caribbean and with flexible lending instruments (e.g., adaptable program loans that can be tailored to the individual needs over time). A similar approach has been used for some of the small African states. Collectively, the donors have taken steps to streamline processes, procedures, and practices in line with country needs. These measures have included aligning support with budget cycle years, standardizing reporting and auditing arrangements, and joint strategy preparation. These have been carried out in both country and regional contexts (e.g., Caribbean Forum for Development and the Pacific Forum Secretariat).

121. Despite these positive steps, more radical measures to lower the administrative burdens of aid on the inevitably limited capacity of the small states, are warranted. While "harmonization" is clearly a step in the right direction there are obviously limits to its impact in a small state environment, where the burden of dealing with several donors is inevitably high even if all their procedures are identical. A higher level of donor cooperation, where their aid operations are effectively integrated or jointly managed, would appear to be needed. For example, one donor could be selected to manage the aid activities of all others in individual countries. In such cases, the managing donor would appraise programs and projects and disburse funds on behalf of all aid agencies (or each donor would disburse directly on receipt of appropriate documentation from the managing donor). Collective aid policies for individual counties could be agreed at periodic donor meetings led by the recipient state, and implementation and results could be reviewed and monitored at the same gatherings. One variant of such an approach would be to establish country trust funds, again managed by one donor on behalf of the others. Such multi-donor trust funds have long been used for global programs such as CGAP (the Consultative Group to Assist the Poorest, a multi-donor consortium for micro-finance) and ESMAP (the Energy Sector Management Assistance Programme). There is, therefore, ample precedent for such cooperative efforts. The Maldives Trust Fund, established for post-tsunami assistance, provides an interesting model.

122. There is, of course, always a danger that donors will "gang up" on the recipient, but such risks would appear to be minimal if the principle of country leadership is firmly established, and if analytical work underpinning assistance is carried out jointly by government and donors. Such an aid cooperation model would not necessarily prohibit individual donors from providing direct support, tailored to their own comparative advantage, at the request of the country and the 'managing donor.' For example, the World Bank and IFC could concentrate on the provision of global specialized knowledge where they have a unique ability to transfer good practice and experience across countries, and the regional banks and the bilaterals could focus on targeted project and program support, including disaster mitigation and relief.

123. Not only would the adoption of more radical approaches to aid management reduce the burden on the small states, but they also have the potential to significantly reduce the donors' own per capita cost of administering ODA. The per capita cost of administering aid programs for the small states is inevitably high; e.g., the World Bank's administrative budget for the Pacific islands and the Caribbean is about US$1 per capita per year. A 'managing donor' or 'trust fund' model could significantly reduce the totality of individual donor costs by avoiding duplication and reducing overheads. Such savings could in turn be used to support more technical assistance (TA) and advisory products for the small economies.

124. Irrespective of whether more collaborative approaches emerge, it is essential that donors further streamline their lending instruments and tailor them to the needs of the small states. While several donors have experimented with innovative instruments, most continue to use products designed for larger countries. The net result is high transaction costs and inflexibility when circumstances change. An increased emphasis on program/budget support within agreed country strategy frameworks would appear to be

indicated. Given that the costs of preparing individual small state country strategies by each donor are prohibitive, for both donor and recipient, ideally such new products would need to be introduced within a new cooperative framework similar to that described above. The development of small states regional sector lending instruments in such areas as finance, infrastructure, education and health, would also appear to be a priority. Given the critical importance of private sector development and trade to small states it is important that the donors review the relevance of their products designed to support these activities and explore innovative approaches.

125. It is also apparent that, either individually or collectively, donors need to take steps ensure that they are able to recruit and promptly deliver the TA expertise required by the small states. While the broad policies necessary to underpin economic growth and achieve social equity are applicable to both large and small economies, the latter face a set of challenges that requires that these general approaches be adapted to their unique requirements. For example, the creation of supra-national regional regulatory authorities for the financial and utility sectors, air traffic and fisheries management, and the environment requires a specialist expertise that can develop prescriptions tailored to the needs of small states. Similarly, dynamic private sector development requires that advisers have practical business knowledge/experience as well as a policy competence. The global aid community typically has ready access to the latter but not the former. In small states, where macro and micro issues often merge, the identification of specific investment opportunities and the business skills to convert them into reality are just as important as the establishment of a conducive investment climate.

126. The donor community would serve the small states well if it could collectively establish a global system to identify and nurture the development of small state development expertise, systematically collect and share the specialized knowledge, and deliver it on a just-in-time basis to small states. The World Bank and Commonwealth Secretariat have small states websites that collect data, reports, and other information on small states. These are important mechanisms for systematic knowledge sharing, but the potential pay-off to additional networking initiatives would appear to be significant. The small states themselves are the best source of such expertise; some of these countries have developed and introduced sophisticated policies, regulations, and institutions tailored to the special needs of small states. However, many of these lessons and experiences are not readily available to other small states. For example, Malta, Barbados, and Mauritius have successfully introduced value added tax systems, the Eastern Caribbean has significant experience in designing and operating regional financial, monetary and telecommunications regulatory authorities and procurement services (the OECS Pharmaceutical Procurement Service lowered the cost of pharmaceuticals in the region by as much as 40 percent), Samoa has successfully managed to reduce their cost of air transportation through innovative selection of foreign carriers, the Maldives has developed a vibrant tourism sector from meager beginnings, Iceland has a long and successful record in protecting its fishery resources and in enforcing the related regulations, and Singapore's experience in "bonding" emigrants to recover the cost of higher education is potentially useful to other small states seeking to enhance their human resource base.

127. The 2005 draft report recommended that the Small States Forum commit to developing such a networking system and ensure that its member states actively participate. If this experiment succeeded, it could be used as a model for other cooperative efforts and give practical meaning to the Forum itself. In this connection it is important to emphasize that such a networking system would not substitute for the work of the World Bank, Commonwealth Secretariat and other donors; rather it would serve to reinforce and complement their on-going assistance programs. During the consultation process, most governments expressed their enthusiastic support for such an initiative. It is therefore encouraging to note that Malta plans to formally submit such a proposal, to the 2006 Small States Forum. It will include the establishment of a permanent small states network in close collaboration with the World Bank, with the aim strengthening the cooperation between small states, sharing good practice between these states and providing continuity between one session of the small states forum and another.

128. Mechanisms designed to more effectively share small states knowledge and build specialized expertise *within* development agencies would also appear to be indicated. Most donors tend to organize themselves along regional and geographical lines. While this clearly makes sense for larger countries and regions (e.g., within the Africa and Latin America regions, many countries face similar development challenges), the specialized needs of small states are sometimes neglected in such organizational structures. For example, professionals working on Pacific small states could benefit from working on the Caribbean and vice versa; typically regional organizational structures inhibit such movement. An organizational unit that includes *all* the small states could readily learn from the experience of others, automatically transfer lessons of experience (good and bad) across the globe, and build up specialized small state expertise across sectors and themes. Another variant of this approach would be for the larger donor agencies to establish small central units, with both a mandate and the authority, to share small states lessons across their operational departments. It is not the purpose of this report to tell individual donors how to organize their own internal operations. However, it is strongly recommended that each donor should review their own internal structures/systems with a view to strengthening their capacities to serve the special needs of the small states.

Conclusions and Recommendations

129. The key characteristics highlighted in the 2000 Task Force report as typifying small economies and largely determining their development priorities remain valid. Disadvantages stemming from remoteness and insularity, susceptibility to natural disasters, limited institutional capacity exacerbated by the indivisibility of core government functions, limited diversification, high degree of openness to the global economy, difficulties in accessing private external capital, and poverty are the cold realities for many small states and inevitably dominate their development agendas. Nothing has happened in the intervening six years since the 2000 report to make them less relevant.

130. However, a number of issues and developments that are worthy of increased attention have become apparent since the 2000 report was published. Taken together, these suggest that efforts to prolong reliance on preferences do not have promising or

productive prospects. Instead, small states should adopt positive adjustment measures and shift their attention to designing and implementing aggressive, export-based development strategies. This requires increased emphasis on efforts to exploit and create comparative advantage in the service sectors, while at the same time not neglecting scope for competitiveness in other sectors. By their nature, the service sectors are less vulnerable to the high transport and other infrastructure costs faced by small states, especially the remote ones, and, in contrast to the traditional commodity exports, have robust long-term market prospects. The success of small states in implementing such an outward-oriented approach will be critically dependent on accelerating the adjustment process, including by creating a conducive investment climate; empowering and improving the quality, health and safety of their human resources; enhancing regional cooperation; building environmental and other resilience mechanisms specifically designed to offset their unique vulnerabilities; and improving the quality and volume of international assistance designed to support these efforts. Such measures will also be important for the agriculture sector which is and will remain a substantial sector in some small states for both domestic and export markets. The critical elements of an updated and revised strategy are summarized below.

Increasing competitiveness and improving the investment climate

131. Increased attention to private sector development is critical to the success of the outward-oriented development strategies proposed above. This in turn requires increased focus on developing the required overall conducive investment climate and a move away from specific incentives. Such a strategy requires securing property rights, improving land tenure systems, simplifying the tax regime, enacting appropriate competition legislation, providing an adequate physical infrastructure, enhancing education and health infrastructure, and improving governance. The disturbing increase in the indebtedness of small states that has occurred since the publication of the 2000 report, coupled with the reality that traditional preferences to the small states are eroding faster than originally anticipated, further highlights the importance of urgently enacting these adjustment programs.

132. Tax reform and tax administration remain key areas of weakness in many small states. While a uniform import duty may not be particularly distortionary in small states where almost all consumables, other than food are imported, a move away from a reliance on import duties would appear to be indicated. Small states cannot remain outside the framework of international trade rules if they are to successfully follow an outward-looking development strategy and have full access to opportunities to expand their trade in tourism, finance, and other services. Reductions in public expenditure to correct fiscal imbalances in an era of dangerous increases indebtedness are also required. In doing so, vital services must be maintained and protected. Innovative efforts to secure public sector efficiency gains, including more outsourcing; greater use of user charges, tuition fees for higher education (while maintaining the access of the poor), and fees and taxes on financial services; reducing special business incentives, achievement of a better balance between public and private sector wage levels; reductions in public service employment; and more selective use of subsidies will also be necessary.

133. Ensuring that the small states exploit the considerable potential of their diaspora communities can be a major contributory factor to the success of private sector development. These overseas communities have considerable potential to provide the needed finance, entrepreneurship, and markets.

134. Recent improvements in the development of international financial regulations and standards, agreements on anti-money laundering measures, and the emergence of a consultative approach to the issue of harmful tax policies provide the basis for several small states to emulate the success of others in becoming viable offshore financial centers. It is important that the small states continue to improve their regulatory and supervisory mechanisms, including through regional cooperation.

135. The last five years have seen an increasing recognition of the central importance of good governance and capacity building to enhance overall competitiveness. While the overall performance of small states with respect to governance is generally satisfactory, some of them have demonstrably suffered from weak and unstable political institutions as well as corruption. Given the central importance of good governance for economic success, particularly in the case of open economies, as well as the potential for small states to move more quickly than the larger countries in this area, it is important that governments of small states give priority to these matters. There is also considerable potential to improve governance and performance of the public sector through regional cooperation (see below) and outsourcing of key government services.

Empowering and improving the quality, health and safety of the small states human resources

136. Though small states in general have more highly educated populations relative to the larger low- and middle-income counties, it is essential that they invest in and further improve the quality of their educational systems if they are to exploit the current and emerging service opportunities. Countries benefiting from the migration of educated and trained people from small states should provide increased support for human resource development in these states. Recipient countries should also develop more open immigration policies for both skilled and unskilled workers. Mobility of labor is as important as mobility of goods, services and capital, for economic adjustment

137. Crime and security have emerged as major issues facing a number of small states. Not only are the social and economic costs of this crisis very high, but crime rates severely undermine the prospects for developing a successful and vibrant outward-oriented development strategy. It is critical that the small states, with the active assistance of the international community, give priority to solving these problems.

138. The devastating social and economic costs of the global HIV/AIDS pandemic are not unique to the small states. However, some of the African small states have the highest incidence rates in the world and the Caribbean small states are the most seriously affected countries in the Western hemisphere. The long-term impact on health, economic growth, and the public finances will be severe. Because HIV/AIDS attacks the most active economic cohorts, the pandemic also threatens to undermine the outward-looking

knowledge-based development strategy advocated in this report. It is vital that the small states and the donor community attach the highest priority to aggressively combating this disease.

The imperative for regional cooperation

139. Given their small size, individual small states will, inevitably be unable to deliver all the necessary government policy, regulatory and service functions required of a modern state. Yet the availability of these important government functions is essential to the success of the outward-export oriented strategy proposed in this report. It is therefore vital that the small states aggressively seek to replicate the success of many of the pioneering regional regulatory innovations, such as those in the telecommunications and financial sectors in the eastern Caribbean. Other opportunities for developing and intensifying regional cooperation include health and disease control, higher education, secondary school examinations, environmental protection, fisheries regulation and enforcement, air traffic control, utility regulation, procurement of regional air and shipping services, preparing model legislation, cross-border crime prevention, international negotiations, foreign representation, and cultural and investment promotions. Enhanced regional cooperation is needed not only to better provide for domestic needs, but also to increase engagement with a globalizing world.

Building environmental and other resilience mechanisms to offset the unique vulnerabilities of small states

140. Many small states remain particularly vulnerable to environmental problems that threaten their sustainable development, e.g., rising sea levels resulting from climate change, cyclones, destruction of coral reefs, and inappropriate exploitation of natural resources at the expense of future generations. Many small states need to develop sustainable development strategies, and strengthen their mechanisms, institutions, and local stakeholder partnerships designed to protect and manage the environment. However, given the institutional challenges they face it is critical that the donor community strengthen its efforts to support them.

141. Several small states are well-endowed with natural resources, including oil, minerals, and an attractive tourism environment. Ensuring that such resources are optimally managed for the benefit of current and future generations is critical. This in turn requires good governance to ensure that surpluses are not captured by powerful interest groups; investment in physical and human capital to ensure that such surpluses have a long term development impact; establishment of trust or investment funds, when revenues cannot be effectively absorbed in the short-term; keen attention to protecting environmental resources for appropriate tourism development; collaboration with neighboring countries or developed country partners to effectively secure and exploit the resources of the EEZ; and substantial institutional strengthening.

142. The experience of the first years of the decade has shown that small states remain highly vulnerable to natural disasters and environmental shocks. It is therefore encouraging to note that, after years of little progress on establishing appropriate

insurance mechanisms, the Caribbean Catastrophe Risk Insurance Facility has now been inaugurated. It is important that this facility quickly become operational, that donors give it the needed support and that the initiative be extended to other regions of the world. Given the high returns to mitigation measures, it is vital that small states quickly institute the needed practices and building codes.

143. The impracticability of developing affordable long-term commodity risk insurance products combined with the decline in the importance of commodity exports for most small states would indicate that the development of such insurance mechanisms is not now a priority issue.

The role of the international community

144. The small states as a whole are well aided relative to their larger counterparts. However, there has been a declining trend since the mid-1990's, particularly in the Caribbean and Africa, which was only reversed in 2004. In an era of anticipated increases in aid flows, it is important that additional ODA be made available for those small countries that have embarked on the needed repositioning and outward looking strategies. The responsibility for such a development agenda must fall to the small states themselves, but in view of capacity limitations, donors would need to facilitate the reform and adjustment process. The more rapid erosion of preferences than earlier anticipated reinforces the case for additional aid flows. Moreover, the high debt burdens would indicate that such assistance should be extended on highly concessional terms and that the ongoing global efforts to extend "debt forgiveness" to qualifying HIPC countries should be accelerated. The special characteristics and vulnerabilities of small states still warrant special consideration by the international system to deal with those issues that are crucial to the transformation of their economies.

145. Conditions for entry of the small states into the WTO need to be further simplified and efforts to help strengthen the voice of small states in the organization (e.g., through shared representation and enhanced activities and significance of the Work Program on Small Economies) should be intensified. It is also important that any agreements that arise out of the Doha Round negotiations take account of the special interests/needs of small economies. In addition, the ACP/EU EPAs should have a strong development dimension.

146. Since the publication of the 2000 report, many of the major donors have taken steps to streamline their systems and procedures with a view to reducing their administrative and institutional burden on the small states. Although these initiatives are a welcome development, it is apparent that more radical steps are necessary. These could include increased donor specialization, innovative country cooperation approaches where one donor is selected to manage the aid program for all aid agencies, the development of additional assistance "products" tailored to the special needs of small states, systems to ensure that technical assistance familiar with the special needs of the small states is delivered on a just-just-in-time basis, and increased efforts to build and retain the needed specialized expertise within the development agencies. It is also apparent that the small

states themselves are often the best source of relevant expertise. Additional mechanisms designed to more effectively share this knowledge on a just-in-time basis are needed.

147. It is recommended that at the 2006 small states forum, participants consider the possibility of setting up a permanent small states network in close collaboration with the World Bank and the Commonwealth Secretariat, with the aim strengthening the cooperation between small states, sharing good practice between these states and providing continuity between one session of the small states forum and another. It is important to emphasize that such a networking system would not substitute for the work of the World Bank, Commonwealth Secretariat and other donors; rather it would serve to reinforce and complement their on-going assistance programs.

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Annex I

Summary of Consultations and Feedback on this Report

Introduction

1. This report—*Toward an Outward-Oriented Development Strategy for Small States: Issues, Opportunities and Resilience Building: A Review of the Small States Agenda Proposed in the Commonwealth/World Bank Joint Task Force Report of April 2000*, Final Draft Report, August 8, 2005—was originally prepared for the Small States Forum which met in Washington in September 2005 during the Annual Meetings of the World Bank and the International Monetary Fund. In preparing that draft the authors benefited from extensive consultations with the staff of the Commonwealth Secretariat, the World Bank, the WTO, UNCTAD, the IMF, the Asian Development Bank, the Organization of Caribbean States, the African Development Bank, the Caribbean Development Bank, the Indian Ocean Commission, the High Commissioners of the Commonwealth Small States based in London, the World Bank Executive Directors for the small states, the CRNM, the Permanent Missions of the Small States in Geneva, the Pacific Forum Island Countries Office in Geneva, the OECS Geneva Office, participants at the March 2005 Malta conference on vulnerability and resilience of small states, and many others.

2. During the discussions on the report at the 2005 Forum and the Commonwealth Finance Ministers meeting which preceded it, Ministers requested that the Commonwealth Secretariat undertake additional and more widespread consultations with member governments before resubmitting the conclusions of the report to the 2006 Commonwealth Finance Ministers Meeting and the 2006 Small States Forum.

3. In the intervening period and in response to the above request the authors of the report and the Commonwealth Secretariat solicited and received additional written comments from several of the small states. Between May and July 2006 extensive consultations were held with most of the Pacific and Asian small states (during the Annual Meetings of the Asian Development Bank held in Hyderabad), the High Commissions of the Commonwealth Small States based in London, the Permanent Missions of the Small States in Geneva, the Pacific Forum Island Countries Office in Geneva, the OECS Geneva Office, and the Permanent Missions of the Small States to the UN in New York. In addition, visits to several small states governments in southern Africa and the Caribbean took place in June and July 2006. A list of these meetings is appended to this annex.

4. During these consultations, the authors of the report and the Commonwealth Secretariat received significant, thoughtful, and constructive feedback. While there was inevitably, and understandably, some divergence of views between individual small states, there was also a marked degree of consensus on many of the critical issues and challenges facing small states as well as the strategies designed to tackle them. In

particular, there was almost universal support for the "outward-oriented development strategies" highlighted in the review. Indeed several senior ministers and officials emphasized the importance of articulating the specific policy and institutional prescriptions of such an approach at the country level. While such detailed work is obviously beyond the scope of the review, it is clearly important for individual small states and the donor community to ensure that this process is indeed taking place.

5. In light of the feedback, the authors have adjusted or modified some of the recommendations contained in the original draft report. However, the conclusions remain those of the authors.

6. A summary of the feedback received during these consultations is given below. For the sake of clarity, the feed back summary follows the structure and format of the main report.

How Have the Small States Performed Since 2000?

7. There was a broad agreement among small states that the report's summary of macro developments since the 2000 was issued reflected reality. Several governments highlighted gaps or inconsistencies between their own national statistics and some of those contained in the report. However, given that these differences do not affect the overall conclusions of the report, and because the authors have no alternative but to rely on cross country data compiled by experts (principally the World Bank), the figures in the tables relating to specific countries have not been changed.

8. There were, understandably, differences of emphasis as to the causes of some of the adverse macro-economic developments of recent years. For example, some states highlighted the aftermath of September 11, 2001, as a major contributory factor to income volatility. Others stressed the impact of the more rapid than expected erosion of trade preferences and the rapid increase in oil prices. On the positive side, virtually all emphasized the critical and growing importance of remittances by small states migrant workers. There was widespread agreement that the role of traditional crops had eroded; for example it was remarked that the importance of trade in sugar and bananas is dwindling in many small states as illustrated by the fact that in Barbados, sugar contributes only 1 percent to GDP.

9. Several respondents noted the increasing levels of indebtedness faced by some small states (highlighted in the report) and emphasized the need for special assistance/debt forgiveness. They pointed out that the debt burden was inhibiting implementation of "outward oriented" adjustment programs with a disproportionate impact on the poorest segments of society. Some also highlighted that measures designed to combat international terrorism and control of money laundering has placed a high burden on small states; in several cases this has resulted in them borrowing money at commercial rates, thereby exacerbating the debt problem.

10. The impact of the energy crisis, currently facing the small states, the bulk of which are dependent on increasingly expensive oil imports, was emphasized by many

governments. They rightly noted that this was a major gap in the report. However, it was also emphasized that the "crisis" had resulted in the emergence of potentially exciting economic opportunities such as the conversion of sugar cane into ethanol. The importance of developing and receiving support for energy efficiency programs was also stressed.

Does the 2000 Task Force Agenda Remain Relevant?

11. There is a consensus that the characteristics of small states, highlighted in the 2000 Task Force report as having important implications for development, remain pertinent. To recap these are: remoteness and insularity; susceptibility to natural disasters; limited institutional capacity; limited diversification; openness; access to capital and; poverty. Several small states emphasized the continuing high priority of tackling poverty. In this connection, some noted that that they had implemented most of the development strategies suggested by the donor community but that the impact on poverty had hitherto, been limited. There was broad agreement that the additional development challenges identified in the consultants report were valid.

12. Several of the landlocked African small states noted that they shared many characteristics with small island developing states (SIDS) including limited institutional capacity, limited diversification, and poverty. However, they also stressed that they faced some unique challenges e.g., high costs of transit through their neighbors, and suggested that both the 2000 Task Force report and the consultants review had perhaps "neglected" the problems of the landlocked small economies relative to those facing the SIDS. In the view of the consultants, this is a valid criticism. Indeed, there is perhaps a tendency in much of the small states development literature and academic discussions to concentrate on the SIDS. Several adjustments have been therefore been made to the text of the review to highlight some of the challenges faced by the landlocked small countries.

13. In a similar vein, some of the "micro-states" felt that their special challenges had been neglected in the report. This is clearly a valid criticism; however, it is difficult to give adequate coverage to all categories of small states in a generic report.

14. Several reviewers felt that the differences between regions should have been given more emphasis in the report, e.g., the Caribbean does not experience the remoteness problems of the Pacific. It was suggested that the report could usefully include an analysis of the specific characteristics/problems of each major region together with prescriptions. While this analysis is beyond the terms of reference of the present review, it clearly would be a useful exercise for a more detailed report. It should however be noted that several studies by the international financial institutions have, in recent years, covered much of this ground.

15. Given the importance of the "outward oriented" strategy highlighted in the report several reviewers felt the paper would be substantially improved if a road map, with specific timetables and targets, designed to implement the vision could be articulated. They suggested that consideration to developing such an action plan should be given and that there should be some relationship between this plan and the work program of the

World Bank and the Commonwealth Secretariat. It is suggested that this matter be further considered at the 2006 Small States Forum.

Trade: Adjusting to a Changing Global Regime and Representation Issues

16. It is clear from the consultation process that there is widespread recognition that the dismantling of trade preferences is now inevitable and small states should not resist it. However there is an equally strong sentiment that the small states should demand a dignified transition and be helped to participate effectively in world trade. During the consultation process, particularly in Geneva and Brussels, representatives of small states emphasized that integration into the global market is a very demanding process, given the major adjustments that they have to undertake, and given their particular resources constraints. The expenditure indivisibility problem faced by small states further exacerbated the transition. They requested the authors of the report to put more emphasis on the need for a suitably long transition period for the dismantling of import controls, and bringing FDI incentives and manufacturing support mechanisms into WTO compliance.

17. Many of those participating in the consultation process argued that the globalization process is making it difficult for individual countries to pursue policies independent of international rules. They emphasized the market failures in small economies, and the need for policy space to redress them. Currently the WTO rules leave very limited room for maneuver by national governments. All of the small states consulted recognize the potential gains from trade liberalization, but they argued that some compromise needs to be sought to allow flexibility for small vulnerable states, in view of their special circumstances. It was also argued that there is a need for innovative investment schemes designed to (a) find alternative use of the primary product that was exported under preferential schemes e.g., sugar to produce energy; bananas to produce fruit juices; and (b) to finance the transition. It was also argued strongly that the dismantling of non-tariff barriers e.g., restrictions on beef exports from Botswana, Swaziland and Vanuatu were critical to the success of the adjustment process.

18. During these discussions, the issue of Aid for Trade (AfT) featured prominently. It was felt that the original version of the review did not give enough importance to the need that small states be helped to build the supply-side capacity and trade-related infrastructure to enable them to effectively benefit from WTO Agreements and from the globalization process. It was also noted that AfT is not meant replace traditional ODA; rather it should be seen as, being additional to, and complementing existing aid arrangements.

19. Some respondents also commented on the instruments best suited to administer AfT. For example, short term assistance to enable countries to conduct effective negotiations, particularly with the WTO could play a major role. It was suggested that longer term AfT could be organized under a broader donor framework, possibly in collaboration with the WTO, with an extended remit to include non-LDCs. Another issue raised related to the Economic Partnership Agreements (EPA), which were launched in 2002, with the objective of promoting sustainable development of the ACP States, and

helping them attain a smooth and gradual integration into the world market. Some respondents feared that ACP firms will not be able to compete with EU firms in a free trade regime and that government revenue in ACP countries will experience a decline as import duties are decreased. Many of those participating in the consultation on this issue argued that the EPAs need to have a clear development dimension and should not open markets, without taking account of the socio-economic impact of trade measures and easing supply-side constraints. It was further argued that EPAs should be conducive to increase investment flows between Europe and ACP countries and encourage diversification in these economies.

20. An area that was considered as being practically neglected in the report related to the need for small states to forge strategic alliances with like-minded countries to negotiate win-win situations. For example, small states could seek support for *de minimis* exceptions within the WTO schemes, basing the arguments on their negligible percentage of world trade. In return, small states can support larger developing countries in claims which do not harm the interests of small states. All this requires the strengthening of "small states diplomacy", particularly in Geneva.

21. During the Geneva consultation, the role that small states that belong to the donor community, including Malta and Cyprus was discussed. It was argued that these countries can play a major role in directing aid from the EU (a major player in ODA) to small states. These countries can have a major advocacy role in this regard.

Domestic Policies, Economic Management, and Public Finance

22. There is broad agreement that the recommendations of the 2000 report remain relevant, particularly in their emphasis on attracting private investment and providing the complementary public investment in infrastructure, education, and institutional reform. Some representatives of small states felt, however, that the importance attached, by the consultants, in their review on the need to urgently shift the tax base of many small states away from import duties was misplaced. Given the openness of their economies and the high proportion of GDP that is traded, they felt, with some justification, that the distortionary effects of import duties had been exaggerated. Furthermore, several respondents emphasized that their weak institutional base justified a continued reliance on import taxes which were relatively easy to collect. However, it is equally important to note that several of the more successful small states have, as part of their outward oriented development strategies, substantially shifted their taxation base towards broad based consumption taxes and direct income taxes. Malta and Barbados are good examples of the successful implementation of VAT.

23. There was virtual consensus that, given their openness and vulnerability, small states had no choice but to follow conservative debt management policies. However, there was broad agreement with the emphasis given in the review that any reductions in public expenditures resulting from implementing such a policy regime should not be achieved through cuts in vital services, especially those which directly impacted the poor.

24. Some respondents disagreed with the review's suggestion that a greater reliance be based on tuition fees and student loan schemes to finance tertiary education. They felt that any obligation to pay for tuition could restrict the access of the poorer segments of society to higher education and that such schemes were unlikely to be politically acceptable in many small states. The majority of those consulted however agreed with the proposal, noting that it was already established policy in their countries and that the public exchequers could not carry the entire burden of financing the education of university students in the volumes required. The point was however made that such schemes should not discourage deserving students from low-income families to follow university courses.

Towards a Service- and Knowledge-Based Development Paradigm

25. While several governments highlighted practical obstacles in implementing a service and knowledge based development paradigm, there is clearly widespread agreement that long term sustainable development and resilience building are critically dependent on the implementation of such a strategy. Indeed several governments highlighted the importance of developing practical policies designed to implement such a strategy. They were particularly interested in seeing more specific recommendations as to how the service sector could be developed as an integral part of such an of the outward-oriented development approach. In this connection, there was widespread interest in learning from the experience of those small states that have successfully implemented such an agenda.

26. With respect to the implementation challenge, several of the Pacific and African small states noted the gestation period and pay-off to investments in education, particularly higher education, would inevitably be long. Several of those consulted highlighted the restrictions faced by their skilled and unskilled workers in accessing the developed countries labor markets. They emphasized that the success of a service based strategy—with which they broadly agreed—was, at least in part, dependent on the ability of their populations to access the labor markets in the developed countries. The importance of such international labor mobility in helping them to make the necessary structural adjustments, as workers were displaced from previously protected crops such as sugar and bananas, was also stressed. It was noted that the free movement of labor was as essential as free movement of goods, services, and capital, for an efficiently working global market.

27. Despite the importance of encouraging the international movement of labor, several small states noted that they had been victims of a "brain drain." The outflow of doctors and nurses to North America, Europe, Australia, and New Zealand has been significant. While it was recognized that some loss of skilled manpower, at least temporarily, was an inevitable by-product of an "outward looking" strategy, the short term costs of this migration are clearly considerable. Recovering the costs of higher level and professional training from permanent emigrants was a particular concern. Most small states have put bond mechanisms in place to recover costs, but the repayment performance varies widely. For example, the Caribbean seems to experience significant defaults while the Asian countries apparently do much better. Given that these migrants

are filling key gaps in developed country labor markets, it was also noted that additional ODA designed to support medical training in the small states (some pilots are already underway in the Caribbean) and to compensate governments for the training costs of such personnel was warranted.

Private Sector Development

28. There is virtual universal agreement that the private sector has to be the engine of growth and development. However, several states noted that while they had enacted "private sector friendly" policy regimes they were, in many cases, still waiting to see the investment response. Many emphasized the challenge of developing the private sector due to the high cost of doing business in the small states e.g., small domestic markets-particularly in the micro states, the tendency for monopolies to dominate local markets, and high transport costs faced by remote islands and the landlocked countries. Given these unique problems, many officials emphasized the importance of learning from the experience of other small states, as well as the need for targeted technical assistance designed to develop appropriate policy and institutional prescriptions.

29. There was unanimity that the large diaspora of the small states had a key role to play in private sector development and attracting FDI. As noted in the review, the diaspora are a unique source of finance, entrepreneurship, and marketing - particularly for niche products. Interestingly, several small states mentioned that they have, or are, developing a comprehensive set of "diaspora friendly" policies, e.g., Dominica, designed to fully utilize their talents and resources. It was also suggested that the missions/embassies of the small states could play an enhanced role in mobilizing the diaspora. For example, some missions have organized targeted exchanges between the diaspora and the local private sectors on measures designed to increase investment opportunities.

30. A number of government officials highlighted the critical importance of FDI for any outward looking development strategy and in this connection emphasized the importance of enhancing the both the certainty and the predictability of the taxation regime as well as importance good governance.

31. There was widespread agreement as to the potential for additional niche exports. Examples given included exotic fruit juices, and the scope for additional branding of rare rums. It was also noted that ICT was already providing a platform for exports e.g., call centers in the Caribbean and that there were considerable opportunities for additional value added in this sector, including the provision of "outsourcing services" (see the section on Governance and Capacity Building below). The critical importance of ensuring that an adequate telecommunications infrastructure was available to support ICT was also emphasized. The opportunities for niche markets in tourism e.g., cultural and eco-tourism, were also highlighted by several governments; however they also noted that they needed access to specialize expertise to help them exploit these possibilities.

Financial Sector Development and Regulation

32. There was broad agreement with the reviews recommendations on financial sector development. However, many states highlighted the costs that they had incurred in implementing compliance and money laundering reforms in the post September 11 era. Several governments noted the difficulty of generating meaningful financial sector competition particularly in the smallest states. The need for increased regional cooperation in financial sector regulation, which was recommended by the review, was emphasized by several small island states. Several of the landlocked small states e.g., Swaziland and Namibia, noted that they had been less affected by these issues through their membership of regional monetary unions.

Governance and Capacity Building

33. The importance of good and predictable governance as the key element of a sustainable outward oriented development was recognized by all those consulted. Indeed several senior officials felt that good governance was the most important factor. Several governments, most notably in the Pacific, highlighted governance as their major development challenge. In particular, they emphasized the adverse consequences of political instability and excessive political patronage as well as the difficulties of securing property rights in traditional cultures.

34. There was widespread recognition that it was difficult if not impossible for small states to individually and economically provide all the services expected of a modern state. While noting the practical and political obstacles facing greater regional cooperation in the delivery of government and public sector services, particularly in the Pacific, there was close to universal agreement that such approaches should be further exploited and strengthened. Examples included utility regulation, higher education, fisheries protection, crime and security, and financial regulation.

35. There was also widespread agreement, that there were additional and major opportunities for the outsourcing of government services. Examples included revenue collection (already outsourced to independent revenue authorities in several small states), land registration, port administration, customs supervision, social security administration, and the issue of passports and business and divers licenses. In a related matter, several senior officials highlighted the importance of promoting e-government as part of any strategy designed to improve the efficiency of government service delivery. They also rightly emphasized that successful e-government units also had the potential to provide "outsourcing services" to other states (large and small).

36. Several government officials and NGOs from all regions highlighted the importance of strengthening the role of civil society and rightly noted that this was a gap in the review. They emphasized that an effective civil society was particularly critical for small states given the limited size of government. Empowering civil society, to increase the accountability and responsiveness of the state, as well to help tackle key development challenges e.g., education, HIV/AIDS and crime, was in their view a high priority. Many

small states e.g., Botswana and Lesotho have developed comprehensive programs designed to promote the role of civil society.

Security and Crime

37. The emphasis of the review on the emerging crisis in youth unemployment and the related increase in crime was universally endorsed. In particular, it is clear that the problem of unemployed school leavers is overwhelming many small state governments, undermining security and adversely impacting the investment climate and private sector development. Several states highlighted the need for assistance in this area, including increased understanding by developed countries of the consequences of repatriating criminals and the need to open their labor markets for unskilled workers, as well as increased regional cooperation in tackling crime.

HIV/AIDS

38. The conclusions of the report were endorsed. Indeed several states felt that the authors should have given even more emphasis to this crisis. Many of the small states, have developed pioneering and innovative programs to tackle HIV/AIDS, e.g., reducing mother to child transmission in the Bahamas, and in some of them the incidence rate, albeit high, has stabilized e.g., Swaziland and Namibia. However, the sheer scale of the problem is overwhelming. For example, Swaziland expects that 15 percent of its population will be orphans by 2010. The most seriously affected countries noted the long term nature of the problem and the need for continuous and increased assistance. In this connection they noted that while they have access to the Global Fund to fight AIDS, Tuberculosis, and Malaria, several exceed the income threshold to qualify for ODA. Given the human development crisis they are facing they emphasized the need for special and concessional support.

Environment and Sustainable Development

39. The environmental challenges facing small states were emphasized by many officials. They also noted that many of these were beyond their control e.g., global warming and the rising sea level and the increased unreliability of previously established weather patterns. The importance of preserving their fragile ecosystems for sustainable eco-tourism was also highlighted. Some noted that water resources will be a critical issue for many small states in the future and that it might well become a key development constraint; they felt that the review could have paid more attention to this issue. Others highlighted the importance of developing energy efficiency programs. There was also a consensus that regional approaches were required to successfully tackle many of the environmental issues.

Managing Natural Resource Endowments

40. There was a universal acceptance of the need to protect and carefully manage the natural resource endowments in a sustainable manner. Indeed as noted in the report, several small states have provided impressive examples. Some small states, including

those with strong governance, highlighted the practical political difficulties of preserving these resources for future generations and noted the need for continuous vigilance on these matters. Again the need for regional cooperation was emphasized e.g., fisheries protection.

Disaster Insurance and Risk Management

41. As noted in the review there was widespread disappointment that disaster insurance mechanisms had yet to materialize. The need for such mechanisms were highlighted in the original 2000 task force report and reinforced in the review. The particularly severe hurricane season of 2005 as well as the December 2004 Tsunami have exacerbated these concerns. It is therefore encouraging to note that the World Bank has recently made significant progress in developing a Caribbean Catastrophe Risk Insurance Facility which is discussed in more detail in the main text of the report.

42. Several officials emphasized the importance of developing adequate disaster mitigation and hazard management mechanisms including the enactment and enforcement of building codes. The need for putting in place mechanisms for speedy recovery following the incidence of a disaster was also highlighted. Given the past tendency of several small states to give inadequate attention to these issues, this is an encouraging development.

Regional Cooperation

43. The review highlighted the importance increased regional cooperation. Such cooperation was seen as being particularly important for the delivery of government and regulatory services. While several states noted the practical limitations to regional integration for the most remote islands, e.g., the Pacific, as well as the political difficulties associated with challenging local vested interests and ceding sovereignty, it is encouraging to note that the reaction to these recommendations was universally positive.

44. Several respondents noted that the Caribbean had made the most progress in developing such initiatives e.g., the Eastern Caribbean Central Bank, the Eastern Caribbean Telecommunications Authority, the virtual integration of their labor markets and the University of the West Indies. However, even there they suggested that there was scope for further initiatives e.g., increased specialization by country in the delivery of sophisticated health care services for the entire region, the establishment of a regional development fund and increased cooperation and specialization in tackling crime and security. The Caribbean countries expressed a willingness to share their experiences with other regions. The Pacific countries, in turn noted their interest in learning from these lessons of experience.

45. Several of the landlocked African states indicated the need to explore further economic integration with their larger neighbors as well to exploit the potential for additional outsourcing of key regulatory functions to the same countries. However, they also emphasized their inherently weak bargaining position and the tendency of larger countries to ignore, or neglect, the special concerns of their smaller neighbors e.g.,

provision of efficient transport links and other infrastructure services and in their trade negotiations with the rest of the world. They noted that the international community, including the small states acting together, has a key role to play in ensuring their interests are protected.

Aid, Aid Management, and Harmonization

46. While acknowledging that the small states as a group were relatively well aided, many of those consulted echoed the concerns expressed in the review that ODA to small states had fallen in recent years. In some cases, this is a result of success as several countries have graduated to middle income status. However, given the faster than expected erosion of preferences and their special needs during the adjustment transition, many senior officials argued strongly that increased aid-for-trade was warranted. It was suggested that the review should take a tougher stand on the need for the international community to provide increased support for those states adopting an outward oriented approach and positioning themselves to take advantage of globalization. Specifically it was noted that the time lags, as well as the economic and social costs, associated with these transitions are significant, particularly for small states, and that continued support by the international community was therefore warranted. Related to the above it was also noted that easing the access of small country migrants, particularly semi-skilled and unskilled workers, to developed country markets could also greatly ease the costs of the transition.

47. Several of the lower middle income small states also noted that they had ceased to qualify for ODA. This was despite the fact that they faced serious shortfalls in reaching the MDG targets, they had high incidences of poverty and HIV/AIDS, and their institutional, human and physical infrastructures remained weak. They felt that their aid eligibility should also be based on their *Human Development Indicators*. They noted that they were eligible for assistance from the Global Fund to Fight AIDS, Tuberculosis, and Malaria, but not other ODA; there was a need for the development agencies to recognize this inconsistency. Related to the above, several of the highly indebted lower middle income small states also noted that they also failed to qualify for debt relief.

48. Even in those cases where concessional capital assistance could no longer be justified many countries noted a continuing need for technical assistance designed to tackle the complex, challenging and unique governance and policy problems faced by small states. In this connection considerable interest was expressed in developing more effective mechanisms for transferring “best practice” across small states – particularly from region to region and from developed small states.

49. Several of those consulted noted that progress had been made in harmonizing aid practices and policies and reducing the administrative costs faced by recipient countries. For example, a significant portion of ODA to the Pacific islands now comes in the form of budget support. It was emphasized however, that in many cases “aid management” remains a significant burden for small states, and that more radical steps by donors to fully synchronize practices are essential.

Annex II

List of Countries, Organisations and Experts Consulted

Pacific Small States

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African Small States

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	Mrs. Musa D. Fakudze Permanent Secretary, Ministry of Finance
	Mr. Shongwe Deputy Permanent Secretary, Ministry of Finance
	Director of International Trade (Ministry of Foreign Affairs & Trade)
	Head of HIV/AIDS, National Emergency Response Council

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Solomon Islands	H.E. Mr. Colin Beck
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Annex III

Tables

During the consultation process some governments highlighted inconsistencies between their own national accounts and some of the figures given in the tables. However, given the need to present consistent cross-country comparisons, the authors have no alternative but to rely on data compiled by the international institutions, principally the World Bank's World Development Indicators Team of the Development Data Group. The data differences do not affect the overall conclusions of the report.

The aggregates for regional groupings of small states, and for all small states, use the World Bank's World Development Indicators methodology (i.e., implicit gap-filling, weighted averages), except where noted that simple unweighted averages were calculated.

Table A1. *GDP growth (annual %)*

								Annual avg.
	Recent growth							
Country Name	***1999***	***2000***	***2001***	***2002***	***2003***	***2004***	***2005***	***1990-2005***
Botswana	5.4	7.6	5.2	5.0	6.7	4.9	3.8	**5.3**
Cape Verde	8.6	6.6	3.8	4.6	6.2	4.4	5.5	**5.9**
Comoros	2.9	1.9	2.3	2.3	2.1	1.9	2.8	**1.7**
Djibouti	2.2	0.7	2.0	2.6	3.2	3.0	3.2	**0.0**
Equatorial Guinea	41.4	1.5	1.5	17.6	14.7	10.0	..	***19.4***
Gabon	-6.2	2.0	2.5	0.0	2.6	1.4	2.2	**2.1**
Gambia, The	6.4	5.5	5.8	-3.2	6.9	5.1	5.0	**3.4**
Guinea-Bissau	7.8	7.5	0.2	-7.1	0.6	2.2	3.5	**0.3**
Lesotho	0.2	1.3	3.2	3.5	3.1	3.1	1.2	**3.2**
Mauritius	5.8	4.0	5.6	2.9	2.9	4.4	4.5	**4.9**
Namibia	3.4	3.5	2.4	6.7	3.5	6.0	3.5	**4.0**
Sao Tome and Principe	2.5	3.0	4.0	4.1	4.0	3.8	3.0	**2.5**
Seychelles	1.9	4.8	-2.2	1.3	-6.3	-2.0	-2.3	**2.8**
Swaziland	3.5	2.0	1.8	2.9	2.4	2.1	1.8	**3.0**
Bahrain	4.3	5.3	4.6	5.3	7.2	5.4	6.9	**5.0**
Bhutan	7.9	5.6	7.5	8.9	7.1	7.5	5.8	**6.0**
Fiji	6.7	-2.8	2.7	4.3	3.0	4.1	1.7	***2.4***
Kiribati	5.6	1.9	1.8	-4.3	2.3	-1.4	0.3	**3.7**
Maldives	7.8	4.4	3.3	6.1	8.5	8.8	-3.6	***6.6***
Marshall Islands	0.6	0.9	5.5	4.0	1.8	0.4	3.5	**-0.5**
Micronesia, Fed. Sts.	-3.1	8.4	0.3	1.1	5.1	-3.8	0.3	**0.6**
Palau	-5.4	0.3	1.3	-3.5	-1.3	4.9	5.5	***1.4***
Samoa	2.3	7.0	7.1	4.3	1.8	3.5	5.5	**3.5**
Solomon Islands	-0.5	-14.3	-9.0	-2.4	5.6	5.5	4.4	**0.1**
Timor-Leste	..	13.7	16.5	-6.7	-6.2	0.4	1.8	***1.5***
Tonga	3.1	5.2	1.8	2.1	2.9	1.7	2.4	**2.5**
Vanuatu	-2.7	2.7	-2.7	-4.9	2.4	3.0	6.8	**2.0**
Antigua and Barbuda	4.1	3.3	1.5	2.2	4.9	4.1	3.8	**3.4**
Bahamas, The	5.9	5.0	-2.0	0.7	..	..	..	***2.1***
Barbados	2.6	..	..	..	..	..	..	***1.9***
Belize	8.4	12.3	4.9	4.2	9.2	4.6	3.1	**5.3**
Dominica	0.7	0.8	-4.2	-4.7	0.0	2.0	3.1	**0.9**
Grenada	10.1	7.0	-4.4	-0.4	5.7	-2.8	0.9	**3.0**
Guyana	3.0	-1.4	2.2	1.1	-0.7	1.6	-2.8	**3.3**
Jamaica	1.0	0.7	1.5	1.1	2.3	0.9	1.8	**0.9**
St. Kitts and Nevis	3.7	4.4	2.6	1.6	2.1	6.4	4.9	**4.0**
St. Lucia	2.9	0.1	-4.3	0.4	3.0	3.5	5.1	**1.8**
St. Vincent and the Grenadines	3.0	2.0	-0.1	1.4	4.5	6.0	4.9	**2.2**
Suriname	-1.6	-0.1	4.5	3.0	5.3	7.8	5.1	**1.9**
Trinidad and Tobago	4.4	6.0	4.2	7.9	13.3	6.5	6.7	**4.8**
Cyprus	4.6	5.0	4.1	2.1	1.9	3.7	..	***3.9***
Estonia	0.3	7.9	6.5	7.2	6.7	7.8	9.8	**3.1**
Malta	4.0	6.3	0.3	1.5	-2.5	-1.5	2.5	**3.5**

Table A1. ***GDP growth (annual %)***

Country Name	Recent growth 1999	2000	2001	2002	2003	2004	2005	Annual avg. 1990-2005
Small states								
Africa	3.6	3.9	3.5	3.9	4.4	4.2	3.3	**4.3**
Africa (excluding Equatorial Guinea)	*2.0*	*4.1*	*3.6*	*3.1*	*3.7*	*3.8*	*3.3*	***3.8***
Pacific and Asia	4.3	3.7	4.1	4.4	5.9	5.0	5.2	**4.3**
Pacific and Asia (excluding Bahrain,)	*4.3*	*0.9*	*3.3*	*2.7*	*3.6*	*4.4*	*2.0*	***3.0***
Caribbean	3.4	3.6	1.6	3.3	7.2	4.0	4.2	**2.8**
Caribbean (excluding Trinidad and Tobago)	*3.0*	*2.5*	*0.4*	*1.2*	..	..	..	***1.7***
Europe	3.2	6.1	4.0	3.5	2.5	4.1	..	**3.4**
All small states	**3.6**	**4.3**	**3.1**	**3.7**	**5.0**	**4.3**	**..**	***3.5***
Memo items:								
All developing countries	3.2	5.3	3.2	3.6	5.4	7.2	6.5	**4.2**
Low income	5.6	3.9	4.7	3.5	7.0	7.4	7.5	**5.0**
Lower middle income	4.0	5.9	4.8	5.9	6.0	7.6	6.9	**5.4**
Upper middle income	1.3	5.1	0.5	0.7	4.0	6.6	5.5	**2.5**

Source: World Bank, World Development Indicators database, July 2006.

Table A2. ***Merchandise exports (% of GDP)***

Country Name	*1990*	*1995*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*avg. annual chg. 1990-2005*
Botswana	47	45	52	47	45	41	40	46	-0.2
Cape Verde	2	2	2	2	2	2	2	2	1.3
Comoros	7	5	7	8	8	9	7	5	-0.4
Djibouti	6	3	6	6	6	6	6	6	4.3
Equatorial Guinea	49	78	82	108	100	96	145	215	8.3
Gabon	37	55	53	58	49	47	48	58	1.5
Gambia, The	10	4	4	2	3	2	2	2	-13.0
Guinea-Bissau	8	9	29	32	27	28	33	27	13.1
Lesotho	10	17	26	37	53	45	52	46	11.8
Mauritius	50	40	35	36	40	36	33	33	-2.0
Namibia	46	40	39	37	34	28	32	32	-2.9
Sao Tome and Principe	7	11	6	5	9	11	6	9	-2.5
Seychelles	15	10	32	35	33	39	41	57	11.2
Swaziland	63	63	66	84	86	85	77	74	1.8
Bahrain	89	70	78	70	69	68	68	75	-0.7
Bhutan	23	34	23	21	21	22	25	30	-0.7
Fiji	37	31	35	33	31	31	26	27	-0.7
Kiribati	10	16	8	9	6	5	3	1	-10.6
Maldives	36	21	17	18	21	22	23	20	-2.1
Marshall Islands	..	22	6	13	6	5	7	6	-11.6
Micronesia, Fed. Sts.	..	10	8	8	9	9	8	9	1.4
Samoa	8	4	6	6	6	5	3	3	-1.5
Solomon Islands	33	51	23	17	26	32	38	40	-2.4
Tonga	10	8	6	5	10	10	7	5	-2.6
Vanuatu	13	12	11	9	9	10	12	12	-1.3
Antigua and Barbuda	5	11	7	5	5	6	5	6	-4.7
Bahamas, The	34	5	12	8	8	8	..	..	-5.5
Barbados	13	13	11	10	9	9	10	10	-2.0
Belize	32	26	26	19	18	21	21	21	-2.6
Dominica	33	20	20	17	17	15	15	15	-4.7
Grenada	12	8	12	11	9	9	7	9	-0.3
Guyana	65	73	70	69	68	70	75	70	-0.6
Jamaica	25	25	16	15	13	14	16	15	-4.8
St. Kitts and Nevis	18	8	10	9	8	13	12	11	-2.6
St. Lucia	32	19	6	7	7	9	12	15	-8.5
St. Vincent and the Grenadines	42	16	14	12	10	10	9	10	-8.9
Suriname	118	69	45	53	49	63	72	68	-3.5
Trinidad and Tobago	39	46	52	48	43	48	52	57	2.8
Cyprus	17	14	10	10	8	7	6	..	-6.1
Estonia	..	42	70	67	62	61	53	58	4.0
Malta	49	59	63	47	49	46	47	41	-1.1
Small states (weighted average)	**40**	**37**	**44**	**42**	**40**	**41**	**45**	**50**	**1.3**
Small states (unweighted avg.)	**30**	**27**	**27**	**27**	**27**	**27**	**29**	**32**	**-1.2**
Memo: All low and middle-income countries	16	19	25	24	25	27	29	31	4.3

Source: World Bank, World Development Indicators Database July 2006.

Table A3. *Workers' remittances and compensation of employees (received, % of GNI)*

Country Name	*1990*	*1995*	*2000*	*2001*	*2002*	*2003*	*2004*
Botswana	2.3	1.2	0.5	0.5	0.6	0.5	0.4
Cape Verde	17.3	21.8	16.7	14.9	14.1	11.8	9.6
Comoros	3.8	5.2	5.9	5.4	4.9	3.8	3.3
Djibouti	..	2.3	..	..	..	..	..
Equatorial Guinea	..	..	..	..	..	..	..
Gabon	..	0.1	0.1	0.1	0.1	0.1	0.1
Gambia, The	3.4	5.0	3.5	1.8	2.0	2.3	2.1
Guinea-Bissau	0.4	..	1.0	5.5	9.3	10.2	8.9
Lesotho	41.9	31.1	23.4	22.3	22.6	21.9	21.1
Mauritius	..	3.5	4.0	4.7	4.7	4.1	3.6
Namibia	0.5	0.4	0.3	0.3	0.3	0.3	0.3
Sao Tome and Principe	..	..	0.0	2.3	2.0	1.8	1.9
Seychelles	2.3	0.2	..	0.3	0.3	0.3	0.3
Swaziland	12.0	5.7	5.2	5.4	5.2	4.6	3.5
Fiji	1.7	1.7	1.4	1.5	1.3	1.1	0.9
Kiribati	10.4	8.8	7.9	7.6	7.4	5.9	5.3
Maldives	1.0	0.5	0.3	0.3	0.3	0.3	0.4
Samoa	26.2	21.2	19.5	19.7	17.9	14.8	12.6
Solomon Islands	..	..	0.7	0.7	0.9	0.9	0.8
Tonga	20.6	..	..	39.7	45.6	39.5	31.1
Vanuatu	4.9	6.5	15.1	23.0	3.5	3.4	2.9
Antigua and Barbuda	3.8	0.6	1.6	2.3	1.6	1.5	1.4
Barbados	2.2	2.9	4.1	4.8	4.4	4.4	4.1
Belize	4.4	2.3	2.8	2.6	2.0	2.4	2.8
Dominica	8.7	1.4	1.3	1.6	1.7	1.7	1.6
Grenada	8.6	6.8	5.9	6.2	6.5	5.8	6.0
Guyana	..	0.4	4.1	3.5	7.6	14.4	13.3
Jamaica	5.5	11.7	11.6	13.6	15.7	18.1	19.3
St. Kitts and Nevis	12.3	0.9	1.3	1.3	1.2	1.1	1.1
St. Lucia	4.3	0.4	0.5	0.7	0.6	0.6	0.6
St. Vincent and the Grenadines	8.5	0.8	0.9	0.9	1.0	1.0	0.9
Suriname	0.3	..	..	..	1.7	2.5	0.9
Trinidad and Tobago	0.1	0.7	0.5	0.5	0.9	0.9	0.7
Cyprus	1.4	0.5	0.7	1.2	0.4	0.5	1.6
Estonia	..	0.0	0.1	0.2	0.3	0.6	1.6
Malta	2.3	0.6	0.4	0.2	0.2	0.3	0.3
Small states							
Africa	..	4.0	3.2	3.1	3.1	2.8	2.5
Pacific and Asia	5.3	3.5	3.7	5.9	4.6	3.9	3.4
Caribbean	3.0	5.1	5.2	5.8	6.6	7.0	7.0
Europe	..	0.4	0.5	0.7	0.3	0.5	1.4
All small states	**..**	**3.2**	**3.1**	**3.5**	**3.5**	**3.4**	**3.5**
Memo items:							
All developing countries	..	1.2	1.5	1.6	1.9	2.0	2.0
Low income	1.5	2.2	3.0	3.3	3.9	4.1	3.8
Lower middle income	1.1	1.3	1.5	1.7	1.9	2.1	2.1
Upper middle income	..	0.8	0.9	1.0	1.1	1.1	1.1

Source: World Bank, Global Development Finance database; July 2006.

Table A4. ***Foreign direct investment (US$ per capita)***

Country Name	*1990*	*1995*	*2000*	*2001*	*2002*	*2003*	*2004*
Botswana	67	43	32	12	228	236	26
Cape Verde	1	65	73	20	32	31	41
Comoros	1	2	0	2	1	2	3
Djibouti	0	5	5	5	5	15	42
Equatorial Guinea	31	319	240	2,057	688	2,973	3,381
Gabon	76	-282	-34	-69	35	208	237
Gambia, The	15	7	33	26	31	17	41
Guinea-Bissau	2	0	1	0	2	3	3
Lesotho	11	163	66	65	47	64	69
Mauritius	39	17	224	-23	26	52	11
Sao Tome and Principe	0	0	29	21	21	47	353
Seychelles	286	611	296	727	729	700	448
Swaziland	39	58	87	26	82	-55	61
Bhutan	3	0	0	0	0	1	1
Fiji	127	91	44	53	22	27	-11
Maldives	28	28	45	40	39	45	46
Samoa	0	0	-9	7	0	3	3
Solomon Islands	32	5	3	-27	-3	-4	-11
Tonga	2	0	0	0	0	0	0
Vanuatu	87	180	104	92	45	74	106
Bahamas, The	-68	383	830	335	493	605	858
Barbados	43	46	71	71	64	216	186
Belize	90	97	92	233	90	-4	451
Dominica	180	740	154	169	155	285	259
Grenada	139	204	365	575	560	809	401
Guyana	11	101	90	75	59	35	40
Jamaica	58	59	181	236	184	274	227
St. Kitts and Nevis	1,166	488	2,168	1,908	1,713	1,441	1,313
St. Lucia	336	227	353	152	302	636	681
St. Vincent and the Grenadines	73	274	328	180	273	468	471
Trinidad and Tobago	90	237	529	648	612	623	770
Cyprus	186	333	1,087	1,186	1,347	1,110	1,341
Estonia	..	140	283	397	210	679	777
Small states							
Africa	32	29	58	90	88	186	190
Africa (excl. Eq.Guinea)	32	18	51	14	65	77	63
Asia	54	44	25	22	13	17	8
Caribbean	72	143	294	317	290	353	391
Caribbean (excl.Trinidad&Tobago)	67	117	229	226	201	279	288
Europe	..	205	576	688	633	841	991
All small states	52	79	164	195	180	267	290
Memo items:							
All developing countries	6	23	34	35	31	31	40
Low income	1	3	5	6	7	6	7
Lower middle income	5	27	38	38	38	39	44
Upper middle income	28	74	123	131	96	93	150

Source: World Bank, Global Development Finance database, July 2006.

Table A5. ***External debt burden in small states***
(External public and publicly guaranteed debt outstanding and disbursed as % of GNI)

Country Name	***2000***	***2001***	***2002***	***2003***	***2004***
Botswana	9	8	10	7	6
Cape Verde	61	63	64	57	49
Comoros	102	101	100	84	75
Djibouti	42	40	50	54	54
Equatorial Guinea	44	42	..	..	..
Gabon	81	81	78	65	61
Gambia, The	109	110	146	163	163
Guinea-Bissau	352	343	344	317	285
Lesotho	61	62	73	52	43
Mauritius	19	17	18	18	14
Sao Tome and Principe	710	691	625	598	647
Seychelles	54	68	68	67	77
Swaziland	20	21	28	22	18
Bhutan	45	54	70	81	83
Fiji	6	5	5	5	5
Maldives	31	31	37	39	40
Samoa	64	63	62	56	50
Solomon Islands	40	48	68	68	60
Tonga	39	43	46	47	38
Vanuatu	32	30	33	30	27
Barbados	22	28	29	28	26
Belize	72	82	92	107	101
Dominica	62	80	86	84	84
Grenada	48	52	83	76	90
Guyana	170	172	172	176	152
Jamaica	49	55	57	58	61
St. Kitts and Nevis	51	70	84	97	90
St. Lucia	26	27	34	36	36
St. Vincent and the Grenadines	52	50	50	55	59
Trinidad and Tobago	21	19	18	16	12
Estonia	4	3	7	6	5
Small states (unweighted averages)					
Africa	128	127	134	125	124
Pacific and Asia	37	39	46	47	43
Caribbean	57	64	71	73	71
All small states (unweighted avg.)	81	83	88	86	84
Memo items:					
All developing countries	23	22	22	21	18
Low income	35	33	33	31	28
Lower middle income	20	19	19	17	15
Upper middle income	23	22	23	22	19

Source: World Bank, Global Development Finance database, July 2006.

Table A6. *Population, per capita income, and progress toward the Millennium Development Goals*

		2005									
		Pop. (1000)	*GNI per capita (US$)*[a/]	*Poverty*	*Mal-nutrition*	*Primary ed.*	*Gender*	*Child Mortality*	*Births*	*Water*	*Sanita-tion*
African Small Sates	Botswana	1,765	5,180	2	5	2	1	4	1	2	4
	Cape Verde	507	1,870	5	5	1	1	3	2	5	5
	Comoros	600	640	5	4	4	4	3	5	2	4
	Djibouti	793	1,020	5	2	4	4	3	5	4	4
	Equatorial Guinea	504	b/	5	5	4	5	4	2	5	5
	Gabon	1,384	5,010	5	5	4	5	4	5	5	5
	Gambia, The	1,517	290	3	5	4	3	3	4	5	5
	Guinea-Bissau	1,586	180	5	5	5	5	4	4	5	5
	Lesotho	1,795	960	3	4	4	1	4	3	5	4
	Mauritius	1,248	5,260	5	5	1	1	3	1	1	1
	Namibia	2,031	2,990	4	4	4	1	3	3	1	4
	Sao Tome and Principe	157	390	5	5	5	5	4	5	5	5
	Seychelles	84	8,290	5	5	1	5	3	5	5	5
	Swaziland	1,131	2,280	2	5	4	3	4	3	5	5
Pacific and Asian Small States	Bahrain	727	14,370	5	5	1	1	3	5	5	5
	Bhutan	918	870	5	2	5	5	2	4	5	5
	Brunei	374	c/	5	5	1	1	2	1	5	5
	Fiji	848	3,280	5	5	1	1	3	1	5	1
	Kiribati	99	1,390	5	5	1	1	3	2	2	3
	Maldives	329	2,390	5	2	1	1	2	4	4	5
	Marshall Islands	63	2,930	5	5	1	5	3	1	4	3
	Micronesia, Fed. Sts.	110	2,300	5	5	5	5	3	5	1	4
	Palau	20	7,630	5	5	1	1	4	1	3	1
	Qatar	813	c/	5	5	2	1	4	1	1	1
	Samoa	185	2,090	5	5	1	1	3	1	4	1
	Solomon Islands	478	590	5	5	5	3	4	3	5	5
	Timor-Leste	976	750	5	5	5	5	2	5	5	5
	Tonga	102	2,190	5	5	1	1	3	1	1	4
	Vanuatu	211	1,600	5	5	2	3	3	3	4	5
Caribbean Small States	Antigua and Barbuda	81	10,920	5	5	5	5	4	1	5	5
	Bahamas, The	323	15,800	5	5	2	1	2	1	5	1
	Barbados	270	b/	5	5	1	1	3	1	1	1
	Belize	292	3,500	5	5	1	1	3	2	5	5
	Dominica	72	3,790	5	5	1	1	4	1	5	5
	Grenada	107	3,920	5	5	5	5	3	1	5	4
	Guyana	751	1,010	1	2	1	1	3	5	5	5
	Jamaica	2,657	3,400	1	3	4	1	4	1	4	3
	St. Kitts and Nevis	48	8,210	5	5	1	5	5	1	1	4
	St. Lucia	166	4,800	3	5	1	1	3	5	1	5
	St. Vincent and the Grenadines	119	3,590	5	5	5	1	4	1	5	5
	Suriname	449	2,540	5	5	1	1	4	5	5	5
	Trinidad and Tobago	1,305	10,440	4	5	4	1	3	1	4	1
Euro	Cyprus	835	16,510	5	5	1	1	1	5	1	1
	Estonia	1,345	9,100	1	5	1	1	2	1	5	5
	Malta	404	13,590	5	5	1	1	1	5	1	5
	Small states total	30,579	5,180								
	Small states median	478	2,990								

MDG progress key: 1=Achieved | 2=On track | 3=Off track | 4=Seriously off track | 5=No data

[a/] Atlas method; 2002 data for The Bahamas; 2004 data for Bahrain and Cyprus.
[b/] Upper middle income (GNI per capita estimated to be between US$3,466 and US$10,725)
[c/] High income (GNI per capita estimated to be above US$10,726).

Source: World Bank, World Bank Indicators database, July 2006.

Table A7. ***Official development assistance and official aid (current US$ millions)***

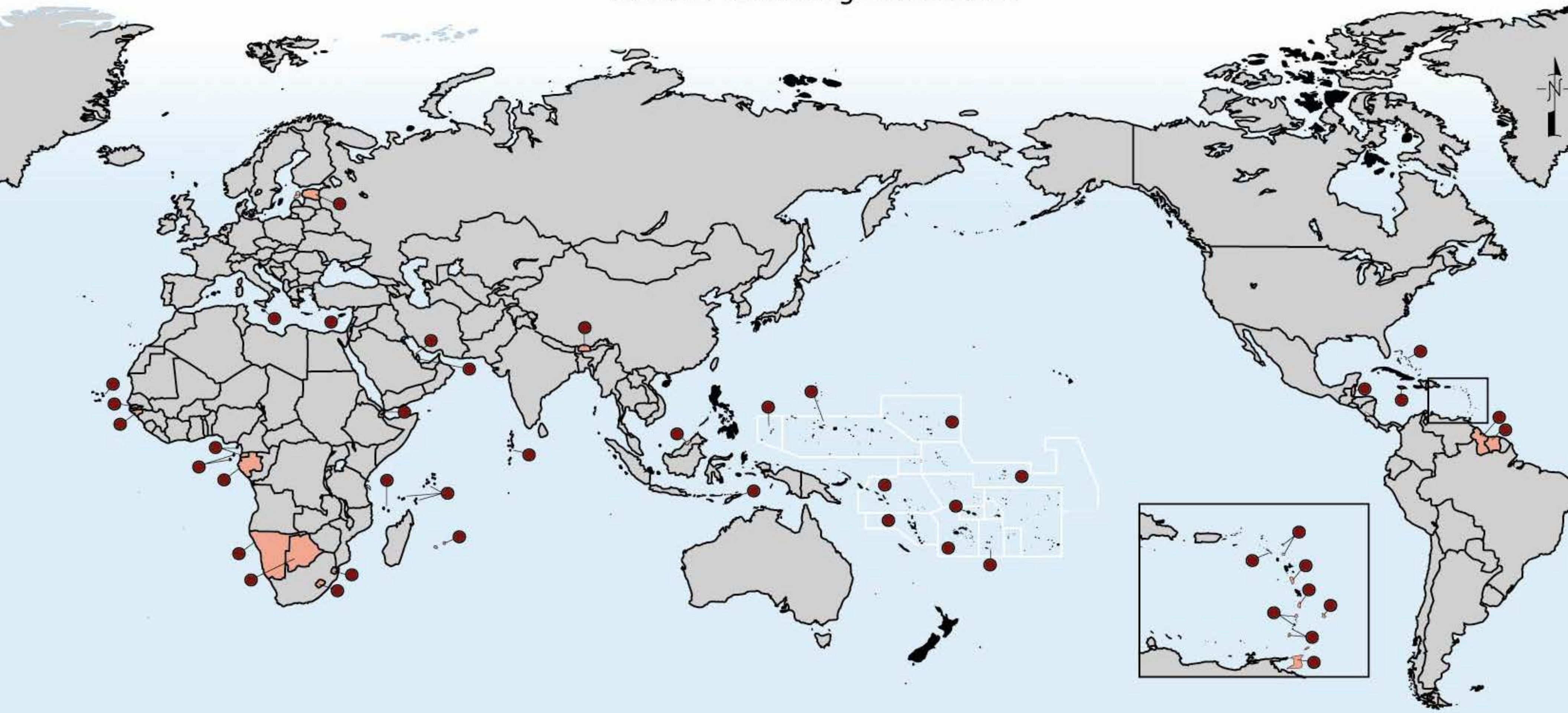
	1990-1992	*1993-1995*	*1996-1998*	*1999-2001*	*2002*	*2003*	*2004*	*2002-2004 Annual average*
	Annual averages				*Recent years*			
Botswana	130	102	101	40	38	28	39	35
Cape Verde	111	119	119	103	92	143	140	125
Comoros	52	43	34	23	32	24	25	27
Djibouti	138	123	88	68	78	79	64	74
Equatorial Guinea	62	39	26	18	20	21	30	24
Gabon	115	142	70	23	72	-11	38	33
Gambia, The	104	67	38	45	61	63	63	62
Guinea-Bissau	117	129	134	64	59	145	76	94
Lesotho	137	125	86	41	76	78	102	85
Mauritius	67	21	35	28	24	-15	38	16
Namibia	149	161	178	147	135	147	179	154
Sao Tome & Principe	54	60	36	34	26	38	33	32
Seychelles	26	15	20	15	8	9	10	9
Swaziland	55	57	32	24	22	28	117	56
Bahrain	82	64	74	24	71	77	104	84
Bhutan	55	70	61	60	73	77	78	76
Brunei Darussalam	4	5	1	1	-2	0	1	0
Fiji	53	49	43	30	34	51	64	50
Kiribati	22	16	15	17	21	18	17	19
Maldives	30	39	28	25	27	21	28	25
Marshall Islands	3	40	62	65	62	56	51	57
Micronesia, Fed. Sts.	5	82	96	116	112	115	86	104
Palau	0	115	64	34	31	26	20	25
Qatar	2	2	1	2	2	2	2	2
Samoa	51	48	32	31	37	33	31	34
Solomon Islands	43	51	42	56	26	60	122	70
Timor-Leste	0	0	1	194	220	155	153	176
Tonga	24	35	28	20	22	27	19	23
Vanuatu	47	41	33	38	28	32	38	33
Antigua and Barbuda	6	3	9	10	14	5	2	7
Bahamas, The	3	2	9	9	5	4	5	5
Barbados	2	1	8	-1	3	20	29	17
Belize	26	26	17	28	22	12	7	14
Dominica	17	17	26	15	30	11	29	23
Grenada	14	12	9	13	10	10	15	12
Guyana	130	91	166	95	65	87	145	99
Jamaica	183	106	50	14	24	5	75	35
St. Kitts and Nevis	8	6	7	6	28	0	0	9
St. Lucia	21	34	23	18	34	15	-22	9
St. Vincent and the Grenadines	17	24	18	10	5	6	10	7
Suriname	62	72	81	31	12	11	24	15
Trinidad and Tobago	8	16	21	8	-7	-2	-1	-3
Cyprus	35	33	33	53	34	14	60	36
Estonia	40	48	72	72	54	85	136	92
Malta	11	27	39	16	11	9	6	9

Table A7. ***Official development assistance and official aid (current US$ millions)***

	1990-1992	1993-1995	1996-1998	1999-2001	2002	2003	2004	2002-2004 Annual average
	Annual averages				*Recent years*			
All Small States	**2,320**	**2,378**	**2,166**	**1,780**	**1,854**	**1,822**	**2,289**	**1,988**
Africa	1,316	1,204	997	673	744	779	954	826
Asia	422	656	581	712	765	751	813	777
Caribbean	496	411	444	255	245	183	319	249
Europe	86	108	144	141	100	108	203	137
Memo items:								
Total low & middle-income countries (US$ billion)	62.3	64.0	55.8	57.7	65.6	76.7	85.5	75.9
Small states' share of total	3.7%	3.7%	3.9%	3.1%	2.8%	2.4%	2.7%	2.6%

Source: World Bank, Global Development Finance database; July 2006 (based on OECD/DAC data).

www.worldbank.org/smallstates



Antigua & Barbuda
Bahamas
Bahrain
Barbados
Belize
Bhutan
Botswana
Brunei
Cape Verde
Comoros
Cyprus
Djibouti
Dominica
Equatorial Guinea
Estonia
Fiji
Gabon
The Gambia
Grenada
Guinea-Bissau
Guyana
Jamaica
Kiribati
Lesotho
Maldives
Malta
Marshall Islands
Mauritius
Micronesia, F. S.
Namibia
Palau
Qatar
Samoa
São Tomé & Principe
Seychelles
Solomon Islands
St. Kitts & Nevis
St. Lucia
St. Vincent & the Grenadines
Suriname
Swaziland
Timor-Leste
Tonga
Trinidad & Tobago
Vanuatu

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