Geo Factsheet

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Small Island Developing Economies

There are a number of different small island economies (SIEs), in different parts of the world such as in the:
- Pacific excluding Papua New Guinea
- Caribbean excluding Jamaica and Trinidad
- others such as Maldives, Seychelles, Cape Verde, East Timor, etc

The Pacific/Caribbean comparison is a good one. For example, the Caribbean SIEs have considerably longer experience of trying to attract FDI (foreign direct investment) and are more favourably positioned to attract North American FDI, as well as to make inroads into the North American market (for example North American tourists). Pacific SIEs are often very fragmented and remote from major populated areas (for example Tuvalu, Kiribati, and the Solomon Islands.

The problems faced by small economies

Whilst not all SIEs are poor, many are categorised within the group of forty-nine Least Developed Countries (LDCs). The SIEs share many disadvantages that derive from their very small size and the limited potential for self sustained growth.

The politics of being a small island economy
There are political as well as economic implications of being small:

- the limited resource pool for the public service - this does not necessarily mean that excellent administrators and politicians do not emerge from small countries, but their numbers are likely to be limited – the same is true for specialists of all kinds in SIEs.
- their relatively great influence in international organizations that do not weight votes by population - in the UN agencies and in the General Assembly, each country (nominally) carries the same weight. Thus a region of small countries potentially has a large bloc of votes, which may be used to pursue its own agenda. Many small islands belong to larger groups, such as OECS (Organisation of East Caribbean States) and use common systems such as currency.
- the improved access to political actors by individuals - - small economies have better communication between the public and the business groups.
- the high number of administrators per capita - this also implies a high administrative cost in small countries, which translates to a high burden on firms, For example in Rarotonga in the 1990s nearly half of all the population worked for the government.

Definitions
Small generally refers to a population of less than one million. Being an island suggests relative isolation and remoteness, and an impoverished access to the markets compared with larger countries that share land-based national boundaries with neighbouring states. SIEs are independent, so this excludes dependencies such as Montserrat, Martinique, Tahiti, and the US Virgin Islands, even though they may display many of the characteristics of small island economies.

The economics of being a small island economy
The main features of a small island economy include

- a small economy has only limited scope for achieving economies of scale
- either the economy becomes very specialized relative to larger countries or the average size of enterprise remains small. In the former case, the economy is very vulnerable to changes in demand. In the latter case the costs remain high relative to larger economies. SIEs cannot both diversify and achieve low costs.
- diseconomies of scale make the costs of providing public services such as health and education very expensive.
- limited domestic market - consumer choice is limited; in addition, the SIE is likely to be in a difficult position when it comes to attracting outside investment, or even keeping local investment at home, since the attraction of entering into a small market is limited.
- a very open economy, with excessive dependence on international trade and trade being a high percentage of GDP - although this brings many benefits to SIEs.
- relatively small impact on other countrie's markets - SIEs are more likely be able to exploit a niche market without arising the fears of larger competitors e.g. nutmeg production in Grenada.
- vulnerability to outside shocks of an economic, climatic or other nature - world market price changes for the limited range of goods produced, and loss of crops through flooding or wind damage can have a devastating impact. On the other hand, international help will normally be more effective in small countries.
- limited ability to meet recurrent expenditures from locally generated revenues and grossly inadequate national savings.
- limited range of natural resources which forces undue specialisation.

In addition to these ‘size’ features, the fact of being an island is also significant. There are high transport costs, and islands are often vulnerable to weather extremes. Road and rail are usually the cheapest form of transportation for goods, though ocean transport can be cheaper for raw materials. Thus, exporters face higher marketing costs and manufacturers and consumers face higher import costs.

Islands have certain assets that have significant economic value. The tourist industry is a reflection of the high demand for coastal holidays. Moreover, insularity provides a barrier to the spread of many diseases and pathogens that could impact on farm yields. They also have the ability to develop strong, often-unique cultural identities, being relatively pure from globalised culture.

There is a **comparative advantage** in goods and services with low transport components or costs. This includes services which are sold electronically and those where the consumer bears the transport cost, such as tourism. In addition, there is a comparative advantage in coastal goods, such as good beaches, and accommodation. Once again this implies tourism developments.

Finally, the domestic market may not be of interest to larger countries or TNCs because it is too small. TNCs will supply these markets from other countries. Nethertheless TNCs do invest in some SIEs including tourism, or in plantation crops and deep-sea fishing, or, of course, oil.

Trade characteristics of a small island economy
Islands have natural protection for their indigenous industries as a result of remoteness, isolation and high transport costs. This could be enough to keep small import-competing enterprises competitive in an open trade system (i.e. without tariff protection).

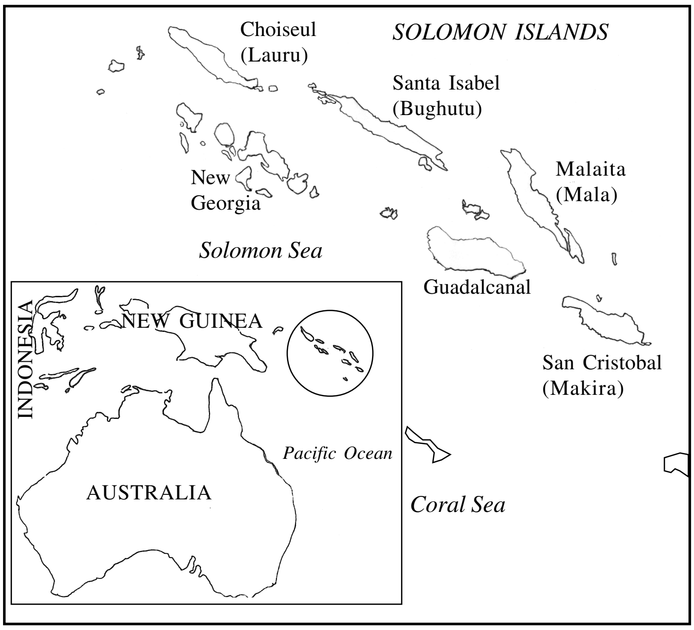
Exports and imports have additional costs because of the remoteness of the islands. The range of goods exported and imported in a small island economy is likely to be limited. This is because there is a cost advantage in only a small number of product lines. Equally the import range is limited as a result of small consumer markets.

Unstable import prices can have a devastating impact on a small island economy for two reasons. First, the narrow export base as a result of the limited number of commodities produced leads to large changes when world prices fluctuate. Unstable import prices can also destabilize an economy, especially when the import item (such as petroleum) is important in the costs of manufacturing.

Small island economies (SIEs) face a basic trade policy dilemma. Do they encourage free trade and investment, hoping to find lucrative niches in the world marketplace, or do they request others to respect their small size and vulnerability and allow them to maintain a trade policy built on domestic protection? The dilemma is particularly acute in the area of agriculture.

Case studies of SIEs
These three case studies have been selected to show the variety of issues
1. Solomon Islands
2. Caribbean
3. West Africa

1. Solomon Islands



- GNP per Capita $870
- Inflation 8.1%
- Widespread underemployment
- Very large balance of payments deficit (28 million $)
- Debt 3 times estimated revenue
- Life expectancy 72 years
- Education - 62% literacy
- Health - 1 doctor per 8719 people
- Telephones 17 per 1000 people
- No TV service. Islanders appose it on grounds of cultural dilution

The Solomon Islands are a good example of a small island economy experiencing problems. Scattered over 645,000 km^2 and consisting of several hundred islands, most of the population of over 400,000 live on just six islands. The Solomon Islands gained independence from Britain in 1978. Most of the islands are coral reef and just 1% of the land can be used for arable farming.

The Solomon Islands are on the verge of bankruptcy. Only recently they exported gold, palm oil, timber and canned tuna. But the Japanese pulled out of the Taiyo fish cannery at Noro, timber exports were hit by the Asian slump, Ross Mining closed its Gold Ridge mine (which only opened in 1998 but accounted for 30% of the Islands' GDP) and Guadalcanal's palm-oil plantations have been abandoned. At the end of December 2002 the Solomon Islands were badly affected by Cyclone Zoe, which did a tremendous amount of damage to the subsistence economy.

Cyclone Zoe
In December 2002 1,300 people on three of the Solomon Islands (Tikopia, Mota Lava and Anuta) were killed during Hurricane Zoe. The eye of the cyclone passed near Tikopia and narrowly missed more populated parts of Vanuatu and Fiji.

On top of the high winds, Cyclone Zoe also caused a storm surge that raised the sea level by around 6 m, with waves breaking on ground more than 15 m above sea level. There was no radio contact with the islands for over 72 hours and rescue efforts were hampered by poor weather, isolation, and a lack of funds.

It was not until a week after the cyclone struck the Islands that a patrol boat carrying relief supplies and a medical team reached the devastated region. The government of the Solomon Islands blamed the public holiday for the continued hold-ups with the relief operation.

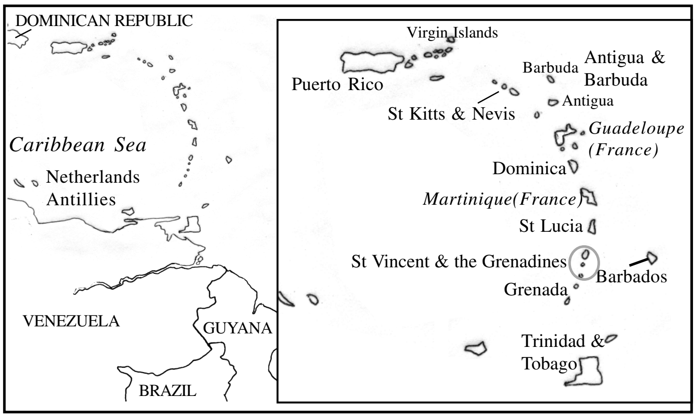
The long-term problem is how the Solomon Islands, a failed state bankrupted by years of civil war and corruption, will be able to cope with rebuilding and recovery.

Sustainability
Attempts at developing the island sustainability are proceeding slowly. There are indications that current patterns of economic development are unsustainable as trends in energy, water and sanitation suggest.

Energy
With mining, light industries and tourism acting as the main engines of economic growth, the energy requirements of the Solomon Islands have been growing rapidly. Currently power is generated from fossil fuels, and the fuel import bill has become a growing strain on the economy. Dependence on imported energy is among the key factors that aggravate the vulnerability of Small Island Economies like the Solomon Islands. The increasing demand for imported petroleum products for the growing fleet of vehicles and motorboats and for electricity generation on the outer islands has been straining the foreign exchange reserves.

Water & Sanitation
Rainfall in the Solomon Islands ranges from 3000 mm to 5000 mm annually. Although the nation is endowed with numerous rivers and streams, water availability is as variable as the rainfall. With poor water retention and natural and human disturbances in the catchment areas, the Solomon Islands is often confronted by water shortages and contamination. Currently, 64% of the population have access to safe drinking water and only 16% have access to sanitation. This lack of sewage disposal facilities is a major concern. As the demand increases, proactive measures will be needed to increase supply and reach.

2. SIEs in the Caribbean



Some of the Caribbean SIEs face big debt problems (over 100% of GDP in Dominica and Antigua), the result of economic mismanagement, declining tourism revenues and changing trade rules, for example with respect to banana export

The Caribbean has the world's largest group of SIEs. The islands argue that their small size makes it harder to cope with economic difficulties. They face major problems. Preferential trade arrangements for Caribbean producers of bananas are to be scrapped in 2006 and for sugar by 2009. The loss of these industries hits deep. Dominica exported $24m of bananas in 1993 but only $9m in 2000. Without protection, only Guyana and Belize can compete with Brazil in sugar production — and then only with modernisation and job losses.

The main earner for most Caribbean SIEs is tourism. It has fluctuated ever since the September 11th terrorist attacks on the USA as Americans have cut down on foreign travel. One further problem with tourism is the high running cost of hotels with lower re-occupancy rates, competition from cruise ships and new resorts. Tourism needs stability but drug trafficking and violence are giving certain Caribbean countries a bad reputation. As a very volatile industry it is rarely the total answer to economic problems.

The most thriving Caribbean economies include the Bahamas and Barbados, where tourism is combined with financial services. Many Caribbean SIEs do have considerable potential for tourism, with oustanding coral reefs, atractive rainforests and excellent bird life, combined with welcoming and hospitable people.

The islands of the Eastern Caribbean are rich in resources, which can be used to provide services. Where those services can be transported cheaply (such as via a telephone link), or where the consumer comes to the area to collect them (such as in tourism), the transport cost disadvantage is minimized. This suggests that most of the countries in the region will need to exploit their comparative advantage in services, including but not limited to tourism, as a way of developing their income potential. Many Caribbean people have good standards of education, with high standards of English. This would be an advantage for back office work such as call centres.

In order to overcome their small size the small islands of the Caribbean are joined together in OECS. They are also members of a free trade area called CARICOM.

St Lucia

St Lucia is one of the leading members of the OECS.
St Lucia's economy is relatively stable if not very strong. Tourism has replaced agriculture as the most important part of the economy. It now accounts for 12% of GDP and 33% of employment. Tourism is seen as the way forward in St Lucia, and there have been many recent developments and extensions to St Lucia's tourism base, such as the expansion of the Rodney Bay resort, near Gros Islet north of the capital, Castries, to form a major tourist enclave.

Agriculture is the second most important industry, involving about one-third of the working population. Bananas are the most important crop and until recently earned about 40% of St Lucia's export earnings. Most of the farms are small family farms and the bananas are marketed through the St Lucia Banana Corporation.

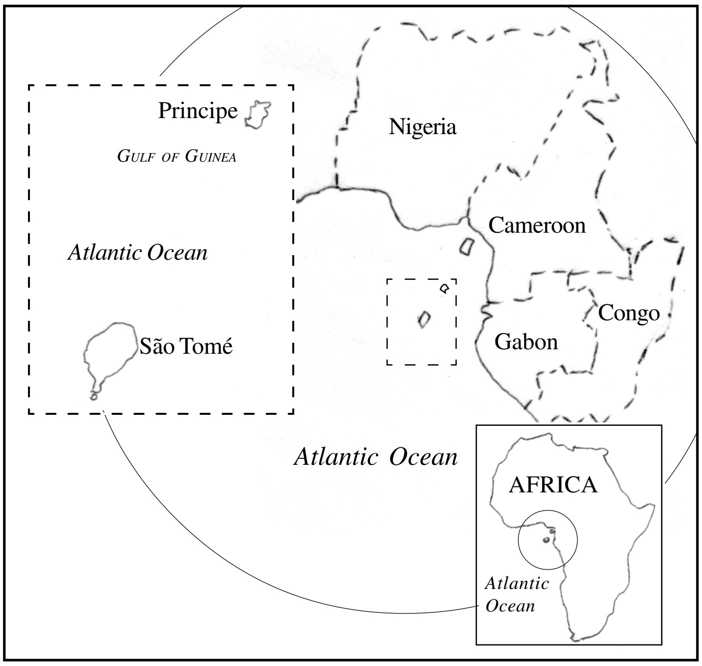
In recent years banana wars have had a devastating impact on St Lucia's economy. St Lucia's bananas are not very competitive compared with the US transnational companies based in Central America. However, they have benefited from a special trading arrangement with the European Union, although the World Trade Organisation has declared this arrangement illegal. Although St Lucia farmers have tried to broaden their agricultural base (diversify) there has been limited success.

With a small domestic market of under 150,000 people the manufacturing sector in St Lucia comprises just over 170 firms of which more than half (55%) employ less than 10 workers. In 1999, manufactured exports amounted to less than 5% of St Lucia's export of goods and services. St Lucia has severe shortages of some (appropriate) technical skills, resulting in low productivity. The most common areas of manufacturing include textiles, handicrafts and furniture.

Thus, for good or bad, St Lucia's economic success is closely connected with the success or otherwise of the tourism sector. In the light of the terrorist attacks on the USA, and the likelihood of global recession, tourism might not be the cure that once it had seemed. In response St. Lucia has tried to develop a wide tourism base, with emphasis on high value, up-market tourism.

	Population	GNP per Capita	Unemployment	Weaknesses
Antigua	66,000	$7,380	10%	Over-reliance on tourism
Barbados	263,000	$6,560	16%	Narrow economic base. Over-reliance on tourism
Dominica	74,000	$3,040	15%	Over-dependence on bananas and tourism
Grenada	98,600	$3,140	20%	Lack of diversification. Low labour productivity
St Kitts & Nevis	41,000	$6,260	4%	Dependence on sugar cane
St. Lucia	149,000	$3,190	19%	Many tourists resorts foreign owned. Banana issues
St Vincent	111,000	$2,420	40%	Little diversification. Over-reliance on bananas
Trinidad & Tobago	1,500,000	$4250	16%	Some drug issues. Insufficient diversification

3. West African SIEs



- *GNP per capita $290*
- *Inflation 71.3%*
- *Unemployment 28%*
- *Large balance of payments deficit - $12 million*
- *Life expectancy 64 years*
- *Education-75 % literacy*
- *Health -1 doctor per 3125 people*
- *Telephones 19 per 1000 people*
- *1 TV state owned service*
- *Very high ownership of radios*

While Sao Tome looks to oil and gas as a catalyst for its economic development, some West African SIEs (and land-based economies) have had negative experiences related to oil. The Democratic Republic of Sao Tome and Principe is a small island off the west coast of Africa. It gained Independence from Portugal in 1975, and between 1975 and 1990 it was ruled by a single-party regime (largely funded by World Bank and IMF). Since 1990 it has been ruled by a democratic government. Sao Tome has one of the highest aid-to-population ratios in Africa. It has some potential for farming and tourism but no land-based mineral resources. In recent years there have been significant finds of offshore oil in the region.

Its population of 150,000 people scrape a living from cocoa, fish, aid and tourism. But oil firms believe that billions of barrels of oil may lie beneath the island-state's territorial waters. Oil could change everything.

However, oil could be dangerous for São Tomé. Two of São Tomé's neighbours, who are both small and oil-rich, (and not islands) suggest oil is not always an economic cure. In Equatorial Guinea, a former Spanish cocoa colony which now pumps more oil per person than Saudi Arabia, oil has done little to ease poverty or lengthen life, and much to corrupt politics.

Its economy, once negligible, has grown at 40% annually since 1996, when the boom began but the country's agriculture is blighted: cocoa and snail farmers have rushed to the towns to grab a slice of the oil bonanza.

In neighbouring Gabon, decades of oil revenues have corrupted Gabonese society and eroded the work ethic. Citizens aspire to soft billets in the civil service, and turn their noses up at menial jobs like taxi driving or shop keeping, which they leave to immigrants from poorer places such as Togo and Mali. Agriculture in Gabon, as in Equatorial Guinea, is all but dead. Sadly for Gabon, however, the oil is running out. The Gabonese may need to revert to their former occupations.

On the other hand, oil development could bring in large quantities of foreign exchange that would enable the country to find a range of development projects and services to improve the quality of life as happened in the Shetlands in the North Sea oil boom of the 1980's.

Conclusion

Small island economies experience a number of disadvantages on account of their size and their relative inaccessibility. Many of them suffer relative to larger countries on account of their weaker bargaining power. However, there is a range of SIEs – some of them relatively successful, such as St. Lucia, some of them taking a battering, such as the Solomon Islands, and others on the verge of possible rapid change, such as Sao Tome. All are caught up in the global workplace and market, and their potential for success depends upon how they can tap the markets of the MEDCs, whether through tourism, farming, oil or foreign exchange as an off-shore banking centre such as the Cayman Islands or Bermuda.

Further Reading

A good source of information can be found at the Financial Times at http://wwwnews.ft.com/home/uk and then enter the search icon with small island economies

The Economist at http://wwweconomist.com
is an excellent for resources. It has a very good search function, although some articles have to be paid for.

Exam Questions

Outline the main issues in developing small island economies. (25)

This is an issues question, so it requires some exemplification of the points rather than just a list. The issues include

- small size – lack of home market, few economies of scale, lack of a variety of resources, few specialists etc
- remoteness – increased transport costs, general lack of rail and road, reliance on boat and airplane
- vulnerability to larger countries in terms of trading preferences
- vulnerability to climatic and other hazards, such as tectonic hazards in the Pacific and in the Caribbean
- insularity – being an island may strengthen cultural and social identities but may add extra costs to imports and exports
- being surrounded by water provides a potential for coastal tourism
- SIEs in tropical areas have a climate, which may be considered a resource for tourism as well as a potential climatic hazard

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