

## More on Globalization<sup>1</sup>

### NEW OPPORTUNITIES AND CHALLENGES FROM GLOBALIZATION

1. Other sections of the Task Force report dealt with vulnerability, the transitional needs in moving to a more liberalized trading environment, and capacity building, but small states face more general difficulties and opportunities in adapting to globalization. Globalization is a multi-dimensional process that is transforming in a profound way all aspects of national and global activities and interactions. Inherent in the process is the decline or demise of some industries and products and the simultaneous generation of opportunities for the creation of other goods and services. The process is driven by continuing innovation and technological change and is associated with the elimination or reduction of national barriers to the global movement of goods, services, capital, technology and certain kinds of labor. The emerging global market is characterized by intense competition and the need for flexibility in economies and responsiveness by economic agents within them.

2. Globalization is not a new phenomenon but rather the process has accelerated in recent years, calling for more rapid reaction from small states, many of which have limited resources and capacity to respond. Hence, globalization brings opportunities as well as challenges for small states. The latter, particularly as related to the globalization of trade, pose special difficulties for these countries. However, the prospects for small states to benefit from globalization exist in both trade and other areas of endeavor as information and communications technology shrink distances and help overcome the disadvantages of remoteness and isolation.

3. In order to take advantage of such opportunities, small states will need to undertake what some have described as a strategic global repositioning of their economies. As in the case of responding to changes in the international trade regime, they need to create enabling environments and provide the right kind of public policy support – for example, in training and education and new or modified regulatory frameworks – to encourage new activities, many of which will be in the service sectors. Some small states will need external support and advice as they seek to achieve this repositioning. Of course, globalization affects different countries in different ways and a mix of unique responses will be needed to meet the individual circumstances of countries and regions.

4. In work following its Interim Report, the Task Force focused in particular on emerging issues that bear on the provision of international financial services, and on the new opportunities provided by information technology and electronic commerce. Both areas were the subject of extensive discussion at the [Global Conference on the Development Agenda for Small States](#), in London, in February 2000.

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<sup>1</sup> This text is extracted from *Small States: Meeting Challenges in the Global Economy*, Report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States, Washington DC and London, April 2000.

### *International financial services*

5. A number of small developing countries have already become successful in the provision of both onshore and offshore financial services. For a variety of reasons the provision of offshore financial services is also a matter of concern to the international community. One is the need to combat money laundering, an areas where the small states concerned have been cooperating in global efforts. Recently international concerns have turned to the subjects of harmful forms of tax competition, and possible implications of offshore centers for global financial stability. These two topics are currently the subject of scrutiny, respectively, by the OECD's Forum on Harmful Tax Competition and the Financial Stability Forum.

6. This is causing concern for a number of small states because of a lack of adequate consultation on the matters being addressed. At the London conference in February 2000, the OECD indicated its willingness to engage constructively with small states on tax competition issues and to respond to their call for a multilateral discussion. This represents a positive development on both sides. Financial services are of substantial importance to the economies of small states, and small states therefore have a strong interest in fostering the predictability and stability of the operations of financial institutions based in their territory. At the same time, these countries need to improve financial operating practices and regulatory standards in order to safeguard the international banking and financial system. There is also a global interest in action to combat financial and tax crime, and to address harmful forms of tax competition. It is important for all these issues to be considered in international fora where small states themselves have a voice, so that their interests can be taken into account. It would therefore be appropriate for multilateral institutions to study these issues and look for solutions that pay proper regard to the interests of small states as well as the need to foster stability in the global financial system and to counter international financial and tax crime.

### *Information technology and electronic commerce*

7. Work on the opportunities that information technology and electronic commerce can bring to small isolated states suggests that these technologies can provide a major impetus to their development, especially for those countries with a well-educated and computer-literate workforce. Using the technology of efficiency—information technology and e-commerce—in a globalized, technology-based trading system means that competitors can now become collaborators, suppliers and customers, irrespective of size.<sup>2</sup>

8. These technologies also offer unprecedented opportunities for small states to reform and re-engineer government services, become part of global supply and demand chains, create new businesses and generally increase welfare. Success will depend upon planning and generating the preparedness to adapt and become responsive to change.

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<sup>2</sup> Schware, R & Kimberley, P, *Exploiting Information Technologies for Electronic Commerce and Better Public Sector Management*, paper presented at the Global Conference on the Development Agenda for Small States, London, 17-18 February 2000.

9. Success also requires the correct public sector infrastructure, crucially a regulatory framework that will deliver high-quality/low-cost telecommunications services. The level of investment for telecommunications can remain disproportionately high for small states as compared with larger countries, although in this area too technology and global competition are dramatically reducing costs. This is especially relevant in some areas—for example, the Caribbean and Pacific—where some existing, long-term monopoly supply agreements militate against the attainment of potential international competitiveness by small states seeking to diversify into new, high-technology- and communication-dependent service industries. It is important to note that, in facing this challenge, many small states will require external support from the multilateral development banks and others. Box 8 illustrates the kind of regional approach, with support from international institutions, that can work in this area.

10. Small states will also need support from international organizations on the issues of appropriate regulation on the taxation of e-commerce and control of criminal use of the technology.

#### *Public and private sector policies for exploiting new opportunities*

11. These two areas—financial services and use of information technology and e-commerce—represent two examples of the kind of new opportunities open to small states in the new global economy. There will be others. Earlier sections of the Task Force report, on the transition to a new global trading environment and building capacity, set out the kind of domestic policies and external support that will best position small states to take advantage of these opportunities. Sound economic policies will be key, as will regional co-operation—including not only improved economic management and reform but also complementary public policies and investments to provide infrastructure, education, appropriate regulation, and all the other underpinning of a successful market economy.

12. Actions on the above policy fronts and the ability to discern changes, to adopt and adapt to new technology, and to reorganize rapidly will determine the capacity of the productive sector in small states to respond to the new opportunities. Firms, governments, and individuals must get accustomed to a lack of permanence.

13. The fortunes of production of goods and services in small states may increasingly depend on their firms' ability to seek out and form strategic corporate alliances. Companies have to be flexible, responsive, competitive, innovative, efficient, and customer-focused. The fragmentation of transnational production processes into separate stages being undertaken in different countries and strategic corporate alliances has made it possible for networks of small firms to overcome the limitations of size and compete effectively against large corporations. In this context, and provided that the right kind of enabling policies and supporting infrastructures are in place, strategies for small firms to ensure their survival and profitability in the global economy include:

- specializing in a single aspect of production or distribution;
- capitalizing on specific market niches where economies of scale are not a determinant of competitiveness;

- flexible service industry specialization;
- concentrating on the economies of speed, which are now more important than the economies of scale—and which can be exploited thanks to new low-costs communications technologies; and
- strategic corporate alliances which have made it possible for networks of small firms to overcome the limitations of size.

14. Increasingly, the world economy will be dominated by knowledge-based industries, especially services, making the quality of human capital a critical factor. The productivity of labor (workers and managers) will have to be upgraded, and this means improvement in the quantity and quality of education. Because of past emigration, a significant part of the human capital of small states resides outside of their borders. Policies to encourage repatriation of skilled nationals can have a high pay-off, as this is the quickest way to improve the quality of the workforce. Making the workforce more knowledgeable and productive involves better education both within the individual enterprise and in the society as a whole. Firms need to put more emphasis on vocational training and on-the-job education. New technologies can help—for example, multimedia training enables workers to learn faster and in more detail, particularly those workers who are functionally illiterate.

15. Firms in small developing countries generally cannot afford the costs of research and development but can realize opportunities in the global marketplace by the transfer and adaptation of knowledge, and by greater use of indigenous research capacities combined with networking with relevant institutions abroad. The capacity for absorption of knowledge and new technology requires the development of an appropriate national educational institutional infrastructure. Education should thus remain a priority of governments in small states. In the more developed small states—such as in the Caribbean, there should be an emphasis on increasing the scientific and technological component of education and the devotion of more resources to secondary and university level training. Much of the university-level education will have to be undertaken overseas—although the substantial cost involved, particularly for study at institutions in developed countries, is an impediment to the efforts of small states to expand institutional capacity and research. On the other hand, many of the small states in the Pacific and Africa still need to first grapple with the challenges of simply delivering effective and universal basic and secondary education. While some needs can be met by overseas training sponsored by donors, for the most part these small states need to embark on a long-term effort to overcome problems of delivering culturally appropriate education in a cost-effective manner in order to build up education standards more generally.

16. As discussed above, a strong information and communications capability will help improve the competitiveness in new areas of business, including financial services. Acquisition of these capabilities has been expensive both in terms of money and people, but costs are going down, and regional approaches can help. It will be important for small states to have institutions that are abreast of these developments and able to take advantage of them quickly. In some small states, the revolution in information technologies and in communications has already encouraged an expansion of tourism and of other service sectors (into areas such as communications, information technology-

based activities and financial services). In the medium-term, these are areas of business most likely to offer significant new opportunities for small states.

17. As stressed throughout the Task Force report, it will be important also that the international development, finance and trade organizations and donors offer their support when small states implement the public policies and investments needed to facilitate such developments.

### **Box 1. Key actions to respond to globalization opportunities**

Some small states will need external support and advice as they seek to reposition their economies. They need enabling environments and the right kind of public policy support—for example in training and education, and creating regulatory frameworks—to encourage new activities, many of which will be in the service sectors. In this context actions in two specific areas will be important for many small states.

- One new area in the service sector where some small states have been successful is in the provision of onshore and offshore financial services. These activities are, however, currently the subject of scrutiny by the OECD's Forum on Harmful Tax Competition and the Financial Stability Forum (FSF). This is causing concern for a number of small states because of lack of representation in the OECD and FSF and lack of adequate consultation on the matters being addressed. At the London conference in February 2000, the OECD indicated its willingness to engage constructively with small states on tax competition issues and to respond to their call for a multilateral discussion. It is important to recognize the substantial importance of financial services to the economies of many small states. But this must be weighed alongside the clear need for improvements in financial operating practices and regulatory standards, in order to safeguard the international banking and financial system, and the need to take action to prevent financial and tax crime and to address concerns about harmful aspects of tax competition. It is important for all these issues to be considered in international fora where small states themselves have a voice so that their interests can be taken into account. It would therefore be appropriate for multilateral institutions, including the IMF, to study these issues and look for solutions that pay proper regard to the interests of small states.
- Finally, work on the opportunities that information technology and electronic commerce can bring to small isolated states suggests that these technologies can be a major source of help in their development. But success requires the correct public sector infrastructure, crucially a regulatory framework that will deliver high quality/low cost telecommunications services. It is important to note that this provides a challenge in which many small states will need external support from the multilateral development banks and others.