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PREM WEEK 2000:

GLOBALIZATION AND GROWTH WITH EQUITY

SMALL STATES -- REGIONAL CHALLENGES

PARALLEL SESSION NO. 11

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P R O C E E D I N G S

MS. SALOP: [In progress] -- Everyone knows Orsalia, so Orsalia Kalantzopoulos. Natasha Beschorner from the Pacific, Orsalia, of course, talking about the Caribbean, and Alan Gelb talking about the small states in the African context.

In September, in Prague, we had a Forum on small states, and that followed up on the work of the Task Force on Small States that the Bank had sponsored with the Commonwealth Secretariat last year. At the Forum, we really focussed on the three main groups of small states in the Caribbean, in the Pacific, and in Africa, and we agreed at that time that the Bank would sponsor an annual Forum, probably at the time of the [World Bank/IMF] Annual Meetings, although I think the future of the Annual Meetings is in question given the context in which they actually are being held these days, but subject to that, that we would have the Forum at the time of the Annual Meetings. There was also a suggestion by some of the participants that we have pre-fora for the individual groups, and, again, particularly the three main groups.

In the Caribbean, as Orsalia will make clear, actually they had a longstanding group, a longstanding community of interest there, and the Pacific is also developing. In Africa, there is less coherence among the small states themselves for lots of reasons that Alan will talk to us about, but I think that is an important area for challenge for the Bank going forward to develop the small states initiative in the Sub-Saharan African context.

So we will be over the course of this year doing work with the regions on small states issues, and this is an important opportunity, I think, for us to inform each other on what is going on and to ask questions and to see how we take this forward in the coming year.

Let me turn the floor over to Orsalia who will talk to us about small states issues in the Caribbean. Orsalia.

MS. KALANTZOPOULOS: Thank you for being here.

Let me get started. I will give you one example of what needs to be espoused that just came up last week. The Caribbean has the highest HIV/AIDS incidence than any other place in the world except Africa, and we tried to do our economic analysis and to find out what would be the impact. They are below Africa with the exception of Haiti, but when would the incidence of AIDS really have an economic impact on the region as a whole?

While the number is about 5 percent of the population, and so in Africa -- and I may have this wrong -- in the case of the Caribbean, it is when the incidence of AIDS is less than half of this incidence in Africa. So, if AIDS becomes a major economic issue in Africa at 5 or 10 percent, in a smaller state, the significance of such an epidemic becomes apparent much, much more early. This is the main reason for this, the very limited capacity you have in these countries.

You go in a small country like Trinidad or St. Lucia, you have one procurement specialist in a country of 1.3 million people. If something goes wrong from AIDS or it emigrates to

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the United States or somewhere else, they literally lose 100-percent of their capacity. So just the issue of the smallness makes the way we work with them and brings out the issues of capacity much more pronounced and important than in any other country that one may be working.

The Caribbean is an extremely diverse region. There are two countries that [inaudible] Dominican Republic that has 8 million people -- everybody thinks that the Dominican Republic is a small country. Well, it is the same size as Bolivia, much bigger than Guatemala and El Salvador and so on and so forth. Dominican Republic has 8 million people, and Haiti, somewhere between 8- and 10 million people. Nobody knows. So, if one were to exclude these two countries that are medium-sized, you are left with the [inaudible] from Caribbean that has countries that range from Jamaica which is the largest, 2.5 million people, to St. Kitts and Nevis, which is the smallest of our countries with 75,000 people, and in between, you have Trinidad and Tobago, 1.3, and Guyana, 800,000, and so on and so forth.

The level of development is extremely diverse as well. Barbados, which has 250,000 people, is a country with exemplary governance, that has graduated from the Bank, excellent pro-poverty strategies, and then you have Guyana with 800,000, it is an IDA country. It is a HIPC country. It is [inaudible] democracy with extremely limited administrative capacity and zero tourism, mostly dependent on sugar and mining. Then you have a country like Trinidad and Tobago which is an oil producer and has some tourism, but, in essence, is an oil producer. Right now, our dialogue with Trinidad is non-existent because, with the oil price where it is, the country doesn't need us. Also, we have the [inaudible] states of the Eastern Caribbean which are the OECS countries, the very small islands, St. Lucia, St. Vincent, St. Kitts, 50 percent IDA, 50 percent IBRD because of their vulnerability.

What the Bank does is country assistance strategies for the bigger of the countries like Jamaica, Guyana, Belize, which I did not mention, Trinidad and Tobago, and we do a regional strategy for the smaller -- the countries of the Eastern Caribbean which is the OECS, and we include in that Barbados. Our approach in all the countries, regardless of size -- this includes the Dominican Republican and Haiti, to some extent – is … we get involved in areas where we have a clear comparative advantage and where it makes sense at the regional level. For example, one area where we are working is disaster mitigation management and insurance. It is something that is absolutely necessary for the countries. Other institutions do not have the global experience to bring in. So the Bank has a role to play, but it also makes sense at the regional level to reduce the vulnerabilities in these countries.

In the past, before '97, what the Bank did for the smaller countries was wholesaled its lending through the Caribbean Development Bank, which is a subregional institution. At the request of the countries and because of problems that the Caribbean Development Bank was facing in disbursing its funds and doing, really, the more different and

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innovative things that the countries were asking, we have been changing our strategy, and we are lending directly to the countries, always keeping these two principles I mentioned, which is we have to be bringing some value-added so others will not be doing what we are doing when that makes sense at the regional level.

In addition, in the Caribbean, the Bank is one of the smaller players. In terms of resources, the European Union, I think, is the largest donor agency with the U.K. [inaudible] …. So, in most of the countries, we are the third or fourth donor in terms of financial support. However, the Bank does share the Consultative Group for the Caribbean, which is the major coordination forum for the entire region, and all the countries are represented, including Haiti, the Dominican Republic, and we have been inviting Cuba as an observer.

It is through this forum that the Bank tries to do its donor coordination and also brings into the forefront areas and issues that we think that are important and sensitive for this kind of [inaudible]. It is the countries themselves that decide on the agenda of the consultative group, but normally a lot of the issues come into the agenda through the Bank. They are suggested by the Bank.

One case in point was the HIV/AIDS discussion this past June, and the issues of sustainability in the tourism industry, which is very important, for the region. Another area where we plan to discuss -- to bring at this next year when we meet again is the social issues of [inaudible] risks because of the nature of social imbalances and crime and violence.

One of the great things of working in small countries is the freedom the institution gives you because the numbers are so small, we can do things that people do not even realize we are doing. Dave DeFerranti, who chairs the Middle-Income Countries Task Force, the other day came over and asked me, "What are you doing on catastrophic insurance, Orsalia? Are you doing anything on contingent lines?," and I said, "Yes, of course, David. Two years ago, we went to the Board with a $10-million contingent line in the event of a hurricane, if countries were to be hit by a hurricane, and they were implementing disaster programs." Well, they have access to this $10-million contingent line. Now the Bank is thinking of moving forward for the rest of its member countries, the middle-income states.

We were also able to do what we call the APLs, the Adjustable Program Loans that are normally done within a country. Vertically, you move a program. We have taken it horizontally. So each small state or small country, as they are ready to embrace or to move on a program, they become part of this APL that is across countries as opposed to within countries. So one of the great things in working in these smaller countries is the possibility and ability to innovate because there is very little money that you put at risk. It is one thing to innovate with a contingent line of $200 million and another thing to do it with $10 million.

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Let me stop at this, and maybe we can discuss a bit more some of the things we are doing in our subregion and take questions later on.

MS. SALOP: Thank you, Orsalia. I think that was a useful opening for the [inaudible]. It would be good to get each of the regional perspectives on the table, and we can start to discuss it across. You have laid out a picture of very diverse countries [inaudible], but [inaudible].

MS. BESCHORNER: Thank you.

I would like to take you to a completely different region which is the South Pacific, and I would very much like to get some feedback from you about how we could really adopt a regional approach in this kind of environment. I also have some colleagues here who may be able to respond to some very specific questions. One of them has just come back from the Solomon Islands where we have not only a small states issue, but also a post-conflict problem as well, for those of you who wanted to go to the post-conflict discussion.

In the Pacific Region, we are working with nine member countries: Samoa, Fiji, Vanuatu, Marshall Islands, Federated States of Micronesia, Palau, Kiribati, and Tonga, so a very large number of countries, large number of islands spread over a land area of about 88,000 square kilometers. That is about the size of Belgium, but a very large ocean area which is equivalent to the size of the United States, so an enormous region, very many small islands. These island groups are not only very different from each other, but there is quite a bit of internal diversification as well. Per capita income ranges from about $750 in the Solomon Islands to over $7,000 in Palau, with countries such as Samoa around the $1,000 range and Fiji, pre-crisis, certainly about $2,000.

Most of these economies have had very modest growth over the past few years, certainly no higher than 3 percent. They are very dependent like many of the small states on commodities. They are very vulnerable to global warming at the moment, as well as other catastrophes, and they are extremely isolated from world markets.

Most of these countries have extremely high telecommunications costs. They are using satellite systems. So ideas about globalization resonate somewhat more differently here.

Countries have a somewhat low manufacturing base. Manufacturing is typically about less than 10 percent of GDP, and they have very large public sectors. Governments in Pacific Island countries are involved in everything from agricultural marketing to trading, aviation, mining, and even running hotels.

The public sector plays such a considerable role in the economy that, for example, the wage bill in the Solomons and Fiji earlier this year, about 45 percent of public expenditure went on wages.

Most of the Pacific Island countries have adopted reform programs, and we have some copies here of the Pacific Regional Strategy that has a very nice matrix in it of the Vanuatu Comprehensive Program, the Samoa Statement of Economic Strategy, and the Kiribati Development Strategy. So they all have very ambitious-sounding macro and public sector and governance reform programs, but they are also extremely dependent on external aid. In the case of the Marshall Islands, the aid to GNP ratio is about 61 percent; Palau, about 46 percent; and even in countries such as Samoa and Kiribati, it is about 18-percent aid dependence.

There has been quite a move towards regional approaches to development, and there have been quite a few bodies that have been established to do this. These include the South Pacific Forum, Forum Fisheries Agency, South Pacific Regional Environment Program, South Pacific Applied Geoscience Program, Tourism Council for South Pacific, and a number of these bodies meet regularly to exchange information on environmental policy, trade and investment, promotion for private sector. The agency that we are most closely associated with is the Pacific Islands Forum and the Forum Economic Ministers meeting that takes place once a year.

In this context, what kind of approach is the Bank taking? We have just in the last year produced our first Pacific Regional Strategy, but although this looks at the regional environment, the difficulty has been in translating this regional thinking into regional operations. What we have is pretty much a country-by-country approach. We are focussing very much on health and education sectors in individual countries, notably Samoa, Vanuatu, and the Solomons. We have had an adjustment program in the Solomons, and now we are looking at a potential emergency operation.

The area where we seem to be doing the most work on a regional basis is the regional economic report. If anyone is interested, we have a draft of a summary for *Cities, Seas, and Storms*, and this tries to draw together some of the more pressing concerns for many of the countries right now, such as what to do about increasing urbanization and the pressure on small towns, how to combat climate change, and how to manage natural disasters.

So, as I mentioned at the beginning, this is just a very quick overview of what the Pacific environment is like and the kind of interventions that we have, but it is mostly a request for feedback on what regional approaches you think would be feasible here.

Thanks.

MS. SALOP: Thank you, Natasha.

Alan, the Sub-Saharan African Region.

MR. GELB: Thanks, Joanne.

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When I was asked to speak at this, I said I would rather not talk about smallish things because, actually, although Africa has a number of the very small states which are the subject of this, most African states are, in fact, small, even if they are not micro states. We have, I think, 15, you said, of small states here -- well, anyway, 11 small states. We also have 15 landlocked countries in Africa, some of which are small, and just to give you some perspective, the GDP of Sub-Saharan Africa is about the same as Belgium, and that is broken down into 48 countries. So the median country in Sub-Saharan Africa has a GDP of a little bit over $2 billion. There are many countries with financial systems that are smaller than [inaudible], and if you fly in, let's say, to Dulles Airport at night and you look at the lights outside as you circle, right down below you is the [inaudible] of Ethiopia which we think of as a big country now. So most African countries are very, very small by practical standards, even if they are not micro countries.

Another feature about Africa is that when you look at the very small and the small states, the very small states do not cluster in a certain sense that they do in the Caribbean where you have got a whole bunch of islands or in the Pacific. What typically happens is that there are close interdependencies between very small states and bigger states, in some cases, between, for example, South Africa and Swaziland or South Africa and [inaudible]. So the issue with small states is not typically small states vis-a-vis small states, but small states vis-a-vis their neighbors who happen to be bigger, even if they are not really big states. Because of geography, there are all sorts of interdependencies, and, of course, that can lead to sensitivities, what about Big Brother. The other state here, Nigeria, for example, even though it is not a big country economically, looms over West Africa like a giant, and South Africa dominates Southern Africa.

So, of course, politically, in terms of the economic interrelationships, there are obviously going to be some sensitivities here, and one has a number of regional associations in Africa, and one also has other things that divide countries, including the heritage and language, some [inaudible] and so on. Language settlement does not always follow geographical logic in Africa. So these things make Africa, I think, a little different from situations of the Caribbean and Pacific.

Some of the consequences of smallness -- and I think what we should be doing should be driven by some of these consequences that we observed of economic smallness in Africa -- regulatory costs are very high relative to the size of the market. These countries are not growing rapidly. They are not very attractive to investors, and it is even less attractive if you have a really tiny country economically that you have to [inaudible] regular barriers.

Service costs are very high. We recently discussed the Regional Assistance Strategy for West Africa, which I shall advertise, using one of the nice green slides, and this shows just how high service costs are because of, again, limited markets, limited competition in telephone, power, water. These costs are multiples of what they could be in a broader, more competitive environment.

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There are high costs of trading between countries, high transaction costs, whether it is trading goods or trading tourists. For instance, whereas we would like to see common tourist circuits in parts of Africa, you will sometimes find that tourists have to get off a bus at one border, walk across with their baggage, and get onto another bus because the companies have not been authorized to operate across countries. Visas are another impediment.

There is a question, perhaps, about basic liability of certain states in Africa because, remember, these are artificial borders, and, historically, in parts of Africa, particularly West Africa, people have traditionally migrated a great deal, and so, if you really take borders and location seriously, you get into some real questions with some countries where the borders were not imposed with a view toward the liability of certain states.

Of course, you have a lot of instability, which was mentioned before. These are very heavily commodity-dependent countries, usually a couple of key commodities, and so, if you look at real exchange rates, for instance, leaving aside the Franc Zone where countries are bound together with one franc, you will see that they bounce all over the place relative to their neighbors, so a lot of relative instability here.

Another factor that we are concerned about is because of the capacity limitations on these countries, it is very difficult for them to participate effectively in world fora. For example, if you take the World Trade Organization, half of the countries in Africa virtually have no representatives at all in Geneva. It is probable only South Africa, and all of Sub-Saharan Africa actually has the capacity to participate in global trade negotiations, but these are some of the features which we see as being sort of important.

There has been quite a long history of political imperatives towards economic integration in Africa, and I think because of the geography, the issue with small states is really how to integrate with their neighbors rather than how to form a union of small states, the kind that would not make too much sense. This has been a political imperative for some time, but very little done so far.

One colleague has expressed it to me this way. He has said, "Well, you know, you previously had highly autocratic countries and no private sector, and you do not get a bunch of dictators and state enterprises wanting to amalgamate. They want to preserve their power." What has happened now is that there has been considerable political liberalization, and the private sector is beginning to develop a certain stake in cross-border transactions. So we are hopeful that the political movement towards economic integration gets backed up with some real action in economic terms. This is much more important than just the trade flow issue because the real issue is not so much where the African countries form an optimal trading area or currency area, but it is just related to the scale, and I think it is more on the investment side, frankly, than on the trade side.

There is no shortage of regional associations in Africa. I just wrote down at random here. You have got the West African Union. You have got ECOWAS. You have got the CMAC, the East African Community, [inaudible], and many others that I have probably forgotten about. Of course, one of the problems is that these are all in varying states of development, and they, in some cases, cross over in their countries which are members of two of them. So there are conflicting obligations. One of the problems that we are facing here is how to help Africa rationalize its own regional association structure. That is one of the issues that I think is ahead of us.

How do we go forward? If we look, we see two patterns of regional association in Africa. In some of the Franc Zone areas, there is already a common base, a strong common base for association, underpinned by essentially a common currency, common monitoring authority. In some other areas, there is not, and what we find here is what we call integration by emergency, where what happens is that countries will tend to get together around specific projects, business licensing or power pooling or air transport regulation or whatever it happens to be. The trick then is out of these common projects to share resources and to work collectively together, it is to build a strategy towards greater regional integration, and this is tricky because this process moves at different speeds across different topics, and it has what we call variable geometry – that not all countries will move at the same speed – and somehow this whole mass has to be kept moving in a generally forward direction.

This is really what is happening in most of Africa, and it is also something that we can encourage through focussing on development corridors. In Southern Africa, for example, you have the Maputo Corridor, which is sort of integrating Mozambique with South Africa, but there are many other areas. In West Africa, you have, say, the Gas Pipeline Project which can create a sort of development corridor across West Africa, but this is sort of how the process is moving.

What are the barriers here? Well, there are several kinds of barriers. First of all, I think you have to accept history and existing structures as a barrier. You would not design African States today on economic grounds as they have been designed before, and you would not probably give them their linguistic affiliations. So there are all sorts of historical and geographical factors there.

There is the Big Brother issue that right now the countries in Southern Africa that need to integrate with South Africa are very scared of South Africa's domination since it is 80 percent of Southern Africa's GDP alone. So there is that issue, how does one deal with that.

Countries still have very different tariff structures, even when they are together in the same regional association. This is not true in West Africa where they have imposed a common external tariff.

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There is the problem of compensation of countries getting together to form a customs union since, geographically, some are interior, like Zambia or Burkina that are interior to a group of countries. They lose revenues when they drop their tariffs on intra-zone trade. Others may benefit. So how do you deal with that? What sort of compensating transfers do you have?

I have two minutes, and that is fine. Small states, small time, Joanne.

Then, of course, there are some other issues that you have to face, the question of labor migration. Take that as tricky issue. Because of geography and history, again, labor migration is a very important issue in some of these areas, and you cannot imagine, for example, in West Africa an economic union that somebody says, "Well, capital is going to be free and goods transfer is going to be free, but no labor migration at all." What happens, then, to the poor interstates? So these are some of the issues, and the asymmetries [inaudible].

What can the Bank do about this, and what is the Bank doing? Well, there is quite a lot that the Bank is doing, and, actually, I should not be the one telling you this because some of my colleagues who are here are much more intricately involved than I am, but let me just give you kind of a picture of some of the things that we are doing at least in moving forward.

First of all, of course, we are inhibited. Our budgets are set on a country basis, and IDA also is allocated on a country basis. So this is not one of the issues that we do face in terms of how we deal with subregional organizations. We have set aside subregional budgets in the region we have for work on West Africa, on East Africa, on Central Africa and Southern Africa, and we have produced some regional strategies. We have one on [Southern Africa], for example. We have this one on West Africa. So we are trying to think regionally. We have supported a number of initiatives to harmonize regulation such as the [inaudible] initiative which is thought to bring in a common business [inaudible] across a number of Franc Zone countries, not only in West Africa.

We can support common projects such as the Maputo Corridor which was supported. Energy projects in West Africa, for example, we can support. We are just about ready to go on a project which is called the Trade Facilitation Project for East Africa. What happens is we and the countries put money into a pool of funds which is then used to underwrite political risk cover for across-border trade transactions in Africa. The idea is there to create much possibility of much more [inaudible] of trading relationships between countries. That is an example.

We have just appointed a regional coordinator for economic integration, by the way, Marie-Françoise Marie-Nelly, to sort of bring our work together here. In a number of areas, transport roads, ports, and so on -- air transport is another one where I think there has been some success in Africa recently in trying to move towards integrated air space and opening up. There again, we can complement that by providing funding for facilities and upgrading country by country.

We have some umbrella operations, we call them. We have one on HIV/AIDS which, essentially, is a line-of-credit countries in Africa which can then draw on support to their AIDS projects. I think we should distinguish clearly the real purpose of that operation is not simply to encourage a regional approach in Africa. It is to cut our own transaction costs. One of the problems is that we have very high transaction costs in dealing with small countries. We need to keep that objective separate.

One thing we need to do much better is we need to ensure that country programs and CASs [country assistance strategies] are sensitive to their regional context. I have sat in meetings of CAS discussions with small countries like [inaudible] where, from the first draft of it, you would not know that it was a tiny speck of land in the middle of South Africa. This is a problem, and I think it is something that we are going to have to pay much more attention to.

I also wonder whether we should not think, discuss, if we are really serious about moving forward, as to whether part of IDA should be thought of as being allocated by region or subregion. Right now, I think there is a bit of disincentive to be engaged in common projects because what happens is a country will see that its share of finance for a common project is taken out of its own IDA allocation, but if we are serious and we believe that there are positive externalities from this, why do we not think of encouraging part of the pool of funding that we are administering to be actually set aside to first go to countries which are willing to cooperate regionally, and could we tip the incentives a little bit that way in their favor?

Thank you.

MS. SALOP: Thank you, Alan. I want to thank the panel very much, and I want to open it up to questions.

I think that we have heard a very interesting set of presentations focussed differently on different issues, and one particular interest that I have and that I hope we will be able to get into discussion of is what the Bank can do, to go back to Alan's final point.

Mentioning using the umbrella project and I think AIDS you mentioned, I -- Orsalia had mentioned at the outset the ability to innovate particularly when you are working on a small country, and actually the horizontal APL process was, indeed, originated in the Caribbean Region, so under that license of innovation that Orsalia and her colleagues had.

But I think the idea of what we can do, what we are doing to help reduce transaction costs, our own and also our clients, I think that is really important, and it is the name of the game, and how we can design ways of working that will help to do that.

So let me open it up for questions and comments.

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[The remaining portion of audio tape was not transcribed because of low audio quality.]