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“Whether small states can get away with annoying big states seems to be a question with a lot of potential for getting at some central issues in the field of International Relations.” Jason Sharman (2006)

“The global financial crisis arose amidst the failure of the international community to give the globalized economy credible global rules, especially with regard to international financial relations and macroeconomic policies...Nothing short of closing down the big casino will provide a lasting solution.” UNCTAD (2009)

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Introduction:

The ongoing global financial turmoil (GFT) has brought to the fore yet again the question of forces driving the globalised economy and ways to tame them. There is a burgeoning literature and on-going debate amongst economists and political scientists on the causes and consequences of an increasingly globalised world economy. Part of this discussion, driven by scholars and policy makers alike, is the question to what extent this process has contributed to the marginalisation and/or exclusion of, and some would say was achieved at the expense of, large chunks of the population and certain countries or group of countries[1].

Underpinning this debate is a discussion regarding the respective roles of free market forces and government regulation. At the same time, globalisation is accompanied by (or indeed lead to) a relatively new phenomenon, namely the increasing tendency of otherwise sovereign states to surrender part of their sovereignty to supranational institutions. Part of this process is the greater degree of regional trade, economic and monetary integration between groups of countries, sometimes accompanied by various levels and degrees of political integration. This is particularly the case when one is looking at the evolution of European Integration and the creation of the European Union (EU). These debates have many analytical facets and theoretical underpinnings, as well as empirical implications, which are well beyond the remit of this lecture[2]. Rather, I propose to look at some of these issues from the perspective of a subset of countries which are often neglected from this debate, namely small states[3].

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[1] Collier (2007) argues that this group is fairly large, and includes some fifty-eight states, and about one billion people who are currently “missing the boat” (see Chapter 6).

[2] Some of these issues, the causes, consequences and sequencing of economic integration agreements are discussed in Estevadeordal and Suominen (2007, 2008), Bergstrand, Estevadeordal and Evenett (2008), Baier, Bergstrand, Egger and McLaughlin (2008), and in the case of the EU, Eichengreen (2004), Alesina and Perotti (2004), and more recently, Eichengreen and Boltho (2007), Bergstrand (2008).

[3] Collier (2007) speaks of “Small countries” that are badly governed. However, the author doesn’t provide a formal definition of what are small countries, other than that “combined, they have fewer people than either India or China. And since their per capita income is also very low, the income of

More specifically, in the next section I propose to explore what is so special about small states in general, and why they are sometimes (or ought to be) seen as a *sui generis* group of countries, while in the following section I focus on the lessons learned so far form the global financial crisis. In the penultimate section I focus on the implications on the implications of this crisis for small states, before drawing some general conclusions.

What is the Problem with Small States?

There are two important reasons why one would want to focus on small states in the context of a lecture on international political economy and the global financial turmoil. First, as suggested in Sharman's quote at the begging of this presentation, because of their size, small states often lack some of the key features of "normal-sized" countries, such as armies, full-fledged diplomatic missions[4] and tax collection services. Therefore, they often offer interesting case studies to explore relations between them and larger, richer or more powerful neighbours or partners[5].

Second, after the collapse of the Soviet Union, and the ensuing disintegration of many of its constituent parts and satellites (with the more recent example the secession of Abkhazia and South Ossetia from Georgia) there is a proliferation of new, often small, states which is changing the landscape of international relations. Following the (relatively) short periods of euphoria, many of these states started forging more or less strong bilateral and multilateral links with former

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the typical country in also negligible [sic], less than that of most rich-word cities" (p.7). Curiously, in his discussion on the subject (of failing) small countries, he mentions Nigeria, Bangladesh, Chad, Angola, Central African Republic, Haiti, Liberia, Sudan, Somalia, Solomon Islands, Zimbabwe and Democratic Republic of the Congo, not exactly the smallest of states by any standard.

[4] Thus many small states, most of which are members of the Commonwealth, can't even afford to have permanent missions and representations at the UN (whether in New York or in Geneva) or at the WTO, and are thus serviced by a common office, run by the Commonwealth Secretariat funded by Commonwealth development partners.

[5] For a recent excellent analysis from a constructivist perspective of the struggle for global tax regulation between small states and the economically powerful members of the Organisation of Economic Co-operation and Development (OECD) see Sharman (2006).

regional foes and friends, with a view to (re)building closer political, military and economic relations. In the economic and trade spheres, this process provided added impetus to the on-going upsurge of international cooperation agreements, resulting in a very dense network of bilateral and regional economic integration agreements, often described as a "spaghetti bowl". In fact, many analysts argue that for small states, "global connectedness" is the only way to prosperity in an increasingly integrated, and technologically sophisticated, global economy. However, deepening relations with other countries often requires considerable resources, both in the public and private sectors. But, as we pointed out above, this is something they dearly miss, and this is why small states, with their limited capacity, need to be strategic in their international outreach efforts[6].

So, what do we mean by small states? Notwithstanding some dissenting voices, it is generally recognised that small states are sovereign, internationally recognised, countries with populations of up to 2 million inhabitants[7]. Although to a large extent arbitrary, this cut-off point has, nevertheless, the basic attribute of (what Schelling calls) a "focal point"[8], namely that it provides a (rational) point of convergence among researchers, in the sense that it focuses their attention on the issue.

Based on this definition there are, currently, 49 small states. Most of them are located in three regions, namely, Africa, East Asia-Pacific and Latin America and the Caribbean, of which thirty-one are islands[9]. Only

[6] Rose and Stevens (2004), based on the recent theories of economic growth and with reference to New Zealand, develop a set of "criteria for selecting countries as partners for deeper bilateral economic linkages across six global connectedness dimensions: FDI, R&D links, trade in goods, inbound tourism, education export, and people linkages". (p.i)

[7] Kuznetz (1960), in his path-breaking essay on this issue, used population as the relevant size concept, but set the 10 million mark as his upper limit. On the other hand, the Commonwealth Secretariat in its work on small states uses the 1.5 million inhabitants cut-off, although it includes in this group larger member countries such as Jamaica, Namibia, Lesotho and Papua New Guinea.

[8] Also known as the "Schelling point", after the name of the US economist and game theorist who first coined and developed the concept, Thomas Schelling (1960).

[9] Note that given that the main reliable source of data on most of these countries is the World Bank's **World Development Indicators** (WDI), this number does not include non World Bank members such

eight of them are in Europe, while five are EU member states (see Table 1).

This list calls for several remarks. First, most of these countries, gained their independence after 1960, while four, namely Timor-Lest, Montenegro, Estonia, and Slovenia became independent states only recently. This relatively recent phenomenon of the proliferation of small states, appears to have been the main driving force for the continued interest on the issue. Second, population size is highly correlated with two other features, namely insularity and isolation[10].

Scholars and policy-makers have debated the question as to why small states should be classified under a separate category, along with the other groupings of countries with such epithets as: "Less Developed", "Developing", "Emerging", "Transition", etc. The general consensus is that because of their size, small states share a number of characteristics which warrants their inclusion in a separate grouping in the global nexus of relations between nations. It should be notice here that despite the fact "that small states as a group do not have low incomes, nor are their growth rates lower, on average, than those of other countries" (Favaro and Peretz (2008)), nevertheless these characteristics do inhibit their economic development. Furthermore, although small states receive considerable volumes of Official Development Assistance (ODA), relative to the size of their populations and economies, they nevertheless face additional costs in managing this ODA[11] .

While different authors, country officials and international organisations, emphasise different aspects that, in their view, are

as Cook Islands, Nauru, Niue and Tuvalu. Furthermore, for the purposes of this paper, we have also included Slovenia in this group, which, according to the latest Eurostat data, has a population of 2030000 inhabitants.

[10] For a discussion and some evidence of this, see Winters and Martins (2004).

[11] See World Bank, IEG (2006).

relevant and common to small states, the most often mentioned "enduring" characteristics are[12]:

- Remoteness and insularity[13];
- Susceptibility to natural disasters such as hurricanes, tsunamis, cyclones, earthquakes, tropical storms which typically affect the entire population and economy;
- Highly volatile growth rates;
- Limited institutional capacity, due to the high per capita cost of public services;
- Limited economic diversification, due to the narrow resource basis and small domestic markets;
- Openness and heavy reliance to world trade and market access to export their commodities;
- Limited access to external private capital;
- Poverty due to the limited employment opportunities.

In addition, more recent challenges are now gradually emerging, albeit at different degrees, such as:

- The faster than anticipated erosion of the preferential access to markets for traditional exports;
- Increased environmental susceptibility due to global warming;
- Rising concerns with respect to growing youth unemployment in some of these economies, the costs of the post-9/11 security concerns, and drug-related crime; and
- The costs and devastating effects of the HIV/AIDS pandemic.

[12] See Commonwealth Secretariat/World Bank (2000), accessible at www.worldbank.orf/smallstates; and the follow-up study, by Briguglio et al. (2006).

[13] One could have added "landlockness" as a distinct characteristic. Indeed, Collier (2007) argues that these countries are indeed in a trap which, coupled with "bad neighbours" could have devastating effects on development of the countries concerned.

Looking at this list, it is clear that most of these phenomena represent real challenges to the economic development and growth potential of most, if not all, small states. At the same time, if one is interested in developing and implementing policies to address these challenges, then one needs to analyse more carefully the nature of these challenges, as well as their developmental implications.

An increasing number of economists are now asking these questions, and are coming up with some interesting answers. Looking at the nature of these challenges from the policy perspective, it is important to note, at the outset, that not all these challenges are equally susceptible to policy interventions. Indeed, insularity, isolation and susceptibility to natural disasters are largely unalterable "handicaps", and could certainly not be subjected to policy intervention[14]. Furthermore, some economists are asking a more fundamental question, namely is (population) size exogenous, as most studies seem to assume, or is the size of a country endogenous and thus determined by (external) causes? This is a question familiar to many philosophers, since Plato and Aristotle, and to political scientists and historians, since Montesquieu, but rather new for us economists. Recently, some economists have argued, and provided evidence to that effect, that while it is true that size influences economic performance, the converse is also true. In particular, a key factor determining the boundaries of a country, and therefore its size, is its degree of openness to trade[15]. The basic argument is fairly simple and posits that, as far as economic performance is concerned, trade could be a substitute to country size and a small domestic market.

[14] Hughes and Brewster (2002), coined the expression "endowed handicaps" to describe these challenges.

[15] Other factors include the economies of scale associated with the provision of public goods and the degree of "heterogeneity" within the country. See in particular, among others, Alesina, Spolare and Wacziarg (2000) and (2004).

Furthermore, because these challenges are often interrelated, i.e. statistically highly correlated, it is difficult to untangle the specific effects of each one of them on economic performance.

For example, remoteness (i.e. geographical location) and insularity are highly correlated with each other and population size. Thus, two regions, the Pacific and the Caribbean, which are almost entirely comprised of small island states, together represent almost half the list of small states. Another example is the high degree of correlation between the susceptibility to natural disasters, the resulting increased environmental susceptibility to global warming, and the highly volatile growth rates of small states. In addition, the heavy reliance of small states on word trade, coupled with the limited diversification of their export base, means that the faster than anticipated erosion of trade preferences will have an even greater effect on their performance than for countries with either a more diversified economy and/or less reliant on export markets. In the same vein, as correctly pointed out by Hughes and Brewster (2002), most of the foreign investment flows in these economies where the direct result of the preferential access to key developed markets. Thus, the erosion of trade preferences has also had a negative effect on FDI flows.

Even so, Winters and Martins (2003) have attempted to unravel and quantify the effects of some of these characteristics on the (microeconomic) performance of small states. Their conclusions are very revealing: "We conclude that there are significant size effects on the costs analysed (transportation costs, labour costs, etc)… Overall, the results are striking, pointing out to strong potential economic disadvantage of small size" (p.3). Further down, they write "at very low size, the cost disadvantages [in key export sectors such as electronic assembly, clothing and tourism], are crushing, but that they dissipate fairly quickly as size increase…[and] that economic smallness presents significant policy challenges." (p. 5)[16].

[16] Of course one could argue (and some did) that some of these challenges are not caused by smallness as such but, rather, by bad economic policies and poor governance. Hughes and Brewster

The EU has long recognised that geographical or regional disparities inhibit economic growth and development. This is even more so following the recent addition of twelve new member countries, ten of which have levels of economic development well below the EU-15, pre-enlargement average. Hence, the necessity for a greater focus on EU cohesion and the need for better funded regional policy instruments.

Looking at the enlarged EU, in 2007, the five large Member States (i.e. those with more than 5 per cent of EU27 GDP) represented more than 72 per cent of the GDP of the EU27. At the other end, the ten smaller members (i.e. with less than 1 per cent of EU27 GDP) represented less than four 4 per cent of EU27 GDP. In fact, the combined GDP of the ten Medium-sizes Member States (i.e. those with 1-5 per cent of EU27 GDP) was barely larger than that of the largest economy, Germany (23.7 per cent compared to 19.7 per cent)[17].

As a result of the latest EU enlargement the number of small states (as per our definition) within the EU has increased by four, namely: Cyprus, Estonia, Malta and Slovenia, hereafter referred to as EU4[18].

Like their counter-parts in the rest of the world, these states had, in 2007, relatively robust GDP growth rates (4.4 per cent, 7.1 per cent, 3.9 per cent and 6.1 per cent respectively), well over the EU27 average (2.9 per cent)[19]. At the same time, they also share most of the challenges identified[20]. Indeed, all four are on the fringes of the EU and, relatively

(2002) as well as Winters and Martins (2003) have looked at this claim and rejected it, opting instead for a distinct and separate size effect. That said, in some cases, small states are indeed badly governed which of creates an added handicap often difficult to overcome (see Collier (2007), Chapter 5)

[17] See Eurostat (2008a), Table 2.2.1, p.29.

[18] Latvia, with little over 2.2 million inhabitants, and Lithuania, with over 3.3 million inhabitants could, conceivably, also have been included, but were not for the sake of consistency.

[19] See Eurostat (2008a), Figure 2.2.9, p.38.

[20] A recent World Bank study by Thomas and Pang (2007) on this subject uses instead a very curious and arbitrary selection of countries, which includes: Estonia, Iceland, Ireland, Luxembourg and Slovenia. Interestingly and amazingly, it seems completely oblivious of the existence of Malta and, quite surprisingly, drops early-on in the discussion Cyprus, the second best performer in the EU zone

remote from the main core of the EU, have limited institutional capacity to implement the EU acquis, are relatively open to trade and have limited access to foreign capital.

Furthermore, the EU4 can be regrouped into two smaller subgroups: the two smaller Mediterranean islands (Cyprus and Malta) members of the Euro area since January 2008 with a common colonial heritage and, Estonia and Slovenia which are following a parallel transition to market economies. Countries in each subgroup face additional challenges. For the former, there is increased environmental susceptibility to climate change, such as repeated periods of prolonged drought, and an enhanced vulnerability to illegal immigration and people trafficking because of their location. For the latter, both countries gained independence after the break-up of larger centrally planned economies, with the resulting loss of preferential access to traditional markets and sources of inputs, the need to privatise their economies, and to radically readjust their growth and development strategies[21].

In order to address these issues the EU is pursuing an active regional policy to reduce economic and social disparities, to show solidarity and remain competitive and to meet the challenges of the 21st century.

To that effect, it has developed a number of financial instruments aimed at three specific objectives, namely:

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in terms of GDP growth, see Eurostat (2008b) Table 3.1.1., on the grounds that it "has shown relative decline to mediocre economic performance (sic)" (p.8); at the same time, it includes in the group, Ireland (with a population of over 4 million) for no other reason than "because its recent growth experience", and Iceland (a non-EU member country), while completely ignoring Lithuania, without any explanation provided. In another glaring omission of the paper, in the discussion of Luxemburg there is no mention of the beneficial role of Benelux, one of the most successful and lasting examples of monetary and economic integration which preceded the EU. Finally, in reviewing Estonia's economic strategy (p.15), it refers to "two elements" [of successful policy response to smallness, namely]: "(a) Streamlining the state...", "(b)Emphasis on technology...", and "(c)Reorientation of trade patters..." (sic).

[21] See the discussion in Thomas and Pang (2007).

(1) achieving Convergence between countries, i.e. "to promote growth-enhancing conditions and factors leading to real convergence for the least-developed Member States and regions";

(2) strengthening Regional Competitiveness and Employment, for outside the Convergence regions; and,

(3) European Territorial Cooperation to "strengthen cross-border co-operation through joint local and regional initiatives, trans-national co-operation aiming at integrated territorial development, and interregional co-operation and exchange of experience"[22].

These instruments include, among others,

(1) the European Regional and Development Fund (ERDF), aimed at strengthening social cohesion in the EU "by correcting imbalances between its regions";

(2) the European Social Fund (ESF), seeking to "improve the employment and job opportunities within the EU";

(3) and the Cohesion Fund (CF), "aimed at Member States whose Gross National Income (GNI) per inhabitant is less than 90% of the Community average".

All EU4 states are (still) eligible to receive funding from the CF, and partly from ERDF[23], see Table 2. In fact, referring to Table 3, while the average EU27 citizen will receive, during the 2007-13 period, on average euro 698,000 of regional cohesion support, Cypriots will receive more

[22] For more details, follow the following link: www.ec.europa.eu/regional_policy.

[23] An instrument may have more than one objective. Thus, ERDF funds can be used for all three objectives, ESF for the first two, while CF can only be used for Convergence. Also note that for the purposes of the regional policy, Estonia and Slovenia are considered "regions" at the level 2 of the EU's nomenclature of territorial units for statistics (NUTS) and are therefore eligible to access ERDF and ESF.

than euro 800,000 and the citizens of the remaining three more than euro 2,000,000 each[24].

However it is worth pointing out that the objectives of this policy, and instruments used, were not specifically designed and aimed at addressing the challenges specific to small states. In that sense, they are not addressing the needs of these states. Furthermore, looking at the FDI outflows from the EU15 to the twelve new member states[25], it is clear that the EU4 are not the main recipients of FDI from fellow member states.

In particular, in 2004 they received only EUR 2.6 bn, which represents a mere 1.6 per cent of the total extra-EU15 FDI and 13.6 per cent of the total outflows to new member states. The respective figures for 2005 and 2006 are: EUR 7.8 bn (i.e. 2.7 & 20 per cent respectively) and EUR 5.7 bn (i.e. 2 &15 per cent respectively)[26]. In fact, at the end 2006, the lion's share of FDI stocks held by EU-15 in the new member countries, i.e. 77 per cent of the total, were in four countries, namely: Poland (EUR 68.4 bn), Hungary (EUR 64.6 bn), Czech Republic (EUR 52.4 bn) and Romania (EUR 24.4 bn).

The Key Lessons from the Global Financial Turmoil

Looking at the GFT from the vantage point of a national regulator, it is revealing to note the five lessons that SARB Governor Tito Mboweny has drawn from the current GFT[27]. This confession is instructive because it reveals that policy-makers, who should have known better, either chose to disregard or perhaps didn't even attend their Economics 101 lectures!

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[24] These figures were derived by dividing the indicative financial allocation for each country (in current prices) for the period 2007-2013, by the population on August 1 2008.

[25] See Eurostat (2008c).

[26] Note that the 2006 figure for Malta, and therefore EU4, doesn't include the EUR 8.9 bn one-off investment from the German chemical and financial sector linked to activities of Special Purpose Entities, which are mainly holding companies.

[27] See the speech by Governor of the South African Reserve Bank, Tito Mboweni, entitled "Central Banks and Financial Stability-some lessons for the future", http://www.bis.org/review/r090319b.pdf .

In particular,

Lesson 1: "The sum of perfectly rational individual decisions doesn't equal a perfectly rational market".

This is what every first year economics student knows as the "fallacy of composition". It summarises what any financial regulator should have known, namely, that at a systemic level the integrated global financial system is finite and that although risk can be passed around, this does not mean it has disappeared!

Lesson 2: "If something seems too good to last, it probably is."

Again this lesson is known to every economics freshman as Milton Friedman's famous aphorism "there is no such a thing as a free lunch"! So that when asset prices, the balance sheets of financial institutions and profit targets out-grow consistently and significantly the growth rates of the real underlying economy, then something is wrong and will have to yield!

Lesson 3: "The seeds of the next crisis are sown in the solutions for the current one."

Looking at the types of action taken by central banks and ministries of finance to deal with the GFT it is difficult to think what else they could do to restore confidence in the banking system. These include significant injection of liquidity, the lowering of collateral requirements, asset swaps, longer-maturity refinancing operations, intervention in foreign exchange markets, co-operation among central banks in their open market operations, monetary accommodation, quantitative or credit easing, capital injections into banks and other financial institutions, substantial fiscal stimulus packages and, in some cases, nationalisation of banks. Again, students of macroeconomics should know that the problem with these policy initiatives is to avoid three unintended, but common, consequences of such active policy interventions, namely crowding-out of the private sector, inflationary pressures and moral hazard.

Lesson 4: "Every good party needs a strong bouncer."

Clearly in the context of financial markets, the bouncers are the supervisors who, need it be said, must have the necessary muscle to weed-out potential trouble-makers. Pushing Tito Mboweny's analogy a step further, clearly bouncers seem to know their trade better because, more often than not, they act proactively, through "face control". Unfortunately, regulators haven't quite mastered the tricks of the trade yet. Indeed, although the warning signs were there, namely excessive leverage, unreliable credit-ratings, under-pricing and under-estimation of risks, herding behaviour through the excessive reliance on similar mathematical models, skewed executive incentives etc, the "bouncers" were caught napping and/or chose to ignore them!

*Lesson 5: "Common sense should prevail" (or, as Voltaire actually wrote, "common sense is quite rare")***.**

Here, the Governor warns of the growing divide between mathematically unsophisticated Boards of Directors, who of course have the necessary business acumen, and the people they are suppose to oversee, namely the engineers/mathematicians who develop increasingly complex risk management models, but lack basic business skills. Again very few economics student (that I know!) will disagree with the governor's statement that "perhaps one good thing about the current crisis is that engineering students will in future actually do what they have been trained for: to be engineers. In the past decade or so, the financial world has been taken over by mathematicians, statisticians, engineers and scientists."

Although candid, for many observers this *mea culpa* doesn't go far enough. Many analysts now believe that the problems run deeper require more radical remedies. According to the UNCTAD's 2009 report quoted at the beginning, "The crisis dynamics reflect failures in national and international financial deregulation, persistent global imbalances, absence of an international monetary system and deep inconsistencies among global trading, financial and monetary policies." As a result of this diagnosis, UNCTAD's report is an indictment against *laissez faire*. It advocates instead a "*comprehensive reform and re-regulation with a vigorous role by Governments working in unison*" and proposes a number of national and multilateral remedies that place government debt inflation, the (global) re-regulation of financial markets and (global) exchange rate arrangements at center stage. The key objective of this exercise should be "*the systematic weeding out of financial sophistication with no social return.*" At the same time, and not surprisingly, UNCTAD calls for a revival and broadening of multilateralism and cooperation in global economic decision-making, which will be driven by the UN (i.e. the G192!).

In the same spirit, another UN Committee of Experts, known as the "Stiglitz Commission"[28], asserts:

The current crisis reflects problems that go beyond the conduct of monetary policy and regulation of the financial sector. It also involves deeper inadequacies in areas such as corporate governance and competition policies. Many of these failings, in turn, have been supported by a flawed understanding of the functioning of markets, which also contributed to the recent drive towards financial deregulation. These views have been the basis for the design of policies advocated by some of the international economic institutions, and for much of the architecture of globalization. More generally, the current crisis has exposed deficiencies in the policies of some national authorities and international institutions based on previously fashionable economic doctrines, which held that unfettered markets are, on their own, quickly self-correcting and efficient. Globalization too was constructed on these flawed hypotheses; and while it has brought benefits to many, it has also enabled defects in one economic system to spread quickly around the world, bringing recessions and impoverization even to developing countries that have developed good regulatory frameworks, created effective monetary institutions, and succeeded in implementing sound fiscal policies.

[28] See UN (2009)

So, other than the fact that, as we pointed out above, there are really no new lessons coming out of the current crisis. What is remarkable is that many of the things that are now being advocated to get us out of the GFT, are in fact long-standing demands by Small States in their quest for a fairer and more equitable international division of labour and a fairer globalised economy.

Some Implications for Small States

Under these circumstances, what are the implications for Small States? Clearly, all these lessons are relevant to Small States and need to be acted upon by national and global policy-makers. However, given the enhanced vulnerability to external shocks identified earlier, one expects that Small States, more than any other country grouping, will be adversely affected by the current turmoil. Looking at the array of Small States identified earlier, it is clear that each region has its own specific circumstances which can not easily be generalised. It is nevertheless possible, and therefore useful, to identify recurring common specific areas of concerns cutting across regions.

More specifically, we can observe a:

- Drop in remittances from the Diaspora, especially in the Caribbean and Pacific, where they are often the largest or second largest source of foreign exchange;
- Drop in export commodity prices, as a result of the dramatic reduction in global demand, especially in Africa;
- Protectionist tendencies in European and North American markets affecting all exports, across the board;
- Drop in tourism revenues, across the board;
- Drop in construction activity, especially linked to the tourist industry and residences bought by expatriates and foreigners, across the board;
- Drop in (the already very low) FDI, especially those linked to tourism, construction, and commodity exports, across the board;

- Drop in capital flows due to enhanced political risk, the "flight to quality", and the focus on short term end of yield curve, across the board;
- Drop in (already low) SME lending, due to the sharp contraction in liquidity and increased risk aversion, even from indigenous banks who take a very short term view, across the board;
- Increase in youth unemployment and crime and illegal immigration, with a growing number of Caribbean, Pacific and Mediterranean countries becoming increasingly vulnerable to these threats to human security;
- Increase in the levels of public debt, in countries such as Iceland and the Baltic states;
- Renewed and concerted assault by G8 and G22 on so-called "Tax Havens", in a drive by OECD countries to enhance their fiscal revenues, which affects countries which rely on their International Financial Services Sectors;
- Regulation "externalities" as a result of calls for enhanced, costly, national and international regulation and supervision thus putting additional pressures on already severely capacity-constrained administrations, across the board;
- Continued marginalisation in world affairs, lack of voice in the reform of IFIs and global governance, across the board;

Conclusions

There is increasing recognition that globalisation represents challenges and opportunities for small and large states alike. There is also recognition that small states face special challenges as a direct result of their size. Most of these states are concentrated in three regions, the Caribbean, the Pacific and Indian Ocean. At the same time, as a consequence of the collapse of the Soviet Union, the number of small states in Europe has increased dramatically. We also argued that the proliferation of states and the EU's recent enlargement presents additional challenges to the EU27 because the Union's traditional regional policy instruments are ill-suited to respond to the needs of these new member countries. Furthermore, in drawing the lessons from the GFT we were able to highlight some of the weaknesses of the current globalised economy. We also identify some implication of the current crisis on Small States. It will seem that what the crisis is bringing to the fore is that the actions that could have prevented the GFT, or could remedy its implications are the kind of initiatives that Small States have been arguing for some time.

Table 1. Small States (2 Million or less inhabitants)

Africa	**East Asia, and Pacific**	**Latin America, and the Caribbean**	**Europe, Middle East, and South Asia**
Botswana	Brunei	Antigua and Barbuda	Bahrain
Cape Verde	Fiji	Bahamas, The	Bhutan
Comoros	Kiribati	Barbados	**Cyprus**
Djibouti	Marshall Islands	Belize	**Estonia**
Equ.Guinea	Micronesia (FS)	Dominica	Iceland
Gabon	Palau	Grenada	**Luxembourg**
Gambia, The	Samoa	Guyana	Maldives
Guinea-Bissau	Solomon Islands	St. Kitts and Nevis	**Malta**
Lesotho	Timor-Leste	St. Lucia	Montenegro
Mauritius	Tonga	St. Vincent and the Grenadines	Qatar
Namibia	Vanuatu	Suriname	San Marino
Sao Tome and Principe		Trinidad and Tobago	**(Slovenia)**
Seychelles			
Swaziland			

Source: Based on Favaro and Peretz (2008), Box 1.1, p.3; EU members in bold (added)

Table 2. Eligibility of Small States to EU Regional Programmes

	Cohesion Fund	Convergence Objective	Regional Competitiveness and Employment	European Territorial Co-operation
Cyprus	Yes	No	Yes	Yes
Estonia	Yes	Yes	No	Yes
Malta	Yes	Yes	No	Yes
Slovenia	Yes	Yes	No	Yes

Source: www.ec.europa.eu/regional_policy

Table 3. Cohesion Policy (2007-13), (indicative) per capita financial allocation by EU27 member state (‘000 EUR, Current Prices)

Belgium	212	Luxembourg	134
Bulgaria	895	Hungary	2519
Czech Republic	2571	**Malta**	**2040**
Denmark	112	Netherlands	116
Germany	320	Austria	175
Estonia	**2579**	Poland	1765
Greece	1820	Portugal	2026
Spain	778	**Slovenia**	**2077**
France	225	Slovakia	2146
Ireland	204	Finland	324
Italy	483	Sweden	206
Cyprus	**805**	United Kingdom	173
Latvia	2035	Romania	914
Lithuania	2045	**EU27**	**698**

Source: Author’s calculations from www.ec.europa.eu/regional_policy.

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