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PRIVATE SECTOR DEVELOPMENT AND SME'S

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Abstract:

This paper seeks to highlight the role of private sector development in the resilience building of small states. It refers to small and medium sized enterprises (SMEs) stressing the extent to which SMEs can enhance economic flexibility, an important element in economic resilience, defined as the ability to withstand and rebound from exogenous shocks.

The private sector, compared to the public sector, is generally more exposed and therefore responsive to market realities. As a result, a strong private sector is vital for resilience building, and this is especially so in small states, which tend to be highly exposed to external shocks. However the private sector can be inefficient and characterized by inertia, especially if there is a proliferation of monopolies and oligopolies Therefore the paper contends that the development of this sector should be accompanied by appropriate polices to encourage private sector competitiveness and efficiency.

The paper also discusses the role of SMEs in small states and their role in resilience building. It argues that the backbone of the economies of large and small economies are SMEs. In the case of small states most firms are likely to be micro-enterprises, employing fewer than 10 persons. The paper argues that small states should attempt to maximize the contribution of micro-enterprises towards the enhancement of competitiveness, by creating an atmosphere congenial to entrepreneurship, improving access to funds, particularly venture capital, and encouraging clustering. The paper also uses the 'Doing Business' Index published by the World Bank to identify the weaknesses of some small states and to highlight area where business reform is required.

1. Introduction

The inherent economic vulnerability of small states is well documented and has been duly recognised internationally (Briguglio, 1992, 1995; and Atkins et al., 2000). 'Economic vulnerability' associated with small states stems from the fact that small states are characterized by inherent and permanent features which render them exposed to economic forces beyond their control.

This vulnerability is essentially due to the small size of these economies and to the conditions related to insularity, remoteness and peripherality which makes them highly dependent on international trade and thus susceptible to exogenous economic conditions. Indeed small states are characterised by a high degree of openness which is marked by a dependence on a narrow range of exports and a high dependence on strategic imports. The small size of the market and a quest to reap economies of scale also limits the possibilities of diversification. Moreover, small states are often characterised by high unit costs partly due to problems related to indivisibilities of overhead costs, large transport costs, limited ability to exploit economies of scale and high dependence on industrial supplies. These inherent characteristics tend to result in higher per unit costs thereby eroding the external competitiveness of small states.

The recent wave of globalisation has brought on a new set of economic challenges including a faster than anticipated preference erosion for exports (World Bank and Commonwealth Secretariat, 2006) as well as greater exposure to economic shocks. The latter is mainly due to the fact that globalisation tends to magnify the frequency and magnitude of economic shocks. Unless backed by appropriate policies, these challenges will translate into enhanced risk. On the other hand, with adequate policies, small states can transfer these challenges into opportunities.

The manifestation of the inherent vulnerability of small states can be observed by the wide variability in output which often mires their economies. According to Easterly and Kraay (2000), part of the greater GDP volatility is due to the enhanced volatility in terms of trade shocks. While such fluctuations are unwelcome it is often argued that the benefits that can accrue from this higher degree of openness outweigh any of the growth disadvantages related to greater output volatility.

Indeed, in spite of these inherent characteristics, a number of small states[1] have recorded high GDP per capita. This observation has led to what has been coined as the 'Singapore Paradox' (Briguglio, 2003) referring to the fact that in spite of economic vulnerability, Singapore has managed to register a high GDP per capita. Briguglio (2003, 2004) explains this paradox in terms of the appropriate economic policies which have been adopted by Singapore and other small states with a high GDP per capita, to withstand, absorb and bounce back from adverse exogenous shocks.

Briguglio et al (2006) identify four determinants of economic resilience namely, macroeconomic stability, governance, social development and microeconomic market

[1] See Annex 1

efficiency. This paper will focus on the latter variable whereby microeconomic market efficiency is understood to incorporate the extent to which markets can adjust in an efficient and effective manner in light of exogenous shocks.

This paper contends that the extent to which small states respond to exogenous shocks, be they positive or negative, strongly depends on the efficient operation of the price mechanism and on the flexibility of the goods and services, capital and labour markets. This paper argues that the degree of efficiency and flexibility is exuberated in the private sector as opposed to the public sector as the private sector tends to be more exposed to market competition where survival requires a quick and cost effective response to market realities.

However, the paper also recognises that markets in small states are often thin and lack institutional capacity (Downes, 2006) to the extent that market failure is more likely to be pronounced in small states. As a result the paper also notes the role of government n supporting the market as well as creating an environment that is conducive towards the efficient operation of the market, focusing on the need to support and encourage the development of the private sector as well as the promotion of small and medium sized enterprises (SMEs).

The paper is structured as follows. Section 2 deals with private sector development and economic resilience, noting the supporting role that government needs to play to encourage the development of the private sector. Section 3 discusses the role of SMEs in the private sector taking into consideration the contribution of the informal sector in small states while Section 4 presents a snapshot of existing policies that are conducive to private sector development across a number of small states with an emphasis on business reform. Section 5 focuses on the imperative need to manage reform while, section 5 concludes the study.

2. Private Sector Development and Economic Resilience

All economies, be they small or large, are exposed to the risks and challenges awarded by globalisation. In the case of small states these risks and challenges tend to be magnified as their inherent economic vulnerability renders them more exposed to exogenous shocks, over which they can exert little or no control.

Competitiveness, which provides the means by which countries can survive and thrive in a globalised market environment, is encouraged by a market based approach. In the case of small states appropriate policies to foster competitiveness and private sector development could actually determine the extent to which the inherent openness to trade translates into a strength or weakness.

Briguglio et al (2006) define economic resilience as a country's ability (a) to recover quickly from a shock, (b) to withstand the effect of the shock and (c) to avoid the shock altogether. One of the pillars upon which resilience depends is based on microeconomic market efficiency and thus the efficiency with which resources are allocated and are flexible enough to reallocate when exposed to negative or positive exogenous shocks.[2]

Economic theory indicates that the extent to which the price mechanism can operate efficiently and effectively depends on the degree of competitive forces and thus the number of buyers and sellers in the market as well as the absence of externalities in the market. If the above conditions hold, the price awarded by the market would reflect the productive and allocative efficiency in production and consumption. Moreover, response to economic shocks also depends on the degree of flexibility awarded by the factors of production to adjust to exogenous shocks.

Lewis (2004) explains that the key to increasing productivity and efficiency is through intense, fair competition which tends to prevail in an environment where private sector initiatives are encouraged. Loayza and Soto (2003) also indicate that the prerequisites for the proper functioning of markets include private participation and the existence of competition among private agents.

Indeed, the private sector compared to the public sector is generally more exposed and therefore responsive to market realities and therefore is more equipped to absorb and recover from shocks. In addition, the private sector builds up entrepreneurial skills whilst the public sector is often encumbered by inefficiency and over employment and therefore hinges on competitiveness. It is thus within this framework that the role of the private sector plays an important and crucial role in building the economic resilience of small states.

Competition in Small States

It must however also be duly recognized that that in the absence of conditions which render a market efficient and effective, there will be a tendency for the market to fail. This situation tends to prevail even more so in small states compared to their larger counterparts as domestic markets in these economies are typically too small and too thin to operate in an efficient and effective manner.[3]

Moreover, given the small size of the domestic market and the need to achieve a certain minimum efficient scale of operations for the export market, there are typically only a small number of operators which dominate the market resulting in monopolistic and oligopolistic market situations. In addition, small states, given their relatively small volume of trade and tend to be price takers. In the case of imports, the low inter-industry linkages and the limited possibility for import substitution also tends to result in monopolistic import channels.

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[2] Cordina (2004a) presents a conceptual application of the extent to which shocks faced by small states result in asymmetric effects. Typically the effects of negative shocks outweigh positive ones due to the diminishing marginal productivity.

[3] This argument tends to hold in the choice of an exchange rate regime with macroeconomic success mostly awarded to small states which have opted for hard and soft pegs as opposed to a freely floating exchange rate (Bugeja, 2004).

Another notable characteristic of small states is that their markets are typically protected by natural barriers to entry due to the minimal likelihood of success in setting new business where the market is already saturated by a limited number of players.

Indeed, when this situation occurs, policy intervention is required to minimize the welfare loss associated with market failure. In the case of monopolistic and oligopolistic market structures, competition law is required to reduce the chances of abuse from dominant positions (Briguglio and Buttigieg,2004).

Government's Supporting Role

The existence of market failure however does not exclude the importance of the private sector nor the key role that it plays in nurturing economic resilience. Indeed the Joint Commonwealth and World Bank report duly recognizes that while small states face huge competitive challenges, for most small economies, investment in small and medium sized enterprises particularly in the export sector offers the best chance of rapidly creating jobs, increasing national income and widening the tax base. Consequently, governments of small states need to comprehended the supporting role that they may play, particularly where the likelihood of market failure is greater, and shift their attention on providing support to the private sector and designing and implementing aggressive outward looking export based strategies.[4]

The business environment in which firms operate is an important driver for the development of the private sector. The opportunities and incentives that firms have to invest, create jobs and to grow depends on the prevailing business environment. In turn the environment depends on the costs and ease of doing business and the risks associated with doing that business, factors which government can influence.

In addition governments of small states must carefully design policies of deregulation, privatization, and liberalisation of international transactions in a timely manner so as to strengthen competitiveness. A flexible labour market is also crucial in this regard as it provides the cornerstone required to achieve high employment levels and broad participation of the labour force. Moreover private sector activity requires certainty, predictability and confidence in the economy all of which also depend on the effective implementation of government policies. Without these key requirements the private sector, be it domestic or foreign owned, is unlikely to flourish or succeed.

In fact, a favourable overall investment climate not only supports domestic capital accumulation but also attracts foreign direct investment, considered as a powerful means of enhancing competition and the growth potential of small states. For one thing, FDI facilitates the international transfer of know-how, thus fostering the competitiveness of

[4] Nuie, for example, has tried to establish partnerships with private sector companies from countries with which it has aid partnerships so as to use their expertise - United Nations Press Release ENV/DEV/811: Building Small Island Capacity to Withstand Economic, Environmental Shocks: Focus of Panel at UN Mauritius Conference

the host country directly. At the same time, FDI can help to improve the productivity of local companies by stimulating imitation of new technologies.

Therefore private sector development, which is considered an important component of resilience, can only flourish when the public sector comprehends the value of the private sector not only in terms of its contribution to economic growth and employment but also its ability to adjust to shocks and adopts adequate policies which support its development

This entails setting the right incentives and providing efficient institutional arrangements as well as influencing costs through the regulatory burden, taxes, infrastructural services and labour market regulation. Government also influences risks through policy predictability as well as through contract enforcement. Policy makers must aim at strengthening and enforcing intellectual and other property rights, contract law, bankruptcy procedures and antitrust regulations to foster private sector development. Indeed, appropriate competition policy and anti trust legislation play a key role in ensuring a level playing field and are thus conducive towards promoting a favourable investment climate.

Public infrastructure also plays a complementary role as it must be adequately developed and maintained to provide an environment which is conducive to the development of the private sector.

3. SMEs as the backbone of an economy

Typically the private sector in most small states, which tends to be small by global standards, is supported by micro enterprises employing only a few workers.[5]. For example, in Malta, about 94% of enterprises employ less than ten persons, 4% employ between 10 and 50 persons and only 1% employ more than 50 persons. If the definition of what constitutes an SME in terms of employment in the EU (up to 250 persons) is applied to Malta, then almost 100% of firms located in Malta would be considered SMEs. This type of scenario is likely to prevail in most small states.

Despite their small size, SMEs currently account for over 85% of firms and 60-70% of employment in the OECD economies (OECD, 2000). In Europe, the average number of persons employed in European enterprises is six workers, with micro enterprises employing an average of 2 persons. This ratio is very similar to Malta's ratio.

A number of SMEs in small states also operate within the informal market which seems to be more exposed to adverse economic shocks particularly since unlike the formal sector it tends to be driven by demand (Blunch et al., 2001). The informal sector also contributes significantly towards employment and economic activity. Indeed Charmes (2000) indicates that as much as 50 per cent of non-agricultural GDP can be attributed to the informal sector in sub-Sahara Africa, Asia and Latin America. While no detailed study exists on the contribution of the informal sector to the economy of small states, one can safely assume that it is also likely to contribute significantly.

[5] See http://rru.worldbank.org/Documents/other/MSMEdatabase/msme_database.htm.

However it must also be noted that a large informal economy is detrimental to long run economic growth.. Indeed large informal activity is not conducive towards the provision of public goods needed for economic growth, nor does it contribute towards stability which is needed for businesses to trade and invest with confidence.

Therefore nurtured policies to address resilience must also take into consideration the characteristics of the informal sector. This does not entail a one size fit all approach but rather, supporting policies to drive the informal sector to formal activity need to be tailor-made to the specific requirements of the sector be it agriculture, manufacturing, services or otherwise.

Encouraging the setting up of SME's

Early economic theory was based on the notion that small enterprises were at a disadvantage vis-à-vis larger enterprises because of the fixed costs of learning about foreign environments, limited capacity in reaping economies of scale and difficulties in negotiating with national governments.

However the fragmentation of production processes into separate stages and strategic corporate alliances has made it possible for networks of small firms to overcome the limitations of their size and to compete effectively against large corporations. In fact entrepreneurship and SME development have recently emerged as the engine of economic and social development throughout the world. (Carree and Thurik, 2003)

The crucial role played by SMEs is that they provide fertile ground for entrepreneurial potential to flourish.[6] In a liberalized and globalised environment SMEs tend to respond quickly to dynamic market conditions and evolving consumer preferences as they are faced with minimal problems related to industrial relations and a low degree of bureaucratic time wasting. This flexibility is particularly important for small states when faced with adverse exogenous shocks.. Consequently policies directed towards the development of SMEs particularly in the formal sector, are a crucial undertaking for small states to build economic resilience.

There are various other positive features associated with SMEs typically arising from motivation and commitment, and the ability to exploit market niches. SMEs also believed to have a stronger competitive tendency, all of which results in better economic growth and dynamism (Cordina, 2004b).

A decisive step in enhancing the development of SMEs is through fostering an adequate strategy such as to ensure their survival and profitability in the global economy. Two areas where SMEs must nowadays focus are:

[6] Entrepreneurship and SMEs are related but certainly not identical concepts. Entrepreneurs, for example, are the main drivers of the firm creation process where young and small firms play a role. On the other hand, the entrepreneurial energy of a country, region or industry is often described using phenomena such as firm creation and turbulence (Carree and Thurik, 2003).

- Economies of speed exploited through low costs communication technologies and
- Strategic corporate alliances, small firms networks and clusters

New communication tools have made it easier for small firms to reach foreign partners. This is particularly relevant for small states as they typically have a significant emigrant population that maintains close relations to their homeland. These groups of individuals tend to have network connections, market connections and entrepreneurial talent which can be utilized to develop networks between SMEs in small states. The joint World Bank and Commonwealth Secretariat report states that this valuable source of investment and network for small states should not be undervalued.

Clustering too can be of particular benefit to SMEs in small states since their small size often results in difficulties in financing in house services such as training, research and marketing. Small firms working in clusters can attain the advantages of large firms while retaining the benefits of specialization and flexibility.

Networking also allows SMEs in small states to combine the advantages of smaller scale and greater flexibility with economies of scale and scope in larger markets.

To reap the benefits that are associated with the development of SMEs one must also understand the challenges that these small firms are often subject to. Most SMEs often have trouble obtaining finance because banks and traditional lending institutions are averse to risky ventures. SMEs also tend to find difficulties in exploiting technology and are often characterized by low managerial capabilities. In addition regulatory burdens tend to weigh down significantly on the promotion of SMEs.

The fact that there are usually only few start ups which survive underscores the need for governments to reform polices and to adopt framework conditions that have a bearing on firm creation and expansion. This issue is dealt with in the following section.

4. Business Reform conducive to Private Sector Development

The microeconomic environment in which an entrepreneur operates is typically far from supportive or conducive towards nurturing entrepreneurial skills. The challenges range from complicated and excessive regulatory controls, burdensome procedures irregularities in the market structure and fragmented logistics services. Such inefficiencies raise the cost of production, increase the risk of market loss and in effect constraint external competitiveness.

Recent analytical work has led to a broad understanding among policymakers and development practitioners that microeconomic reforms aimed at strengthening property rights, unleashing competition, and reducing the costs of doing business are critical in creating a sound investment climate which allows the private sector to prosper and thus contribute towards economic growth (World Bank 2004a, 2004b, 2005). Also recognized is the fact that these changes need to be credible and sustained for private firms to respond by increasing investment and production. Clear and consistent rules and regulations are critical to investors. As a result, policy makers in small states must recognize that for the private sector to develop and for SMEs to flourish, there is a strong need for policies to be geared towards the establishment of an institutional environment which reduces the costs of doing business.

The World Bank, on an annual basis, publishes a database on the costs of doing business in a number of countries, 40 of which are considered small states.[7]

The methodology used in calculating the 'Doing Business Index' has several advantages including transparency as well as the fact that it uses factual data. On a less positive note, the index is also myred by limitations such as the fact that it is based on standard assumptions which may be questioned and the fact that measures of time involve an element of judgment and may therefore be subjective. Overall however, the index does provide an overall picture in terms of the ease of doing business and has been used to highlight a number of case studies.

This section of the paper presents a snapshot of the costs of doing business in a number of small states giving an indication of the extent to which private sector development is encouraged and to highlight areas where particular reform is required.

The Doing Business Index (2006a) covers regulations affecting 10 areas of business:[8]

- Starting a Business
- Dealing with Licenses
- Employing Workers
- Registering Property
- Getting Credit
- Protecting Investors
- Paying Taxes
- Trading Across Borders
- Enforcing Contracts
- Closing a Business

Starting a Business

Easing start-up was recently listed by a panel packed with Nobel laureates as one of the most cost effective ways to spur development – ahead of investing in infrastructure, developing the financial sector and scaling up health services.

In Australia and Canada, the best performers in this category of the index, it takes 2 procedures to set up a business in less than 3 days and between 1% and 2% of income per capita to start a business.

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[7] Small states in this report refers to any country with a population of 1.5 million people or less, plus Botswana, Guinea-Bissau, Jamaica, Lesotho and Namibia.

[8] See Annex 1 for the ranking achieved by small states in the Doing Business Index.

In Jamaica, which ranks 10 globally, it takes 8 days to set up a business following 6 procedures and it costs 9.4% of income per capita.

On the other hand, the procedure of setting up a business in Guinea Bissau, which ranks amongst the worst performers, it takes 1233 days and costs more than double the income per capita. In Suriname the costs are also alarmingly high registered at seven times the income per capita.

According to this data, small states need to reform the procedure time and initial costs associated with setting up a business particularly since this is usually the first hurdle that is required to encourage private sector development. Experience shows that removing obstacles to business start-ups is associated with new formal business, added jobs and more investment.[9]

Dealing with licenses

This topic tracks the procedures, time, and costs to build a warehouse, including obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections.

In terms of dealing with licenses St.Vincent and the Grenadines score as the country with the least amount of government regulations in dealing with licenses. It takes 11 procedures to acquire a license over a period of 74 days. Moreover the cost of dealing with licenses is among the lowest at 10.6% of income per capita.

Small states which fare badly in this sub-index include Papua New Guinea and Sao Tome and Principe where it costs 110% and an impressive 1657% of income per capita to deal with licenses respectively. In both small states, the time it takes to deal with licenses is about 200 days. Needless to say, this kid of excessive burden encourages informal activity.

Employment regulations

Employment regulations are designed to protect workers from arbitrary, unfair or discriminatory actions by their employers. These regulations – from mandatory minimum wage, to premiums for overtime work, grounds for dismissal and severance pay – have been introduced to remedy apparent market failures.

However each point of regulation tends to create a restriction on the company's ability to use its workforce effectively. Indeed government is often faced with a struggle in reaching the right balance between labour market flexibility and job stability.

Employment regulations, covered in the Doing Business index include measures to assess the extent of flexibility in the labour market. The sub-index examines the difficulty of hiring a new worker, rigidity of rules in expanding or contracting working hours, the non-

[9] World Bank. 2005. Doing Business in 2006: Creating Jobs. Washington D.C.

salary costs of hiring a worker, and the difficulties and costs involved in dismissing a redundant worker.

The Marshall Islands ranks as the country with the least amount of rigidity in the labour market both in terms of hiring and firing workers. This however may occur at the expense of a loss in job security. In Singapore, which ranks as the 5th country with the least amount of employment regulations, there is limited rigidity in the labour market and no rigidities in hiring and firing.

Small states which fare badly in terms of employment regulation include Cape Verde, Comoros, Guinea-Bissau and Sao Tome and Principe which all score a ranking of over 100.

It is important to note that small states usually experience fluctuations in demand and therefore there is wide scope for reform directed towards flexible working hours. There is also the possibility of allowing swaps of working hours between peak and non peak hours which has been adopted successfully by Hungary and the Czech Republic. These type of labour market reforms can bring labour costs down considerably and increase the external competitiveness of small states. Other reform considerations include a move from severance pay which hits troubled business at the worst time possible, to unemployment insurance.

Registering property

Defining property rights is one of the most important prerequisites required in developing the private sector. If there are difficulties in establishing these property rights and the transfer title on property then private sector initiative is likely to dwindle. In general when it is too burdensome to go through official channels, owners transfer ownership informally. This inevitably results in a loss in tax revenue for the government and it also results in a situation where owners lose clear title to their land thus making financing even more difficult.

Among the 175 economies measured in the registering property sub-index, 4 small states– the Maldives, Marshall Islands, Micronesia and Timor-Leste - have registered the worst global ranking. In the Maldives, companies are not allowed to transfer property at all. According to the Business Report on OECS countries, in the Marshall Islands, only one property has been registered in the last year and that process took 2 years and multiple disputes.

In Iceland it takes only 14 days to register a property, the cost of which is typically 0.4% of property value. In Singapore, also considered a small state, it takes 9 days to register the property and it costs 2.8% of the value of the property.

New Zealand, which is the country which scores the highest global ranking, the procedure is done online and immediately effective while the costs which come largely from stamp duties and legal fees represent a mere 0.1% of property value.

Getting Credit

Access to credit is critical to ensure strong business growth. Yet one of the numerous difficulties often faced by SMEs is obtaining credit to finance their operations. This problem tends to be magnified for micro enterprises operating in small states as there are usually limited credit information systems available, thus magnifying the risks of lending. Moreover there tends to be weaknesses in the regulations which affect the legal rights of borrowers and lenders.

Singapore ranks 7 globally as collateral and bankruptcy laws tend to facilitate lending. However, other small states such as Timor-Leste and Comoros do not have the required legal rights and therefore score the worst ranking in this sub-index.

The World Bank suggests that a policy reform in this area should include refraining from credit subsidies. Problems often lie in weak credit information systems and weak collateral laws. Reformers should address these areas first. Some have been tempted by the idea that subsidies can increase access to credit. But experience shows otherwise

Protecting Investors

This topic measures the strength of minority shareholder protection against misuse of corporate assets by directors for their personal gain.

Singapore ranks a global ranking of 2 in this category with very high scores in terms of transparency of transactions, liability on the directors for self-dealing, shareholders ability to sue officers and directors for misconduct.

Most other small states such as Antigua and Barbuda, Dominica, Fiji, Grenada, Samoa, St.Kitts and Nevis, St.Lucia and St.Vincent and Grenadines all score a sufficient global ranking of 19. Most of these small states score highly in terms of liability of self-dealing and possibility of suing but low in terms of transparency of transactions. [10]

Paying Taxes

High progressive income tax rates tend to discourage private initiative. However it is not just the level of taxes that are important to encourage private sector development but it is also the type of tax system applied on business activity. If the system is complex it is less likely to encourage the development of SMEs and most probably also act as an incentive for entrepreneurs to evade taxes. Maldives scores as the country with the shortest time spent in filling returns. According to the data, the total tax rate as a percentage of profit in the Maldives is 9.3% of profit. Indeed this environment has been conducive towards attracting FDI and developing the private sector in the Maldives where FDI accounts for 22.6% of GDP (UNCTAD, 2006).

[10] Each category within this sub index is standardised between a score of 1 to 10 thus increasing the likelihood that countries obtain an equal ranking.

In Jamaica, the tax system is complex with over 400 hours required to comply with all business taxes. The tax rate in the Marshall Islands, at over 60% of profit is also not conducive to private sector initiative. Nor is the system in Antigua and Barbuda where 528 hours per year are spent on complying with business taxes. There are also 3 different payroll taxes which must be paid each month, in person, and at 3 different locations.

In terms of reform, small states need to adopt moderate tax rates that increase private initiative as well as consolidate the tax system so as to avoid excessive compliance costs.

Trading across borders

This category includes the extent to which international trading is encouraged. Singapore ranks globally as the 4th country with the lowest amount of regulations in terms of trading. In Singapore it takes 6 days to export and import and the average cost per container is about $375 container.

Countries not faring too well in this category include Guyana, Bhutan, Djibouti, Namibia, Swaziland and Guinea Bissau. In Guyana it takes approximately 60 days to import and export and the cost per container averages at $1600 thus discouraging trade.

Given the inherent characteristics of small states which render them so dependent on international trade, reform must be undertaken to encourage the private sector to engage in international trade. Typical reform strategies include developing the port infrastructure and efficiency in customs. It also includes an efficient transport market.

Enforcing contracts

An additional burden faced by the private sector is the long delays in enforcing contracts which tend to be costly in monetary terms and timely terms. Commercial courts should be fast, fair and affordable and efficient in their operations (World Bank, 2007).

Typically in small states it is both costly and timely to enforce a contract. For example, in Jamaica, it takes 415 days to enforce the contract the costs of which over a quarter of the debt. In Trinidad and Tobago it takes over three and a half years to enforce the contract while in Papua New Guinea the cost of enforcing the contract is 110% of the value of the debt. In OECS countries, despite an identical code of civil procedure dictating the process for commercial court cases, there is still a difference on the efficiency of contract enforcement.

Closure of a business

The final category which is measured in the Doing Business index is the closure of a business. This topic identifies the weaknesses in existing bankruptcy law and the main procedural and administrative bottlenecks in the bankruptcy process. The more complex the regulations or the complete lack of regulations tends to discourage creditors from lending to small businesses thus restricting access to finance.

Singapore ranks as the country with the second least complex and costly procedure for declaring bankruptcy as it takes approximately 9 months to close a business and the bankruptcy costs amount to 1% of the estate.

Most other small states such as Fiji, Seychelles, St.Kitts and Nevis, Trinidad and Tobago have recorded no procedures in closing businesses.

Doing Business

The average sum of the above indicators results into what the World Bank has coined as the 'Ease of Doing Business Index'.[11]

Table 1 presents a snapshot on the overall ease of doing business in small states covered in the index. Globally small states have performed slightly better than larger economies. Two-thirds of the 40 small states included in the global sample rank in the top half of the index. Small states tend to perform well on the ease of dealing with licenses, employing workers and paying taxes. But few small states make it easy to register property, get credit or enforce contracts.[12]

Singapore ranks as the country, among the 175 countries, with the least amount of bureaucratic procedures and burden on businesses. Existing regulation has strengthened property rights and encouraged trade. There is adequate regulation which protects investors thereby encouraging investment and development and Singapore also provides easy start up and closure requirements to encourage the development of SMEs. Moreover Singapore also has low rigidities in the labour market allowing for flexibility to counteract and respond to shocks. It is thus no surprise that Singapore has also ranked as the most resilient economy in the resilience index calculated by Briguglio et al (2006).[13]

[11] The ranking on each topic is the simple average of the percentile rankings on component indicators.
[12] Doing Business (2006b): Organisation of Eastern Caribbean States
[13] The two indices do not cover the same set of countries.

Country	Ease of Doing Business Rank
Singapore	1
Iceland	12
Estonia	17
St. Lucia	27
Fiji	31
Mauritius	32
Antigua and Barbuda	33
Samoa	41
Namibia	42
St. Vincent and the Grenadines	44
Botswana	48
Jamaica	50
Tonga	51
Maldives	53
Belize	56
Vanuatu	58
Trinidad and Tobago	59
Kiribati	60
Palau	62
Solomon Islands	69
Dominica	72
Grenada	73
Swaziland	76
Seychelles	84
St. Kitts and Nevis	85
Marshall Islands	87
Micronesia	106
Gambia	113
Lesotho	114
Suriname	122
Cape Verde	125
Gabon	132
Guyana	136
Bhutan	138
Comoros	144
Equatorial Guinea	150
Djibouti	161
São Tomé and Principe	169
Guinea-Bissau	173
Timor-Leste	174

Source: World Bank: Doing Business 2006

A notable point is that a study carried out by USAID suggests that there is a highly statistically significant correlation between a country's overall performance on the Doing Business indicators and the size of its informal economy such that a worse environment for doing business correlates with a larger informal economy. Other statistical evidence suggests that when correlated individually most of the measures of regulatory burden in the Doing Business report are correlated with the estimated size of the informal economy, such that a country with lower level of burden in any individual area can be expected to have a smaller informal economy than a country doing less well in that area.

5. Managing reform

Indeed in the *Mystery of Capital,* Hernando de Soto (2000) exposed the '*damaging effects of heavy business regulation and weak property rights'*. With burdensome entry regulations, few business bother to register. Instead they choose to operate in the informal economy and own informal assets which cannot be used for financing purposes. Moreover, even those that operate in the formal sector would tend to feel less incentivised to enlarge their operations or declare their activity.

Governments therefore need to establish the optimal level of regulation, one that provides enough incentives to develop the private sector but not too costly to exert a burden on SMEs.

Managing reform however is not an easy task as more often than not the list is long with prioritization and sequencing proving to be a daunting task. However there is no doubt that reform must be undertaken if small states want to build the tools required to withstand, rebound and absorb shocks.

This need is further intensified as many governments throughout the world are already taking action. Indeed two hundred and thirteen reforms – in 112 economies – were introduced between January 2005 and April 2006. Reformers simplified business regulations, strengthened property rights, eased tax burdens, increased access to credit and reduced the cost of exporting and importing. As a result, small states simply cannot afford to fall behind.

6. Conclusion

The inherent vulnerability of small states stems from the fact that small states, particularly island states, are highly dependent on trade and therefore exposed to exogenous shocks over which they can exert little or no control. The recent wave of globalisation has given rise to a new set of challenges. The extent to which these challenges translate into enhanced economic risk or opportunities depends on the economic resilience of small states.

One of the essential foundations of economic resilience rests on the efficient and effective operation of the market and the degree of flexibility awarded by the market Typically, the greater the extent of competition driven by the private sector, the greater the operational efficiency of the price mechanism and flexibility in reallocating resources when exposed to exogenous shocks. Indeed it can be argued that the private sector builds entrepreneurial skills which allow it to be more exposed and responsive to market realities than the public sector.

In small states the private sector is essentially made up of micro enterprises which are burdened with costly bureaucratic regulatory procedures and with difficulties in finding funding opportunities.

Consequently government must play a complementary role providing an optimal level of regulation as well as adequate competition law in markets which are dominated by a few players. Government driven policy must also be channeled towards developing effective governance, an adequate infrastructure and an educated labour force all conducive towards developing the private sector of an economy.

This necessity has become even more so pronounced as the frequency and magnitude of external shocks has increased significantly such that the economic survival of small states strongly depends on this reform.

Annex 1

Economy	Year	Ease of Doing Business Rank	Starting a Business Rank	Dealing with Licenses Rank	Employing Workers Rank	Registering Property Rank	Getting Credit Rank
Antigua and Barbuda	2006	33	22	15	40	71	101
Belize	2006	56	103	4	14	117	83
Bhutan	2006	138	79	145	116	41	159
Botswana	2006	48	93	136	62	34	13
Cape Verde	2006	125	144	93	137	122	65
Comoros	2006	144	136	68	149	83	159
Djibouti	2006	161	157	106	125	137	117
Dominica	2006	72	24	51	50	78	101
Equatorial Guinea	2006	150	162	96	172	57	143
Estonia	2006	17	51	13	151	23	48
Fiji	2006	31	55	27	28	71	21
Gabon	2006	132	142	54	159	149	101
Gambia	2006	113	124	73	25	130	143
Grenada	2006	73	50	12	34	145	83
Guinea-Bissau	2006	173	175	78	173	171	143
Guyana	2006	136	78	74	60	52	159
Iceland	2006	12	16	30	42	8	13
Jamaica	2006	50	10	93	26	107	101
Kiribati	2006	60	72	76	18	62	101
Lesotho	2006	114	113	75	91	129	117
Maldives	2006	53	31	9	5	172	143
Marshall Islands	2006	87	13	5	1	172	117
Mauritius	2006	32	30	49	64	156	83
Micronesia	2006	106	39	11	12	172	101
Namibia	2006	42	86	19	44	127	33
Palau	2006	62	45	42	7	13	117
Samoa	2006	41	91	51	11	60	83
São Tomé and Principe	2006	169	122	142	175	144	117
Seychelles	2006	84	42	69	84	50	159
Singapore	2006	1	11	8	3	12	7
Solomon Islands	2006	69	76	40	53	159	143
St. Kitts and Nevis	2006	85	105	7	35	136	117
St. Lucia	2006	27	43	10	29	51	101
St. Vincent and the Grenadines	2006	44	29	1	48	101	83
Suriname	2006	122	158	100	39	120	117
Swaziland	2006	76	112	16	47	140	21
Timor-Leste	2006	174	160	173	115	172	159
Tonga	2006	51	23	37	4	108	117
Trinidad and Tobago	2006	59	35	81	27	154	48
Vanuatu	2006	58	65	33	96	91	117

Economy	Year	Getting Credit Rank	Protecting Investors Rank	Paying Taxes Rank	Trading Across Borders Rank	Enforcing Contracts Rank	Closing a Business Rank
Antigua and Barbuda	2006	101	19	145	47	47	54
Belize	2006	83	118	33	111	150	24
Bhutan	2006	159	118	68	150	56	151
Botswana	2006	13	118	67	89	77	22
Cape Verde	2006	65	135	100	20	80	151
Comoros	2006	159	83	34	118	167	151
Djibouti	2006	117	168	51	148	169	122
Dominica	2006	101	19	20	97	159	151
Equatorial Guinea	2006	143	83	137	96	91	151
Estonia	2006	48	33	29	6	20	47
Fiji	2006	21	19	49	70	86	106
Gabon	2006	101	99	94	112	77	130
Gambia	2006	143	162	165	24	53	76
Grenada	2006	83	19	45	84	143	151
Guinea-Bissau	2006	143	142	109	125	154	151
Guyana	2006	159	151	121	155	122	131
Iceland	2006	13	83	13	18	8	13
Jamaica	2006	101	60	163	74	46	23
Kiribati	2006	101	33	14	31	136	151
Lesotho	2006	117	142	44	121	130	57
Maldives	2006	143	60	1	91	83	114
Marshall Islands	2006	117	151	69	90	103	117
Mauritius	2006	83	11	11	21	109	67
Micronesia	2006	101	162	45	40	139	148
Namibia	2006	33	60	28	144	64	42
Palau	2006	117	162	70	66	151	52
Samoa	2006	83	19	42	62	54	125
São Tomé and Principe	2006	117	118	149	69	152	151
Seychelles	2006	159	46	24	81	73	151
Singapore	2006	7	2	8	4	23	2
Solomon Islands	2006	143	46	23	34	102	101
St. Kitts and Nevis	2006	117	19	116	37	135	151
St. Lucia	2006	101	19	9	45	160	39
St. Vincent and the Grenadines	2006	83	19	32	48	125	151
Suriname	2006	117	156	21	43	111	143
Swaziland	2006	21	168	38	133	132	56
Timor-Leste	2006	159	142	124	73	175	151
Tonga	2006	117	99	81	17	126	92
Trinidad and Tobago	2006	48	15	27	22	156	151
Vanuatu	2006	117	60	19	120	88	45

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