
PRIVATE SECTOR DEVELOPMENT AND MICRO-ENTERPRISES IN SMALL STATES

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Abstract. This chapter seeks to highlight the importance of private sector development in building the economic resilience of small states. It refers to small-sized enterprises stressing that such firms 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 more 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 characterised by inertia, especially if there is a proliferation of monopolies and oligopolies. The chapter contends that the development of this sector should be accompanied by appropriate policies to encourage competitiveness and efficiency. The chapter also discusses the role of micro-enterprises in small states and their role in resilience building. In the case of small states most firms are likely to be micro-enterprises, employing fewer than 10 persons. The chapter argues that small states should attempt to maximise 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.

1. Introduction

The inherent economic vulnerability of small states¹ is well documented and has been duly recognised in many publications (see for example Briguglio, 1995; Atkins et al., 2000). Such vulnerability is essentially due to the small size of these economies which makes them highly dependent on international trade and on a narrow range of exports, rendering them very susceptible to exogenous economic conditions. This is exacerbated

¹ Small states in this report refer to any country with a population of 1.5 million people or less, plus Gambia, Guinea-Bissau, Botswana, Lesotho, Namibia, Jamaica, Cape Verde, Singapore and Papua New Guinea.

by their high degree of dependence on strategic imports, such as fuel and food. The small size of the market and their limited ability to reap economies of scale also limits their possibilities of diversification. Moreover, small states are often characterised by high unit costs partly due to problems related to indivisibilities of overhead costs and relatively high transport costs thereby eroding their external competitiveness (Winters and Martins, 2004).

The recent wave of globalisation has brought on a new set of economic challenges including a faster than anticipated preference erosion for exports as well as greater exposure to economic shocks (Briguglio et al., 2006). The latter is mainly due to the fact that globalisation tends to increase exposure to external economic forces.

The inherent vulnerability of small states is often manifested by output and export volatility. According to Easterly and Kraay (2000), part of the greater GDP volatility is due to the enhanced volatility in the terms of trade. Cordina (2004a) points out that output volatility in small states may be exacerbated by macroeconomic factors which are not conducive to aggregate demand stabilisation. While such fluctuations are unwelcome, some benefits can accrue from a higher degree of openness. Some authors (see for example Easterly and Kraay, 2000), have argued that the benefits may even outweigh the disadvantages related to output volatility.

Indeed, in spite of these inherent characteristics, a number of small states² have achieved a relatively high GDP per capita. This observation has led to what has been coined as the “Singapore Paradox” (Briguglio, 2004) referring to the fact that in spite of economic vulnerability, Singapore has managed to register a high GDP per capita. Briguglio (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, microeconomic market efficiency, good governance and social development. This chapter will focus on microeconomic market efficiency which relates to the extent to which an economy, through the working of the market mechanism, can adjust following an exogenous shocks.

This chapter is based on the premise that the extent to which small states respond to exogenous shocks strongly depends on the efficient operation

² See Annex 1.

of the price mechanism and on the flexibility of the goods and services, capital and labour markets.

The chapter also argues that market efficiency and flexibility is more pronounced in the private sector as opposed to the public sector as the former tends to be more exposed to market competition where survival requires a quick and cost effective response to market dynamics. For this purpose, private sector development is given centre stage in this study. However, the chapter also recognises the important role of government particularly in setting a market environment which is conducive to private sector development.

Given that in small states, the private sector operates mostly through small or micro-enterprises, the chapter also assigns particular attention to such firms.

A snapshot of existing policies that are conducive to private sector development is presented with reference to the Doing Business Index (DBI) constructed and published by the World Bank.

The chapter 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 presents a discussion on the regulatory framework suitable for private sector development, while Section 4 deals with the role of small firms in private sector development. Section 5 concludes the chapter, calling for the need for small states to strengthen their private sector in order to enhance market efficiency so as to improve their ability to withstand or bounce back from external economic shocks.

2. Private Sector Development and Economic Resilience

All economies, be they small or large, are exposed to the risks and challenges emanating from 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 is based is microeconomic market efficiency, that is the efficiency with which resources are allocated and reallocated in the wake of exogenous shocks.³

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 in an economy 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 as opposed to the public sector is generally more exposed and therefore responsive to market realities and therefore is better 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 under-employment which results in higher per unit costs and therefore impinges on competitiveness. It is within this framework that the role of the private sector plays an important and crucial role in building the economic resilience of small states.

Market Imperfections and Market Failures

It must however also be duly recognised that markets in small states are typically very small and thin, and this leads to market imperfections and market failures. In fact, given the small size of the domestic market in small states, and the need to achieve a certain minimum efficient scale of operations for the export market, the market would typically be characterised by a small number of operators which dominate the market

³ 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.

resulting in monopolistic and oligopolistic market situations. 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.

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 as the market would typically be saturated by a limited number of players.

Indeed, when this situation occurs, policy intervention is required to minimise the welfare loss associated with market failure. In the case of monopolistic and oligopolistic market structures, the enforcement of competition law is instrumental in reducing the chances of abuse from dominant positions, but even here, small states face a number of constraints (Briguglio and Buttigieg, 2004). In this regard Lee (2008) discusses the dangers of tolerating higher levels of concentration in the market with the pretext of allowing “champion” industries in small states are to be competitive in the regional and global arenas.

The Supporting Role of Government

The existence of market failure however does not reduce 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 (Briguglio, Stern and Persaud, 2006) duly recognises 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 play an important role in this regard, particularly in the case where the likelihood of market failure is greater.

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, to 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 governments can influence.

Governments of small states have an additional role of designing and implementing policies of deregulation, privatisation, and liberalisation in a manner which promotes competitiveness. A flexible labour market is also crucial in this regard as it adds to the overall market flexibility and provides the cornerstone required to achieve high employment

levels. In addition government plays an important role in ensuring economic and political stability especially since the private sector requires certainty, predictability and confidence in the economy. Without these key requirements the private sector, be it domestic or foreign owned, is unlikely to flourish or succeed.

In fact, the government's role in fostering 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 the host country directly. At the same time, FDI can help to improve the productivity of local companies by stimulating imitation of new technologies.

Government also influences risks through policy predictability as well as through contract enforcement. This requires the strengthening and enforcement of 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 (Lee, 2008).

The role of the government in providing the physical infrastructure in small states is also of major importance in promoting private sector investment and initiative, given that such amenities as electricity, water and telecommunications are often natural monopolies.

It is important to stress in this regard that policies aimed at developing the private sector need to be credible and sustained for private firms to respond by increasing investment and production. Clear and consistent rules and regulations are critical in this regard.

3. Regulatory Framework and Private Sector Development

An inappropriate regulatory framework may exacerbate the problems associated with market imperfections and market failures. 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 constrain 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 (including costs related to starting a business, employing workers and accessing credit) 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, Downes, 2006).

The World Bank publishes, on an annual basis, a database on the costs of doing business in a number of countries, 41 of which are considered to be small states (World Bank, 2006). The index covers 10 areas of business, namely:

- 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 component of the index, it takes 2 procedures to set up a business in less than 3 days and between 1 percent and 2 percent of income per capita to start a business.

In Jamaica, which ranks 10 globally, it takes 8 days to set up a business following 6 procedures and it costs 9.4 percent 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 1,233 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 (World Bank, 2005).

Dealing with Licenses

This area 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 scores the highest global score implying that it is 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 percent of income per capita.

Small states which fare badly in this sub-index include Papua New Guinea and São Tomé and Príncipe where it costs 110 percent and an impressive 1,657 percent 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 kind 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-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 types 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, four 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 two years and multiple disputes.

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

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

Getting Credit

Access to credit is critical to ensure strong business growth. Yet one of the numerous difficulties often faced by small states, is obtaining credit to finance their operations. In small states where the financial sector is poorly developed additional difficulties are encountered by the private

sector to secure outside capital for purposes of starting a business (Fairbairn, 2007) .

Singapore ranks seventh globally since 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.

Protecting Investors

This component of the index measures the strength of minority shareholder protection against misuse of corporate assets by directors for their personal gain. Singapore has 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 also score a relatively high ranking. These small states tend to score highly in terms of liability of self-dealing and possibility of suing but low in terms of transparency of transactions.

Paying Taxes

High progressive income tax rates tend to discourage private initiative. However it is not just the level of taxes that is important to encourage private sector development but also the type of tax system applied on business activity. If the system is complex it is less likely to encourage the development of small firms and most probably also acts 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 percent 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 percent of GDP (UNCTAD, 2006).

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 percent of profit, is also not conducive to private sector initiative.

Neither 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 three 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 component of the index 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 \$1,600 thus discouraging trade.

Given the inherent characteristics of small states which render them so dependent on international trade, reforms 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

A common burden faced by the private sector is the long delays in enforcing contracts which tend to be costly in terms of money and time. Commercial courts are not always fast, fair, affordable and efficient in their operations (World Bank, 2006). In many small states it is expensive in terms of costs and time to enforce a contract. For example, in Jamaica, it takes 415 days to enforce the contract, the costs of which are 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 percent of the value of the debt. In the Eastern Caribbean 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 component of the index relates to the closure of a business. This 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

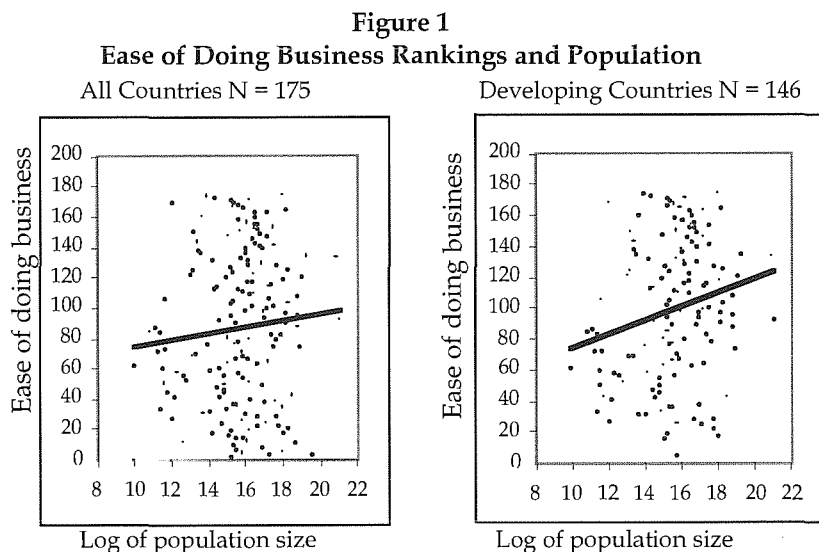
tends to discourage creditors from lending to small businesses thus restricting access to finance.

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 percent of the estate.

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

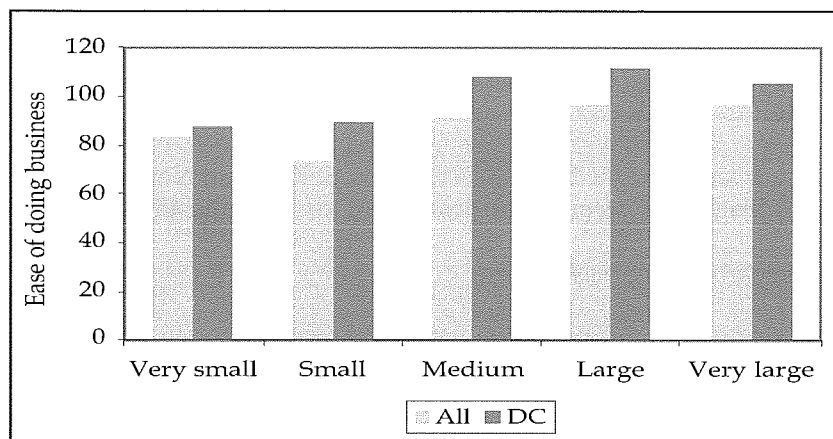
The Performance of Small States

The average sum of the above indicators results into what the World Bank has coined as the Ease of Doing Business Index. Appendix 1 presents a snapshot on the rankings in the Ease of Doing Business Index in small states covered in the index. Globally small states have performed, on average, better than larger countries. Indeed a correlation of the Ease Doing Business Index and population, in terms of rankings, indicates that there is a positive relationship, albeit weak, between the two variables, with the correlation being higher when only developing countries are considered, as shown in Figure 1 and Figure 2. It should be emphasised here that this is a general tendency, because there are many small states that perform badly and many large states that perform outstandingly on the index.



Source: World Bank (2006)

Figure 2
Ease of Doing Business Rankings and Population in All Countries
and in Developing Countries (DC)



Source: Same as for Table 1

Legend: Very small: Countries with a population of 1.5 million or less.

Small: Countries with a population of between 1.5 million and 5 million.

Medium: Countries with a population of between 5 million and 10 million.

Large: Countries with a population of between 10 million and 50 million.

Very large: Countries with a population of more than 50 million.

DC: Developing Countries i.e., all countries excluding Canada, USA, EU Member States, Switzerland and Iceland, Singapore, Australia, New Zealand and Japan.

Of interest in this regard is that two-thirds of the 41 small states included in the global sample rank in the top half of the index. In general small states tend to perform well on the ease of dealing with licenses, employing workers and paying taxes. But many small states create difficulties with regard to ease in registering property, and fare badly with regard to obtaining credit and enforcing contracts.

It should be noted that Singapore, which is a small state, ranks first 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 small firms. 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).

Inherent Costs and Ease of Doing Business

Winters and Martins (2004) argue that small states face serious disadvantages in terms of costs. This reality needs to be juxtaposed against the finding that small states, in general, score relatively high on the Ease of Doing Business Index, as shown in Figure 1. This seeming contradiction can be explained in terms of inherent negative features and policy induced positive features of small states. Indeed while Winters and Martins refer to unit costs that could be associated with inherent features of small states, such as those related to indivisibilities of air and sea freight as well as higher unit costs in relation to utilities, the “Ease Doing Business” index refers to costs which are policy driven. In fact, Winters and Martins (2004), when testing whether small economies have worse economic policies than larger ones, concluded that there is no evidence to back this presumption.

The World Bank Index suggests that the governments of small states need to manage reform in order to mitigate the inherent negative features of being small.

4. Small Firms as the Backbone of the Economy

Typically the private sector in most small states consists mainly of micro-enterprises employing only a few workers.⁴ For example, in Malta, according to the National Statistics Office, about 94 percent of enterprises employ less than ten persons, 4 percent employ between 10 and 50 persons and only 1 percent employ more than 50 persons although this 1 percent employs about 33 percent of the total employment. 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 percent of firms located in Malta would be considered SMEs. This scenario is typical in small states.

Encouraging the Setting-up of SMEs

Small enterprises are associated with a number of disadvantages vis-à-vis larger enterprises because of high fixed costs in relation to activity, limited capacity in reaping economies of scale and difficulties in negotiating with financial institutions and the national governments. However, small-sized firms have a number of advantages which may offset scale disadvantages, including a high degree of motivation and commitment to the business, the ability to exploit market niches which require small production runs and the ready support by family members.

⁴ See http://rru.worldbank.org/Documents/other/MSMEDatabase/msme_database.htm/.

These features permit small firms to thrive and survive in a fiercely competitive world (Cordina, 2004b). The role of government in this regard is to try to provide an enabling environment to help small firms minimise their disadvantages, notably fragmentation and maximise the advantages, most importantly entrepreneurship.

Small firms lead to fragmentation of production, and therefore to small runs and high units costs. One way to mitigate this problem is to promote networking and clustering between small firms to mitigate the limitations of their size.

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. Through such networking, market connections can be forged. This point was given importance by the joint World Bank and Commonwealth Secretariat report (Briguglio, Stern and Persaud, 2006).

Clustering can also be of particular benefit to small firms, particularly for the procurement of services such as training, research and marketing. Small firms working in clusters can attain the advantages of large firms while retaining the benefits of specialisation and flexibility.

Small firms are often associated with motivation and entrepreneurial talent. In a liberalised and globalised environment small firms tend to respond quickly to dynamic market conditions and evolving consumer preferences as they are faced with minimal industrial relations and bureaucratic problems. This flexibility is particularly important for small states when faced with adverse exogenous shocks. The crucial beneficial role played by small firms in this regard can be enhanced through an enabling regulatory environment as well as appropriate policies directed towards the development of entrepreneurial skills. These are crucial for small states in order to build economic resilience.

5. Conclusion

The inherent economic vulnerability of small states stems from the fact that these states, particularly island ones, are highly dependent on international trade and are 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, which in turn requires market flexibility. 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. Private sector development is therefore essential in order to generate entrepreneurial skills which allow firms to respond rapidly to market realities. The public sector is not generally equipped for such flexibility.

This chapter has argued that it will be greatly beneficial for private sector development if governments create a regulatory regime conducive to entrepreneurship, including a level playing field for competition. Although the World Bank's Ease of Doing Business Index indicates that in general small states do not far badly in this regard, there are many inherent features which render small states disadvantaged, including the very small size of the average business concern and the relatively high cost they face due to indivisibilities of overhead expenditures.

The chapter has emphasised the point that policies aimed at developing the private sector need to be credible and sustained for private firms to respond by increasing investment and production. Clear and consistent rules and regulations are critical in this regard.

With the globalisation process, exposure to external shocks, especially for small states, has increased and the economic survival of these states strongly depends on their ability to withstand and bounce back quickly from such shocks. A suitably equipped private sector, able to respond to market realities, is therefore essential.

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Appendix 1

Rankings of Countries in the Ease of Doing Business Index

Country	Rank in the Ease of Doing Business Index	GNI per Capita in US\$	Population
Singapore	1	29320	4,393,208
Iceland	12	50580	298,967
Estonia	17	11410	1,341,042
St Lucia	27	5110	166,014
Fiji	31	3300	853,485
Mauritius	32	5450	1,253,434
Antigua and Barbuda	33	11210	83,612
Samoa	41	2270	185,583
Namibia	42	3230	2,050,821
St Vincent/Grenadines	44	3930	119,635
Botswana	48	5900	1,757,885
Jamaica	50	3480	2,663,736
Tonga	51	2170	102,448
Maldives	53	2680	336,982
Belize	56	3650	297,234
Papua New Guinea	57	770	5,995,265
Vanuatu	58	1710	215,341
Trinidad and Tobago	59	13340	1,308,770
Kiribati	60	1230	100,551
Palau	62	7990	20,200
Solomon Islands	69	680	489,228
Dominica	72	3960	72,396
Grenada	73	4420	108,148
Swaziland	76	2430	1,126,159
Seychelles	84	8650	85,757
St Kitts and Nevis	85	8840	48,393
Marshall Islands	87	3000	65,383
Micronesia	106	2380	110,985
Gambia	113	310	1,552,746
Lesotho	114	1030	1,788,978
Suriname	122	3200	451,566
Cape Verde	125	2130	4,095,143
Gabon	132	5000	1,405,767
Guyana	136	1130	751,174
Bhutan	138	1410	647,000
Equatorial Guinea	150	8250	514,890
Djibouti	161	1060	805,657
São Tomé and Príncipe	169	780	160,055
Guinea-Bissau	173	190	1,632,865
Timor-Leste	174	840	1,029,195

Source: World Bank: *Doing Business 2006, World Bank Indicators*
Rankings out of 175 countries