Small States around the World: How are they Different?

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Increased IMF interest in "small states"

Fund-wide interest, with support from IMF management

- Staff: "Small Islands Club" shares data and experiences.

- IMFC (April, 2012): Encouraged enhanced attention to small states.

- Staff recently undertook an initial "stock taking" of economic issues in small states.

  – Seeks to identify what is special or different about small states, in macroeconomic terms.

  – Key results summarized here are tentative. Work is ongoing.

Stocktaking Exercise: Background

Definitions:

- SS1: Small population (population below 1.5 million)
- SS2: Small economies (PPP GDP in bottom ¼ globally)
- SS3: Small Islands Club
- SS4: Micro states (population below 200,000)

Sources:

- Existing studies and literature
- Data: IMF (IFS, WEO, Fin'l Access Survey); WB (WDI, FinStats, Fin Dev'p Database); others
- Internal IMF *Survey of Small State Mission Chiefs*

Country	SS1	SS2	SS3	SS4	Country	SS1	SS2	SS3	SS4
Africa									
Botswana	X	X			Liberia		X		
Burundi		X			Malawi		X		
Cape Verde	X	X	X		Mauritius	X	X	X	
Central African Republic		X			Namibia	X	X		
Comoros	X	X	X		Niger		X		
Equatorial Guinea	X	X			Rwanda		X		
Eritrea		X			Sao Tome & Principe	X	X	X	X
Gabon	X	X			Seychelles	X	X	X	X
Gambia, The	X	X			Sierra Leone		X		
Guinea		X			Swaziland	X	X		
Guinea-Bissau	X	X	X		Togo		X		
Lesotho		X			Zimbabwe		X		
Asia and Pacific									
Bhutan	X	X			Papua New Guinea		X		
Brunei Darussalam	X	X			Samoa	X	X	X	X
Fiji	X	X	X		Solomon Islands	X	X	X	
Kiribati	X	X	X	X	Timor-Leste	X	X	X	
Lao PDR		X			Tonga	X	X	X	X
Maldives	X	X	X		Vanuatu	X	X	X	X
Mongolia		X							
Europe									
Cyprus	X				Malta	X	X		
Estonia	X	X			Montenegro	X	X		
Iceland	X				San Marino	X			
Luxembourg	X								
Middle East and Central Asia									
Bahrain	X	X			Mauritania		X		
Djibouti	X	X			Qatar	X	X		
Western Hemisphere									
Antigua and Barbuda	X	X	X	X	Haiti		X		
Bahamas, The	X	X	X		Jamaica		X		
Barbados	X	X	X		St. Kitts and Nevis	X	X	X	X
Belize	X	X			St. Lucia	X	X	X	X
Dominica	X	X	X	X	St. Vincent & the Grens.	X	X	X	X
Dominican Republic		X			Suriname	X	X	X	
Grenada	X	X	X	X	Trinidad and Tobago	X	X	X	
Guyana	X	X	X						

Conventional wisdom supported

Small states have:

- Bigger government
  - Because public goods provision more costly?
- More trade openness
  - Trade-related revenues more variable
- More frequent natural disasters (in some regions)
- Larger, more variable trade & CA deficits
- Among LICs, higher public debt-GDP ratios

Smaller countries have higher expenditure ratios...

...and higher trade openness
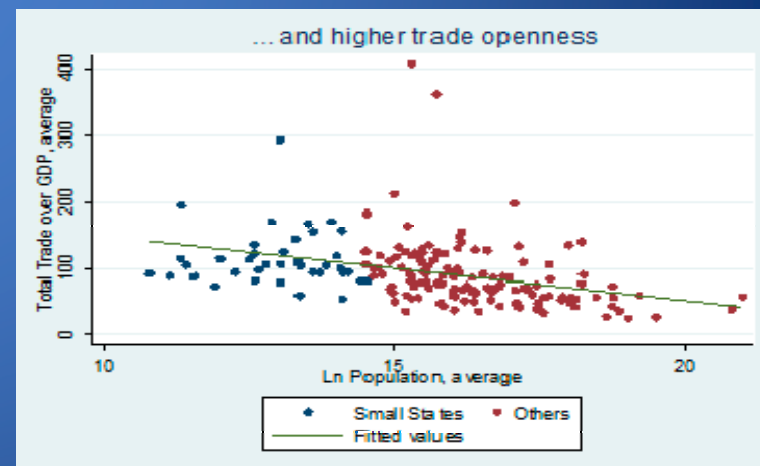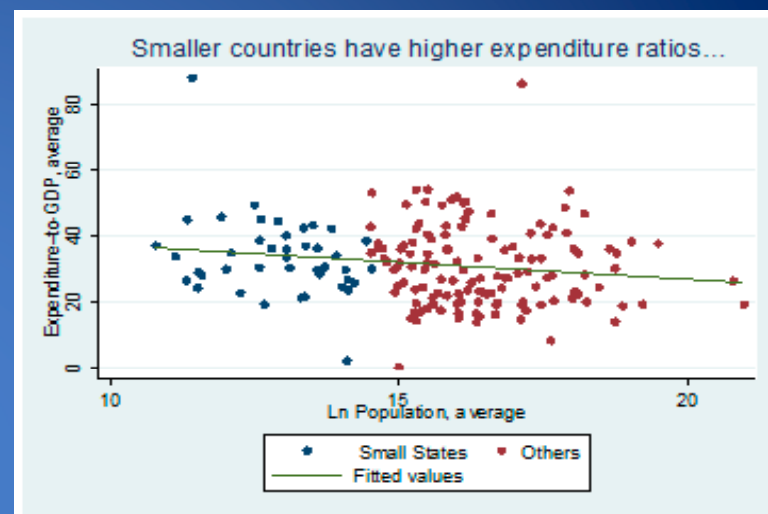
Surprising or less well-known characteristics:

Terms of trade (ToT) variability is not greater

- Except when services are excluded

Export concentration similar to that in larger states

- But wide variation

More financial depth (credit-GDP ratios)

Stronger social, education, and development indicators
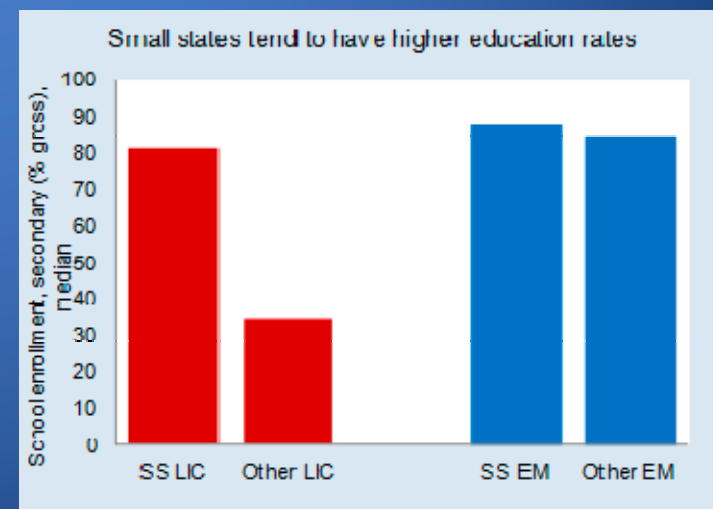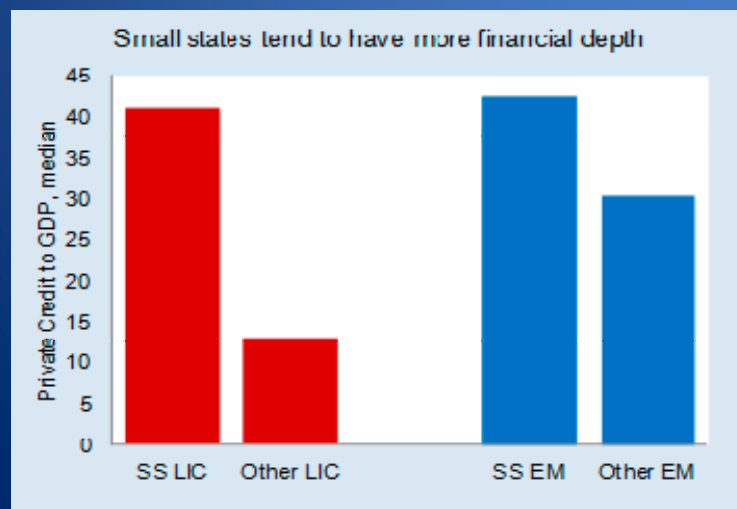
Income and growth

How do small states compare on income levels and growth rates?

- Levels of per capita income are somewhat higher in small states than in their larger regional neighbors, and

- Per capita growth rates are similar to those of larger neighbors.
  - Based on simple cross-country regressions of PPP-based income measures

- But size does matter in the growth process:
  - Small states <u>do</u> have unique growth obstacles.
  - As a group, they have overcome these obstacles with other growth drivers.
  - Openness, education, and financial development substitute for a larger market or other advantages of size.

Are small states as developed as the income measures suggest?

Some possible wedges between income and welfare levels:
- High *cost of public services* could result in lower supply (thus lower welfare) or higher taxes (lower private consumption).
- Income measures fail to capture capital losses from natural disasters.

Empirically, development levels are in line with income measures:
- UNDP Human Development Index (HDI).
- Cross-country regressions: consumption levels and poverty rates align with those in larger countries of similar income levels.

Do small states experience more volatility?

Evidence on output volatility is mixed...

- Using data for 1960-95, Easterly and Kraay found output variability to be higher in countries with population below 1 million.

- In our larger, longer, and more recent sample (1970-2011), no such effect (due to declining role of the primary sector in small states?).

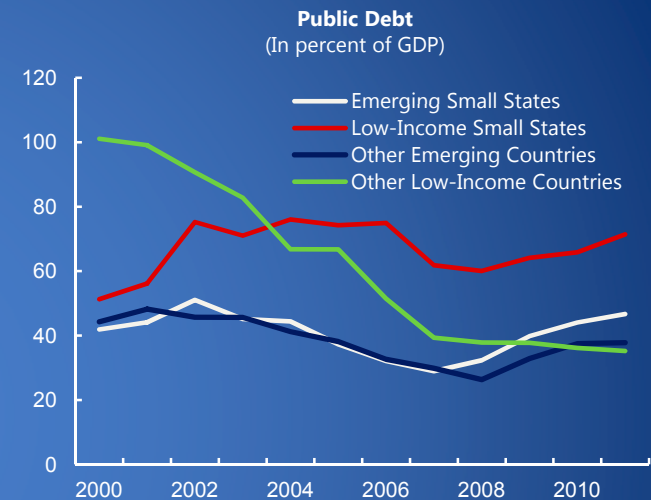...but small state external sectors are clearly more volatile.

- Standard deviations of CA/GDP ratios are about 2 percentage points higher.

- CA volatility greatest in small islands and micro states.

Managing debt and restoring strong fiscal positions is a challenge—especially for small LICs
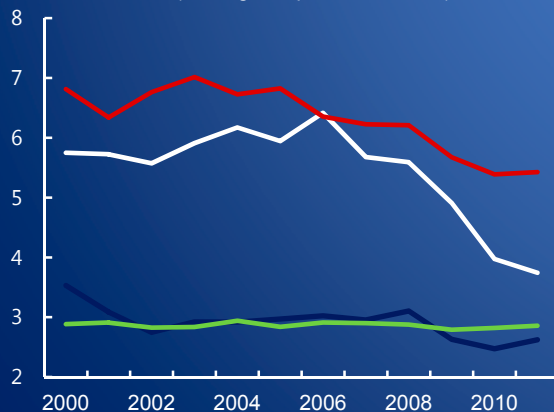
Since 2000, debt has risen in small LICs, fallen in larger ones.

This partly reflects fiscal developments

- Trade tax revenues falling in small states
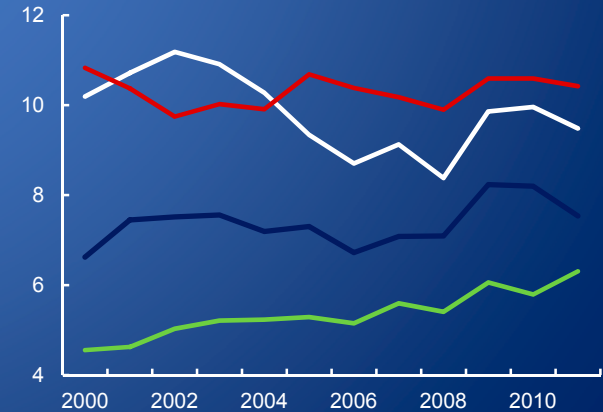- Sustained high wage bills
- Rapidly increasing non-wage spending

Public Debt
(In percent of GDP)

Emerging Small States
Low-Income Small States
Other Emerging Countries
Other Low-Income Countries

Revenue from International Trade
(Average, in percent of GDP)

Total Expenditure
(Percent of GDP)
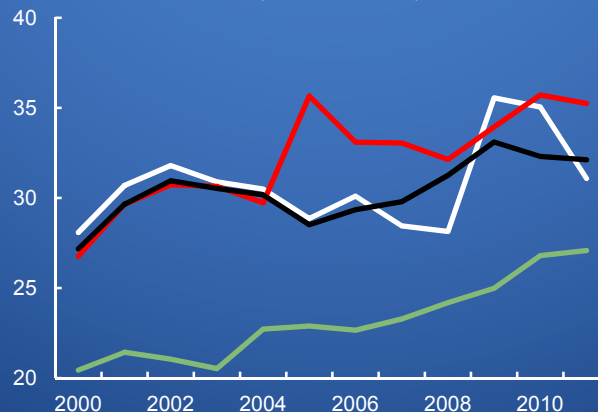
Government Wage Bill
(In Percent of GDP)

Small state financial sectors

Are small state financial sectors helping to moderate the variability?

- Financial sectors are deeper (credit/GDP).
- But they are heavily bank-oriented.
  - Concentrated banking sectors…
  - …whose higher lending-deposit spreads limit financial access
- Partly as a result, there are strong sovereign-to- bank links (through domestic debt).
- Financial systems lack the full range of institutions and instruments—less scope to manage risk.

Bank Concentration, 1993-2009
(In percent, median)

Lending-Deposit Spreads, 2009
(In percent, median)
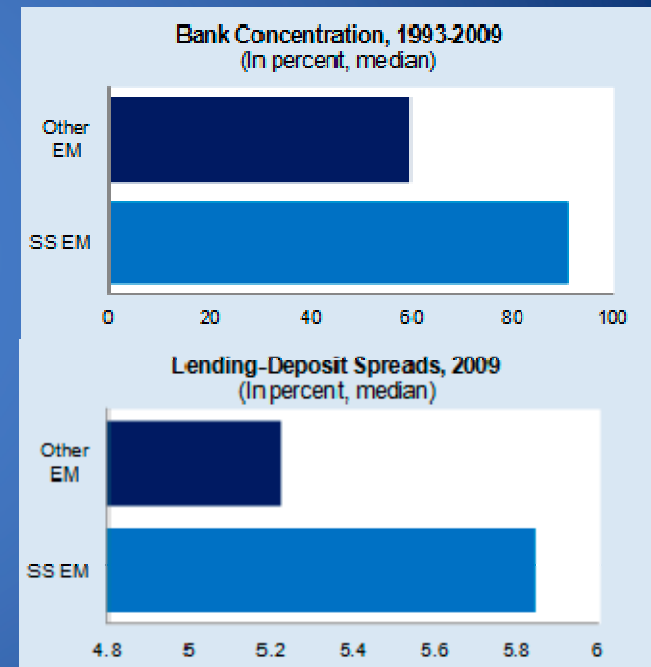
Agenda

Results just discussed are tentative

- Robustness testing (throughout)

- Income levels and growth performance:
  - Examine different regions & time periods
  - Small states very heterogeneous: more analysis of sub-groups
    - Example: *Remote* small states may grow more slowly (perhaps because of high transport and trade costs)

- Possible wedge between *income* and *welfare/poverty*.
  - Other ways to analyze this empirically?

Thank you