

*Economic Development in Pacific Island  
States: Triggers for Conflict?*

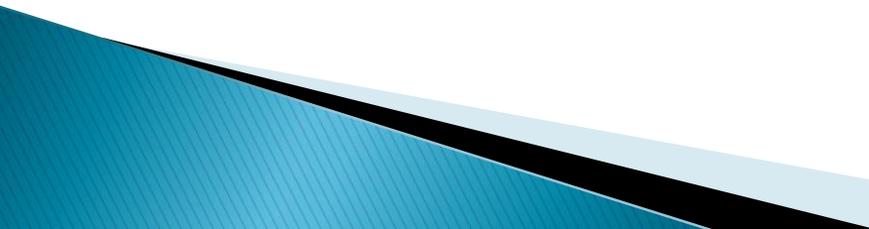
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# Key Economic Characteristics of Small Jurisdictions

- *Small Populations* – precise thresholds irrelevant;
- *Limited Resources* – limited natural resources and labour force; critical reliance upon human capital (knowledge)-intensive activities.
- *Limits On Domestic Productive Activity* – diseconomies of small scale and shallow supply chains limit the feasibility of many productive activities (small market, higher costs, output concentration and limited competition).
- *Exogenous Policy-Dependence* – limited domestic policy autonomy to respond to changes in global economic shocks (exchange rates, inflation, trade and growth volatility).

# Limits On Economic Growth in Small Jurisdictions

- *Specialisation* –specialisation in a few productive activities.
  - *Constrained Diversification* – limited potential to diversify productive activity.
  - *'Structural' Openness to trade* – substantial asymmetries between patterns of production/exports and consumption/imports.
  - *Export-Led Growth* – domestic growth/incomes highly dependent upon export performance based upon international competitiveness.
  - *Exposure to External Shocks* – high dependence on global market conditions.
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# The 'Viability' of Small Jurisdictions: Some Initial Inferences

Post-colonial policy-makers and academics were long concerned with the economic and political 'viability' of smaller territories.

- Major UK parties in 1950s argued for conglomeration; hence the short-lived West Indies and Malay Federations.
- Economic inference: diseconomies mean that only larger jurisdictions [ $>10m$ ] can survive (Kuznets, 1960, etc.).
- Political/IR inference: weak defence capabilities mean that they can't survive as independent entities (Vital, 1967 etc.).

# The 'Viability' of Small Jurisdictions: Some Initial Inferences

More specifically:

- Government size: diseconomies imply high unit costs of government services – high taxation and lower growth and incomes (Cameron, 1987, Alesina & Wacziarg, 1998 etc.).
- Government inefficiency and greater risk of conflict (Alesina & Spolaore, 1996; Alesina & Wacziarg, 1998).
- Smaller jurisdictions incur disproportionate costs of defence (Kuznets, 1960) – prohibitive without critical alliances (Fox, 1959) through 'borrowing power' (Aron, 1966).

# Small Jurisdictions: Empirical Evidence

Many of these *stylised* facts appear mis-specified in reality.

- Small jurisdictions have enjoyed strong economic growth and attained high living standards (e.g., Armstrong *et al.*, 1998; Armstrong & Read, 1998, 2002, 2020; Read *et al.*, 2012).
- Many (even smaller) non-sovereign jurisdictions out-perform small sovereign jurisdictions, normalising for metropolitan resource transfers (e.g., Armstrong & Read, 2000, 2021).

# Jurisdictions Classified By Size Quartile & World Bank Income Group, 2021

<i>World Bank Income Group<sup>1</sup></i>	<i>Total</i>		<i>Largest</i>	<i>2<sup>nd</sup> Quartile</i>	<i>3<sup>rd</sup> Quartile</i>	<i>Smallest</i>
	<i>No.</i>	<i>Share %</i>	<i>No. (Share %)</i>	<i>No. (Share %)</i>	<i>No. (Share %)</i>	<i>No. (Share %)</i>
High	75	35.7	12 (23.1)	15 (28.3)	21 (39.6)	27 (51.9)
Upper-Middle	57	27.1	14 (26.9)	11 (20.8)	18 (34.0)	14 (26.9)
Lower-Middle	54	25.7	18 (34.6)	16 (30.2)	9 (17.0)	11 (21.2)
Low	24	11.4	8 (15.4)	11 (20.8)	5 (9.47)	0 (0.0)
<i>Total</i>	<i>210</i>	<i>(100.0)</i>	<i>52 (24.8)</i>	<i>53 (25.2)</i>	<i>53 (25.2)</i>	<i>52 (24.8)</i>

*Source:* Calculated from World Bank (2022).

# Interpreting the Size/Income Table

- Jurisdictions are grouped simply in size quartiles based upon their population in 2021.
- Jurisdictions are classified according to the four World Bank Income groups (High, Upper- & Lower-Middle and Low).
- The performance of small jurisdictions is surely remarkable in the light of initial inferences.
- Successive generations of this table have been extremely stable over the last 25 years in spite of economic crises and the Covid pandemic (*Armstrong et al.*, 1998; *Read et al.*, 2012; *Read*, 2018).

# Explaining Economic Growth & High Incomes in Small Jurisdictions

*New Growth Theory* uses large-scale statistical studies to explain differences in countries' growth performances. These models generally exclude most, if not all, small jurisdictions but...

Small jurisdictions are the *archetypes* that most broadly conform to key high growth elements (!) – excluding R&D:

- Open trade policies.
- Reliance upon comparative advantage.
- Export-led growth.
- High investment/dependence upon human capital/skills.

# Small Jurisdictions, the HDI, Governance & Wellbeing

Small jurisdictions also perform far better than larger ones in terms of the UNDP *Human Development Indicators*:

- Health,
- Education
- Life expectancy.

In addition, they perform far better in terms of governance (Congdon Fors, 2014; Read, 2018) and wellbeing (Read, 2018).

# Recent Challenges for Small Jurisdictions

The strategy of relying for growth upon offshore financial services, tourism plus natural resources is now under challenge as a result of a series of major shocks and developments:

- The Global Financial Crisis of 2007/08.
- The Covid-19 pandemic.
- Severe weather shocks and rising sea levels.
- Global heating.
- International financial regulation of tax havens.
- International political economy retrenchment (from 02/22).
- China's expansionism, especially in the Pacific.

# Economic Growth & Specialisation in Small Jurisdictions

Small jurisdictions have been very adept at identifying growth opportunities/strategies, supported by effective institutions and good governance. *Most have avoided the policy errors and inertia plaguing many larger economies.*

The most successful exhibit significant niche specialisation in just three sectors:

- Offshore financial services, including OFCs (tax havens) [credibility based on hard currencies - \$, £, €].
- Tourism.
- Natural resource rents (where available).

(see Armstrong *et al.*, 1998; Read *et al.*, 2012; Armstrong & Read, 2020).

# Challenges for Small Pacific Jurisdictions

Small jurisdictions in the Pacific, sovereign or not, face an array of economic and political existential challenges.

- Their prosperity has been founded upon trade and driven by globalisation but their growth has been badly affected by global crisis and retrenchment since 2008.
  - Two key growth ‘pillars’ – long-haul tourism and financial services – are under severe threat.
  - Global heating is driving rising sea levels, leading to a loss of land and fresh water lenses as well as increased population pressures.
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# Challenges for Small Pacific Jurisdictions

Small Pacific jurisdictions also face critical strategic challenges.

- Most are territories or former colonies of major powers or *hegemons* (France, the US and UK as well as Australia and New Zealand) and enjoy advantageous economic, political and defence links.
- Their locations are often of global strategic importance (harbour, airfield and bunkering facilities).
- The Central and Eastern Pacific is an increasingly important arena for China's expanding regional ambitions, challenging the current *Pax Americana*.

# China & the Pacific

This geo-political challenge is taking several different forms under the '*Wolf Warrior*' strategy initiated by Xi Jinping in 2017:

- Intensification of sabre-rattling and threats (military exercises, airspace incursions etc.) under its 'One China' policy towards Taiwan.
- Actively contesting territorial disputes in the South China Sea with strategic EEZs – Paracel and Spratly Islands – through *de facto* occupation (e.g., constructing military facilities).
- Closer defence ties in the Eastern Pacific, notably the 2022 security deal with the Solomon Islands and proposed naval base.

# China & the Pacific

Xi's *Wolf Warrior* strategy has (arguably) been suspended but a critical challenge for some Pacific Island states (and other developing countries) remains.

China has been a significant investor in major infrastructural projects in the region, partly driven by its competitive diplomacy with Taiwan but also to extend its 'soft power' to rival the US and other Western powers. Some of this investment is in the form of aid but the remainder is financed via long-term debt that has created a growing 'debt trap' for some countries; with resources being switched from social expenditure to debt repayments.

# Defence, Conflict & Challenges for Small Jurisdictions in the Pacific

The fallacy that small jurisdictions face overwhelming diseconomies of small size is perhaps most apparent re: defence since *realpolitik* suggests that there is little justification for such expenditure over bilateral and/or multilateral agreements. Small jurisdictions in the Pacific and elsewhere have therefore reaped a ‘peace dividend’, with greater investment *pro rata* in social goods to offset higher unit costs of provision.

Regional geo-political change and strategic realignment in the Pacific however, may threaten the current *status quo* at a time when most if not all small jurisdictions face significant economic and environmental challenges.

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