

Summary

This study is the first to look at the trade effects of the current global slowdown on small states. Small states' exports seem to be affected at least as much as other developing countries' exports. Given the reliance of small states on trade, this means that the effects on their economies may be more sizeable than for other developing countries. We find that those countries exporting minerals and fuels, and 'luxury' goods and services, such as beef and tourism, are likely to be more affected.

On the other hand, countries that export basic agricultural goods, such as sugar, rice and fruits, are likely to be more resilient. We also construct a trade resilience measure on the basis of countries' export markets. As most export markets will be negatively affected by the crisis, this measure is negative for all states except Solomon Islands, whose exports are concentrated on China, which is weathering the crisis well.

Services exports appear to be more resilient to the crisis than exports of goods, although this is less the case for tourism, the major service export of small states. Many small states which depend on tourism are experiencing considerable drops in tourism arrivals and revenues, consistent with the proposition that tourism has a high income elasticity of demand. Vanuatu is an exception to this pattern, in that its increase in tourist arrivals has continued unabated, due in part to political and weather-related problems in its main competitor, Fiji Islands.

According to our computations, the only countries which are expected to have non-negative overall trade-related effects from the crisis are Swaziland and Guyana, due to their dependence on basic agricultural exports such as sugar, rice and essential oils, and their low reliance on affected services exports. At the other end of the spectrum, countries that are heavily reliant on exports of minerals and fuels, such as Botswana and Brunei Darussalam, seem likely to be the most negatively affected. In addition, small states that are very dependent on tourism, such as Malta, Maldives and most Caribbean and Pacific countries, are likely to be particularly heavily penalised.

It is difficult for small states to respond to the trade-induced effects of the crisis, given their limited fiscal space (in the context of shrinking trade-related taxes which represent a large part of government revenues), exchange rate policy and lack of influence in the international trade arena. However, eliminating taxes on exports, ensuring timely finance for credit-constrained domestic firms and reducing the (relatively high) costs of trading may be helpful short-term responses to limit the adverse trade effects of the crisis. The crisis may also sound an alarm bell for small states to act upon certain trade-related policies. They should aim to diversify their export markets, quickly moving away from the system of trade preferences; reconsider the role of offshore

financial centres, which have come under increasing scrutiny; and upgrade and develop trade-related infrastructures to reduce the penalties of remoteness. Finally, the international community has a key role to play in adopting policies to help international trade withstand the adverse effects of the crisis by fighting protectionism, guaranteeing adequate funds to sustain trade finance and providing effective aid for trade (AfT). It is in the interests of small states, especially, to support and stimulate such initiatives.