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Introduction

The global financial system is currently experiencing a prolonged and deepening period of crisis. This global financial crisis began as a money market phenomenon rooted in the US housing market and has now spread to the real economy, both in the USA and abroad. The global credit crunch has compounded an already slowing global economy, marked by falling commodity prices and slowing demand for oil. The crisis has not spared developing countries, as shown *inter alia* by a recent study co-ordinated by the Overseas Development Institute (te Velde *et al.*, 2009b).

For developing countries, trade is a key transmission mechanism that links them to markets that are heavily affected by the financial crisis via changed terms of trade and export demand. This is more so for small states and for small island developing states (SIDS) in particular. These countries are heavily dependent on trade and on external flows (remittances and foreign direct investment (FDI)). Moreover, their exports tend to be more concentrated than those of other developing countries. This combination of factors makes small states more exposed to the vagaries of external markets. Thus they are likely to be particularly vulnerable to a global downturn such as the current one.

This study tries to shed some light on the actual and possible effects of the global financial crisis on trade in SIDS, specifically focusing on the 32 states that comprise the Commonwealth small island community[1] (CSIC).[2] A number of small island states have shown some resilience to the crisis, and in April 2009 the International Monetary Fund was still forecasting positive growth in about half of them (IMF, 2009b). However, their estimated growth rates have all been downgraded and the extent to which the various small countries are resilient in the face of the crisis is still unclear. Given their dependence on trade, a large part of their resilience will have to do with the way trade prospects are affected. Identifying the countries and the sectors which are more likely to suffer the adverse trade-related consequences of the crisis is important in designing possible policy responses.

The crisis comes at a critical juncture for trade in a number of small states. In particular, the very recent changes to the EU's banana and sugar regimes, which have meant the loss of trade preferences in these sectors by several small states, represent additional problems to the challenges posed by the global financial crisis. For instance, the change in the sugar regime will have a negative impact on the exports of countries such as Swaziland, which we expect to be fairly resilient to the crisis.

The study is divided into seven sections. Section 2 describes how the trade-related effects of the crisis may play out. Section 3 considers specifically the possible trade implications in relation to the characteristics of small states. Section 4 analyses the effects of the crisis on trade in these countries, based on sectoral and geographic data; it also speculates on the extent to which the trade effects may affect economic growth and poverty. Section 5 puts the trade effects into context, examining the possible effects of the crisis on small states via other direct channels. Section 6 presents some policy implications of the analysis and Section 7 presents the conclusions of the study.