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Conclusions

For developing countries, trade is a key transmission mechanism of the current global financial crisis. The effects of the crisis on trade are likely to play out through falling demand (due to falling incomes), increased trade protectionism, mainly taking non-traditional forms, and drying up of finance, including trade finance. The adverse effects on trade are possibly even more important for small states, which are heavily dependent on trade, given their need to specialise in a handful of productive activities. This study is the first to look specifically at the trade effects of the current global slowdown on small states. It has shown that small states' exports seem to be affected at least as much as other countries' exports. Given their reliance on trade, this means that the effects on their economies may be more significant than the impact on the economies of other developing countries.

The export dependence of small states on a few sectors and markets implies that if these sectors and/or markets are adversely affected, the effects on small states' exports will be important. On the basis of these characteristics, this study has identified the possible exposure of small states to adverse trade shocks. In particular, countries that export 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 more basic agricultural goods, such as sugar, rice and fruits, are likely to be more resilient. Similar arguments apply in relation to export markets, although most markets appear to be negatively affected by the crisis and that is why trade resilience measures based on merchandise export markets are negative for all states except Solomon Islands, whose exports are concentrated on China, which is weathering the crisis well.

On the other hand, exports of services appear to be more resilient in face of the crisis than exports of goods, although this is less the case for tourism, the major services export of small states. Many small states which depend on tourism are experiencing considerable drops in tourism arrivals and revenues, in line 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 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, it is probable that countries that rely heavily on minerals and fuels, such as Botswana and Brunei Darussalam, will be the most negatively affected. In addition, small states such as Malta, Maldives and most Caribbean and Pacific countries that are heavily reliant on tourism are likely to be particularly heavily penalised.

Other flows, including private capital flows, remittances and aid, are also likely to dry up as a consequence of the crisis, although they do not seem to pose the same strains on the economies of many small states as does trade.

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 the adverse trade effects of the crisis. The crisis may also sound an alarm bell that will encourage small states to implement certain trade-related policies. Small states 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 infrastructure to reduce the handicap 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. It is in the particular interest of small states to support and stimulate such initiatives.