SUPPORTING ECONOMIC TRANSFORMATION

The coronavirus pandemic and small states: a focus on Small and Vulnerable Economies

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Key messages

- The global coronavirus pandemic has struck at a time when Small and Vulnerable Economies (SVEs) were already facing weak trade growth, with year-on-year trade growth already negative by Q3 2019 for the Caribbean region.
- Tourism exports could be halved in 2020, with major economic repercussions, with losses that could range between 4% and 26% of gross domestic product, varying by SVE.
- The value of stimulus packages announced so far by selected SVEs amounts to between 0.03% of GDP (Antigua and Barbuda) and 2.6% of GDP (Fiji), compared with 8% on average by G20 members.
- Data availability is scarce and assessments are partial, yet we need ongoing tracking of impacts. Comments are welcome.

Introduction

Unlike the 2008/09 global financial crisis (GFC), which preceded the Great Recession, COVID-19 represents both a Keynesian demand shock and a supply shock. In addition to the transmission of a collapse in final and effective demand, an endogenous supply shock will occur because economic activity itself must stop to make it possible to contain the spread of COVID-19. There is no parallel for this in modern times. The interaction between the above shocks and economic effects depends on governments' fiscal and monetary policies and private sector/consumer behaviour within each country as well as across and between countries. The provision of major financial stimuli along with social safety nets and actions taken by 'socially responsible' firms will be pivotal to avoid dire social effects. But not all countries are in a position to respond, especially Small and Vulnerable Economies (SVEs), a number of which have been hit by a series of major economic shocks in recent years. This note discusses the channels through which SVES will be affected, focusing on tourism and remittances.

Transmission mechanisms

The epicentre of the COVID-19 outbreak is moving across the three major hubs of global economy – Asia, Europe and the US – and the top trading partners of developing countries. Countries within these regions account for more than half of all global economic activity. These are all major end markets for many SVEs, which depend heavily on tourism and remittances. An estimated $1–2 trillion has been knocked off the value of the global economy. Major economies will enter into recession, reducing global growth rates. Business activity across the Eurozone collapsed in March to an extent far exceeding that seen even at the height of the global financial crisis, according to PMI surveys across the Eurozone – equivalent to GDP falling at a quarterly rate of around 2%. Around one in three persons globally are now in lockdown; the rise in joblessness in developed countries like the UK and US is unprecedented. International transportation is beginning to grind to a halt. The airline industry is under intense financial pressure and some bankruptcies are inevitable.

The trade transmission mechanism of external shocks is amplified within small states because of limited domestic markets, which increase the importance of international trade as a driver of growth. Economic vulnerability is high in view of limited export diversification. These combined effects mean SVEs face the most challenging start to 2020, the last decade of action ahead for advancement of the Sustainable Development Goals and the 2030 Agenda.

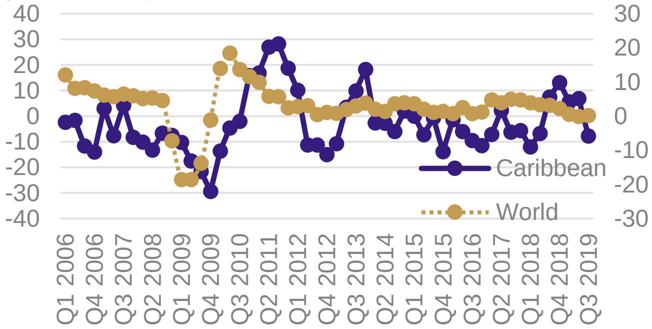
Trade challenges

It is deeply unfortunate that COVID-19 has hit the global economy at a vulnerable time, when protectionist measures and trade wars between the major players were already affecting trade growth – which has struggled to rebound since 2008/09 and subsequent Eurozone crises, and slowdown between 2012 and 2016, especially within SVEs.

Many SVEs are dealing with the continued legacy of economic impacts arising from natural disasters. Others are still adapting to the effects of regulatory changes induced by the effects of the GFC, with de-risking de-linking many small states from global finance through losses of correspondent banking, reducing access to financial services. The growth rate of goods and services had already begun to dip around 2015 for the Caribbean (Figure 1). SVEs with a high dependence on tourism and remittances as a share of GDP (a combined share of GDP over 25%) are Tonga, Jamaica, Seychelles, Belize, Dominica and Fiji (Table 1).

International tourism demand has collapsed. While tourism bookings may have been postponed rather than cancelled, this ratio is not currently known – nor is the duration of the current COVID-19 lockdown. Important cultural events have been cancelled.

Figure 1: Global and Caribbean trade (year-on-year growth rate)



Source: UNCTADStat

Table 1: International tourism and remittances (% total exports and % GDP 2018)

Country	% total exports	% GDP	% GDP
	Tourism		Remittances
Antigua and Barbuda	84	16	1.5
Bahamas, The	77	24	-
Belize	45	19	4.8
Barbados	35	16	2.2
Dominica	69	13	8.9
Fiji	51	16	5.5
Grenada	84	10	41.
Jamaica	53	13	15.9
St. Kitts and Nevis	61	9	2.6
St. Lucia	81	20	2.0
Sri Lanka	28	6	9.1
Seychelles	35	24	1.4
Tonga	46	8	38.5
Trinidad and Tobago	5	3	0.6
St. Vincent and the Grenadines	76	8	5.4
Samoa	63	-	18.4

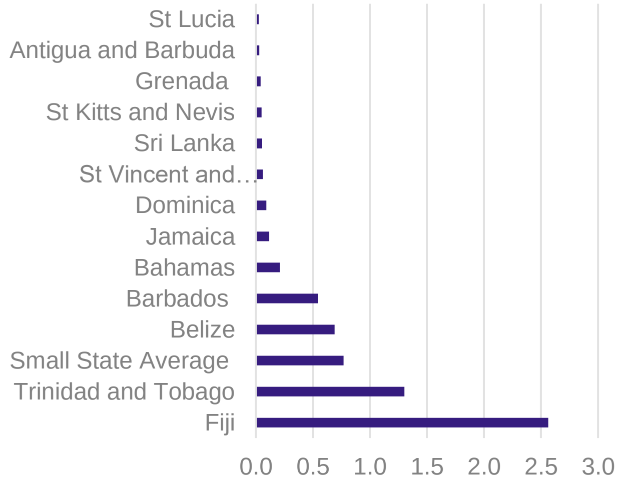
Source: World Development Indicators
Note: Data are not presented for all SVEs; travel and tourism direct contribution to GDP.

If global growth halves, given global trade/growth elasticities of 1:1 since the trade slowdown (the ratio of trade growth to GDP growth), global trade growth could be halved in 2020. However, specific sectors are already projecting even larger declines. The Pacific is expected to be one of the regions hit the hardest by reduced tourist arrivals. In the Caribbean, looking ahead from April to December, a 50% decline in tourism arrivals results in estimated losses to GDP ranging from 4% in Trinidad and Tobago to 20.3% in Barbados and 26% in Bahamas. This assumption – which already has major economic and social ramifications for many SVEs – does not even begin to take into account multiplier effects, dampened domestic demand as a result of reduced consumer spending and overall levels of employment across all sectors (of which services increasing dominate – accounting for on average 65% of total employment in 2019, up from 58% in 2005).

Policy Responses

The economic repercussions cannot be understated. Debt sustainability levels for many countries within the region are high (Dominica: debt to GDP ratio of 74%) or in distress (Grenada: debt to GDP ratio of 66%). A number of SVEs have initiated fiscal and monetary response packages and stimulus measures to adapt to the coronavirus (e.g. Barbados, Trinidad and Tobago, Jamaica, Seychelles, Fiji). Some have relied on the IMF to assist in these efforts (e.g. Barbados), as well other donors, such as China (e.g. Sri Lanka). But preliminary analysis suggests the total value of stimulus packages announced so far by selected SVEs amounts to between 0.03% of GDP (Antigua and Barbuda) and 2.6% of GDP (Fiji), compared to with % on average by G20 members (Figure 2).

Figure 2: Economic stimulus (% of 2018 GDP)



Source: Authors calculations

Other responses include promoting staycations and boosting domestic tourism; promoting postponing rather than cancelling of booked vacations; using hotel closures as an opportunity invest in upgrading of infrastructure; promoting corporate social responsibility to employees, including using and retaining existing skills; waiving business rates, VAT etc.; ramping up diversification efforts, including supporting the promotion of skills upgrading through providing grants to creative industries, as well as to actions needed to combat the coronavirus. Finally, all governments must act to mitigate risks of contagion: when go bust, this can affect individual banks, financial sector and economy balance sheets and liquidity positions. There is a need for enhanced surveillance and stress testing.

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