



# Trade Hot Topics

## Natural Disasters and Trade Resilience in Small States

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### Background

For many years, the international community has discussed the unique set of challenges small states face stemming from their geographical location and size. Several studies have noted that small states are significantly more open to trade as they have bigger trade to gross domestic product (GDP) ratios than their larger counterparts (Krasner, 1976; Easterly and Kraay, 1999; Jahan and Wang, 2013; Nurse, 2016). Moreover, they tend to be highly dependent on strategic imports such as food and fuel. This high degree of trade openness can leave small states vulnerable to shocks from terms of trade and variations in the availability of trade and other development finance sources (Commonwealth Secretariat, 2016).

Moreover, as tiny islands sprinkled in huge oceans, many small states encounter frequent tropical storms and hurricanes. They tend to feature highly on environmental vulnerability indices, including South Pacific Applied Geoscience Commission's EVI, in which 21 of the 34 countries and territories

in the extremely vulnerable category are small states. An International Monetary Fund (IMF) study of 24 small states found that more than one-third of the sample was at significant risk from climate change and natural disasters, compared with only a quarter of other countries (IMF, 2016). This risk is worsened by the increased frequency and intensity of natural disasters across the globe in the past 50 years (Laframboise and Acevedo, 2014; IMF, 2016). Furthermore, the high frequency of disasters and greater vulnerability to severe disasters means that, on average, the annual cost of disasters for small states is more than four times that for larger countries (IMF, 2016).

The coupling of small states' reliance on trade and their vulnerability to natural disasters means that, when a natural disaster hits, it is particularly harmful to trade. Work by Andrade de Silva and Cernat (2012) notes that 'smaller countries are hit from both sides: they are hardest hit and least able to cope.' The study finds that exports of disaster-hit small developing countries decline by 22 per cent as a consequence of the disaster and that

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the observed impact tends to last for about three years, whereas there is no evidence of a significant impact on exports of large developing countries.

The reality of small states' vulnerability and challenges was laid bare once more in early September, as Hurricane Dorian devastated the northern islands of The Bahamas. The Category 5-strength storm lingered over the islands for more than 48 hours, leaving widespread death and destruction. While The Bahamas is still counting the costs of Hurricane Dorian, to date there have been 51 fatalities recorded, with more than 1,300 people still missing and an estimated US\$3 billion in damages. The opportunity cost of severely reduced production, foregone wages and lost trade are yet to be calculated.

Since 2015, there have been 57 instances of natural disasters, affecting nearly 7 million people and resulting in losses of over US\$4.2 billion in Commonwealth small states.<sup>1</sup> According to INFORM's Global Risk Index, which computes the risk of humanitarian crises and disasters, nearly a third of the 31 Commonwealth small states are at medium to high risk of being affected by tropical cyclones and tsunamis.

This issue of *Commonwealth Trade Hot Topics* considers the impact of natural disasters on Commonwealth small states and reviews potential pathways to enhance the disaster resilience of these vulnerable countries. It starts by examining the relationship between small states and trade. It then

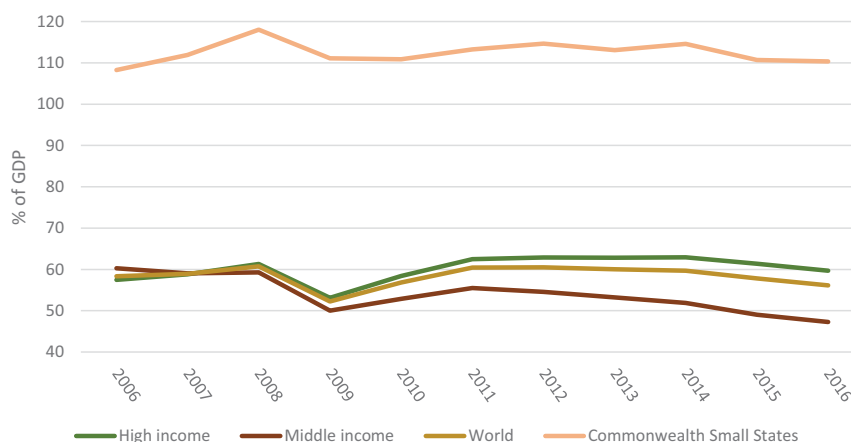
reviews the three mechanisms through which trade is affected when natural disasters strike: direct losses to exports, losses to trade facilitation assets and indirect losses. It concludes by offering suggestions for enhancing the resilience of Commonwealth small states, with actions for both the international community and small states themselves.

### Unpacking the trade dependence of small states

While we have already noted that small states are highly reliant on trade as a result of their unique characteristics, it is worth exploring the reasons for and consequences of this dependence. The small domestic and regional markets of small states and the narrow range of resources available to them mean they are able to produce only a few goods and are not able to take advantage of economies of scale. As a result, small states import much of what they do not produce. The cost of importing further exacerbates their trade balance, as small states face high fixed trading costs, owing to their geographical remoteness and distance from major trading partners. Figure 1 illustrates the stark contrast between the trade dependence of Commonwealth small states and that of other country groups: Commonwealth small states' trade as a percentage of their GDP is almost double that of the world, high-income countries and middle-income countries.

Concentration in a few products – particularly primary commodities – leaves exporters highly

Figure 1: Trade as a share of GDP in small states, 2006–2016 (%).



Source: Authors' calculations using World Bank data.

1 EM-DAT: The Emergency Events Database – Universite Catholique de Louvain (UCL) Centre for Research on the Epidemiology of Disasters (CRED), at [www.emdat.be](http://www.emdat.be)

exposed to shocks to the industry, like a fall in global prices or a loss of agricultural produce owing to a natural disaster. Therefore, ideally, small states would like to have a diversified export base. The export diversification index measures the degree of concentration in a country's exports, where a value closer to zero is highly diversified and near to the global average and a value closer to 1 is highly concentrated. An assessment of how Commonwealth small states have fared in the past 20 years on diversifying their exports generates worrying results. As Figure 2 shows, out of the 31 Commonwealth small states, the exports of 21 were more concentrated in 2017 than they were in 1997. This does not bode well for small states, given that their exports are already highly specialised.

Small states also lag significantly behind developed and developing economies: the Commonwealth small states average on the diversification index in 2017 is 0.78, against the 0.17 of developed countries and the 0.19 of developing countries (see Figure 2). This significant gap and the limited progress made during the past twenty years, between 1997 and 2017, emphasises the urgent need for development partners to enhance existing international support mechanisms to develop focused export diversification strategies that can help small states diversify and reduce their reliance on specific exports.

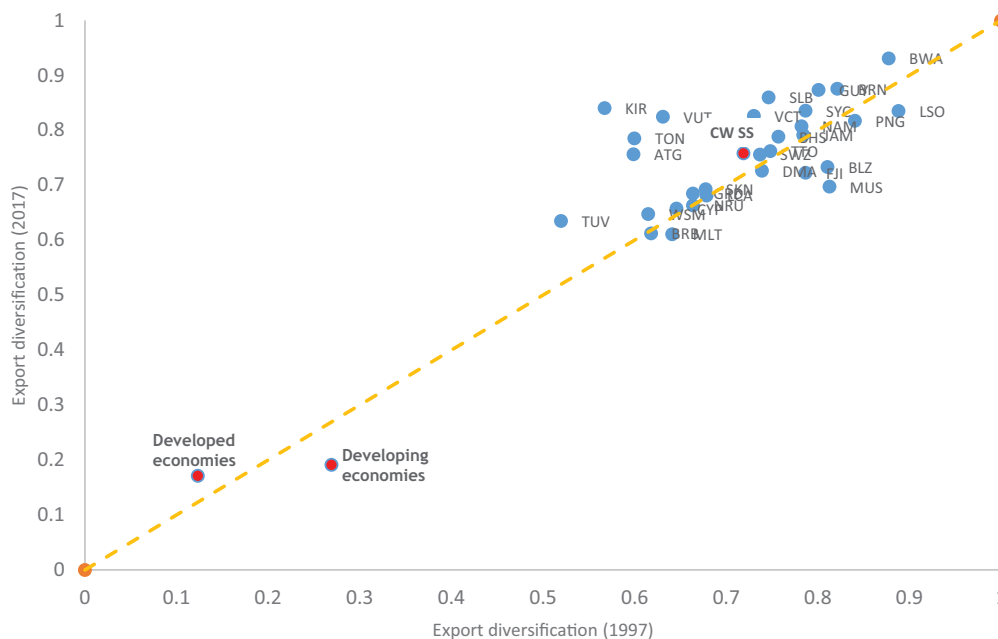
### The economic impact of natural disasters on trade in small states

Given their high dependence on trade, and their vulnerability to natural disasters, when small states are hit by disaster the effect on their trade is tremendous. The impact can manifest in three ways. First, natural disasters can cause direct losses to export earnings, as crops, assets and capital goods are wiped out. Not only are existing assets destroyed, but also invasive pests and diseases spread during hurricanes and typhoons, which can greatly harm future agricultural exports: an outbreak of soil-borne fungus Sigatoka affected Saint Lucia's exports of bananas in the aftermath of Hurricane Tomas in 2010, exacerbating the economic impact of the storm and slowing down the country's recovery (WTO, 2019a).

Second, disasters can destroy critical connectivity infrastructure that facilitates trade, such as roads, bridges, railway, airports and ports. The damage can bring trade to a standstill because in the immediate aftermath of a disaster the affected country's resources are focused on processing relief goods and reconstruction efforts, as opposed to trade.

Third, aside from the economic losses experienced by the affected country, there can be an indirect impact on neighbouring countries. Although Saint Lucia was not directly affected by storms in the 2017 hurricane season, it faced higher costs

Figure 2: Small states' export diversification (1997 and 2017).



Note: The line drawn through the scatter is at 45 degrees. Small states that have experienced increased export concentration are on the right of the line measured at the three-digit group level (SITC Revision 3) in 2017 as compared with 1997. Source: Authors' calculation using UNCTADstat.

stemming from the disruption of regional air travel and maritime shipping, and the rerouting of consignments, resulting in loss of profits (WTO, 2019a). Figure 3 shows the tremendous impact of recent natural disasters on five Commonwealth Small states as a percentage of their GDP.

While reconstruction activity is considered an important driver of economic growth in the aftermath of disasters, it can be a double-edged sword. In the recovery phase, as building and construction materials are imported to assist with reconstruction, these imports exert pressure on the current account and debt levels, which consequently depresses economic growth. In the immediate aftermath, import duties are often waived, and the government forgoes vital income. With export earnings at a standstill and imports arriving for recovery and reconstruction, it is crucial that countries have sufficient domestic reserves to avoid debt risk, or are able to access official development assistance (ODA). For example, in Vanuatu, the stock of public debt to GDP increased 20 percentage points after Cyclone Pam. Furthermore, according to the IMF classification, only six out of thirty-one Commonwealth small states – eSwatini, Kiribati, Lesotho, Papua New Guinea, Solomon Islands and Vanuatu – are defined as lower-middle-income countries and are able to access concessional ODA. This puts the majority of small states at risk of exerting pressure on their fiscal budgets.

Given the potent combination of heavy dependence on trade, narrow specialisation of products and

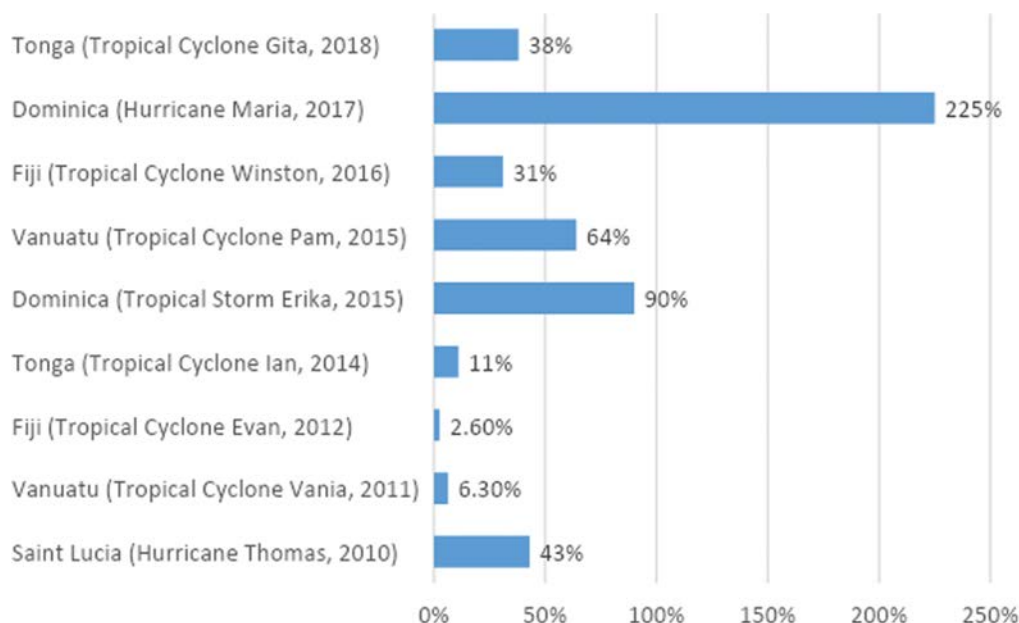
high risk of hydro-meteorological natural disasters, it is not surprising that there are growing calls for more adequate international support mechanisms to mitigate disaster risk and help these vulnerable countries become more resilient.

### Disaster resilience in small states

#### Multilateral initiatives

Mitigating disaster risk and enhancing disaster resilience has been on the international community's agenda since the 1950s. However, since the 2000s, it has become more prominent, with the creation of the United Nations Office for Disaster Risk Reduction and the adoption of the Hyogo Framework for Action 2005–2015. This work has since evolved into the Sendai Framework for Disaster Risk Reduction 2015–2030, which seeks to ultimately reduce disaster risk and losses in lives, livelihoods and health and in the economic, physical, social, cultural and environmental assets of persons, businesses, communities and countries. To this end, the World Trade Organization's (WTO's) Trade Facilitation Agreement, which came into force in February 2017, seeks to expedite border and customs clearance procedures and can serve to remedy some of the trade issues experienced in the immediate aftermath of a disaster. However, many countries are calling for even further flexibility, including 'Special and Differential Treatment allowing developing countries to deviate from GATT [General Agreement on Tariffs and Trade] obligations' during periods of recovery from a disaster.

Figure 3: Natural disaster damage in selected Commonwealth small states (% of GDP).



Source: WTO (2019a).

Small states are also seeking improved access to concessionary finance to help them adapt to climate change and recover from natural disasters. However, climate finance and disaster finance landscapes are becoming increasingly crowded and complex. In many cases, small states struggle to effectively navigate these spaces. Governments suffer from human resource constraints and often have insufficient expertise to successfully draw on available funds.

To assist with this challenge, the Commonwealth has developed two key programmes. The first, the Climate Finance Access Hub, aims to help countries untangle the red tape around climate financing, and make successful applications to the international funds that address climate change. The Hub places national advisors in long-term positions in government environmental departments and agencies to provide technical assistance in accessing climate finance. This support is especially useful for small vulnerable economies that are unable to access ODA as a result of their income classification. To date, US\$500 million of climate finance has already been mobilised through the programme, with a further US\$27.2 million in the pipeline based on the projects being developed.

The second initiative is the forthcoming Commonwealth Disaster Risk Finance Portal, which aims to be a one-stop-shop for disaster risk finance instruments. This web-based toolkit will bring together all the financial instruments offered by regional development banks, multilateral financial institutions and other disaster finance providers. The portal will allow resource-constrained governments to easily find a range of tools they may want to include in their disaster risk finance portfolio – from concessional loans, to grants, to insurance products – by looking at those that are specifically available to them.

### **Country-led resilience initiatives**

While much of their vulnerability to natural disasters comes from inherent features that they cannot do much about, small states have some degree of agency in strengthening their resilience. Indeed, Briguglio (2014) argues that resilience comes from policy-induced changes that increase economic stability, market flexibility, social development and good governance, and lower the effect of a country's vulnerability. Many small states can (and do) pursue a number of proactive policies to enhance their resilience to disasters.

A recent study conducted by the WTO (2019a) revealed some of the most common issues experienced in the wake of natural disasters, and made the following recommendations for enhancing resilience:

- Reform customs procedures in the wake of a disaster to aid the entry of relief goods, and provide clarity on what constitutes a relief item, and whether it is exempt from import tax;
- Revise import tariff policy on reconstruction materials so it is not a barrier: reconstruction is at the heart of rebuilding and stimulates economic growth, therefore it is essential to ensure tariffs on construction materials such as steel and cement are reduced so that it does not disincentivise efforts to 'build back better';
- Design and implement local building codes that ensure imported building materials are resilient;
- Tender essential government services that countries are not able to manage in the wake of natural disasters, which can help with ex-post tendering;
- Export diversification: tourism is seen as better able to bounce back from disasters than agriculture. Box 1 explores another climate-resilient industry: citizenship by investment (CBI).

### **Box 1: Climate-resilient industry – citizenship by investment (CBI)**

In an effort to diversify their economies, some small states have turned to CBI as a climate-resilient economic driver. CBI schemes grant citizenship to people who make substantial financial investments in a country. The investments required tend to be real estate purchases, investment in approved development projects, set-term investments in government bonds or donations to particular charities or funds.

Particularly for small states, where GDP tends to be relatively low, CBI programmes have a significant macroeconomic impact. In the Caribbean region, where five small states offer such programmes, within eight years the industry grew from having no impact on regional GDP, in 2007,<sup>2</sup> to account for budget inflows representing a substantial 5.1 per cent of regional GDP in 2015.

2 The CBI programme in St Kitts and Nevis was being revamped in 2007.

This growth was led primarily by the programmes in St Kitts and Nevis, contributing 3 per cent, and Antigua and Barbuda, contributing around 1 per cent. At a country level, the figures are even more impressive, with budget inflows from the industry representing 14 per cent of GDP in St Kitts and Nevis in 2014 and 9.5 per cent in Dominica in 2015–16.

The programmes in Antigua and Barbuda, Grenada and Saint Lucia are much newer, having started in 2013, 2014 and 2016, respectively. However, they have already proven to be important sources of income, particularly for Antigua and Barbuda, whose budget inflows from the programme represented around 4 per cent of GDP in 2015 (Gold and Myrvoda, 2017).

One major opportunity that CBI programmes present is the chance to fund disaster recovery as well as climate-resilient and sustainable development. The Government of Dominica used the income from its CBI programme to aid recovery from the Category 5 Hurricane Maria, which struck in September 2017 and caused an estimated US\$1.37 billion in damages, amounting to 226 per cent of GDP for 2016 (Assessment Capacities Project, 2018). The CBI programme funded housing and hotel developments, as well as tourism and agriculture projects that are cumulatively helping the country recover. The collected financial resources also enabled the government to make payments to affected homeowners in the region of £26 million, while a government scheme to build 5,000 new homes is being financed entirely by CBI income, according to Prime Minister Roosevelt Skerit (Shah, 2018).

CBI is not without its challenges – and critics. The programmes are easily exposed to mismanagement and fraud. The Organisation for Economic Co-operation and Development (2018) has argued that CBI schemes can be misused to hide assets and evade taxes. As such, the programmes carry a reputational risk for the country; bilateral visa relations have been reviewed for many countries offering CBI programmes.

The CBI industry provides a source of income that is not part of agriculture, fisheries, tourism or financial services, thus serving to diversify small states' economies. Indeed, the St Kitts and Nevis Sugar Industry Diversification Foundation, one of the investment options for CBI in St Kitts and Nevis, was created 'to assist the government with transitioning from sugar as the main industry to a more diversified economy by researching and funding the development of alternative industries'.<sup>3</sup> The scope of the foundation has since expanded to include providing support to the government in its efforts to diversify the national economy and maintain economic stability, and to support, finance or undertake the development of new and existing industries, projects or enterprises.

## Conclusion

The interplay between trade, natural disasters and small states is an issue that is increasingly getting attention. Unlike least developed countries, which enjoy considerable flexibility under existing WTO agreements and access to international support measures, small states have limited mechanisms to assist them with disaster response, and resilience (Vickers and Enos-Edu, 2019). The Caribbean Community (CARICOM), whose members include 12 Commonwealth small states, echoed this sentiment at the WTO's Natural Trade and Disaster Symposium held in May 2019, calling for comprehensive solutions to treat the harmful effects natural disasters in trade, and highlighting the need for small vulnerable economies to have flexibilities corresponding their vulnerabilities

(WTO, 2019b). There are also 10 Sustainable Development Goals and 25 SDG targets related to disaster risk reduction, which clearly indicates the growing importance of this area for all countries.

The path towards becoming disaster-resilient is vitally important for Commonwealth small states, given that the losses are so tremendous. Multilateral initiatives and international support mechanisms that provide assistance and support to disaster-stricken small and vulnerable economies, while helpful, are still insufficient. Development partners need to provide further instruments to mitigate disaster risk and enhance resilience. Aside from international support mechanisms, small states can also look to pursue domestic climate-resilient measures to help their economies rebound from the devastating impact of natural disasters.

3 <http://sknsidf.org/sidf-overview/> (accessed 7 February 2019).

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# International Trade Policy Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade Policy (ITP) Section of the Trade Division of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth – an association of 53 independent countries, comprising large and small, developed and developing, landlocked and island economies – facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITP is entrusted with the responsibilities of undertaking policy-oriented research and advocacy on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITP approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on highly vulnerable Commonwealth constituencies – least developed countries (LDCs), small states and sub-Saharan Africa.

## Scope of ITP Work

ITP undertakes activities principally in three broad areas:

- It supports Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote development friendly outcomes, notably their economic growth through expanded trade.
- It conducts policy research, consultations and advocacy to increase understanding of the changing international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance more beneficial participation of Commonwealth developing country members, particularly, small states and LDCs and sub-Saharan Africa.

## ITP Recent Activities

ITPs activities focus on assisting member countries in their negotiations under the WTO's Doha Round and various regional trading arrangements, undertaking analytical research on a range of trade policy, emerging traderelated development issues, and supporting workshops/ dialogues for facilitating exchange of ideas, disseminating informed inputs, and consensus-building on issues of interest to Commonwealth members.

## Recent Events

11 October 2019: Tapping the Tourism Potential of Small Economies: A Transformative and Inclusive Approach (WTO Public Forum) held in Geneva, Switzerland in collaboration with the WTO and the UNWTO.

10 October 2019: Commonwealth Trade Ministers Meeting held at Marlborough House, London, United Kingdom.

26–27 September 2019: 12th South Asia Economic Summit XII: Shaping South Asia's Future in the Fourth Industrial Revolution held in Colombo, Sri Lanka in collaboration with The Institute of Policy Studies of Sri Lanka

26 June 2019: Launch of the Commonwealth Publication 'WTO Reform: Reshaping Global Trade Governance for 21st Century Challenges,' held in Geneva, Switzerland.

28–30 May 2019: Harnessing Trade Policy for Global Integration: Commonwealth Consultation for the Asia-Pacific Region held in Singapore in collaboration with the Institute of South Asian Studies, National University of Singapore.

4 April 2019: The Digital Economy: The Case of the Music Industry held in Geneva, Switzerland in collaboration with UNCTAD and the Government of Indonesia.

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