Global Economic Prospects

HIGHLIGHTS from Chapter 4:
Small States: Overlapping Crises, Multiple Challenges

Key Points

- *Small states were hit particularly hard by the COVID-19 pandemic, and their recovery has been much weaker than that in other emerging market and developing economies.*
- *The unusual severity of recent shocks is in part the result of small states' large exposure to tourism, reliance on imported food and fuel, and, in many cases, high debt levels. Many small states are also on the front lines of climate change.*
- *Small states urgently need to raise growth and bolster resilience through a wide range of policies. Some of these will require support from the global community.*

Overlapping crises. Small states—37 emerging market and developing economies (EMDEs) with populations of 1.5 million or less—suffered an especially deep recession in 2020. Aggregate output in small states contracted by more than 11 percent in 2020, about seven times as much as in other EMDEs, largely due to their dependence on global tourism, which collapsed during the pandemic (figures A, B). The recovery in small states has been delayed by elevated energy and food prices, which represent a large proportion of imports in these economies (figure C). Slowing external demand and rising borrowing costs pose further challenges for small states, particularly those with sizeable stocks of government debt at variable interest rates or heavily indebted private sectors. As a result of these headwinds, aggregate GDP in small states is forecast to surpass its 2019 level of GDP only in 2023, two years later than other EMDEs.

Vulnerability to shocks. Small states share attributes that make them vulnerable to shocks and contribute to greater growth volatility (figure D). These include highly concentrated economies, reliance on external financing, and limited government capacity. Small states also face growing risks from climate change. The frequency and intensity of weather-related natural disasters in these countries has increased in recent decades, and small states face severe, in some cases existential, threats from rising sea levels and coastal erosion. Small states, many of which are islands, suffer disaster-related damages and losses of close to 5 percent of GDP per year, on average (figure E).

Reforms and support to boost growth and resilience. Accelerating growth while building resilience to future shocks will require extensive domestic efforts supported by the global community. Small states can diversify their economies and better integrate with global markets by improving private sector business environments and enhancing both digital and physical connectivity. They can also limit vulnerability to shocks by investing in climate adaptation, enhancing disaster risk management, lessening dependence on imported fossil fuels, and rebuilding fiscal buffers. Where feasible, small states can reduce trade costs and collaborate with major trading partners and each other to achieve economies of scale (figure F).

Figure 1. Challenges facing small states

GDP in small states is forecast to exceed its 2019 level only in 2023, two years after other EMDEs. The reliance of many small states on global tourism and imports of food and fuel has increased their vulnerability to shocks, and contributed to more volatile growth. Small states are also vulnerable to natural disasters, which have caused damages and losses equivalent to nearly 5 percent of GDP per year since 1990. Small states could achieve stronger, more resilient growth by implementing reforms, including by streamlining trade procedures and increasing transport connectivity.
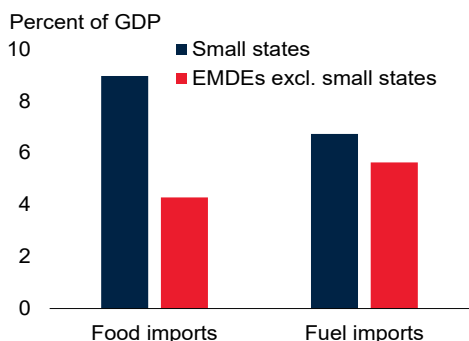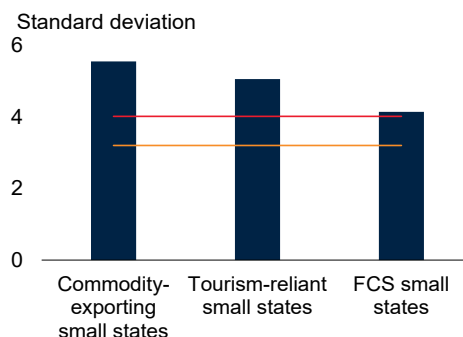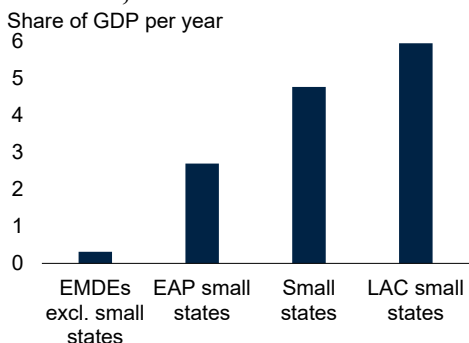
A. GDP compared to pre-pandemic levels

Percent difference from 2019 GDP
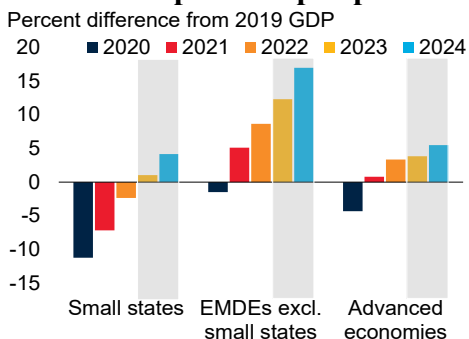
B. Inbound tourism expenditure

Percent of GDP
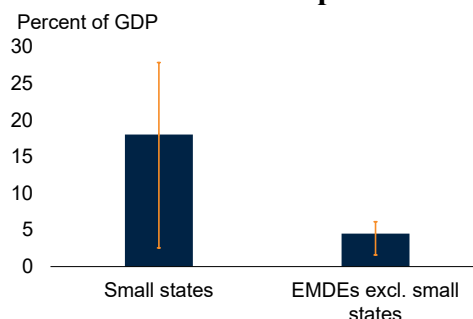
C. Food and fuel imports

Percent of GDP

D. Volatility of growth in small states, 2000-21

Standard deviation

E. Damages and losses from natural disasters, 1990-2021

Share of GDP per year

F. Trade connectivity and costs
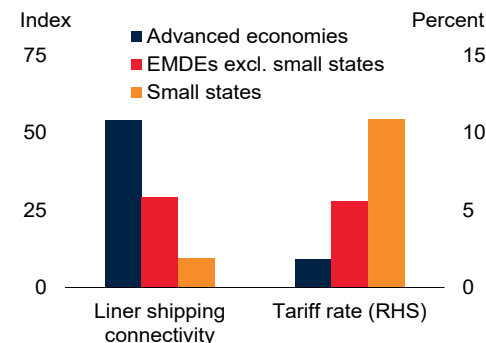
Sources: Comtrade; EM-DAT (database); UN World Tourism Organization; World Bank.
Note: EMDEs = emerging market and developing economies; EAP = East Asia and Pacific; RHS = right-hand side.
A. Growth rates are calculated using GDP weights at average 2010-19 prices and market exchange rates. Sample includes 34 EMDE small states, 115 EMDEs excluding small states, and 37 advanced economies. Guyana is excluded.
B. Bars show averages of indicated country groups. Vertical lines show interquartile ranges within groups. Data for 2019. Sample includes 22 EMDE small states and 81 EMDEs excluding small states.

C. Bars show simple averages. Data for 2019. Food imports sample includes 22 EMDE small states and 95 EMDEs excluding small states. Fuel imports sample includes 18 EMDE small states and 78 EMDEs excluding small states. Energy exporting EMDEs are excluded from the fuel imports sample.

D. Average of standard deviations of growth from 2000-21 for countries in each group. Sample contains 12 commodity-exporting, 22 tourism-reliant, and 6 FCS small states. Sample contains 113 EMDEs excluding small states. Extreme outliers are excluded.

E. Bars are calculated by summing the damages in each country in each year, dividing by nominal GDP, then weighting by nominal GDP.

F. Simple averages of countries in each group. Liner shipping connectivity is an index based on number of ships, their container-carrying capacity, maximum vessel size, number of services, and number of companies that deploy container ships in a country's ports. Data for 2020. Tariff rate is the weighted mean import tariff on all products. Data for 2018.