

# Financing for Development and Small Island Developing States: A Snapshot and Ways Forward

---

UNDP & UN-OHRLLS Discussion Paper

JUNE 2015



*Empowered lives.  
Resilient nations.*



## **Written by**

Gail Hurley, Policy Specialist on Development Finance  
Bureau for Policy and Programme Support (BPPS), UNDP  
Contact: [gail.hurley@undp.org](mailto:gail.hurley@undp.org)

## **Acknowledgements**

With sincere thanks to Amr Ragab and Kabira Namit for background research, and Yumn Almufarrej and Grace Wang for information on non-OECD DAC donors, especially Turkey, China and the Arab States. Thanks also to Pedro Conceição for valuable comments on an earlier version of the paper.

Thanks also to UN-OHRLS for comments on earlier drafts and for their financial support for the publication of this paper.

Disclaimer: The views presented in this paper are those of the author and do not necessarily represent the views of UNDP or UN-OHRLS

# Table of Contents

---

<b>1</b>	Executive Summary
<b>4</b>	Public Debt in Small Island Developing States
<b>20</b>	ODA and SIDS: A Snapshot
<b>29</b>	SIDS and Remittances
<b>30</b>	SIDS and Foreign Direct Investment
<b>34</b>	SIDS and Domestic Resource Mobilization
<b>37</b>	Possible Ways Forward
<b>44</b>	Selected References

## Small Island Developing States

### AIMS REGION\*

Cape Verde  
Comoros  
Guinea Bissau  
Maldives  
Mauritius  
São Tomé and Príncipe  
Seychelles  
Singapore

\* (Atlantic, Indian Ocean, Mediterranean,  
and South China Sea)

### CARIBBEAN REGION

Antigua and Barbuda  
Bahamas  
Barbados  
Belize  
Cuba  
Dominica  
Dominican Republic  
Grenada  
Guyana  
Haiti  
Jamaica  
Saint Kitts and Nevis  
Saint Lucia  
Saint Vincent and the Grenadines  
Suriname  
Trinidad and Tobago

### PACIFIC REGION

Cook Islands  
Fiji  
Kiribati  
Marshall Islands  
Federated States of Micronesia  
Nauru  
Niue  
Palau  
Papua New Guinea  
Samoa  
Solomon Islands  
Timor-Leste  
Tonga  
Tuvalu  
Vanuatu



Tonga

Credit: UN Photo

<sup>1</sup> AOSIS list (Alliance of Small Island States): <http://aosis.org/>

# Executive Summary

---

This paper provides a snapshot of development financing in small island developing States (SIDS). It aims to inform and reinvigorate international policy debates around how SIDS can finance – and meet – the world’s new sustainable development agenda, the SDGs (Sustainable Development Goals). This discussion is particularly timely in view of the Third International Conference on Financing for Development in Addis Ababa, Ethiopia in July 2015. The conference will define the financing framework for the new SDGs. A robust and inclusive outcome to this conference must necessarily recognize the special development challenges faced by SIDS, and include measures designed to support them to meet the SDGs.

This paper reviews recent key data on domestic and international financial flows, such as development and climate aid, foreign direct investment, remittances, tax revenues and savings. It also explores in detail some SIDS’ continued struggles to maintain debt sustainability. All SIDS regions, namely the Caribbean, Pacific, and Atlantic, Indian Ocean, Mediterranean and South China Sea (AIMS) countries are included in our evaluation.

SIDS are extremely mixed when it comes to human development. Some enjoy very high levels of human development such as Barbados and Singapore; others, such as Comoros, Guinea-Bissau and Haiti score poorly. When it comes to domestic and international financial flows, the picture is similarly mixed; some countries rely heavily on domestic and international capital markets (i.e. private finance) to meet fiscal deficits and fund development while others are heavily aid dependent. Some attract foreign direct investment while others do not.

Despite these differences, most share a number of key challenges when it comes to financing for development. These include limited capacities to mobilize domestic resources, high per capita costs when it comes to essential service provision and vulnerability to environmental and economic shocks. Climate adaptation costs are also among the highest in the world for SIDS when measured as a proportion of national output.

The paper finds that, overall, high levels of public debt remain a key challenge for many small island states, especially in the Caribbean. Current approaches, which have relied on SIDS to negotiate solutions with their creditors on an ad-hoc basis, combined with fiscal retrenchment have not, in many cases, been sufficient to adequately address the problem. Moreover, if debt instruments – public and private – expand in the future to help finance the SDGs, there is a risk this may further aggravate already fragile debt positions.

When it comes to development aid, the data shows that SIDS receive very little Official Development Assistance (ODA) as a share of total ODA, at just 5.7%. However when aid receipts are measured as a proportion of national income and on a per capita basis, they are larger recipients. Most aid flows are concentrated in the Pacific and some countries in the region are heavily aid dependent.

On the whole, SIDS have not been able to leverage as much climate and environmental aid as may have been expected, despite their vulnerability to climate change and other environmental shocks. This is due to factors such as limited capacities to apply for and manage climate finance (typically administered via complex funds), as well as unfulfilled donor commitments and a donor bias towards mitigation rather than

adaptation finance. As countries disproportionately exposed to shocks such as extreme weather events, the paper also reviews SIDS' record on accessing sources of international finance that aim to support countries to deal with the impact of shocks and emergencies.

SIDS have also, in many ways, been a success story; most are classified as middle-income. Paradoxically, this makes many ineligible for concessional finance (and a low aid priority for donors). This paper finds however, that many SIDS continue to experience severe structural constraints in their efforts to mobilize more domestic resources for development. Savings rates are also low when compared to other developing countries. Combined with high climate adaptation costs and infrastructure investment needs, these factors mean that international finance will be indispensable to SIDS. We find that while foreign direct investment (FDI) could be strengthened, it also has its limitations as a source of development finance due to its heavy concentration in particular countries and sectors, and its volatility and procyclicality.

The paper makes a series of recommendations which aim to tackle some of SIDS' major financing for development challenges. For instance, further work is needed to assess whether a Heavily Indebted SIDS Initiative and/or expanded use of debt-for-climate/debt-for-nature swaps could be useful in helping to restore debt sustainability in severely indebted countries. We also advocate for the piloting of innovative financial instruments designed to reduce risk and support effective debt management, such as GDP-indexed official sector loans and countercyclical loans. In the case of the former, debt repayments are tied to economic performance; in the latter, debt service is allowed to fall or become zero when a major economic shock occurs. Both instruments attempt, in different ways, to link debt service to ability to pay and could be useful to SIDS.

Finally, we make the case for revisiting eligibility criteria for concessional finance from multilateral and bilateral lenders. Specifically, we propose a basket of indicators be used to determine the most appropriate financial instruments and levels of concessionality for different countries. This basket includes: income per capita, vulnerability to shocks, capacity to mobilize domestic and international finance, level of debt, social indicators and type of programme being funded. More work is needed to operationalize this proposal but the approach could be extremely important to SIDS. All these measures need to be combined with efforts at the national level to strengthen revenue collection and debt management capacities as well as improve the quality of public expenditures.

Looking forward, the evolving development financing landscape presents considerable opportunities for small island developing States in the future. Opportunities include an expansion in environmental and climate focused international public finance, the emergence of new and innovative financial instruments and an expanded donor and lender pool. However SIDS' capacities to leverage these resources and use them effectively must be strengthened. Support will also be needed to help SIDS develop 'bankable' projects. Meanwhile SIDS' vulnerability to shocks is unlikely to diminish and progress (or not) in tackling climate change will profoundly impact their development trajectories. It is hoped that the Addis Ababa Financing for Development process can act as another 'call to action' in support of small island developing States.

**Table 1: SIDS are mostly middle-income and are highly environmentally vulnerable**

<b>Country (available data)</b>	<b>Income Category<sup>2</sup></b>	<b>GNI per capita (2013 PPP current USD)<sup>3</sup></b>	<b>Environmental vulnerability index<sup>4</sup></b>
Antigua & Barbuda	High-income: non-OECD	20,070	Vulnerable
Bahamas, The	High-income: non-OECD	21,540	At risk
Barbados	High-income: non-OECD	15,080	Extremely vulnerable
Belize	Lower-middle income	8,160	At risk
Cape Verde	Lower-middle income	6,220	Vulnerable
Comoros	Low-income	1,560	Vulnerable
Dominica	Upper-middle income	9,800	Extremely vulnerable
Dominican Republic	Upper-middle income	11,150	Highly vulnerable
Fiji	Lower-middle income	7,610	Highly vulnerable
Grenada	Upper-middle income	11,120	Highly vulnerable
Guinea-Bissau	Low-income	1,240	Vulnerable
Guyana	Lower-middle income	6,550	Resilient
Jamaica	Upper-middle income	8,480	Extremely vulnerable
Kiribati	Lower-middle income	2,780	Extremely vulnerable
Maldives	Lower-middle income	9,890	Extremely vulnerable
Marshall Islands	Lower-middle income	4,620	Highly vulnerable
Papua New Guinea	Lower-middle income	2,430	At risk
Samoa	Lower-middle income	4,840	Highly vulnerable
São Tomé and Príncipe	Lower-middle income	2,950	At risk
Seychelles	Upper-middle income	23,270	Highly vulnerable
Solomon Islands	Lower-middle income	1,810	Vulnerable
St. Kitts & Nevis	Upper-middle income	20,400	Highly vulnerable
St. Lucia	Upper-middle income	10,350	Extremely vulnerable
St. Vincent & Grenadines	Upper-middle income	10,610	Highly vulnerable
Timor-Leste	Lower-middle income	6,410	Not available
Tonga	Lower-middle income	5,450	Extremely vulnerable
Tuvalu	Upper-middle income	5,990	Extremely vulnerable
Vanuatu	Lower-middle income	2,840	Vulnerable

<sup>2</sup> Source: SIDS Statistics, UN-OHRLLS (2013) and World Bank

<sup>3</sup> Source: World Bank, World Development Indicators (2014)

<sup>4</sup> Source: UNEP, Environmental Vulnerability Index: [http://www.vulnerabilityindex.net/EVI\\_Results.html](http://www.vulnerabilityindex.net/EVI_Results.html)



# 1

## Public Debt in Small Island Developing States

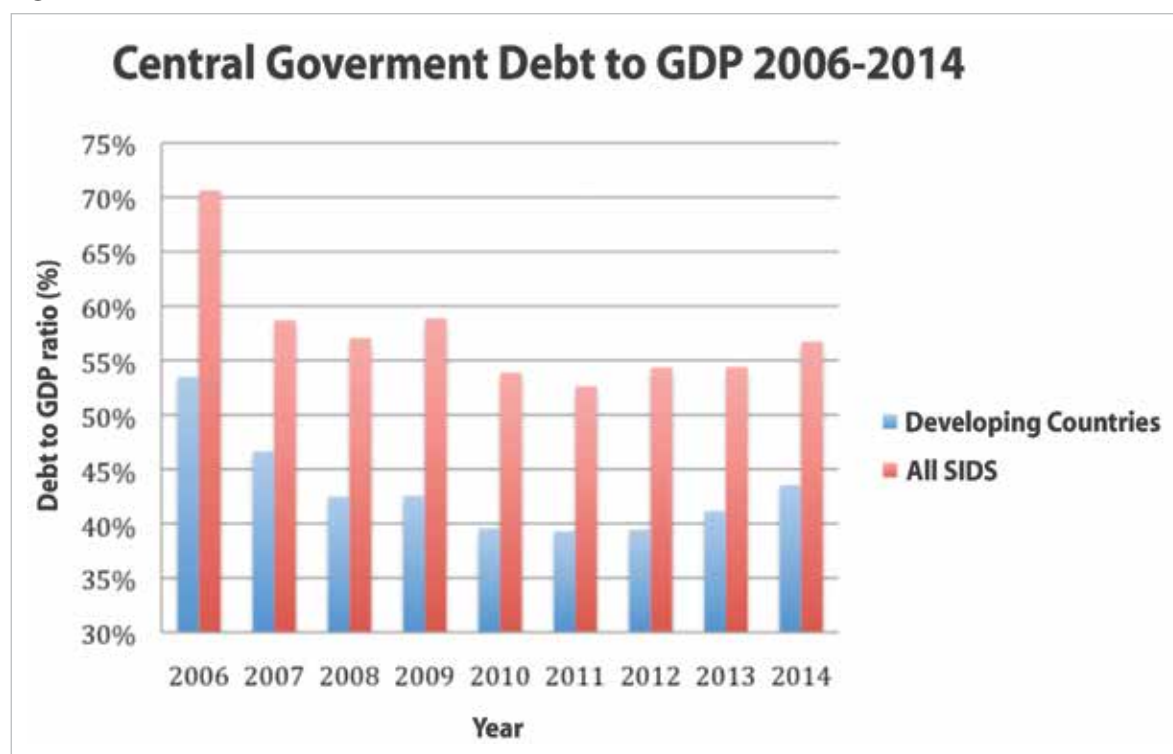
### 1.1 Debt in SIDS: a snapshot

Several small island developing States (SIDS) present special, and in some cases longstanding, debt sustainability challenges. High levels of debt are especially evident in the Caribbean. The problem is severe but is often overlooked, due in part to the higher per capita incomes enjoyed by many SIDS when compared to other developing nations. Income indicators mask, however, these countries' inherent fragility and vulnerability to a range of external shocks such as extreme weather events, climate change and terms of trade shocks.

SIDS are, on average, more severely indebted than other developing countries. In 2014, SIDS' debt to GDP ratios stood at, on average, 57% as compared to 44% in all other middle and low-income countries (see Figure 1). Following some small reductions in debt levels over recent years, debt ratios again began to climb from 2011. Over the last three years, debt levels in SIDS have risen by 4 percentage points.

The majority of this debt is *external* debt, although there are important differences between countries. In 2014, SIDS' *external debt* represented 45% of GDP.

Figure 1: Debt in SIDS



Source: IMF, World Economic Outlook 2015

<sup>5</sup> Developing countries included: 105. SIDS included: 29 (Belize, Cabo Verde, Comoros, Dominica, Dominican Republic, Fiji, Grenada, Guinea Bissau, Guyana, Haiti, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, Micronesia, Palau, Papua New Guinea, Samoa, São Tomé and Príncipe, Seychelles, Solomon Islands, St. Lucia, St. Vincent and the Grenadines, Suriname, Timor-Leste, Tonga, Tuvalu, Vanuatu)



The data hides wide variations between countries, however. In 2014, SIDS in the Caribbean were the most heavily indebted (at on average 73% of GDP) while SIDS in the Pacific had the lowest levels of debt (33%) (see Figure 2). Debt levels in the AIMS SIDS stood at on average 65% of GDP in 2014.

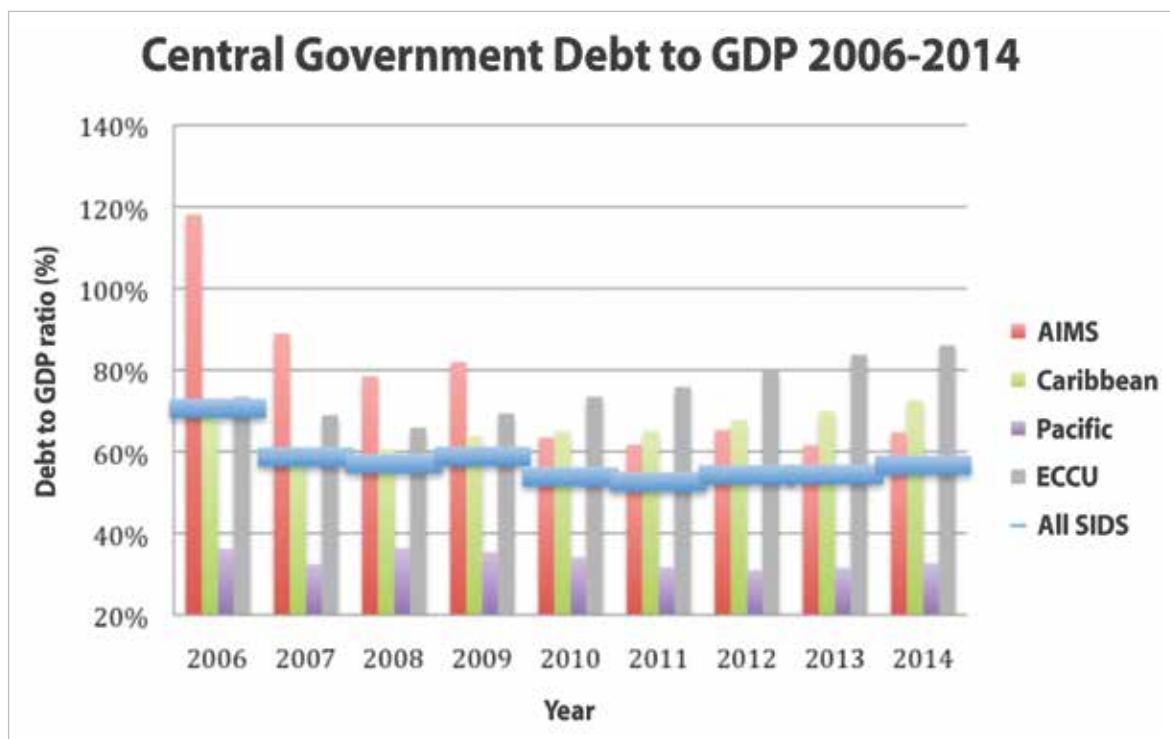
Within the Caribbean, the countries of the Eastern Caribbean Currency Union (ECCU) are more severely indebted again<sup>6</sup>. In 2014, these countries' average debt ratios stood at 86% of GDP. This is much higher than the target established for the region by the Eastern Caribbean Central Bank (ECCB) of 60% of GDP by 2020. Indeed none of the region's countries are predicted to reach this target by the deadline.

Elsewhere in the Caribbean, Jamaica's debt situation is also critical. In 2014, it had an estimated public debt to GDP ratio of 140%. Barbados comes in at an estimated 92%. Belize has also registered a consistently high public debt to GDP ratio over recent years. Several Caribbean countries have also restructured their debt, typically more than once (discussed later).

In the Pacific, debt ratios are overall much lower. However a growing number of these countries are considered at high risk of debt distress. Recent debt sustainability assessments undertaken by the IMF indicate that at least four Pacific countries – Kiribati, Samoa, Tonga and Tuvalu – are at a high risk of debt distress. Samoa's debt, for instance, has climbed from 42% of GDP in 2007 to 62% in 2013.

In the AIMS countries, debt ratios are above the average for developing countries as a whole. The Maldives has seen its public debt to GDP ratio climb considerably over recent years. Debt to GDP in São Tomé and Príncipe, meanwhile, rose from 60% in 2008 to 85% in 2013. High levels of debt have also been a problem in the Seychelles, and the country recently restructured its commercial and bilateral debt (discussed later).

**Figure 2: SIDS' debt levels vary by region**



\*Atlantic, Indian Ocean, Mediterranean, and South China Sea  
 Source: IMF, World Economic Outlook 2015

<sup>6</sup> These countries are: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

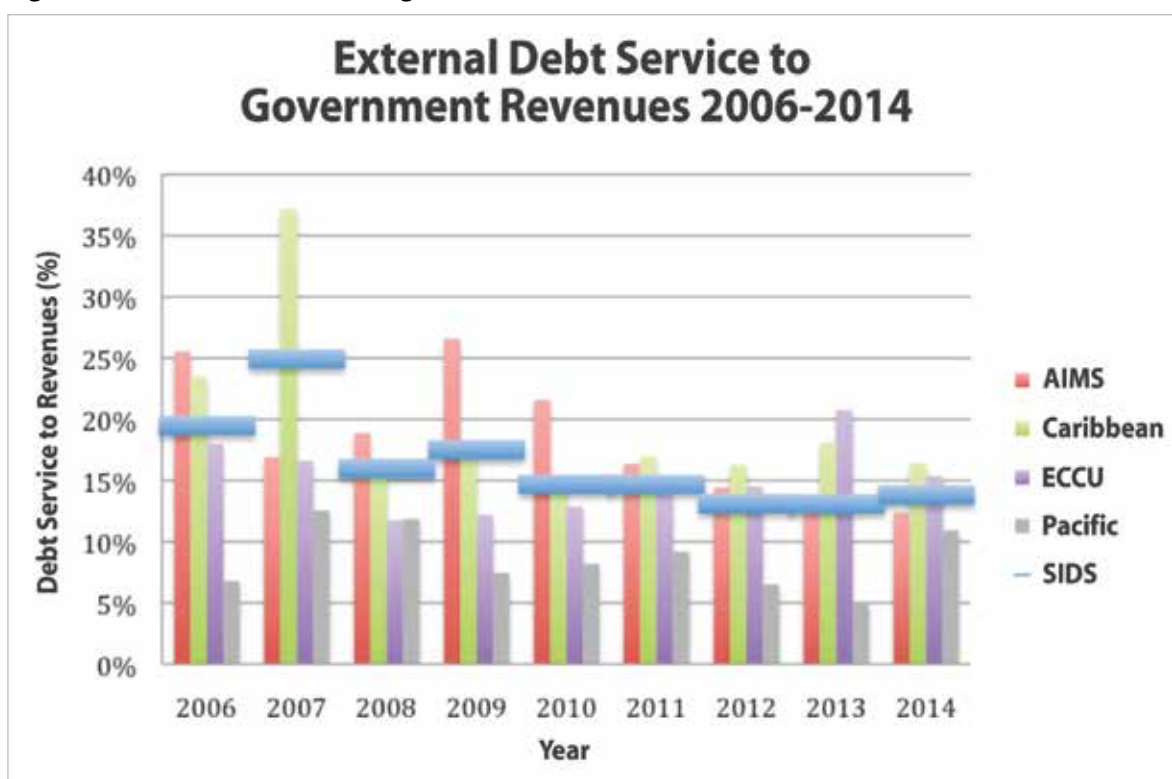
## 1.2 Debt service is high in many small islands

Debt service indicators are also high across several small island developing States. High levels of debt service can be problematic since they can constrain governments' abilities to invest in social and economic development.

For low-income countries, the IMF and World Bank recommend that total public debt service (domestic and external) should not exceed between 18 and 22% of government revenues, depending on the strength of countries' policies and institutions<sup>7</sup>. This threshold can also serve as a useful benchmark for small islands due to these countries' structural vulnerabilities and high socio-economic and environmental development challenges.

Debt service data is patchy and also varies widely across countries. However several countries exceed – or have exceeded in recent years – the 18% threshold, some by a significant margin. In the Caribbean, for example, Belize, Dominica, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines have all allocated more than 18% of government revenues to public debt service over recent years. Elsewhere, the Seychelles, Maldives and Papua New Guinea have also had debt service to revenue ratios higher than 18% over the last few years. In Jamaica, the situation is especially critical; in 2009, interest repayments alone reached an unprecedented 65.1% of government tax revenues.

**Figure 3: External debt service to government revenues<sup>8</sup>**



Source: IMF World Economic Outlook 2015

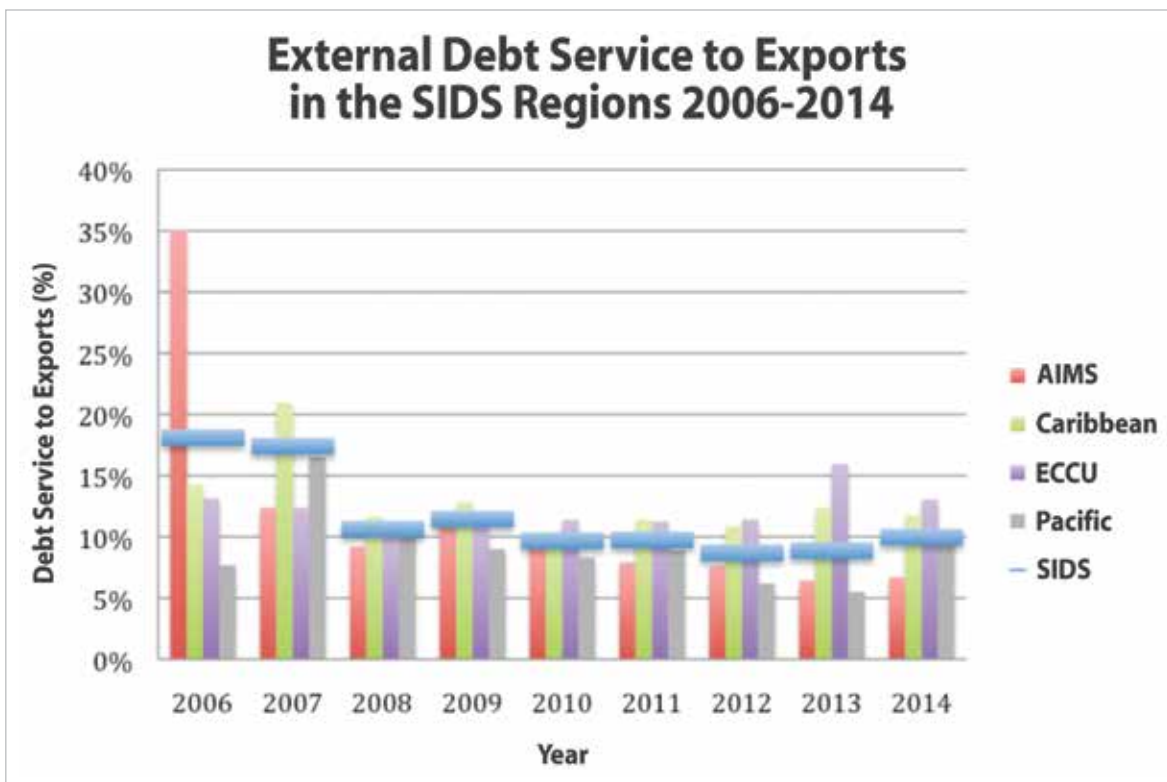
<sup>7</sup> For further elaboration, see: The Joint World Bank–IMF Debt Sustainability Framework for Low-Income Countries': <https://www.imf.org/external/np/exr/facts/jdsf.htm>

<sup>8</sup> External debt service only. Comprehensive data on domestic debt service as a percent of government revenues was not available.

The ratio of *external* debt service to exports (goods and services) is also an important indicator of countries' debt sustainability challenges. This ratio is important since in order to service external debt (typically denominated in hard currencies), countries must earn foreign exchange. The largest source of foreign exchange is usually a country's exports. This means that the larger a country's external debt service burden, the more it must earn via exports, including tourism, to cover those debt service repayments.

The IMF and World Bank's debt sustainability framework for low-income countries sets the threshold for sustainable external debt service at between 15 and 25% of exports, depending on the strength of countries' policies and institutions<sup>9</sup>. SIDS often have a narrow export base and are vulnerable to external shocks, such as terms of trade shocks. These ratios can therefore serve a useful guide for small islands, despite higher per capita income levels in many.

**Figure 4: External debt service to exports**



The data shows that for SIDS as a whole external debt service represents 10% of all annual export revenues, on average. This hides wide variations between countries however. The highest external debt service burdens are in the Caribbean SIDS where debt service represented on average 12% of export revenues in 2014. External debt service is even higher in the ECCU countries (13%). Debt service in the AIMS countries has been reduced over recent years due to several debt relief and restructuring operations (discussed later).

<sup>9</sup> Ibid.

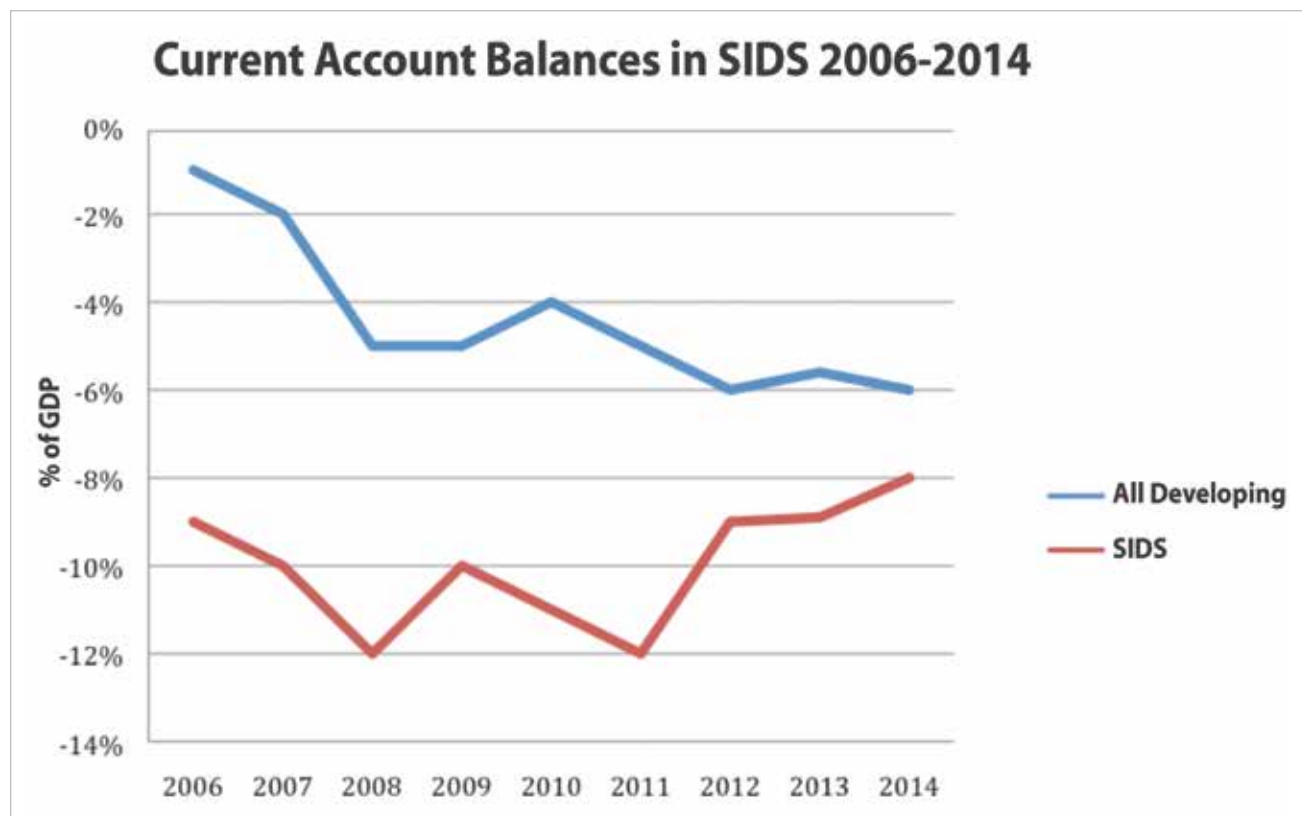
### 1.3 Current account and fiscal balances

Current account deficits are common in developing countries, but SIDS in particular have larger than average current account deficits (see Figure 5). In 2014, SIDS ran current account deficits of, on average, 8% of GDP as compared to 6% for developing countries as a whole. This figure has also been significantly higher over recent years at 12% of GDP in 2008 and 2012. The picture is different across the regions (see Figure 6). Current account deficits are particularly acute in the ECCU group of countries where it has averaged over 20% of GDP in recent years. Persistent current account deficits translate into increased external financing needs, which has in turn been filled by recourse to external debt.

When it comes to SIDS' fiscal positions, the picture varies (see Figure 7). Many AIMS and Pacific countries have improved their fiscal position over the past three years. The same cannot be said about SIDS in the Caribbean where fiscal deficits now average 4% of GDP. Again, fiscal deficits are higher in ECCU countries at, on average, 5% of GDP in 2014.

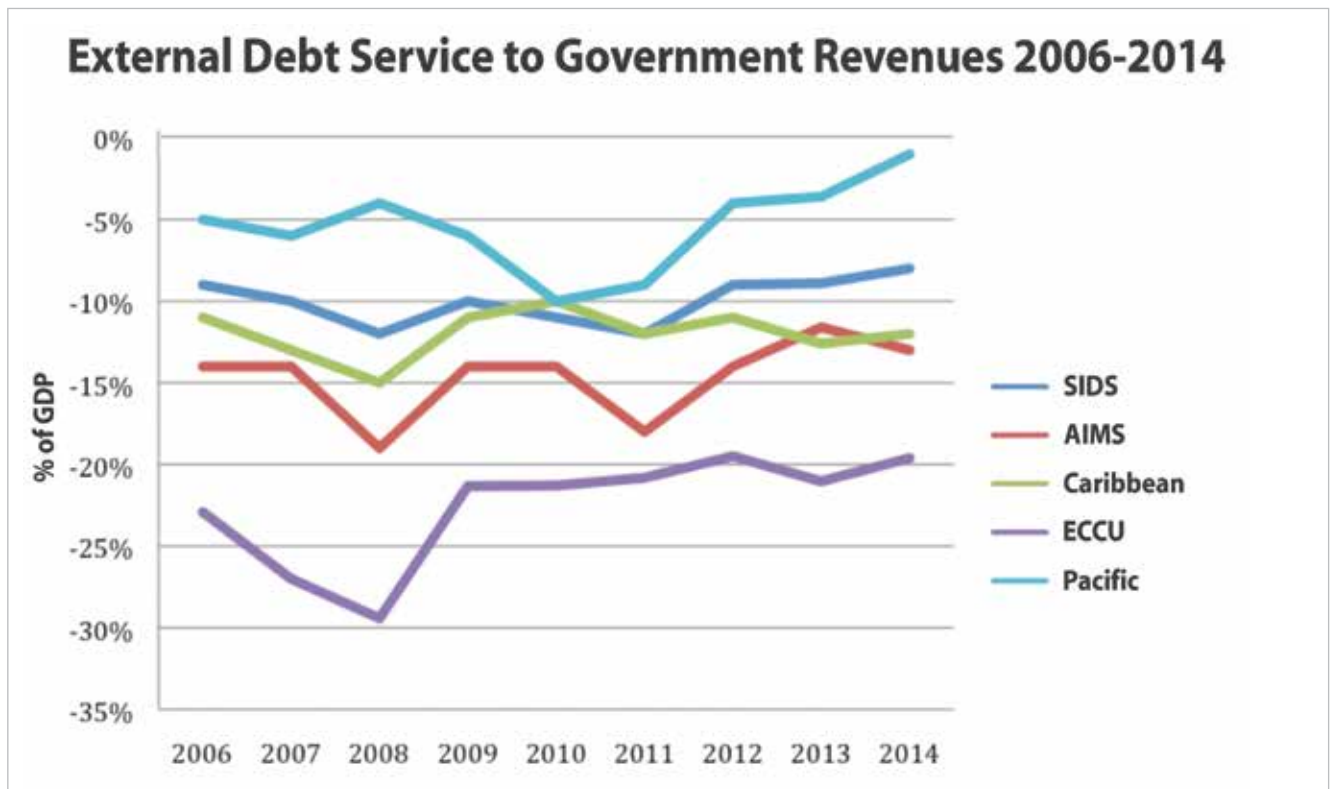
Reserves in SIDS are also low when compared to other developing countries (see Figure 8). As of 2013, SIDS had, on average, reserves covering 3.8 months of imports compared to 5.4 months in all other developing countries.

**Figure 5: Current account balance in SIDS**



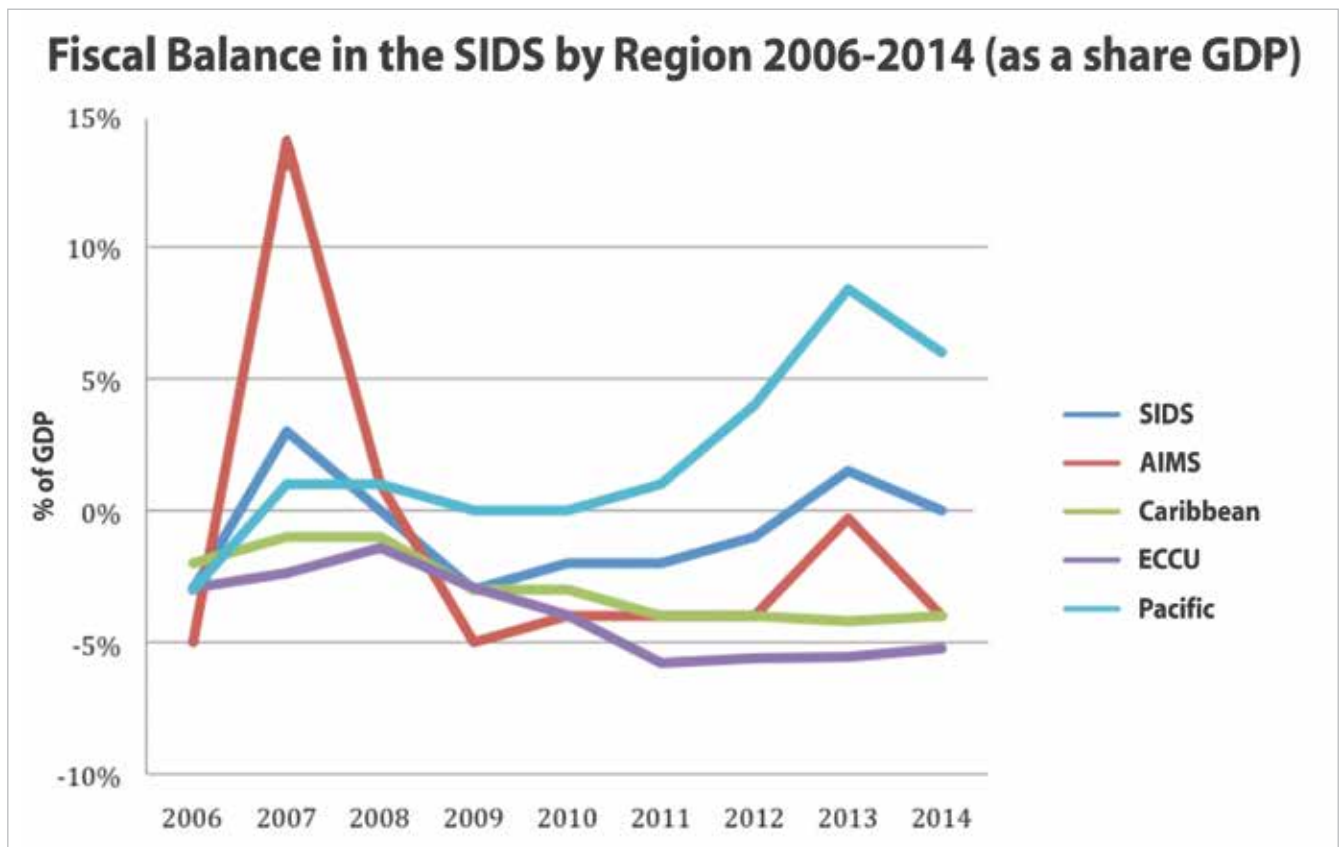
Source: IMF World Economic Outlook 2015

Figure 6: Current account balance in SIDS by region



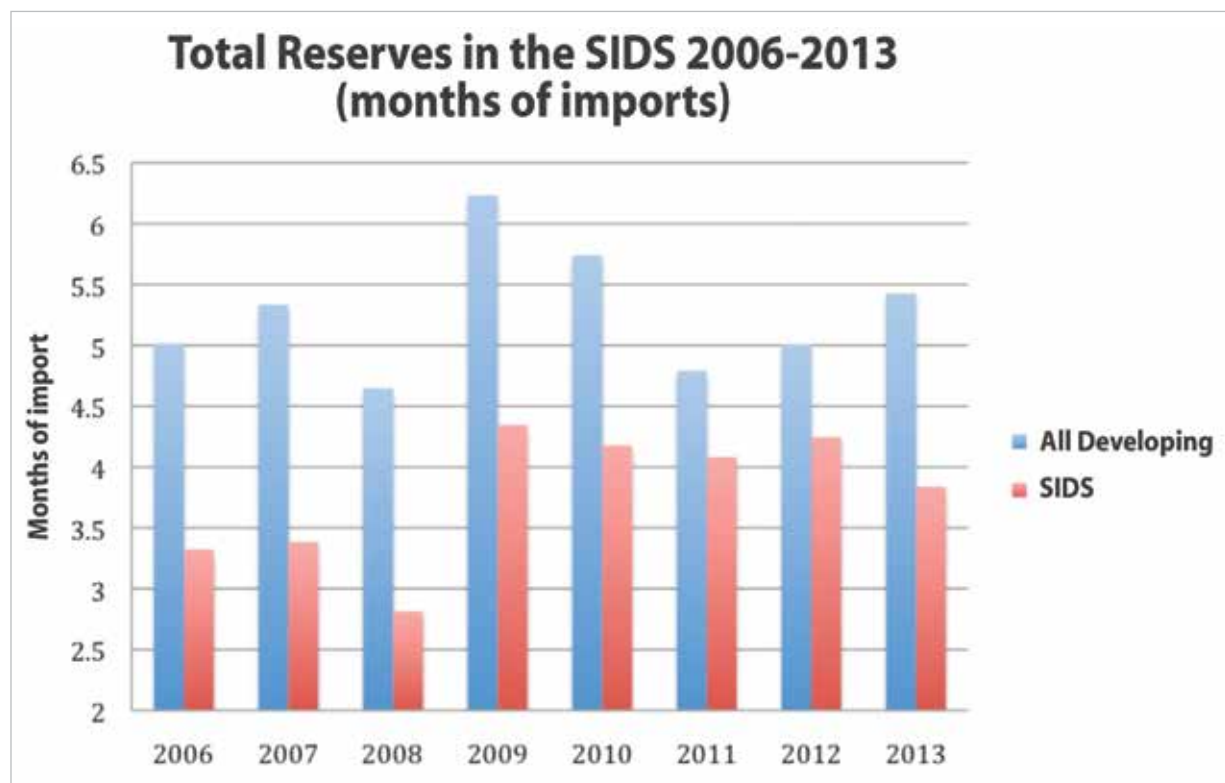
Source: IMF World Economic Outlook 2015

Figure 7: Fiscal balances in SIDS by region



Source: IMF World Economic Outlook 2015

**Figure 8: Reserves in SIDS**



Source: World Bank, World Development Indicators 2015

## 1.4 The lenders

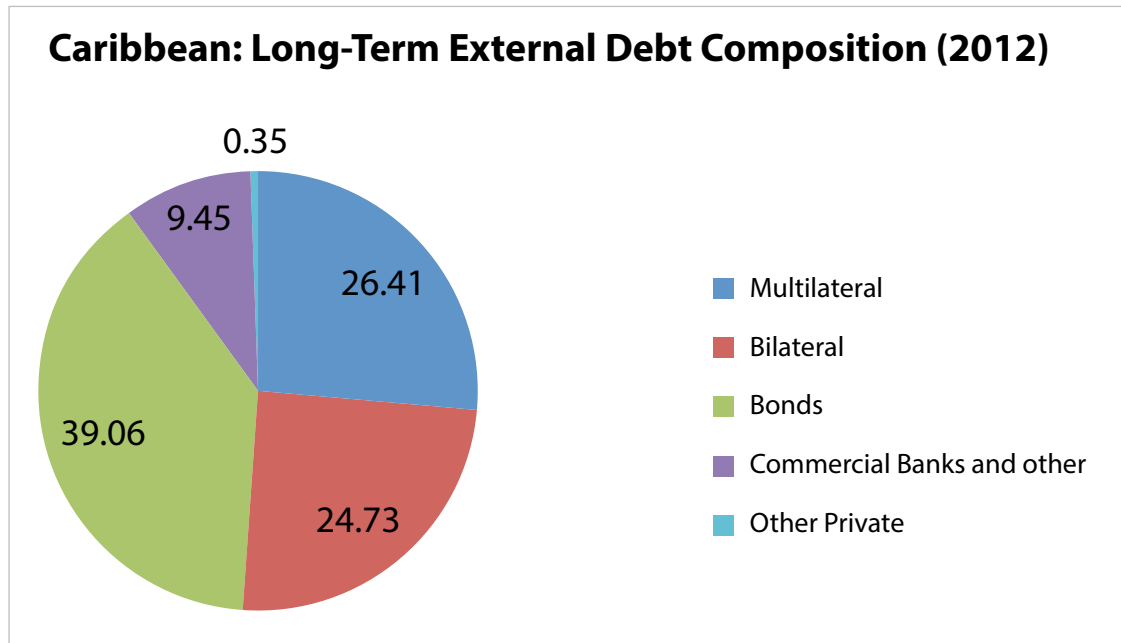
Who are the major lenders? And on what terms and conditions is the debt owed? The balance between private and official, concessional and non-concessional, short and long-term debt also influences debt sustainability.

For example, the dynamics of debt owed to private creditors – domestic and external – is very different to that owed to official bilateral and multilateral creditors (in particular where finance is extended on concessional terms). Private debt is often highly volatile, procyclical and subject to abrupt changes due to perceptions of risk by lenders, exchange rate fluctuations and broader conditions in global capital markets. Maturities can sometimes be very short. Consequently, countries which rely more heavily on capital markets to meet fiscal deficits and fund development are more vulnerable to sharp and unforeseen interruptions in their access to finance, changes in the cost of that finance and the rapid exit of capital which in turn poses risks of debt default and economic contraction.

SIDS' major creditors vary across different countries. It is important to note that they continue to evolve. For instance, the emergence of new creditor countries and/or the deepening of domestic debt markets is having an impact on the composition of public debt in many SIDS.

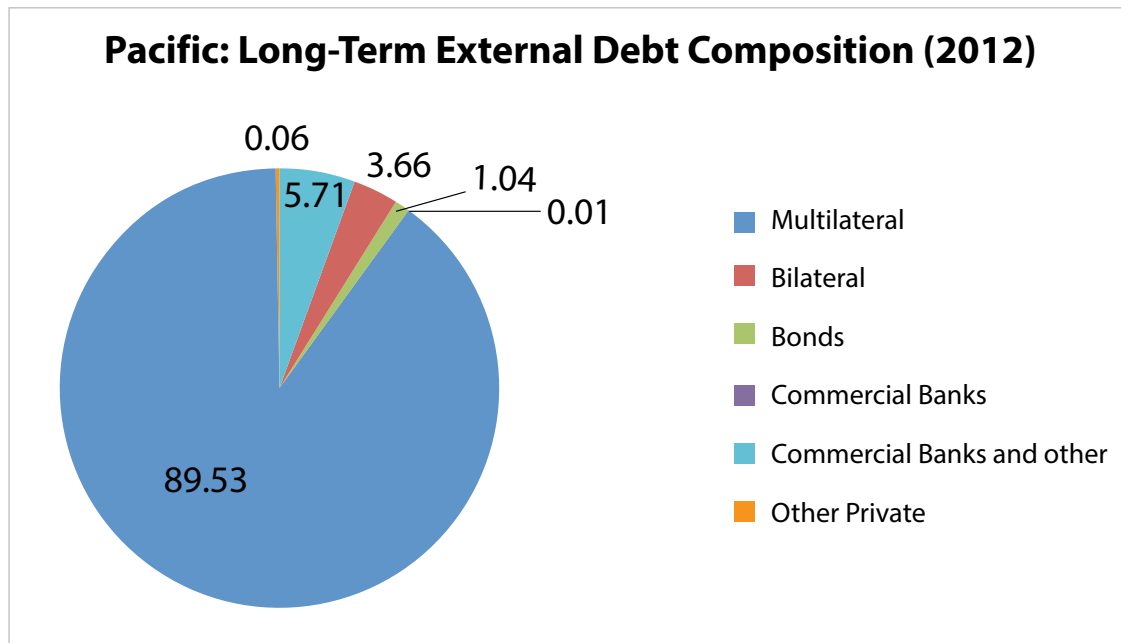
In the Caribbean, several countries owe significant debt to private creditors, domestic and international (although there are important differences between countries). The use of external bond finance is particularly prevalent. In the Pacific, multilateral lenders are the major creditors, in part, because the region is an important beneficiary of bilateral grant assistance (discussed later). More recently however, several Pacific countries have taken-on new debt from bilateral partners such as China. These loans are not always reflected in the data. For the AIMS SIDS, the picture is mixed.

Figure 9: The Caribbean's external creditors



Source: World Bank, International Debt Statistics, 2014

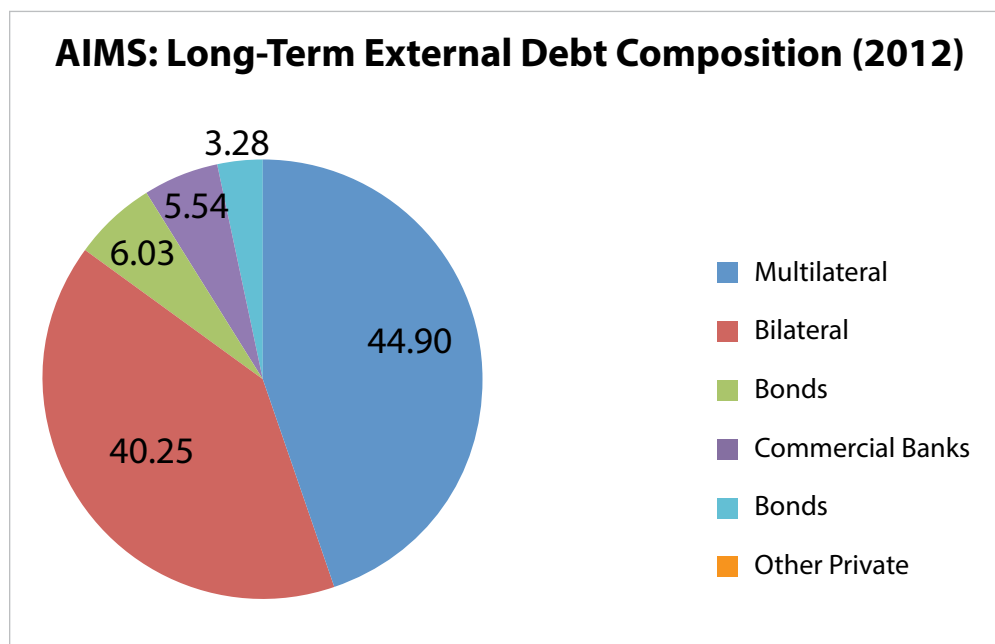
Figure 10: The Pacific islands' external creditors



Source: World Bank, International Debt Statistics, 2014



Figure 11: AIMS' external creditors



Source: World Bank, International Debt Statistics, 2014

For the Caribbean, the predominance of private debt means that most of it is on non-concessional terms which imposes a heavier debt service burden on the country. And indeed, countries such as Belize, Jamaica and the Seychelles, which all hold primarily non-concessional debt, have all needed to restructure their debt – in some cases more than once (discussed later).

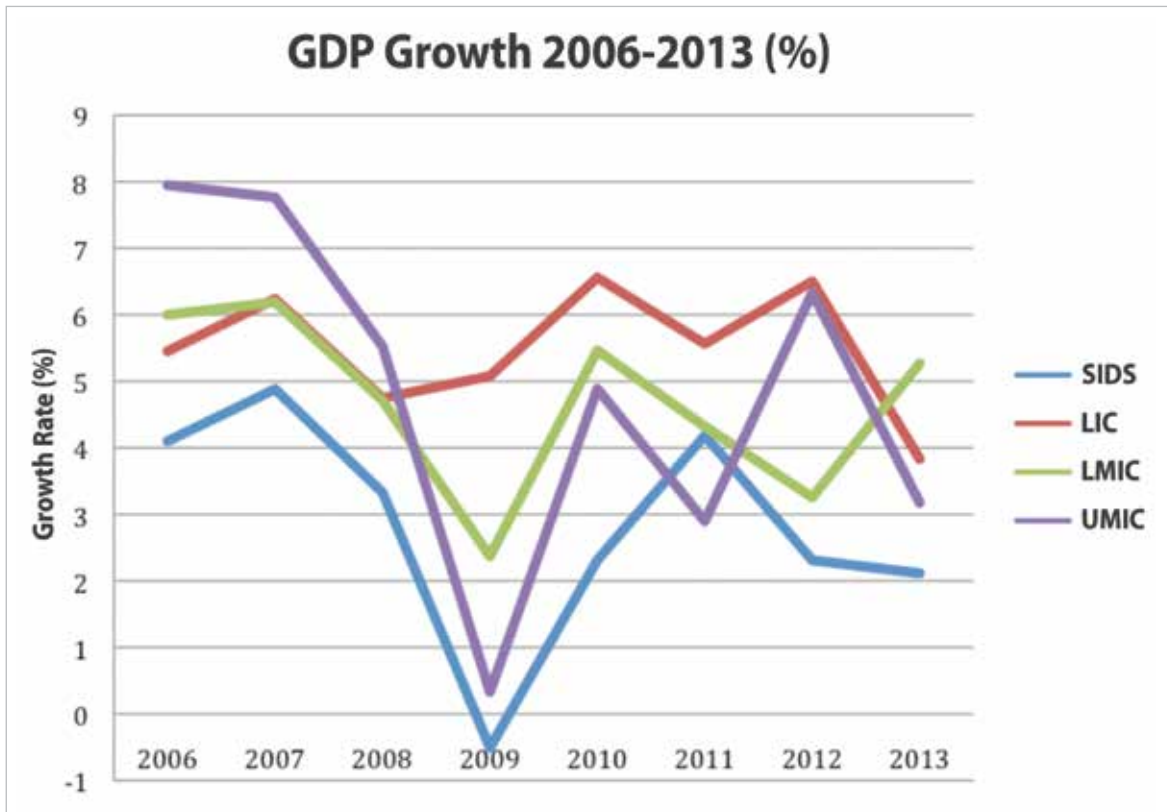
## 1.5 SIDS and economic growth

There are multiple factors which explain higher levels of debt in many small island economies relative to other developing countries. These include vulnerability to shocks such as extreme weather events and terms of trade shocks, as well as weaker revenue bases and poor institutional and debt management capacities. For example, SIDS were more heavily impacted by the 2007/2008 concurrent food-fuel-financial crises – and have been slower to recover – than many other developing countries. In 2009, SIDS' economies shrank by 0.5%. In the Caribbean, the decline was even more severe with the tourism-intensive economies more severely affected than the commodities exporters. While commodity prices mostly recovered in the two years after the crisis, the tourism sector is still struggling with slow global economic growth.

Robust and sustained economic growth is vital to reduce public debt levels. Yet economic growth across many small island developing States has been slow and volatile when compared to other developing and emerging economies. In 2013 for example, SIDS on average grew at 2.1%, while all other developing countries grew at nearly double the rate (4.1%) (see Figure 12).

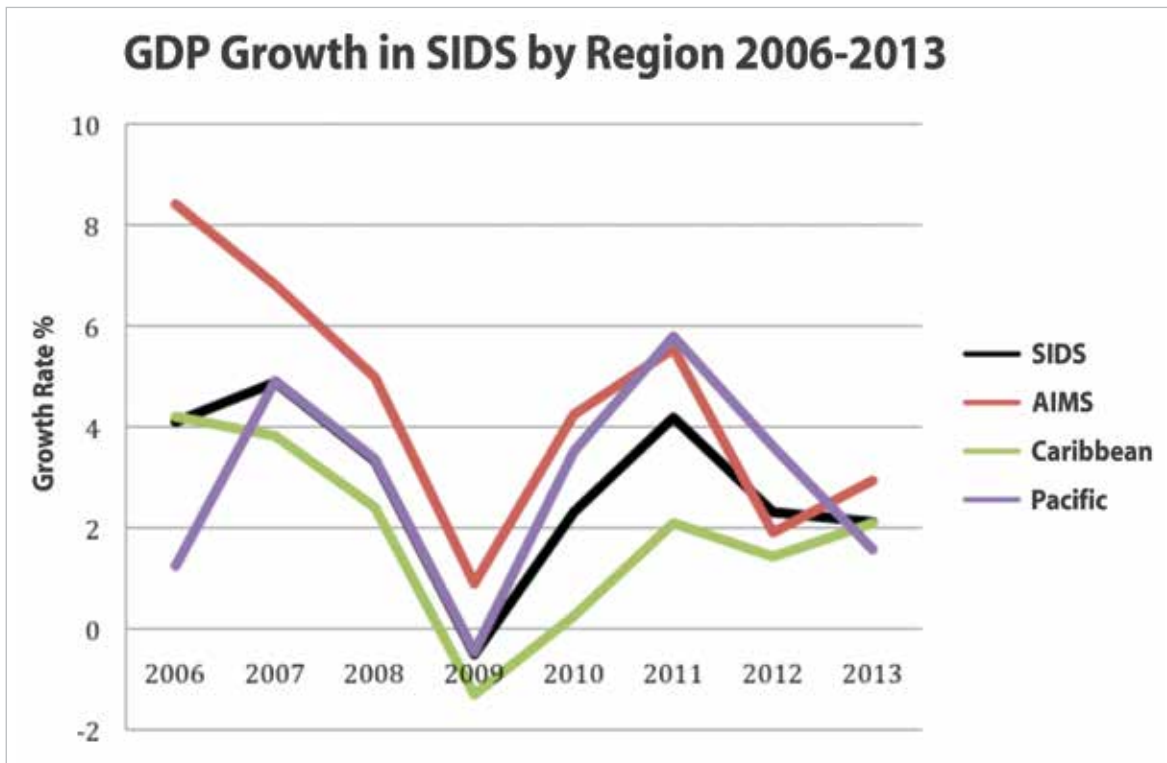
Among SIDS regions, the Caribbean region has the worst record of economic growth while SIDS in the AIMS region had the best record of economic growth during the period under study. Growth in the Pacific is also weaker and highly volatile. In 2013, Pacific SIDS grew, on average, by just 1.5%, AIMS SIDS by almost 3% and Caribbean countries by 2%.

**Figure 12: SIDS' economic growth record is poor next to other developing countries**



Source: World Bank, World Development Indicators 2015

**Figure 13: SIDS' economic growth performance by region**



Source: World Bank, World Development Indicators 2015

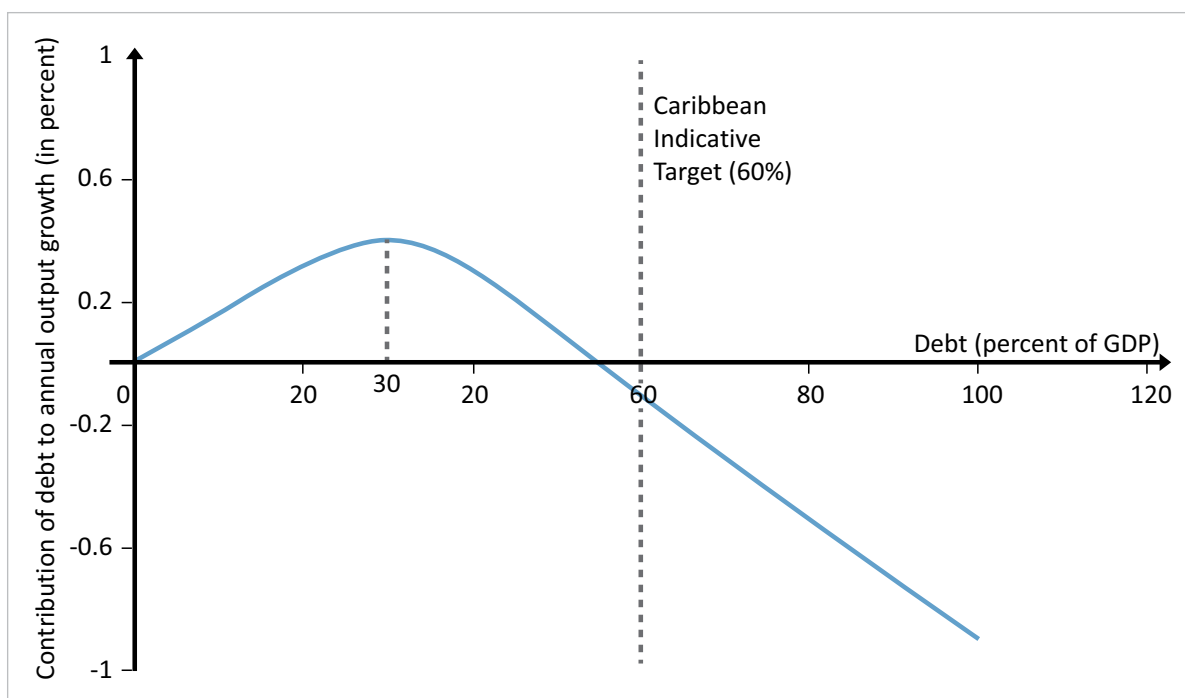
Slow and volatile economic growth rates mean that it is highly unlikely, at least in several cases, that countries will simply ‘grow out’ of high public indebtedness levels. Debt accumulation was particularly rapid between 2008 and 2011, due in large part to the impacts of the recent financial crisis. In the Caribbean, the debt to GDP ratio increased by, on average, 12.7 percentage points over this period. Natural disasters have also contributed significantly to lower growth rates and higher debt in several countries. As an immediate response to natural disasters, governments usually increase spending to aid recovery, rehabilitation and reconstruction.

For example, Dominica’s 2003 debt restructuring was to some extent prompted by the severe imbalances in the external and fiscal accounts after Hurricane Iris, while Grenada’s 2005 debt restructuring was primarily a result of the devastating effect of Hurricane Ivan.

The Pacific region carries similar vulnerability to natural disasters and climate change, and has also experienced significant economic losses. The 2004 Indian Ocean tsunami – which devastated nine countries around the world – also contributed to large unplanned expenditures (and a significant increase in public debt) in the Maldives.

There is considerable divergence of opinion over the level at which public debt acts as a major drag on economic growth performance. One IMF Working Paper has suggested that, for the Caribbean, a debt/GDP ratio exceeding 55% is likely to slow down growth. It argues that the region has a lower threshold for debt than other developing regions due to these economies’ inherent fragilities and vulnerabilities<sup>10</sup>. This means that a key issue looking forward will be how to make economic growth more dynamic and robust in small island developing States.

**Figure 14: Higher debt can act as a drag on economic growth**



Source: IMF, 2013

<sup>10</sup> At debt levels lower than 30% of GDP, increases in the debt to GDP ratio are associated with faster economic growth. But the positive effect on growth diminishes rapidly as debt rises beyond 30% of GDP, and beyond 55% of GDP debt becomes a drag on growth. See: IMF (2012) Caribbean Small States: Challenges of High Debt and Low Growth: <https://www.imf.org/external/np/pp/eng/2013/022013b.pdf>

## 1.6 Debt relief and debt restructuring in small island developing States

Debt restructuring is common amongst SIDS and many have restructured portions of their debt – domestic and/or external – more than once. Indeed UNDP has identified at least 57 debt restructuring operations in 17 SIDS over the last 40 years (see table 2). This suggests that the problem is not one of ‘isolated’ or ‘exceptional’ cases but is much more deep-rooted and systemic.

**Table 2: The frequency of debt restructuring in small island developing States**

Country	Multilateral debt	Bilateral debt	Private external debt	Private domestic debt
Antigua and Barbuda		2010	2008	
Belize			2013	2007
Comoros	At decision point under the HIPC Initiative: interim relief provided	2009, 2010		
Dominica			2004	
Dominican Republic		1985, 1991, 2004, 2005	2005	
Grenada		2006	2005, 2013, 2015	
Guinea-Bissau	At decision point under the HIPC Initiative: interim relief provided	1987, 1989, 1995, 2001, 2010, 2011		
Guyana	Received full multilateral debt relief under the HIPC Initiative and MDRI	1989, 1990, 1993, 1996, 1999, 2004		
Haiti	Received full multilateral debt relief under the HIPC Initiative and MDRI	1995, 2006, 2009		
Jamaica		1984, 1985, 1987, 1988, 1990, 1991, 1993		2010, 2013
São Tomé and Príncipe	Received full multilateral debt relief under the HIPC Initiative and MDRI	2000, 2005, 2007		
Seychelles		2009, 2015	2010	
Solomon Islands			2010	
St. Kitts and Nevis		2012	2012	
St. Vincent and the Grenadines		2007		
Suriname		2009		
Trinidad and Tobago		1989, 1990		

Source: Author’s elaboration based on UNDP, World Bank, IMF, Paris Club and Ministries of Finance

For the most part, SIDS were not included in international debt relief initiatives such as the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). These initiatives aimed to address the multilateral and bilateral debt burdens of some of the world’s poorest and most severely indebted countries<sup>11</sup>.

<sup>11</sup> For more information on the HIPC Initiative, see: <https://www.imf.org/external/np/exr/facts/hipc.htm>

Only five SIDS were eligible for these schemes – Comoros, Haiti, Guinea-Bissau, Guyana and São Tomé and Príncipe; all others were considered too wealthy despite, in many cases, severe public debt levels at the time the initiative was drawn up (mid-1990s).

For the SIDS which did benefit from the HIPC and MDRI schemes, debt levels were reduced significantly (see table 3). Although there were some controversies surrounding the HIPC Initiative and its implementation (in part due to the conditionality requirements associated with the scheme), comprehensive debt relief did help beneficiary countries to reduce their debts to more manageable levels.

Most importantly, it supported improved economic growth as well as helped countries to increase poverty reduction expenditures in the years which followed debt relief (see table 4). In some cases, debt levels have begun to quickly rise again, notably in Guinea-Bissau, Guyana and São Tomé and Príncipe. This shows that debt relief, while sometimes necessary, is often not sufficient by itself to restore long-term debt sustainability and needs to be combined with other policy measures, such as fiscal reforms and improved debt management capacities at the national level.

**Table 3: HIPC and MDRI helped some SIDS to reduce their debt**

	Government Debt (% of GDP) Before/After HIPC Initiative						
	-3	-2	-1	Year of Completion	1	2	3
<b>Comoros</b>	53.5	50.3	46.1	<b>42.5</b>	19.0	*18.3	*16.9
<b>Guinea-Bissau</b>	178.5	167.5	157.8	<b>53.9</b>	49.7	58.5	60.9
<b>Guyana</b>	120.1	129.6	133.7	<b>121.2</b>	118.6	116.0	94.1
<b>Haiti</b>	58.9	34.7	38.2	<b>28.0</b>	17.5	11.9	16.3
<b>São Tomé and Príncipe</b>	327.8	300.2	265.9	<b>104.0</b>	60	69.2	78.1

\*Projections

Source: IMF, 2013

**Table 4: HIPC and MDRI helped beneficiary countries increase poverty reduction expenditures**

	Poverty Reduction Expenditure (% of GDP)				
	-3	-2	-1	Year of Completion	1
<b>Comoros</b>					
In USD Millions	41.6		39.4	37.8	53.6
% of GDP	7.8		7.4	6.6	9.2
<b>Guinea-Bissau</b>					
In USD Millions	33.4		30	33.2	42.9
% of GDP	3.8		3.6	3.6	5.1
<b>Guyana</b>					
In USD Millions	144.3		151	159.5	157.2
% of GDP	12.8		13	13.4	12.6
<b>Haiti</b>					
In USD Millions	166.6		240.3	237.3	325.4
% of GDP	2.5		3.7	3.2	4.1
<b>São Tomé and Príncipe</b>					
In USD Millions	14.4		15.8	19.4	22.3
% of GDP	11.7		11.7	13.4	12.2

\*Blue box denotes start of HIPC

Source: IMF, 2013

For all other SIDS, debt restructuring has been negotiated with individual creditors – or groups of creditors – on an ad-hoc basis.

Bilateral debts owed to countries that are members of the Paris Club have, for the most part, simply been rescheduled rather than reduced<sup>12</sup>. Typically, Paris Club creditors have offered to extend debt maturities over 12 years with a five year grace period. A lowering of interest rates can also be negotiated with Paris Club creditors on a bilateral basis.

So far, only the Seychelles has benefited from a 50% principal reduction in debts owed to the Paris Club. It is the only small island that has had its public debt to GDP ratio drop as a result of Paris Club debt relief (and it should be noted that the Seychelles is classified as an upper middle-income country).

The Paris Club forum has historically represented a useful, if imperfect, forum in which debtor countries could renegotiate their bilateral debt 'en masse' with some of their most important government creditors. However as the creditor landscape becomes increasingly diverse, Paris Club members now hold an increasingly smaller share of SIDS' – and other developing countries' – debt. This means that informal renegotiation structures, such as the Paris Club, may now be less useful than in earlier years.

Moreover, one of the main difficulties has been that, for many SIDS, debt problems are mostly connected to private debt, not official sector debt (the HIPC Initiative and the Paris Club address only officially-held debt).

In order to restructure private debt, debtor countries are obliged to approach private lenders on an ad-hoc basis to negotiate a solution. In practice, this can be a complex, lengthy and arduous process since many countries have a large and diverse set of commercial creditors. This can stretch the capacities of small countries' administrations. In contrast, creditors (and creditor committees) are often well-resourced. Moreover, often SIDS will sometimes share the same *external* creditors, which means that if one debtor country recently renegotiated its debt with its commercial creditors, those same creditors may have little appetite for further renegotiations (or capacities to absorb large losses).

The introduction of collective action clauses (CACs) to bond contracts (mostly since 2003) has, in some cases, facilitated negotiations with external bond holders; a collective action clause allows a supermajority of bondholders to agree to a debt restructuring that is legally binding on all holders of the bond, even those who vote against the restructuring. However not all countries have used collective action clauses in their external bond contracts and such instruments have only been in use more recently so earlier debts are not covered.

These complexities illustrate why different small islands have secured such radically different outcomes when they have restructured their private debt portfolios. As shown in tables 5 and 6, which compare the outcomes of a range of recent debt restructuring operations, the relative level of indebtedness (as measured by stock and flow indicators) as well as the relative wealth of the country do not appear to be the most important factors when it comes to determining how much debt needs to be written down.

The data also shows that countries which opted to simply lengthen maturities and lower interest rates, rather than attempt any 'haircut' to the face value of the debt often found themselves in repayment difficulties again further down the line (e.g. Belize, Grenada and Jamaica). This strategy may help to expand fiscal space in the short-term (which is useful), but does not resolve the problem of large debt overhangs.

<sup>12</sup> The creditor countries that are members of the Paris Club are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom, and United States of America. For more information on the Paris Club, see: <http://www.clubdeparis.org/>

**Table 5: Debt profiles in comparative analysis**

Country	GNI per capita (USD)*	Year	Debt/GDP	Interest Payment/Revenues
Seychelles	18,550	2009	150	25
Jamaica	7,810	2009/2010	139	35
Greece	27,590	2010	144	16

\*GNI per capita (PPP) at the year of the debt restructuring

Source: Author's elaboration based on IMF and Ministries of Finance (2013)

**Table 6: Recent debt restructurings in comparative analysis**

Country	Year of the restructuring	Cut in face value of the debt
Argentina	2002	43.4%
Grenada	2004	0.0%
Belize	2006 and 2012	0.0% and 10.0%
Seychelles	2009	50.0%
St. Kitts and Nevis	2011	31.8%
Greece	2011	53.5%
Jamaica	2010 and 2013	0.0% and 0.0%

Source: Author's elaboration based on IMF and Ministries of Finance (2013)

Finally, multilateral debts (e.g. those credits owed to the World Bank, Inter-American Development Bank, Caribbean Development Bank, Asian Development Bank etc.) have neither been rescheduled nor cancelled for all non-HIPC SIDS. Yet for some SIDS, in particular in the Pacific, multilateral lenders are the most important creditors. Given that several countries in the Pacific are deemed at high-risk of debt distress in the future, it will be important to think about how to resolve possible future multilateral debt problems in an efficient and fair manner.

In sum, when it comes to debt restructuring operations, there are no fixed rules. There is currently little predictability or fairness – either for debtors or creditors – in the outcomes of ad hoc debt restructuring negotiations. The case of high public debt in many SIDS illustrates the need for strengthened approaches to sovereign debt restructuring as a core objective of the post-2015 financing for development discussions.

In the concluding section of this paper, we evaluate the desirability of some form of international debt relief initiative for SIDS, as well as the potential of innovative financial instruments designed to reduce risk.

## 1.7 Debt swaps and debt buy-backs

Several SIDS have instead used debt swaps or debt buy-backs in an effort to address indebtedness problems. These have been used to retire private and bilateral debt. In SIDS, so-called 'debt-for-nature' swaps have been the preferred option; in other developing countries, debt-for-education or debt-for-health swaps have been more widely used.



Debt-for-nature swaps typically involve an agreement between a lender (or lenders), the borrower and a conservation organization to reduce some of the borrowing country's debt in exchange for support of a specific environmental project.

SIDS which have benefited from debt-for-nature swaps include Antigua and Barbuda, Belize, Jamaica and more recently the Seychelles. In 2005, Antigua and Barbuda also engaged in a debt buy-back operation with commercial creditors which lowered its external debt by around US\$500 million. In 2015, the Seychelles, working with the Nature Conservancy secured a debt swap deal with its Paris Club creditors and South Africa. Under the debt swap, the Seychelles will redirect a portion of current debt payments from external creditors to fund conservation activities including the creation of new marine protected areas (the second largest in the Indian Ocean)<sup>13</sup>.

So far, such instruments have not been as widely used as they could be. There is significant potential to expand such initiatives as part of the post-2015 financing for development strategy (building on lessons learned from previous experiences). The pros and cons, as well as various options to further expand debt swaps in SIDS are discussed in detail in the concluding section.

## SIDS AND HUMAN DEVELOPMENT

SIDS are extremely mixed when it comes to human development, as measured by UNDP's Human Development Index (HDI) which combines measurements of countries' average income levels, life expectancy and educational attainment<sup>14</sup>. Some enjoy very high levels of human development such as Barbados and Singapore; others, such as Comoros, Guinea-Bissau and Haiti score poorly.

Before 1990, the HDI increased steadily for SIDS as a whole. But improvements slowed in the 1990s and 2000s, and have further slowed since 2008. The IMF reports that several health indicators have improved much more for larger SIDS than for smaller ones between 2000 and 2010. Crime has become one of the main challenges threatening economies and livelihoods in some Caribbean countries<sup>15</sup>.

Many SIDS have made good progress towards the Millennium Development Goals (MDGs), as demonstrated by MDG national reports. Nevertheless, pockets of poor and vulnerable communities persist due to low-income levels, insecurity and exposure to natural disasters and climate change.

Unemployment and the creation of new employment opportunities represent a key challenge for many governments, which have traditionally acted as the 'employer of last resort'. This, in turn, has led to bloated and costly public administrations (as well as helped to exacerbate public debt burdens since public administration and salary costs are borne by the government budget). The social safety net is not well-developed in many countries and the high unit cost of social service provision means that their sustainability is constantly challenged. These development challenges mean that the need for governments to invest more resources in human development, infrastructure and adaptation to climate change remain very high.

<sup>13</sup> For more information on the Seychelles debt swap programme, see: The Nature Conservancy: <http://www.nature.org/newsfeatures/pressreleases/debt-swap-to-finance-marine-conservation-in-the-seychelles.xml>

<sup>14</sup> For more information on UNDP's Human Development Index, see: <http://hdr.undp.org/en/statistics/hdi>

<sup>15</sup> See UNDP, Caribbean Human Development Report 2012: <http://www.undp.org/content/undp/en/home/librarypage/hdr/caribbean-human-development-report-2012-l/>

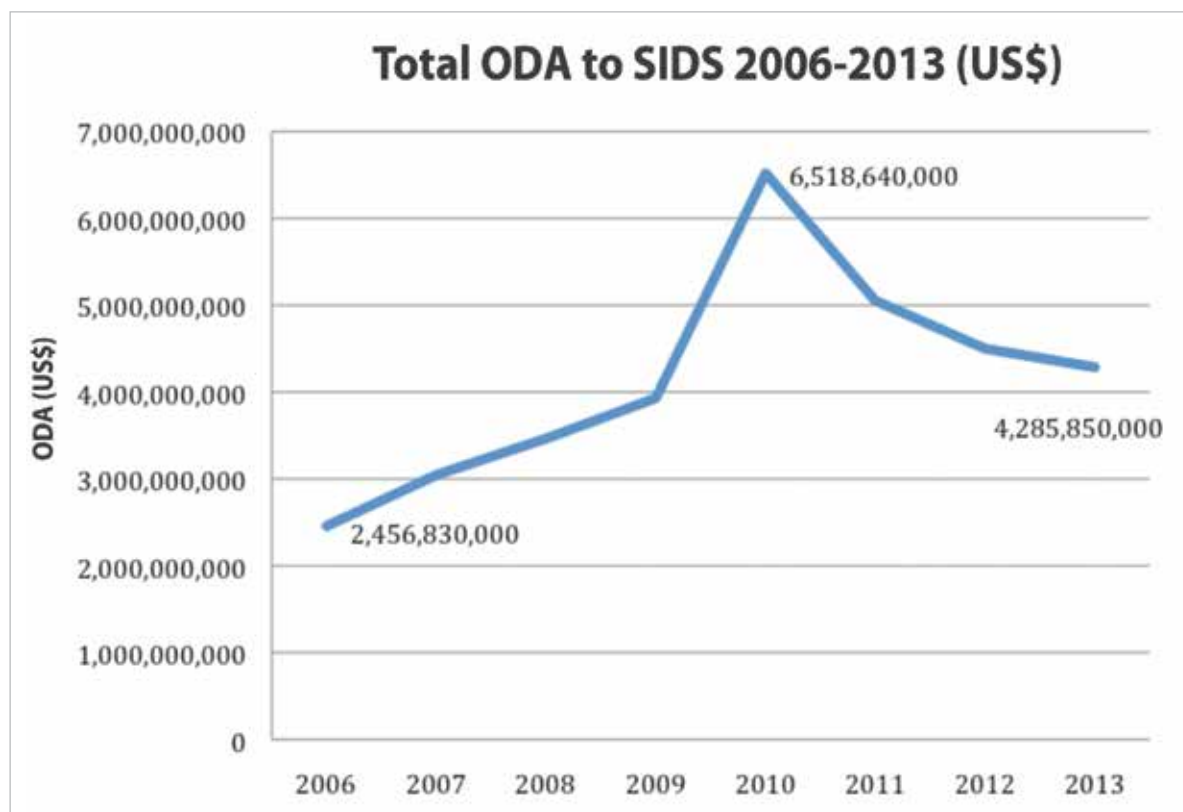
# 2 ODA and SIDS: A SNAPSHOT

## 2.1 ODA from the OECD DAC donors to SIDS

Official Development Assistance (ODA) is a key element in the financing for development landscape for SIDS. In 2013, SIDS as a whole received around US\$ 4.3 billion in ODA. Total ODA for that year was just under US\$ 135 billion which means that SIDS received about 5.7% of total development aid for that year. In 2010, ODA to SIDS 'spiked' temporarily to US\$ 6.5 billion<sup>16</sup>. This spike can be attributed to large inflows to Haiti following the country's devastating earthquake in January 2010.

Although SIDS receive very little ODA as a share of total ODA, when aid receipts are measured as a proportion of GNI and on a per capita basis, they are bigger recipients. As a proportion of GNI, ODA is twice as important in SIDS as in most other developing countries. In 2013, ODA represented 11.5% of GNI in SIDS compared to 4.7% in all other developing countries. In 2013, SIDS on average received US\$ 447 per capita in ODA while low-income countries received on average US\$ 59 per capita.

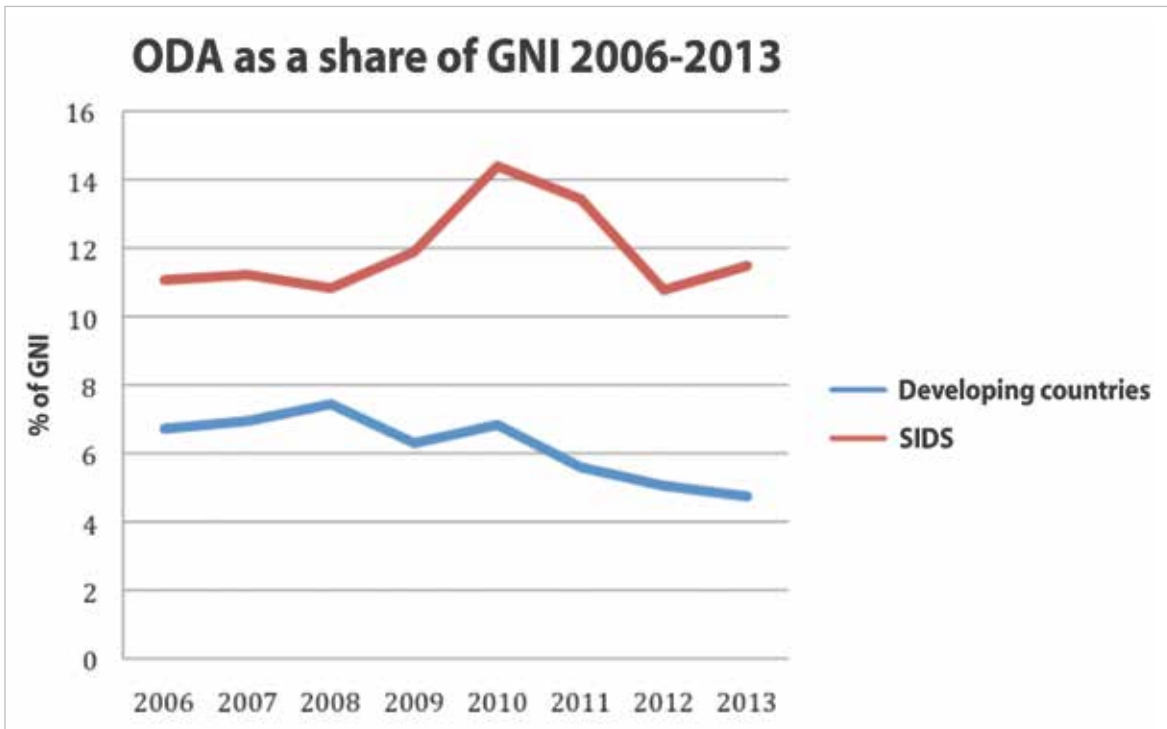
**Figure 15: Total ODA to SIDS: 2006-2013 (US\$)**



Source: World Bank, World Development Indicators 2015

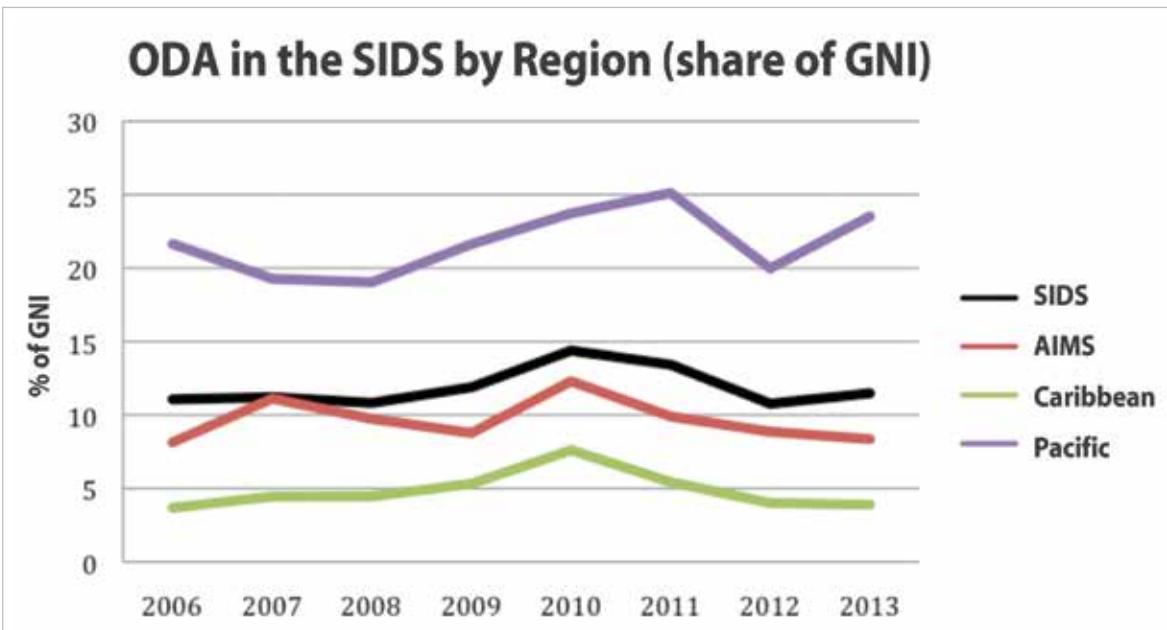
<sup>16</sup> All data are from the World Bank World Development Indicators 2015. 31 SIDS are included in this analysis: Antigua and Barbuda, Belize, Cabo Verde, Comoros, Dominica, Dominican Republic, Fiji, Grenada, Guinea-Bissau, Guyana, Haiti, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, Micronesia, Fed. Sts., Palau, Papua New Guinea, Samoa, São Tomé and Príncipe, Seychelles, Solomon Islands, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Timor-Leste, Tonga, Tuvalu, Vanuatu.

Figure 16: ODA as a share of GNI in SIDS



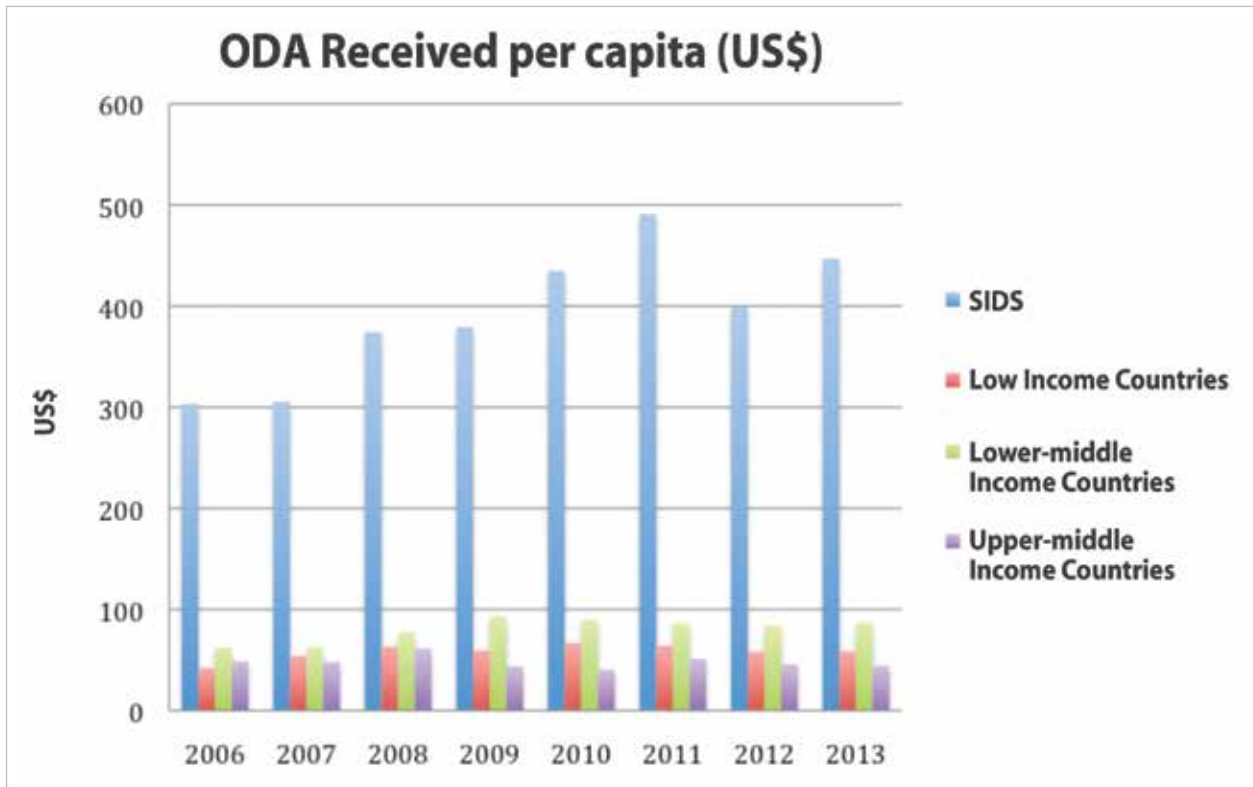
Source: World Bank, World Development Indicators 2015

Figure 17: ODA as a share of GNI by region varies significantly



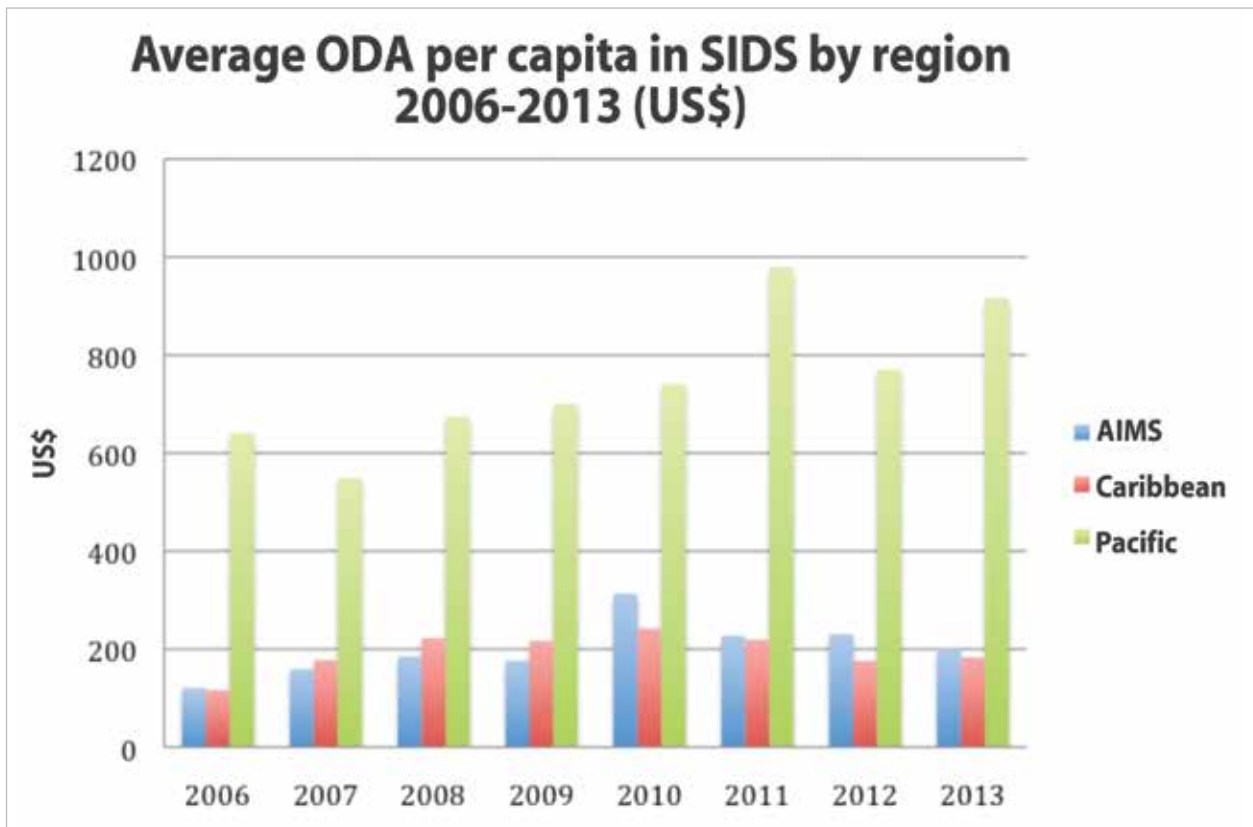
Source: World Bank, World Development Indicators 2015

**Figure 18: SIDS are major beneficiaries of ODA on a per capita basis**



Source: World Bank, World Development Indicators 2015

**Figure 19: ODA per capita varies by region**



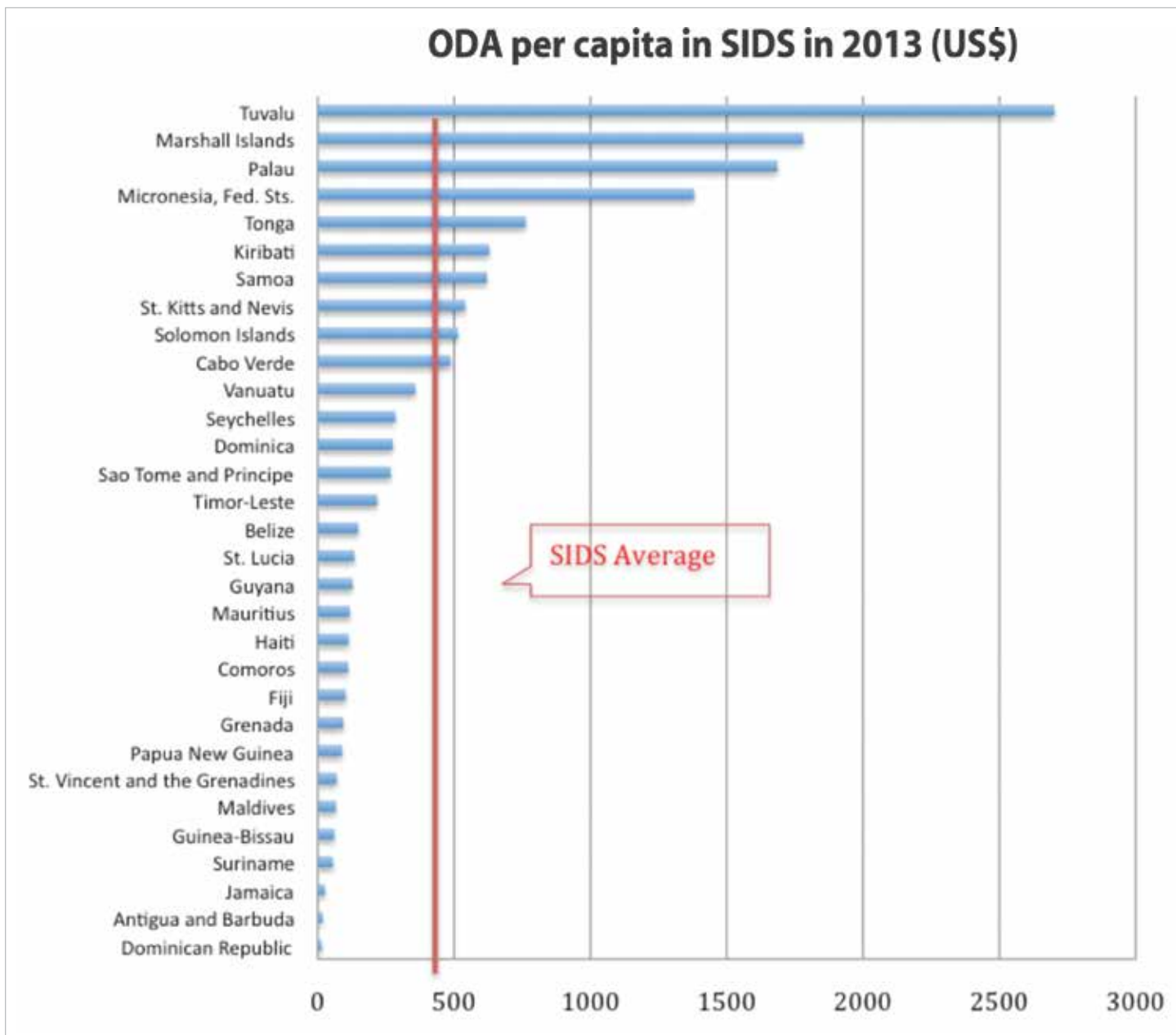
Source: World Bank, World Development Indicators 2015

That said, there is a considerable variation in the distribution of ODA across SIDS. In the Pacific region ODA represented on average 23.5% of GNI in 2013 whereas in the Caribbean, the ODA to GNI ratio was just 3.8% in 2013.

On average, the Pacific region also receives much more ODA on a per capita basis than do the Caribbean or AIMS countries. In 2013, SIDS in the Pacific region received on average US\$ 916 per capita, while SIDS in AIMS and Caribbean regions received US\$ 199 and US\$ 183 ODA per capita respectively. In the Pacific, there is a much higher degree of aid dependency; the Caribbean and AIMS countries, in contrast, rely much more heavily on debt finance.

SIDS also have a relatively small donor base which can accentuate their vulnerabilities. The major OECD DAC donors to the Pacific islands are Australia, New Zealand, Japan, the United States and the European Union (EU). In the Caribbean, the main traditional donors are the UK, the US, Canada, Japan and the EU. Other OECD DAC donors are also present but many have reduced or withdrawn ODA over recent years as incomes have risen (Haiti excepted).

**Figure 20: ODA country by country**



Source: World Bank, World Development Indicators 2015

## 2.2 SIDS and non-OECD DAC financing<sup>17</sup>

Non-OECD DAC donors are an increasingly important source of external financing for SIDS, although data is incomplete. For example, China has provided significant financial assistance – concessional and non-concessional – to many small island developing States particularly since the 1990s.

In the Pacific, close to 60% of Tonga's external debt is now denominated in Chinese renminbi, from loans made chiefly through China's EXIM Bank. China is one of Kiribati's main donors and for Papua New Guinea and Samoa, approximately 30% of these countries' debt is now owed to China. Taiwan has also been an important partner for some countries. For some SIDS, the inflow of funds from China or Taiwan has become almost indispensable.

India meanwhile reports that it has committed project aid of US\$ 70 million to SIDS, in addition to US\$ 350 million in concessional loans and credit lines (as at end-2012). A credit of US\$ 100 million was made available to the Maldives by India in 2009. India now holds close to 60% of the Maldives' external debt. India has also lent money to Guyana and now holds about 4% of the country's external debt.

Several Arab donors have also funded interventions in several small island developing States, especially in other Islamic nations. For instance, the Abu Dhabi Fund for Development has financed projects in the Comoros, Guinea-Bissau, the Maldives and Mauritius. Most of the finance supplied has been loans. The Fund has also extended several loans to the Seychelles.

The Kuwait Fund has supported the Comoros, Guinea-Bissau, the Maldives, Mauritius and the Seychelles with loan finance, principally for infrastructure development (e.g. port development and telecommunications) and for post-tsunami rehabilitation in the case of the Maldives. In the Pacific, the Kuwait Fund has supplied the Solomon Islands with loan finance. It has also extended loans to several Caribbean countries. These include: Antigua and Barbuda, Belize, Cuba, Dominica, Grenada, St. Lucia, St. Kitts and Nevis, and St. Vincent and the Grenadines.

Meanwhile Turkey's development agency, TIKA, reports that between 2010 and 2012, it has provided assistance to SIDS in excess of US\$ 10 million (it is not known what these funds have supported). The agency is formulating its new five year development cooperation plan and it reports that it intends to allocate US\$ 5 million to development programmes in the Pacific region.

Trinidad and Tobago and Venezuela have also become important sources of external finance in the Caribbean region. In the Caribbean, Venezuela has emerged over recent years as the largest donor to Caribbean states based on its oil concessionary facility, PetroCaribe. This initiative supplies oil at reduced prices and allows the buyer to defer repayments for up to 25 years. Some studies estimate that up to one third of the Caribbean region's debt may now be owed to Venezuela. The largest buyers are the Dominican Republic and Jamaica<sup>18</sup>. Recent political and economic challenges in Venezuela may have implications for the continuation of the PetroCaribe initiative in its current form which could, in turn, have repercussions on beneficiary nations.

Looking forward, the rise in 'non-traditional' donor flows provides many SIDS with important opportunities to leverage additional finance from a more diverse set of partners. This is positive. On the other hand, a lack of information and transparency means it is often difficult to assess what these funds have supported and the terms and conditions under which the finance has been supplied. A key issue is the extent to which such flows are concessional, and whether non-OECD DAC lenders will be flexible in the event of payment problems, especially given some small islands' high debt levels. It also becomes increasingly complicated to renegotiate debt with an ever wider set of creditors.

<sup>17</sup> Comprehensive data on non-OECD DAC funders is difficult to obtain; many do not publish comprehensive data (or do not publish it on a regular basis). This section is therefore illustrative and not exhaustive.

<sup>18</sup> See: Royal Bank of Canada, PetroCaribe: A handout, not a hand-up, which may soon run out, May 2013



This assistance is also typically 'tied aid' (i.e. it is conditional on the purchase of goods and or services from the provider nation). This raises issues over the extent to which it represents 'value for money'. These issues all signal a need for far greater information and transparency in such flows in the future.

## 2.3 SIDS and international climate and environmental funds

Over the last decade there has been an explosion in public, private, bilateral and multilateral sources of funds to support climate change interventions and other environmental concerns. Some are mixed public-private partnerships. Only ten years ago, climate finance was managed by a small number of large funds associated with the United Nations Framework Convention on Climate Change (UNFCCC); today there are large number of international public and private funds in operation and this number looks set to rise further in the future.

Examples include the Adaptation Fund (AF), the Climate Investment Funds (CIF), and most recently the Green Climate Fund (GCF), as well as new financial mechanisms such as performance-based payments for reducing emissions from deforestation, degradation, and forest conservation (e.g. REDD+). Several of these funds are capitalized from innovative sources of finance such as a levy on fuel exports or a two per cent levy on the proceeds of certified emission reduction issuances under the Clean Development Mechanism which are allocated to the Adaptation Fund<sup>19</sup>.

Often however, many of these new climate and environmental funds and programmes are under-capitalized. Rather than reflecting the need to manage exponentially increasing resources, the development of new financing instruments appears as a sub-optimal response to an unresolved financing gap. In addition, an unintended consequence of the proliferation in funds for environmental protection and climate change is a dramatic increase in complexity. Requirements, processes and reporting differ markedly among the new funds and instruments.

Countries are faced with the task of identifying which funds are appropriate for them and are currently capitalized, how to access resources, how to blend them to support transformative change and how to develop cost effective methods to monitor and evaluate results<sup>20</sup>. This can be a formidable task, especially for those countries with more limited capacities. These concerns are reflected in the 2014 Samoa Pathway document, an internationally-agreed programme of action to support sustainable development in SIDS<sup>21</sup>. The document also encourages the international community to take steps to address these challenges.



Biodiversity

<sup>19</sup> For further information, see: [http://cdm.unfccc.int/Issuance/cers\\_iss.html](http://cdm.unfccc.int/Issuance/cers_iss.html)

<sup>20</sup> For further information, see: UNTT (2013)

<sup>21</sup> See Samoa Pathway, 2014: <http://www.sids2014.org/index.php?menu=1537>



Despite SIDS' vulnerabilities to climate change and other environmental challenges (see table 1), their record on leveraging funds from various climate/environment-themed funds is so far mixed.

For example, the main beneficiaries of funds under the Clean Development Mechanism (CDM) have been large middle-income nations such as China, India and Brazil, not small countries. Several SIDS have, however, benefited from the UN-REDD programme – the United Nations Collaborative Programme on Reducing Emissions from Deforestation and Forest Degradation in Developing Countries. These are: Guinea-Bissau, Guyana, Papua New Guinea, and the Solomon Islands<sup>22</sup>. The figures for the Adaptation Fund are also better, although projects – and financing amounts – are relatively small. At the end of 2013, 9 SIDS had projects supported by the Adaptation Fund, mostly aimed at helping countries to build the resilience of coastal communities to climate change<sup>23</sup>. The Global Environment Facility meanwhile has benefited the largest number of SIDS<sup>24</sup>.

Looking forward, and as climate and environmental finance expands, SIDS could have important opportunities to leverage more of this finance. However it will be vital for the international community to ensure a balance between adaptation and mitigation finance, as well as ensure that those countries most vulnerable to climate change are able to access adaptation resources. Many SIDS governments have reiterated that more climate finance is needed but access needs to be radically simplified. The widespread donor practice of counting climate finance as development aid also continues to be contentious for many small island governments.

## 2.4 SIDS and financing for shocks

We live in uncertain times. Since the 1980s, progressive financial deregulation – within and between countries – has led to increased instability and recurrent financial and economic crises. Although financial crises – domestic and international – have been pervasive phenomena throughout history their frequency and severity has increased in recent decades. This is combined with volatility associated with more frequent and extreme weather events almost certainly associated with climate change. In many cases these shocks are largely beyond the control of SIDS' governments, i.e. they are not a result of poor domestic policy choices.

At the international level, the international financial institutions (IFIs) are placing increased emphasis on financing for shocks support. Over the last few years, all the major multilateral lenders have created new emergency and shocks loan windows and/or have significantly boosted old ones.

The IMF and World Bank now have a myriad assortment of shocks facilities. These facilities are crucial to many developing countries as they seek to maintain macroeconomic stability and protect social systems in moments of crisis. Many of these are important for – and have been used by – small island developing States. Most recently, the IMF announced the creation of a 'Catastrophe Containment and Relief Trust' to enhance support for low-income countries hit by disasters in areas such as public health and natural disasters<sup>25</sup>.

<sup>22</sup> For more information on UN-REDD, see: <http://www.un-redd.org/Home/tabid/565/Default.aspx>

<sup>23</sup> For further information on the projects supported by the Adaptation Fund, see: [https://www.adaptation-fund.org/funded\\_projects](https://www.adaptation-fund.org/funded_projects)

<sup>24</sup> These include: Antigua & Barbuda, Bahamas, Barbados, Belize, Cape Verde, Comoros, Cook Islands, Cuba, Dominica, Dominican Republic, Fiji, Grenada, Guinea-Bissau, Guyana, Haiti, Jamaica, Kiribati, Maldives, Marshall Islands, Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines, Timor Leste, Tonga, Trinidad and Tobago, Tuvalu and Vanuatu. Detailed country information and individual funding amounts can be accessed at the following link: [http://www.thegef.org/gef/country\\_fact\\_sheets](http://www.thegef.org/gef/country_fact_sheets)

<sup>25</sup> For more information, see: IMF: <https://www.imf.org/external/np/sec/pr/2015/pr1534.htm>

At the regional level, the Inter-American Development Bank, Asian Development Bank, African Development Bank and European Commission also have important shocks and emergency liquidity funds, many of which were created – and all of which have been expanded – since the recent financial crisis<sup>26</sup>.

Public-private partnerships have also emerged to try to improve international responses to major shocks such as the Caribbean Catastrophe Risk Insurance Facility (CCRIF), a multi-country insurance scheme which offers pay-outs to member countries when a severe catastrophe strikes.

The international community's financial support for shocks and crisis response needs to be robust. However, additional considerations are also important. The first is whether these financing facilities are sufficient to compensate for the scale of the external shock. Some shocks windows depend on regular donor replenishments. A second relates to the eligibility criteria for different emergency and shocks windows. For instance, some highly concessional emergency financing may only be available to low-income countries; some SIDS may not therefore be able to access these resources. A third is the predictability and timeliness of shocks financing and the extent to which countries in need can access funds at speed.

While there may, on the one hand, be a high degree of desirability in allocating a higher proportion of official resources to shocks financing, the potential trade off in allocating less funds to other development activities also needs to be considered. One of the most important lessons is that aside from the provision of liquidity during crises, it is equally important to provide official long-term finance when private finance dries up during and after crises, not least to maintain the dynamics of investment projects.

## 2.5 SIDS eligibility for concessional finance and other advantages

Various schemes exist internationally to 'categorize' countries. These categorizations have, in turn, implications on countries' access to different kinds of development finance and trade preferences, among other things.

At the UN, the 48 countries classified as Least Developed Countries (LDCs) are eligible to receive certain international support measures such as trade related preferences, technical assistance and financial support to help them attend international meetings<sup>27</sup>. 'Graduation' out of this category, while positive, implies a loss of these advantages even though in many cases, socio-economic and environmental vulnerabilities will persist.

Nine SIDS are classified as LDCs, namely: Comoros, Guinea-Bissau, Haiti, Kiribati, São Tomé and Príncipe, Solomon Islands, Timor-Leste, Tuvalu, and Vanuatu. Several others have 'graduated' over the last few years, specifically Cape Verde, the Maldives and Samoa. Vanuatu is, in principle, eligible for graduation in 2017. Whether this timetable will now be affected due to the devastation recently wrecked by Cyclone Pam in 2015 remains to be seen.

The international financial institutions, meanwhile, categorize countries according to income level only (countries are low-income, middle-income or high-income)<sup>28</sup>. Low-income countries (LICs) are eligible to receive concessional finance

<sup>26</sup> For example, at the end of 2012, the Inter-American Development Bank launched two new contingent credit facilities for Latin America and the Caribbean; one to help countries deal with shocks caused by external financial crises and another to help nations cope with the aftermath of natural disasters. The African Development Bank created a USD 1.5 billion 'Emergency Liquidity Facility (ELF)' in 2009 to deal with the fallout from the financial crisis.

<sup>27</sup> For further information on the LDCs and the support measures they are able to access, see: UN OHRLLS, The LDCs: Things to Know, Things to Do (2009): <http://unohrlls.org/UserFiles/File/LDC%20Documents/Advocacy%20brochure%20english%20for%20web.pdf>. For more general information on the LDCs, see: UNOHRLLS: <http://unohrlls.org/about-ldcs/>

<sup>28</sup> World Bank, Country and Lending Groups: <http://data.worldbank.org/about/country-and-lending-groups>

from windows such as IDA at the World Bank. At higher per capita income levels – currently above US\$ \$1,215 in fiscal year 2015 for the World Bank – countries ‘graduate’ to finance extended at market terms<sup>29</sup>.

Most SIDS are middle-income countries (see table 1). This means that, for the most part, they are not eligible to receive concessional resources from the multilateral financial institutions. Some bilateral donors also use income per capita to steer aid allocation decisions, although this does vary between donors.

Cognizant of the ‘special’ development challenges faced by many small island States, the World Bank operates ‘a small island exception’ that permits a few SIDS to borrow concessional finance from IDA despite higher income per capita levels. Those SIDS with fewer than 1.5 million people, significant vulnerability due to size and geography, and very limited credit-worthiness and other financing options retain access<sup>30</sup>. Most however are considered ‘blend’ countries, i.e. they can borrow simultaneously from both IDA and the Bank’s non-concessional loan facility, the IBRD. Blend countries include: Cabo Verde, Dominica, Grenada, St Lucia, St Vincent and the Grenadines and Timor-Leste<sup>31</sup>.

All others borrow on commercial terms from the multilateral lenders. It is important to note that several of the countries which are IBRD eligible only (i.e. eligible for non-concessional finance only) are precisely those countries in which debt problems have been more pronounced, e.g. Antigua and Barbuda, Belize, Jamaica, the Seychelles and St. Kitts and Nevis. Given SIDS’ inherent structural economic and environmental vulnerabilities, many governments have called for more favourable access to concessional resources for *all* small islands and to include a measure of vulnerability in multilaterals’ assessments as to which countries should be eligible for concessional finance. We outline possible options for reform in this direction in the conclusions and recommendations to this paper.



Timor Leste - Oecussi

Credit: Louise Stoddard

<sup>29</sup> For more information about the World Bank’s IDA window, see: <http://www.worldbank.org/ida/borrowing-countries.html>

<sup>30</sup> For more information on the small island economy exception, see: <http://www.worldbank.org/ida/borrowing-countries.html>

<sup>31</sup> For further information, see: World Bank country classifications: <http://data.worldbank.org/about/country-and-lending-groups#Blend>

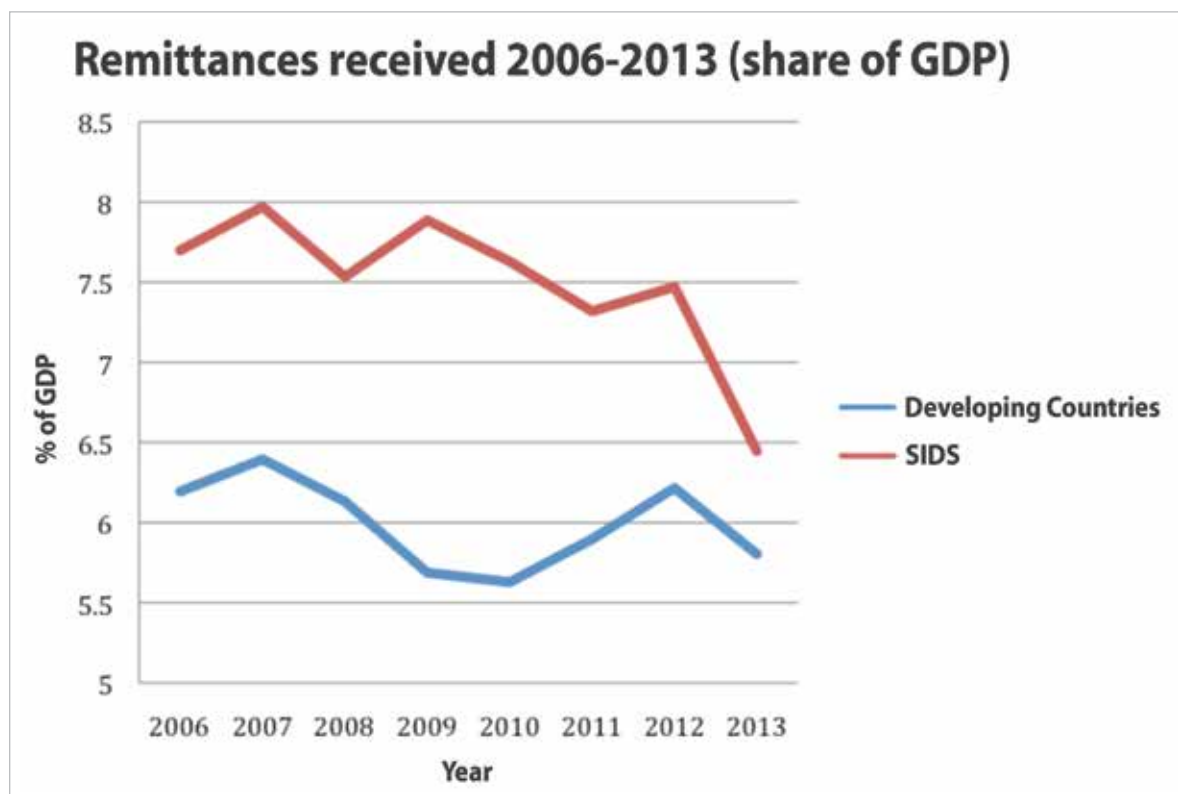
# 3 SIDS and Remittances

Many SIDS have high emigration rates and remittances are an important source of foreign exchange. They also help to support families' consumption and overall welfare.

SIDS receive much larger remittance inflows relative to the size of their economies than any other country group. From 2006 – 2013, remittances represented, on average, 7.5% of GDP in SIDS compared to 5.8% in all other developing countries. They are important both in the Caribbean and the Pacific and over the last decade it has not been uncommon amongst SIDS for remittances to account for more than 20% of GDP and for as many as 90% of households to receive remittances from abroad.

International efforts to reduce the costs of transferring remittances home, as well as initiatives that support families which receive remittances to use them for investment as well as consumption purposes will be critically important to many SIDS.

**Figure 21: The importance of migrant remittances in SIDS**



Source: World Bank, World Development Indicators 2015

# 4 SIDS and Foreign Direct Investment

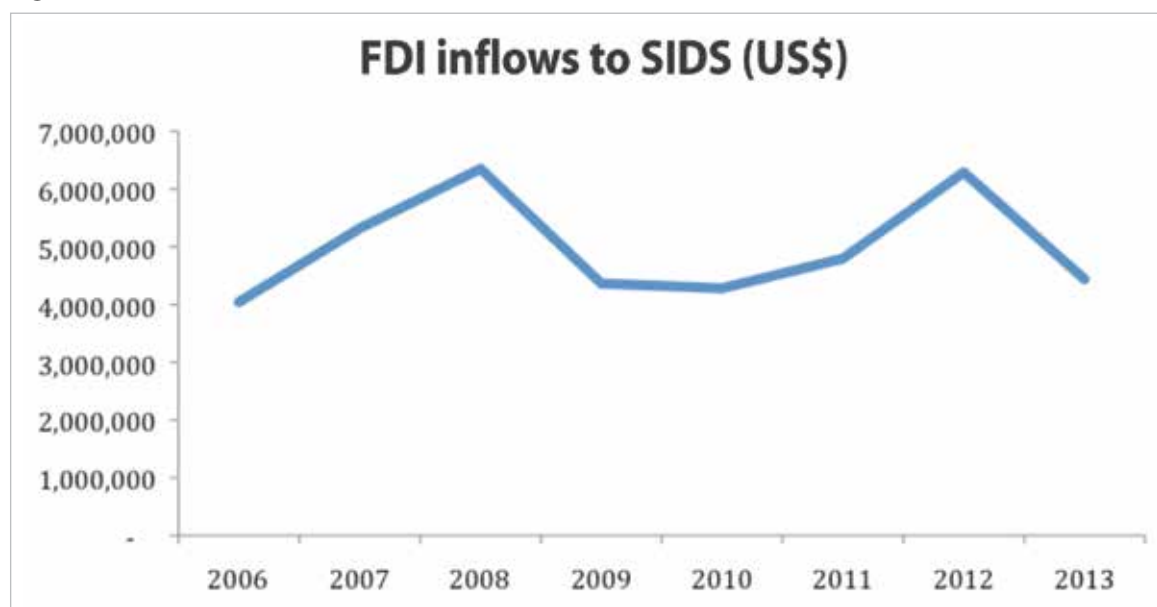
Globally, foreign direct investment (FDI) is extremely high and represents the largest source of external finance for developing countries. Global FDI stood at around US\$ 1.75 trillion in 2013. Of this amount, SIDS received between US\$ 4 to 6.3 billion in FDI inflows from 2006 – 2013, with the highest inflows coming in 2008, just before the onset of the recent financial crisis.

As with other international financial flows such as ODA, the data masks significant variations between countries and regions. The Caribbean is the highest recipient in absolute terms, receiving between 59 – 90% of the total FDI received by SIDS from 2006 - 2013. This amounted to about US\$ 3.1 billion in 2013. The small islands in the Pacific are the lowest recipients with less than US\$ 400 million in 2013.

Developing countries' share of total world FDI in 2013 was just over 42% up from 22% in 2006. SIDS' share, meanwhile, was just 0.25% in 2013, down from 0.29% in 2006; their share of developing country FDI was slightly higher (but still low) at 0.6% (down from 0.94% in 2006). This shows that SIDS have not been able to capture significantly higher shares of rising global FDI.

The data also reveals the high degree of volatility associated with FDI flows, often because one major investment can represent a significant share of SIDS' GDP.

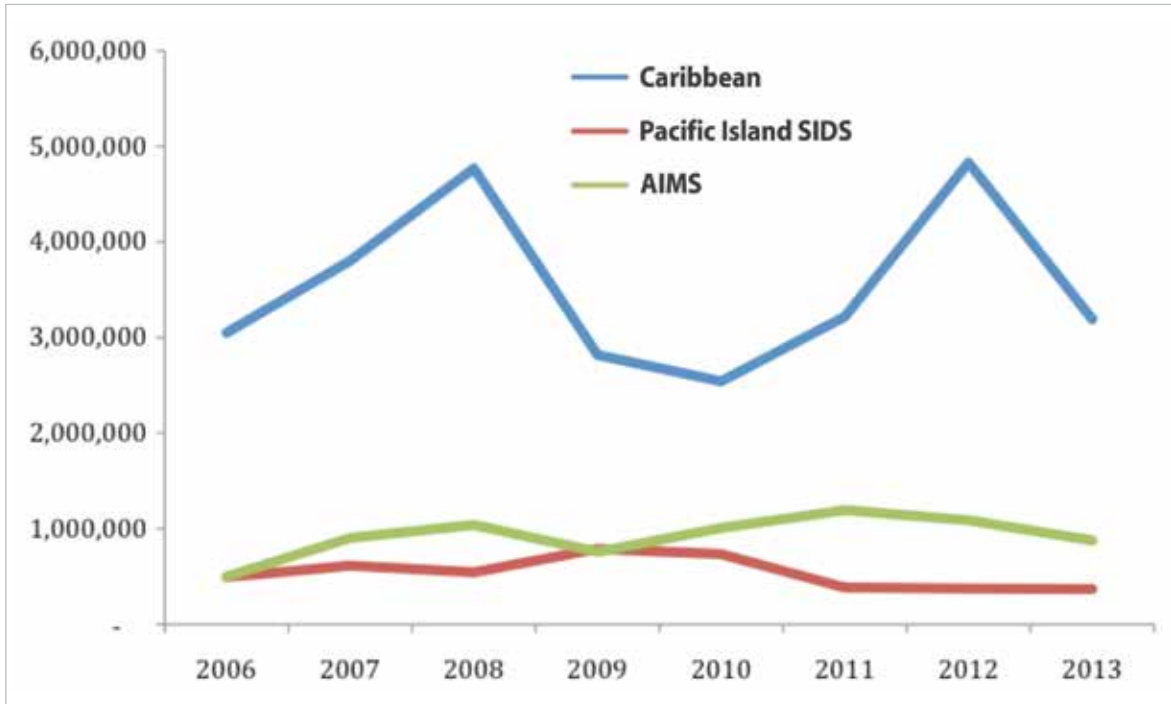
**Figure 22: FDI, total net inflow (US dollars), 2006-2013**



Source: World Development Indicators, 2015

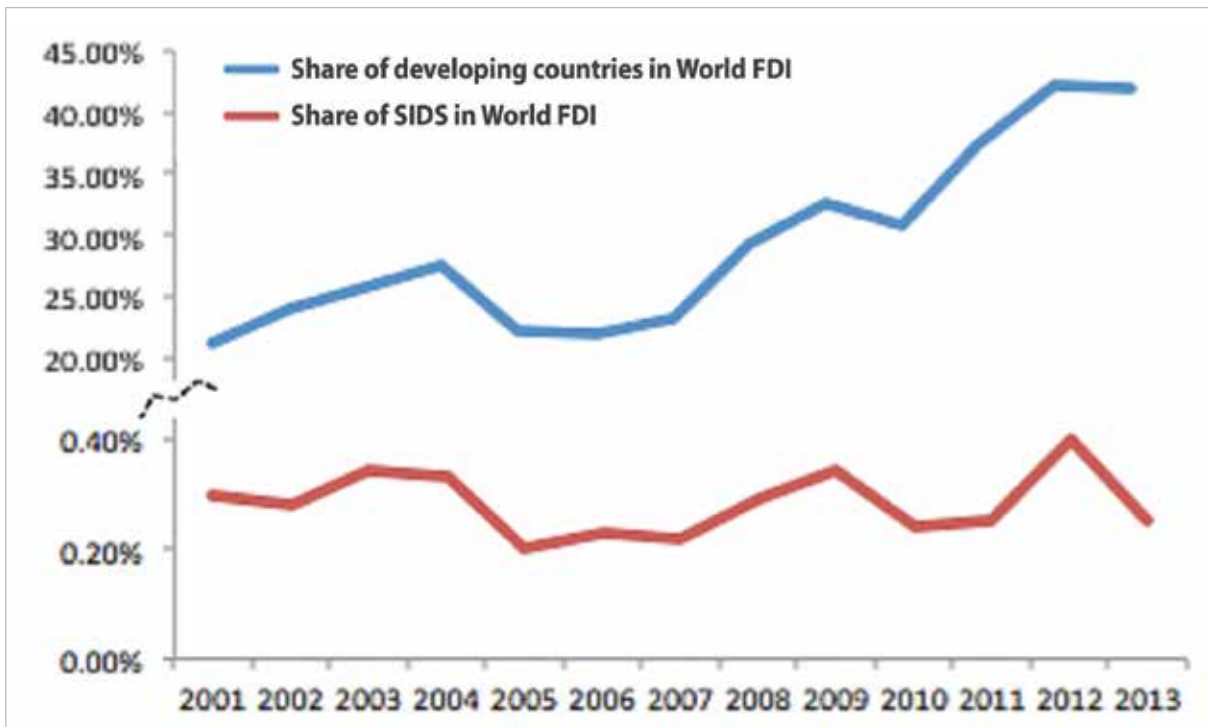


**Figure 23: FDI, total net inflow (US dollars), disaggregated by region, 2006-2013**



Source: World Development Indicators, 2015

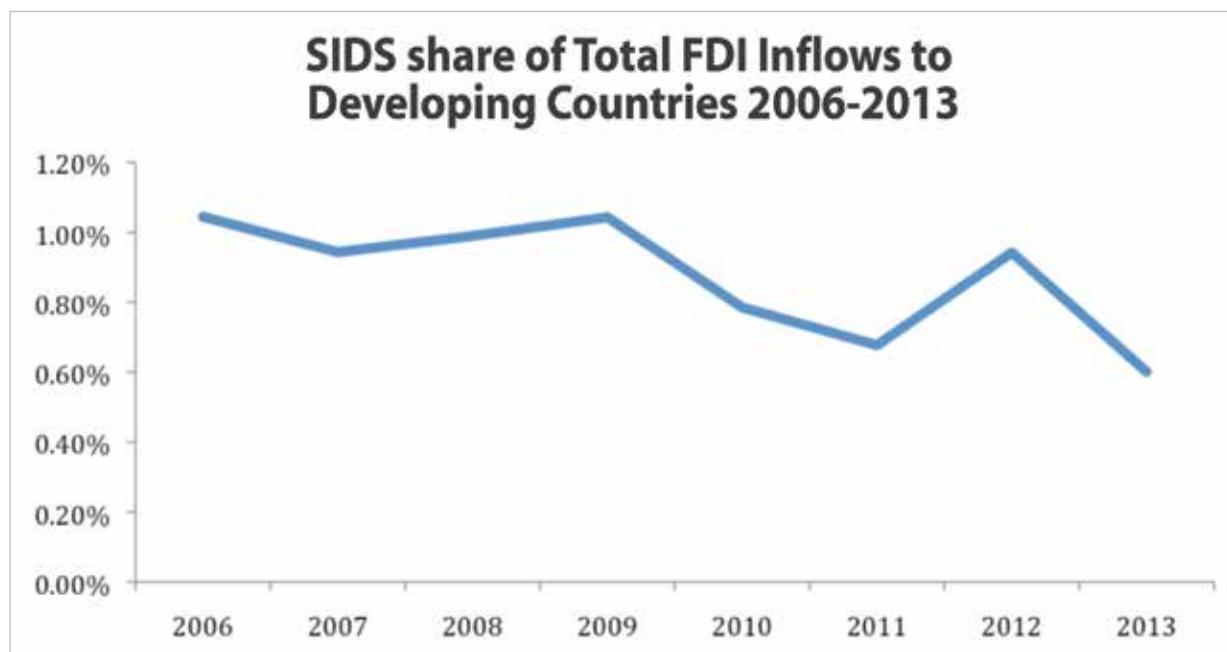
**Figure 24: SIDS' share of global FDI flows**



Source: World Development Indicators, 2015



Figure 25: SIDS' share of developing country FDI

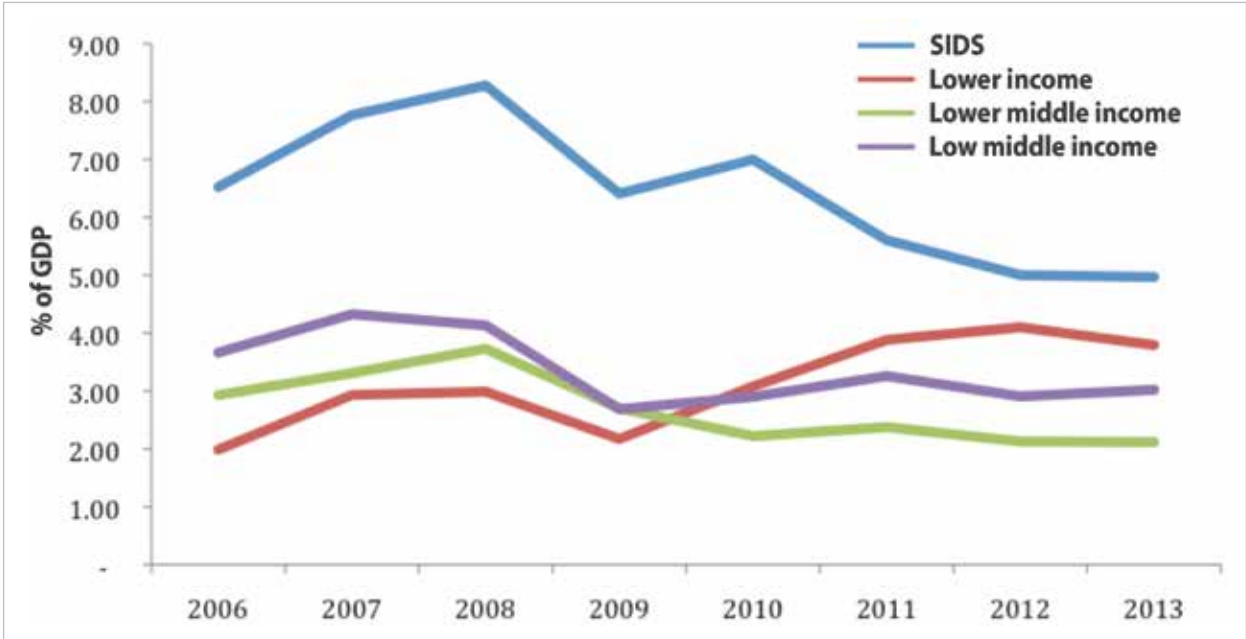


Source: World Development Indicators, 2015

SIDS' FDI inflows are high, however, when measured as a proportion of GDP. SIDS are more reliant on FDI than low and middle income countries. For SIDS as a whole, FDI inflows averaged almost 5% of GDP in 2013; this compares to between 2% and 4% for LICs and MICs. Within SIDS, FDI inflows are more heavily concentrated within the Caribbean and AIMS regions. FDI averaged just over 5.5% for both regions in 2013, although it has been much higher in previous years.

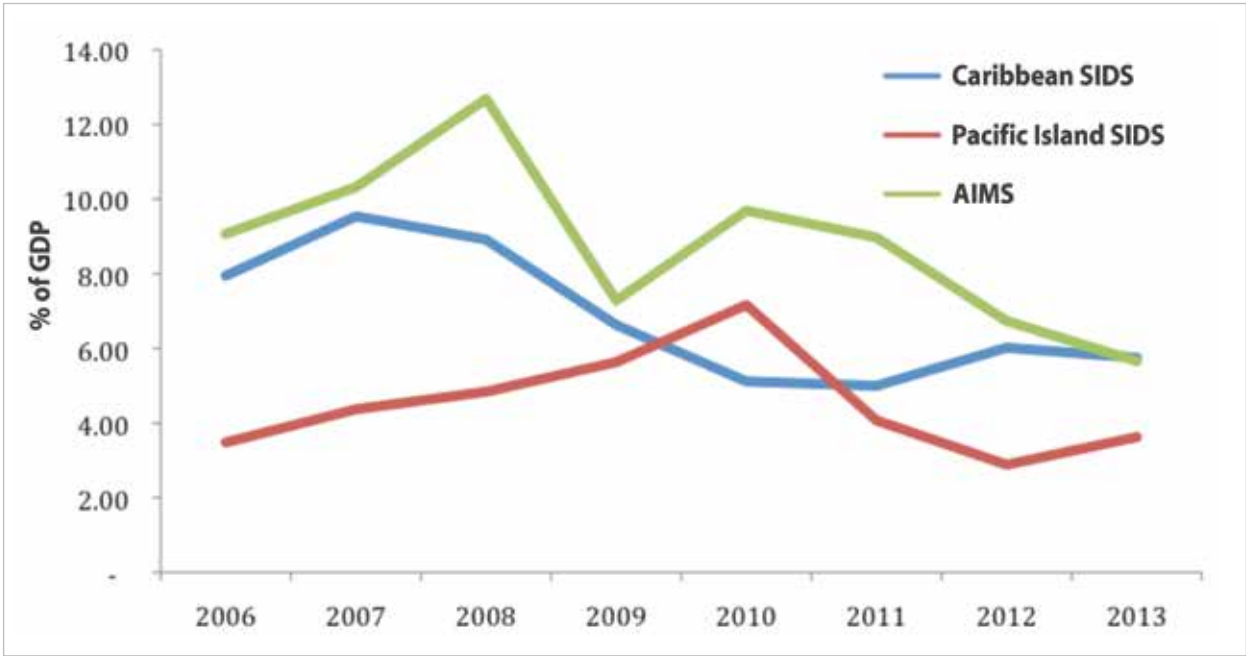
Greater mobilization of private sources of finance such as FDI can potentially help to confront the sustainable development challenges of SIDS. However private financing raises some very important issues from a financing for development perspective. For instance, the *quality* of the FDI matters; it tends to be concentrated in certain countries and in specific sectors (such as tourism and natural resource extraction) and may not boost domestic firms' capabilities, support knowledge and skills development or technology transfer. It can be volatile, procyclical and produce considerable financial leakages through profit repatriation. Most FDI does not consider sustainability issues. These challenges point to the importance of governments putting place robust regulatory frameworks and incentive regimes to steer larger share of FDI flows towards priority sustainable development areas.

**Figure 26: FDI in SIDS as compared to other developing countries (% of GDP), 2006-2013**



Source: World Development Indicators, 2015

**Figure 27: FDI (% of GDP) for SIDS disaggregated by region, 2006-2013**



Source: World Development Indicators, 2015

# 5 SIDS and Domestic Resource Mobilization

International policy discussions on financing the post-2015 sustainable development agenda are rightly placing significant emphasis on domestic resources as the most important source of finance available to fund the SDGs. But compared with larger economies, small island developing States tend to face very different social, geographical, demographic and economic realities. Their economies tend to have a higher degree of openness and be much less diversified, with a narrow resource base and relatively limited types of economic activities. They do not easily benefit from economies of scale.

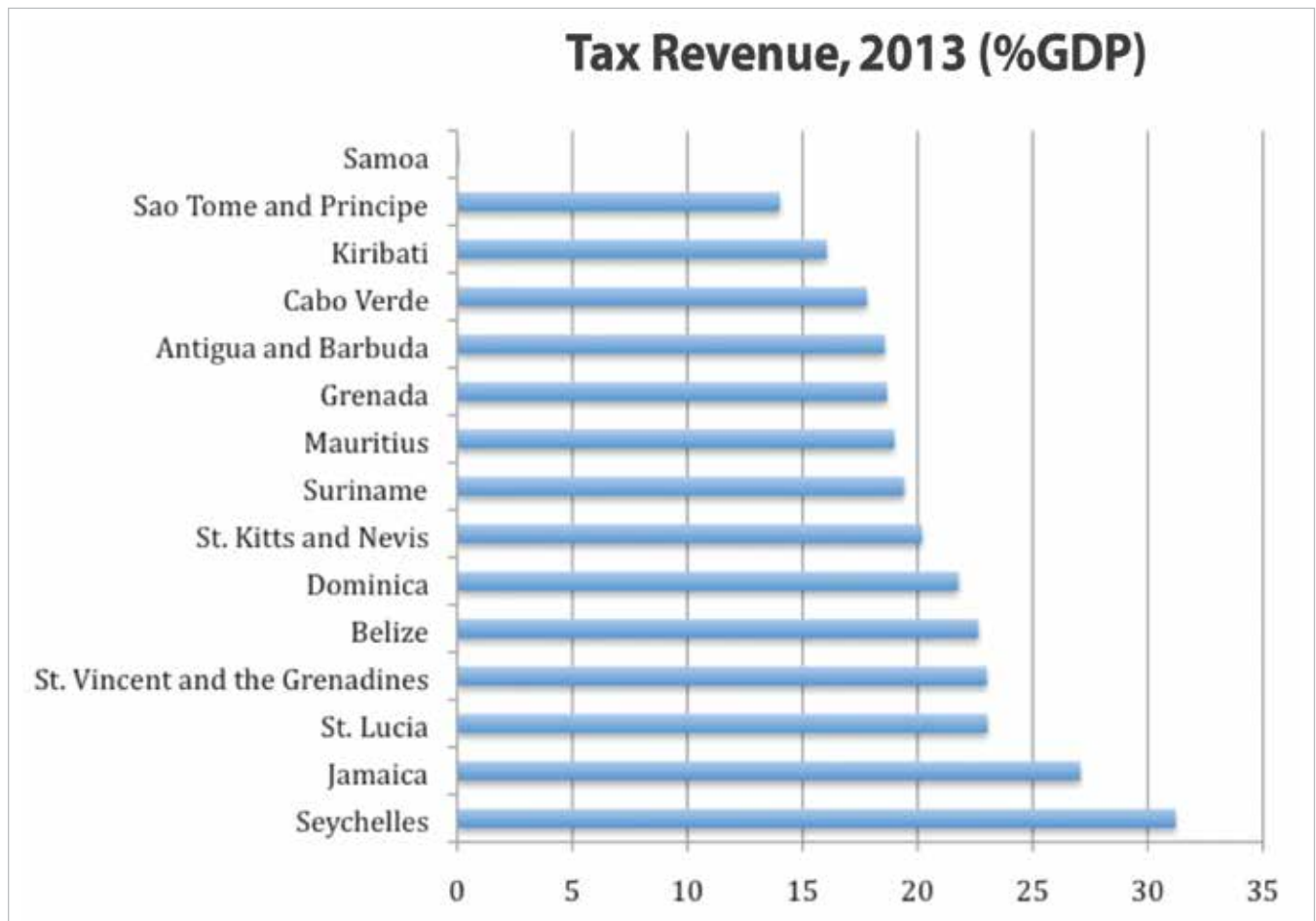
Domestic public financing is therefore challenging for many SIDS. On one hand, the provision of public goods tends to be more expensive on a per capita basis compared to countries with larger (and more concentrated) populations. Tax revenues as a percent of GDP would probably have to be even higher in SIDS than in many other countries because the marginal cost of public good provision is higher. On the other hand, increasing trade liberalization leads to eroding tax bases for many SIDS that are highly dependent on trade taxation for generating tax revenue. Finally, some investments (e.g. in infrastructure) may not seem expensive in volume terms, but for SIDS, they are extremely high and domestic resources alone are unlikely to be sufficient.



Building Seawalls. Tarawa, Kiribati.

Credit: Lauren Day, World Bank

Figure 28: Tax revenue in selected SIDS, 2013 average, % of GDP



Source: World Bank, World Development Indicators 2015

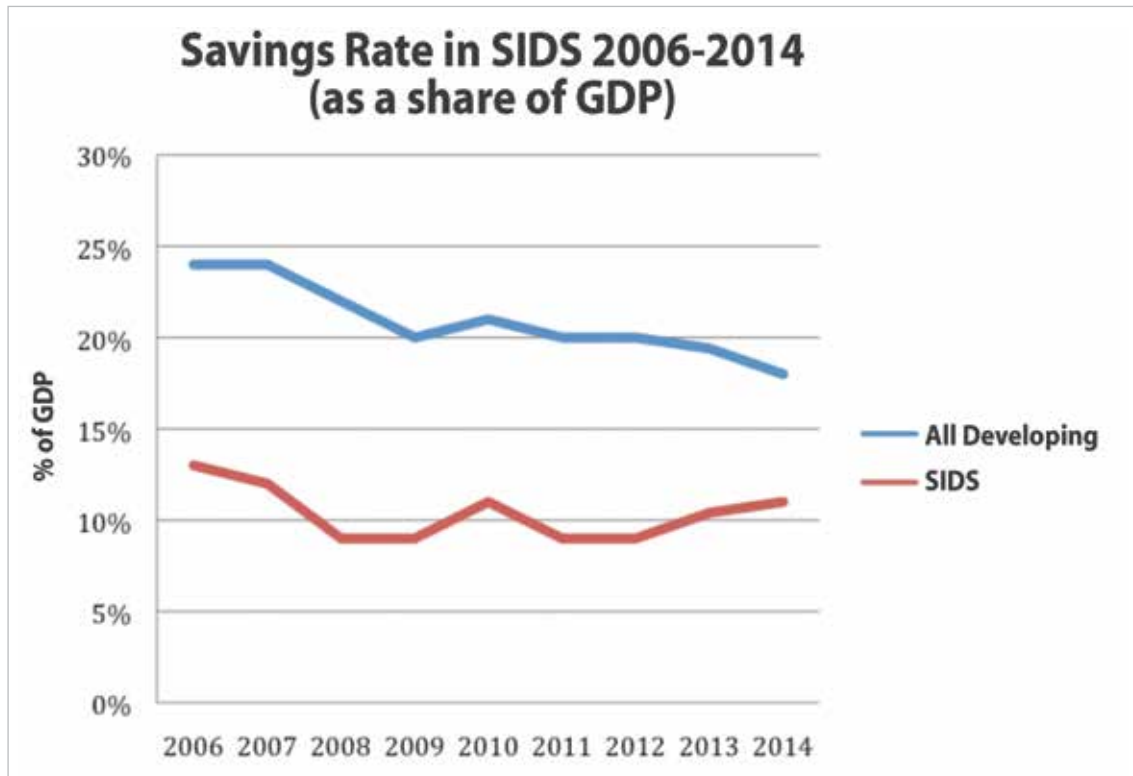
The data shows a wide variation across SIDS in terms of domestic resource mobilization capabilities. Data is however, patchy, especially in the Pacific, so there may be a selection bias in the data presented in this paper. For 15 SIDS where data is available tax to GDP ratios are, on average, 19%. This rises to 21.5% and 20.5% percent in the AIMS and Caribbean regions respectively. Most SIDS have not managed to greatly increase their tax to GDP ratios over recent years.

Some SIDS have managed to broaden the personal income tax base, but many rely significantly on indirect taxation, especially value added and sales taxes which can be regressive. Widespread tax exemptions meanwhile help translate into low collection levels in many countries. Efforts to control tax avoidance and evasion (and other illicit flows) have also, in many cases, been weak. The importance of public sector employment meanwhile implies that states have high expenditures not only in terms of public service provision but also in terms of their wage bill.

While many SIDS can undoubtedly do more to improve the quality of their institutions and expenditures, it must also be recognized that these efforts, while necessary, will also not be sufficient to meet the investment demands of the new sustainable agenda. International resources will be an essential complement.

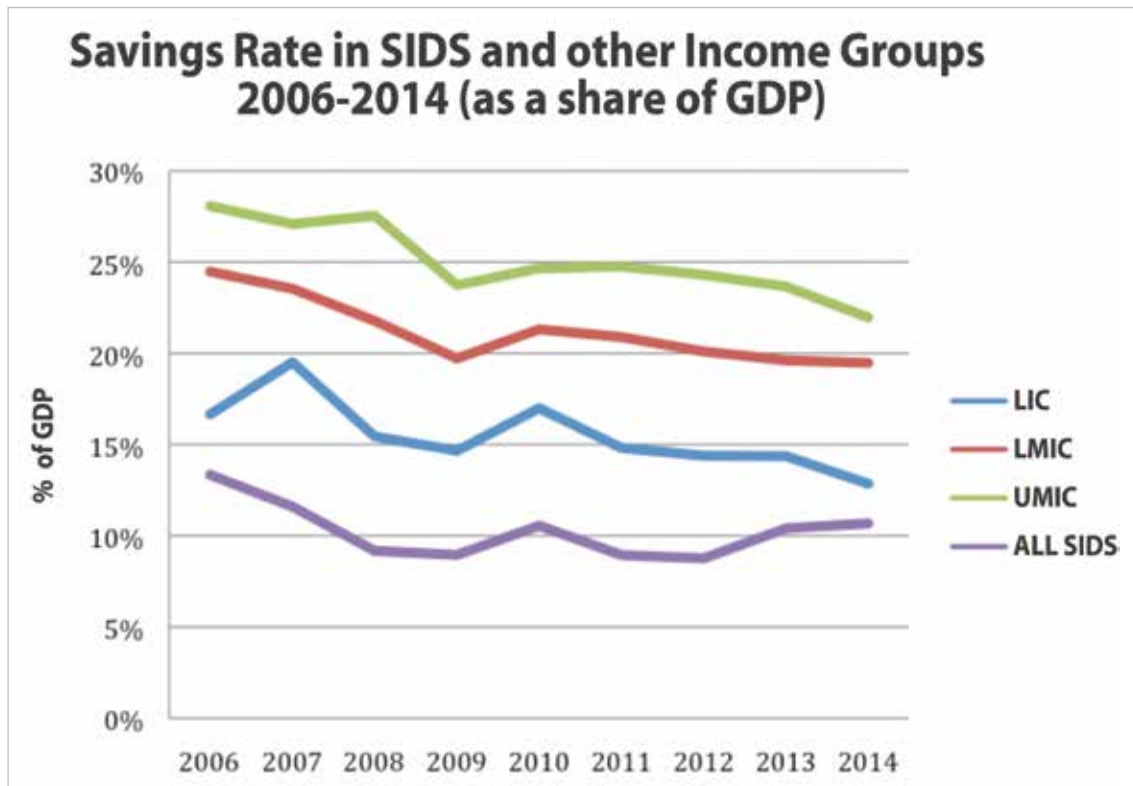
SIDS' domestic savings rate are much lower than other developing nations. SIDS' average savings rate is half that of upper middle-income countries (11% versus 22% in 2014) despite many SIDS being classified as middle-income countries. This means a smaller pool of domestic resources on which to draw to fund investment and development.

**Figure 29: Savings rate in SIDS**



Source: World Bank, World Development Indicators 2015

**Figure 30: Savings rate in SIDS**



Source: World Bank, World Development Indicators 2015



# Possible Ways Forward

---

This paper has provided an overview of some of the major financing for development issues which currently confront many SIDS. Based on this analysis, what are some possible ways forward?

## 1. Enhanced Approaches to Debt Management and Resolution

High levels of public debt not only raise the risk of future debt crises, but also impose other economic and human development costs on debtor countries. Some SIDS are already in debt distress – and have been for some time – while several others are at high risk.

Achieving the SDGs in small island developing States requires debt sustainability. The SDGs will not be achieved where debts are not sustainable. Efforts to boost economic growth, fiscal reforms, and improved public expenditure and debt management capacities will all play an important role. But in some cases this will not be sufficient to reduce debts to manageable levels. Caribbean SIDS in particular will not have the fiscal space to substantially address the SDGs unless the debt overhang is greatly reduced.

Current approaches – which have relied largely on small island developing States to resolve their indebtedness problems themselves through fiscal retrenchment and seeking debt restructuring with individual creditors on an ad-hoc basis – has not, thus far, delivered satisfactory outcomes for many countries.

The HIPC Initiative showed that where comprehensive debt relief was delivered, it supported increases in poverty reduction expenditures and economic recovery in beneficiary countries, when combined with other policy measures. It also helped to ensure fairer burden-sharing between bilateral, multilateral and private creditors. On the down side, many HIPCs struggled with the extensive conditionality requirements which delayed debt relief in several cases.

We can draw valuable lessons learned from the HIPC Initiative experience to determine whether a similar approach may be valuable for some severely indebted SIDS. Such a programme could provide many countries with a much-needed fresh start, especially in the Caribbean where the problem is most acute.

The amounts of money concerned are also relatively small for creditors – at least when compared to previous debt cancellation schemes. A clearly defined mechanism could be developed to facilitate a fair and orderly process. Eligibility criteria as well as the terms and conditions for such an initiative require further work but the international community could invite independent experts to develop various options for consideration. These experts should liaise closely with all stakeholders, including debtor and creditor governments, multilateral institutions, private creditors, UN agencies and civil society organizations.

Debt restructuring cannot, alone, ensure long-term debt sustainability and a ‘fresh start’ will need to be combined with measures to boost domestic resources and improve public expenditure and debt management; in this regard, it may be considered ‘necessary but not sufficient’.



## 2. Debt for Nature/ Debt for Climate Swaps

Small island developing States are especially vulnerable to environmental degradation and climate change. Crucially, countries' abilities to adapt to climate change will depend not just on the actions of national governments but more critically on global commitments to tackle climate change, as well as the volume and availability of external finance for climate adaptation. As such, external factors are likely to support or limit countries' progress on sustainable development regardless of national level policies in this area.

SIDS' climate change adaptation needs are among the highest in the world when measured as a proportion of national output. The capital investments required to finance climate change adaptation are immense and likely to be beyond the capacities of many small island governments. Innovative financing mechanisms, such as debt-for-nature and debt-for-climate swaps could help contribute to the volume of resources available to fund climate adaptation and mitigation, as well as help countries to reduce their debt levels.

The Commonwealth Secretariat (2013) has outlined one option for the scaling-up of debt swaps for climate change adaptation and mitigation, aimed specifically at small states<sup>32</sup>. It proposes that multilateral institutions gradually write down 100% of small states' concessional multilateral debt stock, contingent on the annual payment in local currency of the debt service into a trust fund over 10-15 years. The trust fund would be governed by respective national Central Banks and the funds would be used to finance climate change adaptation and mitigation projects. Under the Commonwealth's proposals, bilateral donors would reimburse the multilateral lenders for the amounts of debt 'forgiven' (as happened with the HIPC Initiative). Based on 2010 data and assuming 100% write down of small states' multilateral concessional debt stock, the total cost of the Commonwealth's proposed initiative could range from an estimated US\$4.5 million to US\$4.5 billion depending on donors' preferred eligibility criteria.

Another option, developed by UNDP (2010), is multi-creditor debt swaps<sup>33</sup>. Under this proposal, official bilateral creditors simultaneously 'club together' to agree on a debt swap for a particular country (or countries). The debt service which would have been paid to several lenders is then paid by the debtor in local currency into a single trust fund for mutually agreed expenditures. This idea, while more ambitious, would free-up greater volumes of finance and would have the advantage of one management and reporting system. It could also be used to reduce both bilateral and multilateral debt.

Given the relatively small amounts of money treated, debt swaps represent a heavy administrative burden; a whole series of political and technical discussions must take place between the debtor, selected creditors and conservation organizations. This can take considerable time. Debt conversions are also by nature shorter-term injections of extra funds. Care must therefore be taken to ensure that debt swaps complement longer-term strategies for the protection and improvement of key ecosystems.

Despite these limitations, debt swaps are an innovative financial instrument which can certainly be explored – and exploited – more actively by several small island developing States. They can help to boost debtor countries' fiscal space in the short-term and release additional funds for much-needed expenditures in valuable environmental and conservation programmes. It may be useful to compile lessons learned from previous experiences (such as the most recent experience in the Seychelles) so that countries without experience of such instruments can learn from others and the international community can ensure that future debt swaps are as effective as they can be.

<sup>32</sup> For further elaboration on the Commonwealth proposal, see: Commonwealth Secretariat (2013): Multilateral debt relief for climate change adaptation and mitigation: [http://secretariat.thecommonwealth.org/files/256664/FileName/Multilateral\\_Debt\\_Relief\\_Final%2813-03-13%29.pdf](http://secretariat.thecommonwealth.org/files/256664/FileName/Multilateral_Debt_Relief_Final%2813-03-13%29.pdf)

<sup>33</sup> See: UNDP (2010), Achieving Debt Sustainability and the Millennium Development Goals in Small Island Developing States: <http://www.undp.org/content/undp/en/home/librarypage/mdg/achieving-debt-sustainability.html>

### 3. Linking Loan Repayments to Economic Performance

External debt management constitutes one of the main tasks that governments have to contend with on a daily basis. It is especially challenging for developing countries. In a context where domestic financial resources are scarce, accessing international finance, private and public, concessional and non-concessional is critical to fund countries' development efforts.

Managing international financial flows can be a challenging task. External shocks – which SIDS are especially exposed and vulnerable to – can easily undermine countries' ability to repay their debt and potentially lead to costly sovereign debt defaults. Debt obligations, on the other hand, have a strong pro-cyclical component: they are easier to meet during times of economic growth, while becoming relatively more onerous to service during economic slowdowns and recessions, making it harder for governments to pursue countercyclical fiscal policies.

Several 'innovations' in financial instruments may help overcome some of these challenges, and may therefore be useful to SIDS.

#### GDP-linked official lending

Proposals to index repayments on sovereign bond to GDP performance are not new. For various reasons, however, their practical application has been limited, with only a few countries opting for this type of debt financing instrument, mainly as part of a debt restructuring programme<sup>34</sup>.

The underlying idea behind GDP-linked securities is to link debt repayments to economic performance, thereby stabilizing external debt dynamics faced by a country and, consequently, minimizing the probability of sovereign debt default. It is a form of linking debt service repayments to a country's ability to pay, as determined by the macroeconomic and external conditions it faces at any given point in time. In a way, this type of security acts as an insurance mechanism allowing issuing countries to hedge against episodes of poor economic performance and the subsequent risk of a (costly) sovereign debt default. Unlike other state-contingent debt mechanisms, such as collective action clauses (CACs) and sovereign contingent convertible bonds (CoCos), which are designed to improve debt crisis resolution processes and only come into effect in the event of debt distress, indexing securities to GDP performance constitutes an ex-ante and preventive mechanism, that seeks to avoid this type of episode in the first place<sup>35</sup>.

Most literature – and proposals – focus on the indexation to GDP of sovereign bonds floated in international financial markets. UNDP (2015) however, puts forward the case for indexing developing countries' external public and publicly guaranteed (PPG) debt with *official* creditors to their GDP performance<sup>36</sup>. Focusing on international official lending, as opposed to other forms of sovereign debt involving private sector creditors (e.g. sovereign bonds), might offer a better chance of making this kind of financing the norm in financial markets. Official creditors are able to operate with a longer time horizon and can therefore factor in the long term benefits that can be derived from this type of debt financing, especially in terms of reducing the risk of sovereign default. Many (if not most) official creditors also have an international development agenda and may see in the adoption of GDP-linked lending a way of supporting global efforts to increase and improve the quality of finance for development. Adopting GDP-indexation principles for debt with official creditors avoids dealing with some of the difficulties experienced and reticence found among market

<sup>34</sup> For a more detailed discussion of the factors behind the lack of practical experiences with GDP indexed debt, see: Conceição P. and Warren-Rodriguez A. (2015) UNDP, Risk-Informed Finance for Development – Enhancing Risk Management and Resilience Through GDP-Linked Official Lending

<sup>35</sup> For a more detailed discussion of the case for GDP-indexed bonds, see UNDP, *ibid.*

<sup>36</sup> *Ibid.*

operators with developing an effective market for GDP-linked securities. Eventually, the adoption by official creditors of GDP-indexation principles could have a demonstration effect on financial markets, by demonstrating the macro- and debt stabilizing effects of this type of financial instruments.

SIDS and other developing countries could potentially derive important benefits from this type of development finance modality, as a way of contributing to a more sustainable path of socio-economic development. An important feature of GDP-linked debt is its counter-cyclical nature. By reducing debt payments in times of economic slowdown, when government revenue also typically declines, it reduces the pressure to cut back on other budget expenditures, implicitly creating greater fiscal space for expansionary fiscal policies. Similarly, increased debt service payments during episodes of high economic growth reduce the scope for expansionary fiscal policies that could potentially fuel growth acceleration spouts. As discussions deepen over how to finance the SDGs in ways that are sustainable, the international community should explore how it can make more effective use of innovations such as these.

## Counter-cyclical loans

Counter-cyclical loans (CCLs) are another mechanism that could help countries better cope with external shocks. Counter-cyclical lending contracts are those in which it is agreed ex-ante that debt service will automatically be allowed to fall, or become zero, in periods when large external shocks (measured in a particular way, e.g. a fall in value of exports or a natural disaster) hit a country.

Such an instrument builds flexibility ex-ante into the loan contract and may help prevent the build-up of new debt since they can reduce the need for new liquidity in the face of external shocks. They can also help to alleviate countries' foreign exchange situation in the wake of an external shock. For the debtor country it would have the important advantages of automaticity (implying no additional conditionality) and predictability (as the conditions under which debt service can be suspended are established ex-ante).

The Agence Française de Développement, (AFrD) has developed such a financial instrument which is now in operation in several HIPC<sup>37</sup>. The French counter-cyclical loan (CCL) replaces 30 year concessional loans at 1% interest, with a fixed grace period (of 10 years) for similar concessional loans, but with a shorter fixed grace period (5 years) and a floating grace period, (also of 5 years); the latter debt holiday on capital repayments can be used automatically if the debtor country chooses to do so, allowing a suspension of debt service by the debtor country if the shock is estimated to be equivalent to 1.5% of GDP or more.

Thus far, counter-cyclical loans have been used only by the Agence Française de Développement, and only in certain low-income countries, however this instrument could be especially useful to those countries hit by frequent – and severe – external shocks such as small island developing States. If CCLs were to become an important proportion of SIDS' debt, debt service 'holidays' could become a valuable and desirable source of foreign exchange and fiscal expenditure savings when major shocks do strike. The Commonwealth Secretariat has been undertaking significant analytical and advocacy work to highlight the potential benefits of such an instrument for SIDS<sup>38</sup>.

<sup>37</sup> The AFD has used such loans in: Burkina Faso, Mali, Mozambique and Tanzania.

<sup>38</sup> See for example: Griffith- Jones, S. Analysis of instruments to help countries cope with unforeseen shocks: the case of the CCL: <http://www.stephanygj.net/papers/AnalysisProposalsInstrumentsHelpCountriesUnforeseenShocks2012.pdf>

## 4. Revise International Policies on Access to Concessional Finance: From 'Graduation' to 'Gradation'

As noted earlier, many SIDS are not eligible to receive concessional finance from the multilateral lenders due to higher income per capita levels. Some bilateral donors also use income per capita to guide their bilateral aid programmes. The rationale behind this approach is that at higher income levels, countries are, on the whole, able to mobilize more domestic resources for development and can leverage private finance.

However, the data shows that, despite similar income per capita levels, countries can have extremely differentiated capacities to mobilize domestic resources and to access external finance. Many SIDS have low capacities to mobilize domestic resources and to leverage external public and private finance. Capacity to mobilize domestic resources is measured by: tax revenues, public expenditure, cash surplus/deficit and government consumption as a percent of GDP; the ability to leverage external finance is measured by: exports of goods and services, foreign direct investment, aid flows and international reserves as a percent of GDP<sup>39</sup>.

An analysis based on these indicators places many SIDS in the lower left-hand quadrant of figure 31, (category D) i.e. they have more limited capacities to mobilize domestic and international finance when compared to other countries. Even 'wealthier' SIDS, i.e. those classified as upper-middle-income also fall into this category, such as Antigua and Barbuda, Dominican Republic, Jamaica and St. Kitts and Nevis. Countries at similar income levels also face very different sustainable development challenges and/or specific vulnerabilities.

This suggests a need to review international policies on eligibility for, and access to, concessional finance from both multilateral and bilateral lenders.

One option is to move towards an approach which is more like that used by the UN to classify LDCs. The UN uses three criteria for identifying countries as LDCs:

1. Gross national income (GNI) per capita
2. The human asset index (HAI)
3. Economic vulnerability index (EVI)<sup>40</sup>

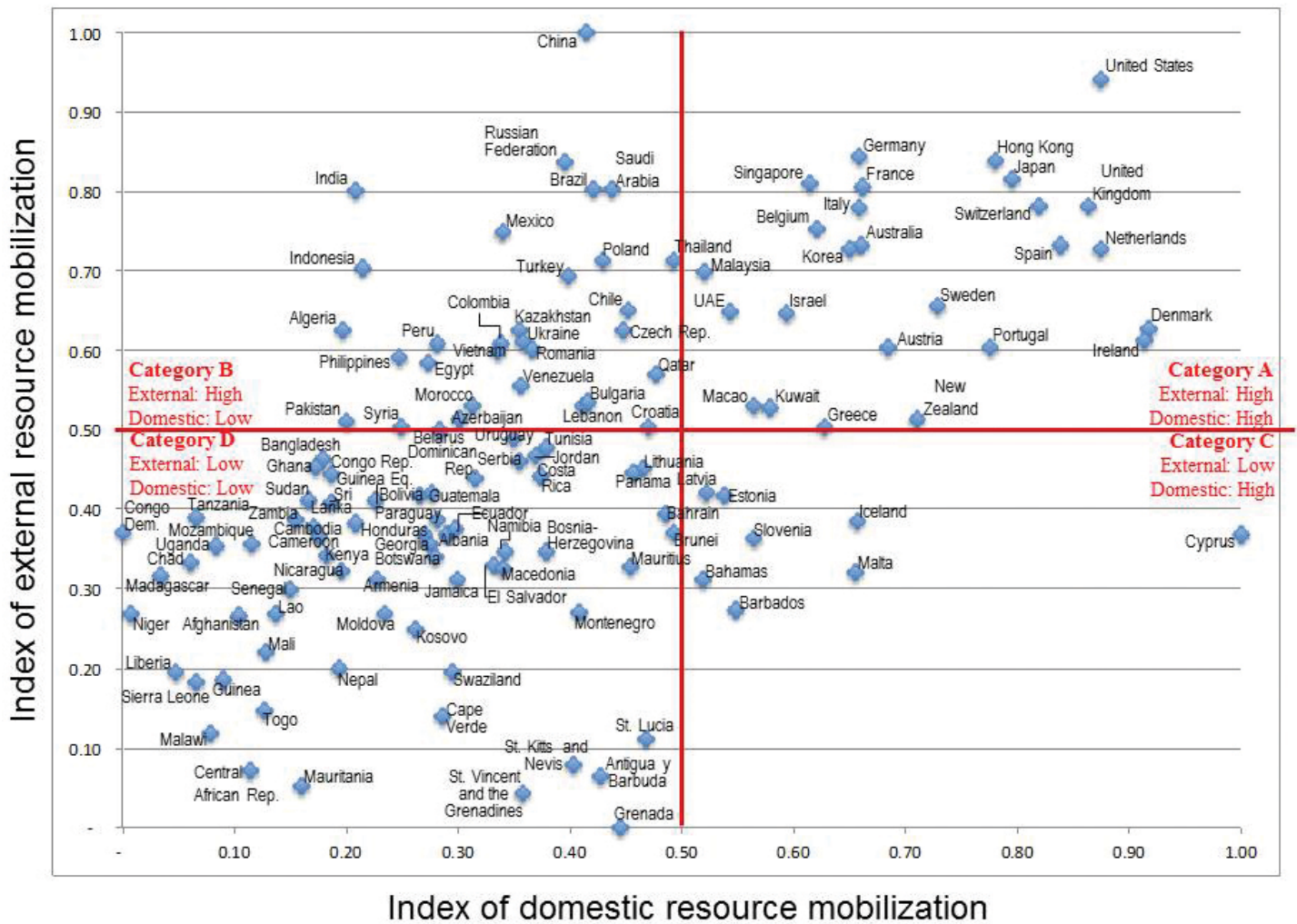
These criteria could be supplemented by three additional indices below:

4. Domestic resource mobilization capacity (as measured by tax revenues, public expenditure, cash surplus/deficit and government consumption as a percent of GDP);
5. Access to external finance (as measured by exports of goods and services, foreign direct investment, aid flows and international reserves as a percent of GDP);
6. Type of programme being funded (e.g. infrastructure, social services etc.)

<sup>39</sup> For further elaboration, see Sagasti, F. (2013), From 'graduation' to 'gradation' in international development finance: <http://www.developmentprogress.org/blog/2013/12/10/graduation-gradation-international-development-finance> and also: UNDP (2014) Where Next for Aid? The Post-2015 Opportunity: [http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/development\\_cooperationandfinance/where-next-for-aid--the-post-2015-opportunity/](http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/development_cooperationandfinance/where-next-for-aid--the-post-2015-opportunity/)

<sup>40</sup> For more information, see: UN DESA: [http://www.un.org/en/development/desa/policy/cdp/ldc\\_info.shtml](http://www.un.org/en/development/desa/policy/cdp/ldc_info.shtml)

**Figure 31: SIDS have lower capacities to mobilize domestic and external resources**



Source: Sagasti, 2013

Taken together, these indices provide a more holistic picture of individual countries’ specific circumstances, vulnerabilities and financing needs. A mix of financial instruments – concessional and non-concessional – could then be tailored to each country<sup>41</sup>. More work is required, of course, to operationalize such an approach and to evaluate the ‘weighting’ that each criteria should be given relative to the other.

Nevertheless an important opportunity is presented by the post-2015 financing for development discussions to seek a consensus on the need to revise current approaches to eligibility for concessional finance – for all developing countries – and to replace outdated systems with more tailored criteria for the allocation of international public finance. As a practical next step, the international community could commission independent expert opinions on alternatives, evaluating objectively the pros and cons of new approaches.

<sup>41</sup> For further elaboration on this proposal, see: UNDP (2014) Where Next for Aid? The Post-2015 Opportunity: [http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/development\\_cooperationandfinance/where-next-for-aid--the-post-2015-opportunity/](http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/development_cooperationandfinance/where-next-for-aid--the-post-2015-opportunity/)



## Concluding Remarks

The evolving development financing landscape presents considerable opportunities for small island developing States in the future. Yet they continue to experience severe constraints when it comes to both domestic and external resource mobilization. Future opportunities include an expansion in environmental and climate focused international public finance combined with the emergence of new and innovative financial instruments. The donor and lender pool is also expanding. Constraints include SIDS' capacities to access these resources and use them effectively. The international community also has a responsibility to ensure a balance between adaptation and mitigation resources, and that the most climate vulnerable countries are able to leverage this finance. SIDS' vulnerability to shocks is also unlikely to diminish, and adequate emergency and shocks finance will be critical at the international level. Finally, borrowers and lenders must work together to ensure sustainable levels of debt.

There is no question that the international development finance architecture can be strengthened and made more responsive to the special sustainable development challenges of SIDS. And many ideas have been tabled in this direction. The Addis Ababa conference on financing for development in July 2015 provides another important opportunity to reinvigorate this debate. As proud custodians of some of the world's most precious natural resources, our oceans (and more), the fate of small island developing States concerns us all.



Marovo Lagoon in the Western Province of the Solomon Islands

Credit: Eskinder Debebe, UN Photo



# Selected References

---

Bernal, R.L. (2012), China and small-island developing States, *The China Monitor*

Briguglio, L. (2013), *The Root Causes of the Debt Challenges in Commonwealth Small Vulnerable Economies*, Commonwealth Secretariat

Commonwealth Secretariat (2013). *Background Paper: A time to act: Addressing Commonwealth Small States' Financing and Debt Challenges*. Washington DC.

Commonwealth Secretariat (2013): *Multilateral debt relief for climate change adaptation and mitigation*: [http://secretariat.thecommonwealth.org/files/256664/FileName/Multilateral\\_Debt\\_Relief\\_Final%2813-03-13%29.pdf](http://secretariat.thecommonwealth.org/files/256664/FileName/Multilateral_Debt_Relief_Final%2813-03-13%29.pdf)

Commonwealth and UNDP work with Caribbean on debt challenges (2013). *Workshop on Countercyclical Loans for the Management of Exogenous Shocks in Small Vulnerable Economies (SVEs) and Non-Traditional Sources of Development Finance*: [http://www.secretariat.thecommonwealth.org/Document/190628/159719/253064/commonwealth\\_and\\_undp\\_work\\_with\\_caribbean\\_on\\_debt/](http://www.secretariat.thecommonwealth.org/Document/190628/159719/253064/commonwealth_and_undp_work_with_caribbean_on_debt/)

Conceição P. and Warren-Rodriguez A. (2015) *UNDP, Risk-Informed Finance for Development – Enhancing Risk Management and Resilience through Gdp-Linked Official Lending*

Greenidge, K., Craigwell, R., Thomas, C., and Drakes, L. (2012), *Threshold Effects of Sovereign Debt: Evidence from the Caribbean*, IMF Working Paper, IMF

Griffith- Jones, S. *Analysis of instruments to help countries cope with unforeseen shocks: the case of the CCL*: <http://www.stephanygj.net/papers/AnalysisProposalsInstrumentsHelpCountriesUnforeseenShocks2012.pdf>

Hurley, G. (2013) *Cash in times of crisis*: <http://www.rightingfinance.org/?p=497>

Hurley, G. (2013) *The Caribbean's silent debt crisis. New policies are needed to break the cycle of debt dependency*: <http://speri.dept.shef.ac.uk/2013/10/28/caribbeans-silent-debt-crisis/>

Hurley, G. and Sekhran, N. (2014) *Small islands need debt relief to pay for climate change*: <http://www.theguardian.com/global-development-professionals-network/2014/nov/06/small-islands-debt-relief-climate-change-adaptation>

*Joint World Bank–IMF Debt Sustainability Framework for Low-Income Countries'*: <https://www.imf.org/external/np/exr/facts/jdsf.htm>

IMF, *World Economic Outlook*, 2015

IMF (2013). *Caribbean Small States: Challenges of High Debt and Low Growth*. Washington DC: International Monetary Fund

- IMF (2013). *Macroeconomic Issues in Small States and Implications for Fund Engagement*. Washington DC: International Monetary Fund
- IMF (2013). *World Economic Outlook: Hopes, Realities, Risks*. Washington DC: International Monetary Fund
- IMF (2013). *Preserving Debt Sustainability in Low-Income Countries in the Wake of the Global Crisis*. Washington DC: International Monetary Fund
- IMF (2013), *Heavily Indebted Poor Countries (HIPC) Initiative And Multilateral Debt Relief Initiative (MDRI) – Statistical Update* <https://www.imf.org/external/np/pp/eng/2013/121913.pdf>
- IMF (2012), *The Challenges of Fiscal Consolidation and Debt Reduction in the Caribbean*: <https://www.imf.org/external/pubs/ft/wp/2012/wp12276.pdf>
- OECD statistical database
- Paris Club: <http://www.clubdeparis.org/en/>
- Royal Bank of Canada (2013), *PetroCaribe: A handout, not a hand-up, which may soon run out*
- Sagasti, F. (2013), *From 'graduation' to 'gradation' in international development finance*: <http://www.developmentprogress.org/blog/2013/12/10/graduation-gradation-international-development-finance>
- Samoa Pathway, 2014: <http://www.sids2014.org/index.php?menu=1537>
- Sanders, R. (2013). "Leaders in self-denial as Caribbean economic crisis worsens." *Caribbean360.com*, 7 November, 2013. Available from: <http://www.caribbean360.com/index.php/opinion/1083230.html#ixzz2jzF4PG6c>
- The Nature Conservancy: <http://www.nature.org/newsfeatures/pressreleases/debt-swap-to-finance-marine-conservation-in-the-seyelles.xml>
- UN System Task Team Working Group on Sustainable Development Financing (2013), "The Variety of National, Regional and International Public Sources for Development Finance". New York: UN
- UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (UN-OHRLLS) (2013). *Small island developing States (SIDS) Statistics*. New York: United Nations
- UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (UN-OHRLLS) (2009). *The LDCs: Things to Know, Things to Do*: <http://unohrlls.org/UserFiles/File/LDC%20Documents/Advocacy%20brochure%20english%20for%20web.pdf>
- UNDESA (2013), *Financing for Sustainable Development in Small Island Developing States (SIDS)*: [https://docs.google.com/gview?url=http://sustainabledevelopment.un.org/content/documents/1153FFSD\\_SIDS\\_final.pdf&embedded=true](https://docs.google.com/gview?url=http://sustainabledevelopment.un.org/content/documents/1153FFSD_SIDS_final.pdf&embedded=true)
- UN MDG Gap Task Force (2013). *The Global Partnership for Development: The Challenge We Face*. New York: United Nations Publication
- UNDP (2010), *Discussion Paper: Achieving Debt Sustainability and the MDGs in small island developing States*

UNDP (2010), Discussion Paper: Jamaica's Debt Exchange: A case study for Heavily Indebted Middle-Income Countries: <http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/jamaica-debt-exchange/jamaicas-debt-exchange/>

UNDP, Caribbean Human Development Report 2012: <http://www.undp.org/content/undp/en/home/librarypage/hdr/caribbean-human-development-report-2012-l/>

UNDP (2014), Where Next for Aid? The Post-2015 Opportunity: [http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/development\\_cooperationandfinance/where-next-for-aid--the-post-2015-opportunity/](http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/development_cooperationandfinance/where-next-for-aid--the-post-2015-opportunity/)

UN ECLAC (2015), Financing for Development in Latin America and the Caribbean, A Strategic Analysis from a Middle-Income Country Perspective

World Bank, World Development Indicators (2015)



The United Nations Office of the  
High Representative for Least Developed Countries,  
Landlocked Developing Countries and  
Small Island Developing States  
(UN-OHRLLS)

[www.unohrlls.org](http://www.unohrlls.org)  
[ohrlls-unhq@un.org](mailto:ohrlls-unhq@un.org)