Small states face unique development challenges. Due to their small population and economic base, these countries are particularly vulnerable to exogenous shocks, such as natural disasters and climate change. With limited economic opportunities and significant migration, they often face capacity constraints.

1. This section is derived from Small States: Vulnerability and Concessional Finance, Technical Note, OPCS, July 2018.
The Small States Forum (SSF) is an important platform for high-level dialogue on how the World Bank Group (WBG) can help to address small states’ special development needs. The SSF comprises 50 members, including 42 countries classified as small states according to the World Bank definition (i.e., those with a population of 1.5 million or less) and eight countries with relatively larger populations that share similar challenges.

While sharing common challenges, the SSF is a very diverse group. There is high variation among members in terms of population size, income levels, geography and other features that result in a wide spectrum of development outcomes. A few examples are provided below.

**POPULATION** • Many SSF members are micro states (i.e., with a population of less than 200,000 people). Population size ranges from 10,000 people in Tuvalu to 2.9 million people in Jamaica.

**GEOGRAPHY** • SSF countries are distributed across all regions and about two thirds are island states. The remaining one third includes five land-locked countries (Bhutan, Botswana, Lesotho, the Kingdom of Eswatini and San Marino).

**REMTENESS** • Several small states, particularly islands, are among the most remote in terms of distance to the nearest international markets (e.g., Pacific islands).

**LAND AREA** • A number of island states have a very small land area (e.g., Nauru has 20 square kilometers), while non-island states such as Namibia and Botswana have 4.5 and 3.1 times the area of all small island states combined, respectively.

Note: Small States consist of Islands, land-locked states and coastal states. Those countries outside the inner circle for Islands are land-locked or coastal.

**Countries underlined indicate FCVs that are classified as fragile according to the Harmonized List of Fragile Situations.


3. Formerly known as Swaziland.
FRAGMENTATION AND DISPERSION • Some countries are archipelagos dispersed over a broad ocean area (e.g., Kiribati has an area of 810 square kilometers distributed in 35 atolls/islands spread over 3.6 million square kilometers of ocean).

VULNERABILITY TO NATURAL DISASTERS AND CLIMATE CHANGE • Many small states are disproportionately vulnerable to a range of natural disasters, particularly those located in disaster-prone areas. About one third of small states are highly vulnerable to climate change, including rising sea-level and droughts.

DEBT BURDEN • Significant growth volatility, relatively slower growth and weak fiscal management have contributed to substantial debt accumulation in many small states. Debt levels for these countries are on average higher than for other developing countries, although there is considerable diversity across individual countries.
The World Bank Group has a long-standing and growing commitment to supporting small states’ development efforts. Small states are a priority for the entire Bank Group, including the International Development Association (IDA), the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA).

In recent years, the World Bank Group support to small states has been ramping up, particularly in three broad areas:

I. Enhancing development finance
II. Fostering private investment and diversification
III. Strengthening client capacity
IDA has been the lynchpin of Bank support to small states. In recognition of their vulnerability due to small size and often geographical isolation, IDA has extended special treatment to small states in terms of access, financing volumes, and concessionality.

- IDA has been the **leading multilateral provider of development assistance** to small economies, accounting for **28 percent** of multilateral official development assistance (ODA) to the SSF members in 2014-16.
- **Small economies have been the largest beneficiaries of the past four IDA replenishments primarily due to a ten-fold increase in IDA’s annual base allocation** from SDR 1.5 million in IDA15 to SDR 3 million in IDA16, SDR 4 million in IDA17, and SDR 15 million in IDA18.
- In per capita terms, IDA17 financing to eligible small states was **five-times higher** than to all IDA countries.
- Core allocations to the 23 IDA-eligible SSF members increased from **$0.9 billion in IDA17** to about **$1.8 billion under IDA18**.
- Total IDA commitments to the 23 IDA-eligible SSF members increased from **$604 million in IDA15** to about **$1.2 billion in IDA17**. Total IDA commitments to this group in the first year of IDA18 alone were **$500 million**.

### I. ENHANCING DEVELOPMENT FINANCE

**IDA FINANCING OF SSF COUNTRIES**

IDA has been the lynchpin of Bank support to small states. In recognition of their vulnerability due to small size and often geographical isolation, IDA has extended special treatment to small states in terms of access, financing volumes, and concessionality.

**Access to IDA resources**

IDA provides concessional resources to the world’s poorest countries—those with a per capita income of $1,145 or below. Based on creditworthiness considerations and policies targeted to address small states’ special needs—such as the **Small Island Economies Exception** introduced in 1985—many middle-income small states have access to IDA resources even though their per capita incomes are above the IDA income threshold. In all, there are 23 IDA-eligible SSF countries, including 20 small states. Six of these countries have Blend status (i.e. are eligible to borrow from both IBRD and IDA).

**Volume of IDA resources**

With a view to strengthening IDA's financial support to small economies, IDA’s annual base allocation has increased ten-fold since IDA 15 (from SDR $1.5 million to SDR 15 million in IDA18). In IDA18, aggregate core allocations to IDA-eligible SSF countries doubled to $1.8 billion relative to IDA17, and for many small states they more than tripled.

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4. The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries’ official reserves. The value of the SDR is based on a basket of five currencies—the U.S. dollar, the Euro, the Chinese renminbi, the Japanese yen, and the British pound sterling. (Source: IMF)
In 1985, the World Bank’s Board approved the Small Island Economies Exception in recognition of small islands’ special characteristics (of size, remoteness, etc.) resulting in similar challenges to those faced by low-income countries. At the time, six small island economies that were due to graduate from IDA were granted the Exception.

Currently, 15 middle-income small island states have access to IDA under the Exception, including 10 countries with IDA-only status and five Blends.* Under the Exception, countries are eligible for IDA concessional credits on Small Economy Terms until they graduate to IBRD-only status. Except for St. Kitts and Nevis (which was granted the Exception in 1985 and graduated to IBRD-only status in 1994), all island economies granted the Exception have remained IDA-eligible.

In terms of actual financing, total IDA commitments to the 23 IDA-eligible SSF members increased from $604 million in IDA15 to about $1.2 billion in IDA17. In per capita terms, IDA’s financial support to small states is five-times higher than to all IDA countries.

**IDA concessional financing terms**

Most IDA-only SSF countries receive grants based on debt distress ratings determined under the World Bank/IMF Debt Sustainability Framework for low-income countries (LIC-DSF). A revised LIC-DSF, effective July 2018, expands the stress testing framework in order to more systematically capture the specific circumstances faced by small states, such as vulnerability to natural disasters.

Credit terms for IDA eligible small states are IDA’s most concessional terms.

*IDA-only status (Kiribati, Micronesia, Marshall Islands, Maldives, Samoa, Sao Tome and Principe, Solomon Islands, Tonga, Tuvalu, Vanuatu); Blends (Cabo Verde, Dominica, St. Lucia, Grenada, St. Vincent and the Grenadines)
Credit terms for IDA eligible small states are IDA’s most concessional terms. In all, IDA credits on small economy terms in FY18 had a grant element of 61 percent, which compares to a grant element of 53 percent for IDA credits on regular terms.

**Additional opportunities for financing: IDA’s Windows**

IDA-eligible SSF countries also have access to additional financing from various IDA windows, notably, the Crisis Response Window (CRW), the Regional Program, and the new Private Sector Window (PSW) introduced in IDA18.

**IBRD FINANCING OF SSF COUNTRIES**

IBRD financing is available to 23 IBRD-eligible SSF countries, which include 19 small states. Total IBRD lending commitments to this group in FY15-17 amounted to over $1 billion, with Jamaica and Gabon each accounting for over one third, followed by Botswana with 10 percent. In per-capita terms, Seychelles has been the top IBRD borrower ($70), followed by Gabon ($43) and Jamaica ($35). Some eligible small states do not borrow from IBRD because they may require credit enhancements (Nauru, Palau), or have limited borrowing headroom.

Thanks to the Capital Increase policy package endorsed by IBRD shareholders in 2018, eligible small states will benefit from a doubling of their IBRD base allocation and a waiver from price increases.

**MOBILIZING OTHER SOURCES OF DEVELOPMENT FINANCING**

The WBG is working with small states to develop innovative financing mechanisms for climate and disaster response. Some of these mechanisms are particularly relevant for IBRD small states that are not eligible for IDA financing.
Climate Finance: Turning vulnerability into opportunity

The World Bank is supporting the mobilization of climate finance in small states through blue bonds, starting with a prototype of the world’s first blue bond in the Seychelles. A $20 million World Bank package approved in September 2017—to improve the sustainability of the Seychelles’ marine resources—includes an IBRD guarantee of EUR5 million to enable the issuance of a $15 million blue bond in 2018. The World Bank Treasury has provided technical assistance for structuring of the blue bond. The proceeds of the bond will be used as grants for fisheries management activities as well as loans to encourage local public and private investment in sustainable fishing and the protection of ocean resources.

Green bonds provide another opportunity for small states to raise climate financing. On October 2017, Fiji, a small island state exposed to floods and tropical cyclones, became the first emerging market to issue a sovereign green bond. The 100 million Fijian dollar ($50 million) bond received overwhelming interest from domestic investors. The bond was structured with technical assistance from the World Bank Treasury and the IFC under a three-year Capital Markets Development Project, supported by the Australian Government. The proceeds of the bond will be used to fund projects promoting low carbon and climate resilient growth consistent with Fiji’s Green Growth Framework.
The World Bank has an extensive track record of supporting the development and implementation of innovative financing mechanisms.

Since its introduction in IDA 15, the IDA Crisis Response Window (CRW) has provided additional resources totaling $309 million to help several SSF members respond to a range of severe natural disasters, including tropical storms, floods and droughts.

In 2018, Dominica received $50 million in CRW resources to help the reconstruction following Hurricane Maria, which resulted in damages estimated at 226 percent of GDP. Tonga also received $20 million from the CRW following Tropical Cyclone Gita, which caused damages estimated at 38 percent of GDP.

The Catastrophe Drawdown Option (CAT-DDO) is a Development Policy Financing instrument that can provide immediate liquidity to countries in the aftermath of a natural disaster. The funds are pre-approved based on a sound disaster risk management program and an adequate macroeconomic framework. The CAT-DDO is now available to IDA countries starting in IDA18. In FY18, CAT-DDOs are being prepared in the Maldives, St. Lucia (under discussion), Samoa, and Cabo Verde, while the Seychelles renewed its CAT-DDO for a second 3-year period.

The Bank has also supported the establishment of two successful regional risk insurance pools—the Caribbean Catastrophe Risk Insurance Facility (CCRIF) and the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI). In 2017, the CCRIF paid US$62 million to 11 countries, including US$20 million to Dominica and US$7 million to Trinidad and Tobago, while the PCRAFI paid US$3.5 million to Tonga after Tropical Cyclone Gita in 2018.

Early warning systems play a critical role in protecting lives, livelihoods and assets. The World Bank has supported the establishment of early warning systems in several small states. When category 5 Cyclone Pam hit Vanuatu in 2015, the World Bank-supported National Warning Center was instrumental in limiting life loss despite Pam’s devastating impact. Currently, the IDA-supported Pacific Resilience Program (PREP) is helping to improve the quality of forecasting and warning services in Samoa, Tonga and Marshall Islands. The World Bank is also helping strengthen early warning systems in Caribbean states such as St. Lucia (flash floods guidance system) and Jamaica (hydrometeorological services). In 2016, the Global Facility for Disaster Reduction and Recovery and the World Bank, launched the Climate Risk and Early Warning Systems (CREWS) initiative. This initiative aims to strengthen multi-hazard early warning systems in least developed countries, including small island states.
II. FOSTERING PRIVATE INVESTMENT AND DIVERSIFICATION

Private investment is a key driver of any country’s economic development. However, small states face challenges in attracting private investment due to their small market size, limited economic opportunities, and often remoteness. The Bank Group seeks to promote private investment in small states through its private arm, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) as well as by strategically leveraging IDA and IBRD financing.

IFC INVESTMENTS

Using new and existing platforms, the IFC is promoting private investment in small states, with a focus on fragile states. Under its Small and Medium Enterprise (SME) Facility, IFC, in collaboration with Treasury, has set up a risk-sharing facility in Sao Tome and Principe and plans to develop additional schemes for Cabo Verde and the Pacific Islands. Under the Agribusiness Facility, $16.7 million was invested in 2017 to support the Solomon Islands (tuna sector), Guinea-Bissau (fruits and vegetables), while in Bhutan IFC has invested in a semi-green field company to produce hazelnuts for export. IFC is also providing advisory services on Public-Private Partnerships (PPPs) to nine small states on airports, power, water and sewerage.

The IFC is also leveraging the new IDA PSW, effective July 2018, including to support housing finance in West Africa (benefitting Guinea-Bissau), risk-sharing in the Pacific and a private sector telecom operator in Comoros9. MIGA promotes private foreign investment through the provision of political risk insurance. MIGA currently supports projects in Djibouti, Gabon, Jamaica and Namibia.

DE-RISKING

De-risking is the phenomenon of financial institutions terminating or restricting correspondent banking relationships with clients or categories of clients to avoid risk. The World Bank Group is supporting small states—which are particularly vulnerable to this trend—to help address some of the causes of de-risking. One of the reasons given by large banks for de-risking is a concern about implementation of anti-money laundering standards. The Bank supports countries to improve the legal frameworks and supervision of these obligations, including through National Risk Assessments (NRAs) of money laundering. NRAs have been completed in 16 SSF member countries, and 11 are ongoing.

In 2018, the World Bank published a correspondent banking survey, investigating solutions to the decline in banking services in emerging markets, including Samoa, Tonga and Jamaica.

9. Blend and Gap small states are not eligible for PSW resources, unless they are classified as fragile.
ATTRACTING INVESTMENTS IN THE BLUE ECONOMY

The World Bank Group is supporting the transition to a blue economy in small states, including through a series of regional initiatives. In 2016, with Bank technical support, Grenada became the first eastern Caribbean state to develop a vision for protecting its “blue space” and to map its road toward blue growth. Under the World Bank-supported Caribbean Regional Oceanscape Project, Grenada’s model is being carried forward in Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines.

MAXIMIZING FINANCING FOR DEVELOPMENT: SUSTAINABLE TUNA FISHERIES IN THE SOLOMON ISLANDS

With one of the world’s largest and most plentiful fishing grounds, the Solomon Islands relies on tuna for revenue, food security and exports. The World Bank Group promotes the sustainable management of tuna fisheries in the country. IDA supports the implementation of sustainable fishing practices under the vessel day scheme (VDS) supported by the Pacific Islands Regional Oceanscape Program, while the IFC has made investments in SoTuna tuna processing company—where two thirds of workers are women—and the National Fisheries Development (NFD), both owned by the Tri Marine Group. As a result, the country captures more value from its tuna resources, providing more jobs and expanding opportunities for women.

SIMILARLY, THE PACIFIC REGIONAL OCEANSCAPE PROGRAM PROJECT IS HELPING TO STRENGTHEN THE SHARED MANAGEMENT OF SELECTED OCEANIC AND COASTAL FISHERIES IN THE SOLOMON ISLANDS, MICRONESIA, MARSHALL ISLANDS,TUVALU AND WILL EXPAND TO KIRIBATI, AND TONGA. THE WEST AFRICA REGIONAL FISHERIES PROGRAM AND THE SOUTH WEST INDIAN OCEAN FISH PROGRAM ALSO SUPPORT IMPROVED FISHERIES MANAGEMENT IN CABO VERDE, GUINEA BISSAU, COMOROS, MALDIVES AND SEYCHELLES AT THE REGIONAL, NATIONAL AND COMMUNITY LEVELS.

ATTRACTING INVESTMENTS IN DIGITAL INFRASTRUCTURE

The World Bank is helping small states’ efforts to develop connectivity infrastructure to drive Digital Dividends. Significant investments in broadband infrastructure are underway, in some cases in partnership with the private sector.
For example, with Bank support submarine cable connections have been completed in Tonga (including outer islands), Samoa, and Fiji and work is on-going in Kiribati (including outer islands), Micronesia, and Tuvalu (pipeline). Accompanying these investments is substantial technical assistance to develop the legal and regulatory enabling environment to support market liberalization, foster new investment and upgrade of access networks (e.g. Fourth Generation Long-Term Evolution (4G/LTE)), and encourage better and cheaper services.

III. STRENGTHENING CLIENT CAPACITY

Given their small populations, many small states face a shortage of skills and capacity constraints, including capacity to absorb development assistance in an effective and sustainable way. The World Bank supports the strengthening of small states’ capacity through technical assistance and training activities, the deployment of flexible operational policies and procedures to fit their specific circumstances, and implementation support on the ground.

Flexible Project Preparation and Design

Preparations Advances (PAs) are available under the Bank’s Project Preparation Facility (PPF). The funding and scope of the facility were increased in 2017 to allow for a programmatic approach to project preparation that can create economies of scale and reduce the administrative burden for clients. Currently, Micronesia is using a programmatic PA to prepare the IDA18 pipeline through a centralized implementation unit at the ministry of finance. PAs have also been approved for Kiribati, Samoa, Tonga, and Marshall Islands.

In the Pacific, the World Bank has provided training to about 300 government officials in Tonga, Samoa, Vanuatu and Solomon Islands on procurement, financial management, as well as the new Environmental and Social Framework. It is also limiting the number of operations per country and ensuring minimum size ($5m). The upcoming Integrated Capacity Building Program in the Pacific will aim to strengthen project management in island states.

In the Caribbean, the World Bank is collaborating with other bilateral and multilateral partners to reduce implementation transaction costs and capacity burden on countries (e.g., St. Vincent and the Grenadines, “Port Modernization Project” currently under preparation).

Fiduciary, Environmental, and Social standards

The World Bank is providing extensive training on a new procurement framework, effective in 2016, that allows the use of flexible arrangements for capacity-constrained clients. To date, the Bank has conducted 17 training events in small states, attended by 273 participants, to raise awareness about the flexibilities available under the new procurement framework.
STRENGTHENING NATIONAL PROCUREMENT CAPACITY IN THE CARIBBEAN

The Bank has partnered with the Caribbean Development Bank to support the establishment of the Caribbean Regional Procurement Centre at the University of Technology, Jamaica. The center will support the professionalization of public procurement in the region. The center ran its first pilot course from November 2017 to May 2018 and produced its first batch of 23 students earning the International Chartered Institute of Procurement and Supply (CIPS) Level 4 Diploma in Procurement and Supply. By establishing a strong cadre of professional public procurement officers, the center will contribute to the effective use of public funds and improved delivery of public services in the Caribbean.

Supporting capacity to build climate and economic resilience

Climate resilience. The World Bank is supporting small states’ efforts to build climate resilience, including meeting their Nationally Determined Commitments (NDCs) on climate adaptation under the COP21. It is assisting small states to translate NDCs into policies and investments, with work ongoing in Sao Tome and Principe, St. Lucia, and St. Vincent and the Grenadines.

Capacity building is part of this initiative: four technical workshops have been delivered with the support of the Climate Action Peer Exchange (CAPE) initiative. The workshops focused on challenges and best practices for implementing NDCs in fiscal operations, including the impact of climate-smart tax and spending policies, energy subsidy reforms and innovative climate financing to help countries to achieve their NDCs on climate adaptation.

Debt sustainability. Training on the revised Debt Sustainability Framework for LICs (LIC DSF), effective July 2018, was delivered in FY18. Twenty-five SSF members benefitted from seven two-day seminars for senior officials and eight five-day workshops for technical staff on the revised LIC DSF.¹⁰

The World Bank Treasury also provides on-demand training to clients to build capacity to engage with insurance and capital markets to increase financing resilience to disasters. Trainings are planned in FY19 for members of the Eastern Caribbean Central Bank (ECCB). Additionally, joint World Bank-IMF assistance is planned to support the ECCB to explore options for state contingent debt instruments that would provide debt service relief to countries in the aftermath of a natural disaster to prevent short-term liquidity problems from transitioning into full debt crises.

Implementation support on the ground
To maximize the development impact of available resources, particularly of the IDA18 scale up, the World Bank is increasing the number of staff and resources deployed in fragile countries and small states. The number of field-based staff working in small states has increased by 36 per cent in 2018 relative to 2016. For both fragile countries and small states, having more staff on the ground provides client governments with support to implement development projects.
LOOKING AHEAD: THE SMALL STATES FORUM NOW AND GOING FORWARD

More than one fifth of World Bank members are countries with a population below 1.5 million. Despite their diversity, these countries share unique vulnerabilities associated with the small size of their economies and high exposure to natural disasters and climate change. The World Bank Group remains strongly committed to helping address small states’ development needs through innovative approaches that fit their specific circumstances. Convening every year on the sidelines of the World Bank Group/IMF Annual Meetings, the Small States Forum will continue to provide a useful platform for dialogue and knowledge-sharing on how the World Bank Group can best support small states. Chaired on a rotating basis among the Caribbean, Africa, and the Pacific; Grenada will pass on the Chair to Fiji after the 2018 Forum in Bali, Indonesia.