Policy Brief

Helping Small Island Developing States graduate to success

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Key messages

- By 2030, between five and twelve Small Island Developing States (SIDS) could lose eligibility to – i.e. graduate from– official development assistance (ODA) as they reach high-income status.
- They may not be ready: unless other sources of finance effectively compensate for the loss of ODA, those SIDS may suffer from socio-economic setbacks and be worse-off after graduation.
- Letting SIDS "graduate for worse" may have broad consequences, given their geostrategic importance and role in the preservation of oceans and biodiversity.
- In past instances, donor support has not been well targeted enough to help SIDS effectively anticipate the consequences of their losing access to ODA, and "graduate to success".
- New multidimensional vulnerability indices (MVIs) can help donors perform a more granular analysis of SIDS' vulnerabilities and related financing needs, and better tailor their ODA support to SIDS ahead of graduation.
- To prepare for successful graduations, SIDS should agree with their partners on new graduation strategies, at least six years before their forecasted loss of ODA eligibility.

What's the issue?

Before 2030, between five and twelve Small Island Developing States (SIDS)[1] might graduate from eligibility to official development assistance (ODA): once they have exceeded the high-income threshold (currently set at USD 13 845), they are no longer deemed to need the same levels of concessional funding as countries with lower income. While it should be viewed as a success and an achievement to celebrate, graduation is often feared by governments: because of their low competitiveness, low domestic resource mobilisation, and insufficient investments in resilient infrastructure, they still have significant finance needs that they have difficulty filling. In the case of the Eastern Caribbean States, many of them at the doorstep of graduation or having already graduated, evidence shows that neither they nor their financial partners among the Development Assistance Committee (DAC) members have assessed challenges and needs well enough to effectively anticipate the consequences of graduation (Piemonte, Kim and Cattaneo, 2024[1]).

SIDS closest to graduation – Palau, Nauru, St. Lucia and Montserrat – remain significantly dependent on ODA, accounting for 38% of their external financial flows on average (2024[2]).[2] In other developing countries, by contrast, that proportion is nineteen times lower: as they grow, other means of financing take over, including non-concessional flows, private investment and domestic revenues. In SIDS, however, private flows seem unable to take off; as for tax revenues, at the time of graduation they represent on average 1.6 times the total amount of external inflows vs. ten times in other developing countries (Table 1).

Table 1. Close to graduation, SIDS continue to be significantly dependent on ODA flows

Flow as a share of the total external mix	SIDS	Other developing countries
ODA	38%	2%
Non-concessional flows (other official flows, or OOFs)	13%	36%
Private inflows	7%	22%
Tax revenues	160%	1000%

Note: Refers to observations over 2017-22.
Source: Author's calculations based on Transition Finance analysis. See OECD (2024[2]) Transition Finance Toolkit, https://www.oecd.org/dac/transition-finance-toolkit/.

Despite income levels that surpass those of most other developing countries, **SIDS may be considered the most vulnerable.** Based on the results of the new UN multidimensional vulnerability index (MVI) (United Nations, 2024[3])**,** they have the highest average and median scores of any "most in need" country grouping, followed in descending order by least developed countries (LDCs), fragile contexts and land-locked developing countries (LLDCs) (OECD, 2024[4]) (Figure 1).

Because of their vulnerability, SIDS remain exposed to sudden income fluctuations, even after they reach high-income country (HIC) status, which puts them at risk of going on and off the DAC list of ODA

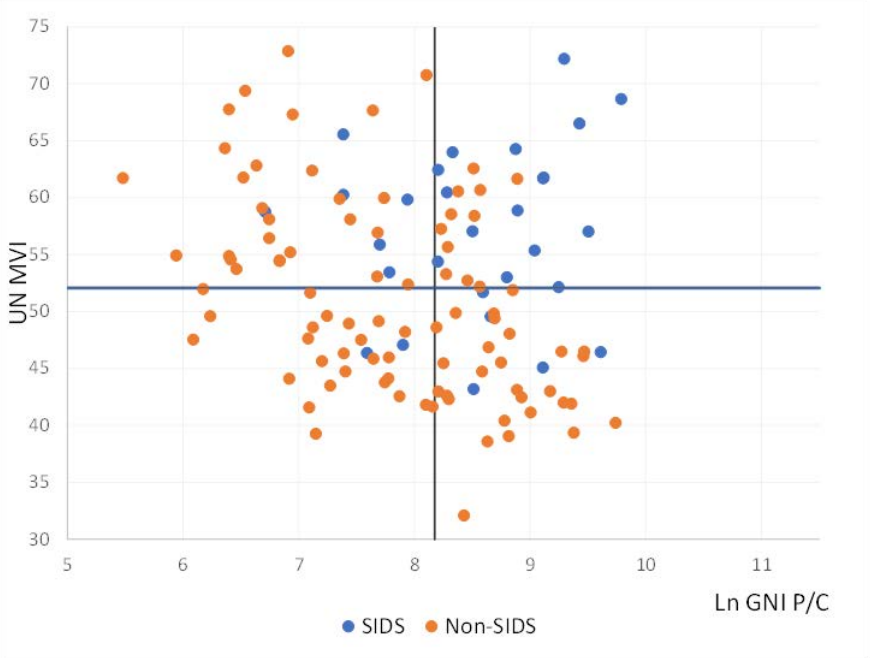
[1] Guyana, Nauru, Montserrat, Palau, Maldives, Mauritius, Grenada, Cuba, St. Lucia, Dominican Republic, Marshall Islands, and St. Vincent and the Grenadines. Guyana and Nauru are expected to graduate as early as 2026.

[2] These are all micro-states. Earlier analysis on non-microstates showed an average of 27%. See: https://web-archive.oecd.org/2020-07-30/560558-SIDS-factsheet.pdf.

recipients[3]. For example, after losing 7.5% of its GDP in 2020 and 13.7% in 2021 as a result of the COVID-19 crisis, Palau was the first country to be reinstated onto the list.

Forced to take on greater levels of debt to respond to natural disasters and economic shocks, SIDS are more indebted than their peers.[4] Moreover, their small economic size hinders their ability to renegotiate existing debt, or secure new debt at competitive terms, (Piemonte, 2021[5]).

Figure 1. SIDS are both richer and more vulnerable than other developing countries



Note: Includes ODA-eligible developing countries. Lines indicate medians for each axis.
Source: Author's design based on UN MVI (2024) and WDI (2024).

Why is this important?

The survival of SIDS' societies is at stake. Although SIDS contribute the least to carbon emissions, they are on the frontlines of the climate crisis and extremely vulnerable to external shocks. However, their often-precarious financial situation makes it difficult for them to respond to such shocks alone. Adverse weather events can wipe out some of their economies overnight: in 2017, Dominica lost 227% of its GDP because of Hurricane Maria; the COVID-19 pandemic translated into an 8.1% decrease in the GDP of SIDS on average in 2020[5], against a 3.6% drop in other developing countries.

SIDS graduating for worse could have effects beyond their borders, given their strategic geographic locations around the globe. Supporting SIDS as independent democracies is crucial to consolidate peace around the world.

[3] When the GNI per capita of a country that already graduated from ODA eligibility slides back down below the HIC threshold, that country may be reinstated onto the ODA list, and thus become eligible again.

[4] Koestier (2017), finds the government debt of SIDS increases by 9.4 percent of GDP on average in the aftermath of severe natural disasters. See https://www.uu.nl/sites/default/files/rebo_use_dp_2017_1717.pdf

[5] The figure refers to ODA-eligible SIDS, excluding Guyana.

SIDS graduation is a test for the international community's capacity to respond to climate change challenges. SIDS have an important role in the management of oceans and biodiversity worldwide: although they make up only 3% of the Earth's land area, they harbour 20% of all plant, bird & reptile species on the planet, twelve of the eighteen centres of marine endemism, seven of the ten coral reef hotspots, etc. (UN-OHRLLS, 2017[6]). Furthermore, protecting ecosystems with large potential emissions of greenhouse gases upon conversion, such as coastal ecosystems, is estimated to be one of the most cost-effective means of climate mitigation. (CBD, 2020[7])

Helping SIDS graduate to success would come at a low price. Official development finance to SIDS that could graduate before 2030 represents between USD 851 million and USD 4.6 billion in commitments (average per year over 2021-22) – that is, only between 0.2% and 1.2% of the DAC community's total ODF commitments per year. Guided by new tools, such as MVIs, which allow for a more granular identification of SIDS' vulnerabilities and related financing needs, donors should be able to reallocate, and/or dedicate additional resources to secure the successful graduations of these countries.

What can policymakers do?

- **Adopt *graduation strategies*** jointly developed among partners. ODA graduation should entail more than a simple notification: such *strategies*, systematically agreed by SIDS governments and their financial and technical partners, would be considerate of SIDS' specific vulnerabilities and promote continuous co-operation beyond ODA. They should be based on the principles of (i) country ownership, (ii) mutual accountability, and (iii) co-ordination of all stakeholders committed to securing smooth ODA graduations. Planning at least six years before a forecasted graduation date, as is done for LDC graduation strategies, could help SIDS prepare to graduate to success. This would not require amending existing rules and criteria pertaining to graduation but would institute a systematic support process for future graduates.
- **Use regional development co-operation channels more extensively.** Most SIDS belong to regional organisations that are ODA-eligible. After their graduation, they can continue to benefit indirectly from the concessional finance and related technical assistance channelled through such organisations to help them, for instance, improve their regulation and business environments, and support economic diversification.
- **Look beyond income levels to assess SIDS' needs.** Using and refining the new UN MVI can help donors improve the allocation of official development finance (ODF) and other resources aimed at addressing SIDS' vulnerabilities. This would help estimate their needs for more funding to climate-related disaster risk reduction (DRR) and climate adaptation issues, as well as economic diversification, which are currently under-funded.
- **Improve domestic resource mobilisation** to decrease reliance on ODA**.** This includes i) phasing out ineffective tax cuts aimed to attract foreign investors in the tourism sector, which deprive governments of significant revenues; ii) promoting private sector development, including through backward and forward linkages in the tourism industry to expand the tax base; iii) promoting more business-friendly environments; iv) adapting regulation to stimulate entrepreneurship and competition; v) increasing value-added in the tourism sector; vi) promoting knowledge exchange and robust statistical systems to better evaluate policy results; vii) improving access and use of climate finance.

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Explore further

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OECD (2022) “SIDS Access to Green Funds”, OECD Members and Partners Database, https://one.oecd.org/document/DCD(2022)34/en/pdf

Small Islands Developing States webpage: https://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/small-island-developing-states.htm

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