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Strengthening Resilience in Commonwealth Small States: Economic Diversification and Climate Adaptation as Key Drivers

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1. Introduction

Despite their limited landmasses and populations, Commonwealth small states possess distinctive and diverse economies. While some depend heavily on natural resource extraction, others focus on services sectors like tourism and finance. However, a common thread uniting them is their susceptibility to economic shocks and the effects of climate change. Because of their compact sizes and often vulnerable geographic locations, these nations are disproportionately sensitive to economic disruptions and environmental changes, including rising sea levels and extreme weather events. It is thus imperative for them to proactively enhance resilience by diversifying their economies and adapting to climate change impacts.

This paper first looks to illustrate the economic and climate vulnerabilities that are unique to small states. In doing this, it explores the challenges of overreliance on single revenue sources such as trade, tourism and capital inflows and highlights the cost of climate change shocks, which are increasing in quantity and severity. The paper then aims to demonstrate ways in which small states can improve their economic resilience through economic diversification strategies such as promoting entrepreneurship, offering attractive corporate tax incentives, developing niche industries, diversifying the tourism industry, investing in digital technologies and leveraging remittance inflows for investment, as well as discussing climate adaptation strategies, from investment in resilient infrastructure to implementation of the circular economy. The paper also points out the role of the global community in both committing to continuing climate mitigation activities and improving the availability of climate finance for small states, to aid them during times of climate crisis and enable them to implement their climate adaptation strategies.

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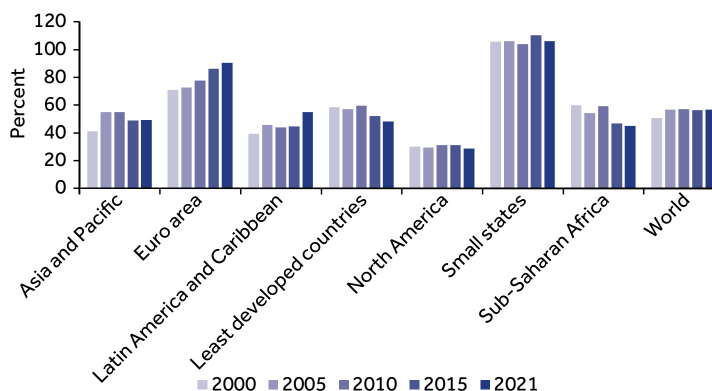
2. Economic vulnerability: overreliance on trade, tourism and capital inflows

The economies of the Commonwealth small states are vulnerable as a result of their heavy reliance on trade, tourism receipts and capital inflows, and this is compounded by limited competitiveness and inadequate infrastructure. This dependency leaves them exposed to global economic shocks, as seen during the Covid-19 pandemic, which disrupted tourism, trade and capital inflows. To enhance resilience, these nations need to pursue new strategies focused on diversifying their economies and reducing dependence on a few sectors. This will create a stronger foundation for sustainable growth and development.

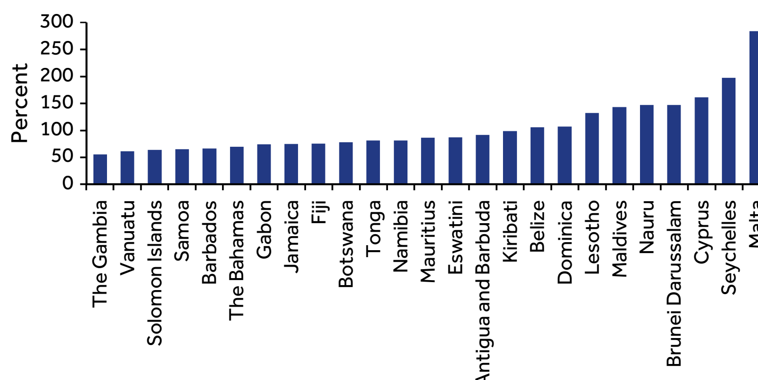
Small states rely heavily on international trade, with trade-to-gross domestic product (GDP) ratios averaging 106 per cent in 2021 compared with a world average of 57 per cent (World Bank, 2023a). Figure 1a shows that small states surpass other regions in terms of trade ratios, highlighting the importance of trade for these nations. Figure 1b presents the trade-to-GDP figures for each Commonwealth small state. Malta, Seychelles, Cyprus, Brunei Darussalam, Nauru, Lesotho, Maldives, Dominica and Belize exhibit the highest trade-to-GDP ratios. This further emphasises the crucial role international trade plays within small states. It is worth noting that no

Figure 1a. International trade sector, small states vs rest of world (% of GDP)



Source: World Bank (2023a)

Figure 1b. International trade, small states, 2021 (% of GDP)



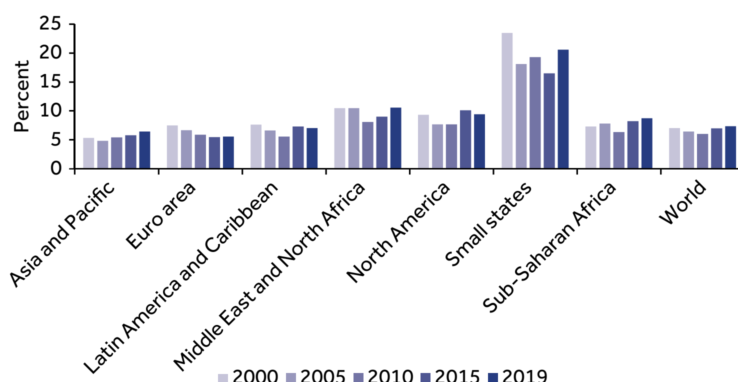
Source: World Bank (2023a)

Commonwealth small state has recorded a trade-to-GDP ratio below 50 per cent, with The Gambia posting the lowest figure, at 55 per cent, in 2021.

The economies of many small states rely heavily on tourism. Figure 2a demonstrates that tourism receipts contribute around 21 per cent of total exports in small states, which is approximately three times higher than the world average and about four times higher than the Euro area average. Futhermore, the proportion of tourism receipts (as a percentage of total exports) in small states is approximately three times larger than that in Asia and the Pacific, and of that in Latin America and the Caribbean. It is more than twice that in sub-Saharan Africa. These figures indicate that the tourism industry has a significant influence on the performance of many small states.

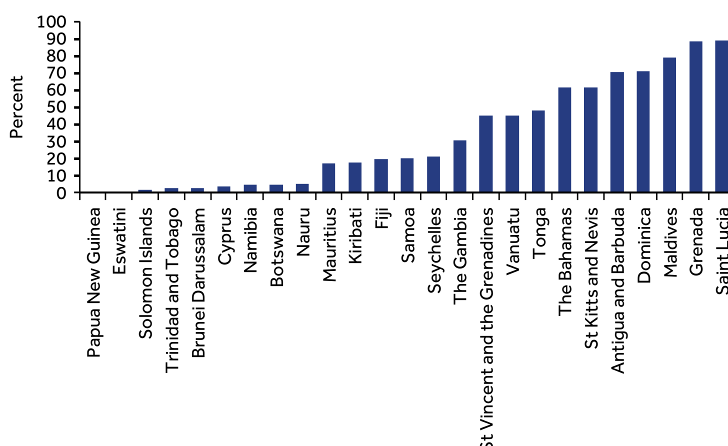
For example, Figure 2b presents data from 25 small states, revealing that Saint Lucia, Grenada, Maldives, Dominica, Antigua and Barbuda, St Kitts and Nevis, and The Bahamas

Figure 2a. Tourism, small states vs rest of world: international tourism receipts (% of total exports)



Source: World Bank (2023a)

Figure 2b. Tourism, small states: international tourism receipts, 2020 (% of total exports)



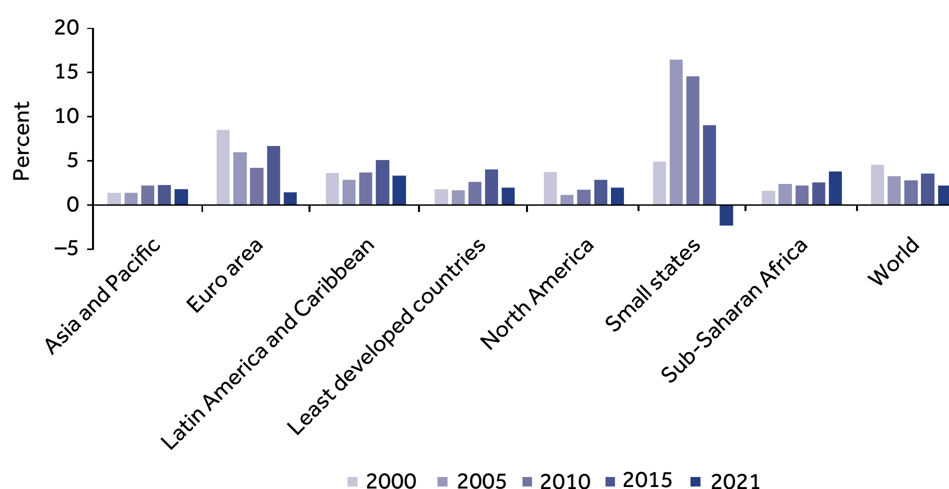
Source: World Bank (2023a)

have tourism receipts that account for more than 50 per cent of their total exports. Moreover, 12 of these small states have tourism receipts exceeding 20 per cent of exports; for 16 of them, the figure is above 10 per cent. Most small states with tourism receipts exceeding 50 per cent are concentrated in Latin America and the Caribbean (the exception is Maldives), underscoring the significance of tourism in this region.

Foreign direct investment (FDI) plays a crucial role in driving the economies of many small states. From 2000 to 2021, FDI contributed approximately 10 per cent to the GDP of these nations (World Bank, 2023a). Notably, Figure 3a illustrates that the collective contribution of FDI to the GDP of small states surpasses that of other country groupings. In 2005, FDI contributed around 17 per cent to GDP, while in 2010 it constituted approximately 15 per cent of GDP. Despite experiencing a decline to 9 per cent in 2015, the FDI contribution remained higher than in other regions and was 5.4 per cent above the global average for that year. The United Nations Conference on Trade and Development (UNCTAD) attributes this slowdown to reduced investments in the extractives and construction sectors, along with decreased involvement from energy investors in certain small states, like Trinidad and Tobago, and Mauritius (UNCTAD, 2016). The adverse impact of the COVID-19 pandemic in 2020 led to a drastic contraction, with FDI's contribution to GDP plummeting to −2.60 per cent.

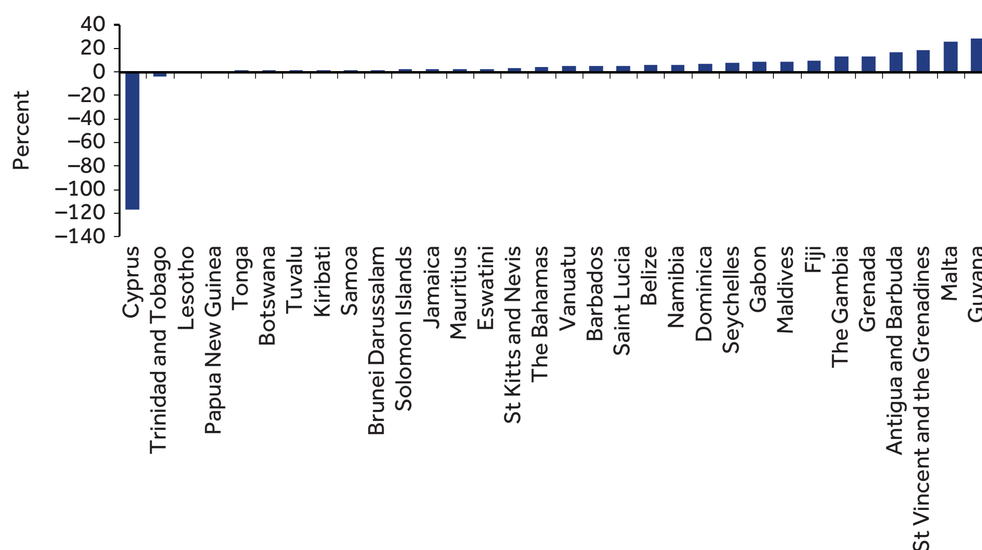
Figure 3b provides a closer analysis, revealing that Cyprus experienced a staggering 117 per cent contraction in FDI (as a percent of GDP) in 2021. Other small states, such as Trinidad and Tobago (−4.5 per cent), Lesotho (−0.5 per cent) and Papua New Guinea (−0.04 per cent), also witnessed contractions in their FDI-to-GDP figures.

Figure 3a. Foreign direct investment, small states vs rest of world (% of GDP)



Source: World Bank (2023a)

Figure 3b. Foreign direct investment, 2021 (% of GDP)



Source: World Bank (2023a)

3. Commonwealth small states and the struggle with climate change

Small states are affected disproportionately by the severity and frequency of climate-related hazards. The severity of these hazards in many small states is larger than in other countries because most small states are on low-lying islands, making them vulnerable to ocean and coastal ecosystem changes. For instance, 80 per cent of Maldives is less than 1 metre above sea level. Kiribati averages 1.8 metres above sea level while Tuvalu averages 2 metres above sea level. Furthermore, extreme weather events are a recurring theme in many small states, leading to losses and damage to infrastructure, human lives and human-related activities.

Recently, there have been several occurrences of natural disasters, with severe impacts on many small states. Prime examples of these events in 2023 across African small states include Tropical Cyclone Freddy affecting Mauritius in February and flash floods affecting Lesotho in March. In the Pacific, the category 4 cyclones Judy and Kevin affected Vanuatu in March 2023. In 2022, the Pacific region was affected by droughts – which hit Kiribati in May and Tuvalu in August. Seismic events also affected the Pacific region in 2022, and countries such as Fiji (in November), Papua New Guinea (in September), Solomon Islands (in November), Tonga (in January) and Vanuatu (in 2022 and 2023) were all affected by earthquakes, creating large problems for these countries and slowing their growth momentum. The Caribbean was affected by Hurricane Lisa in November 2022 (Belize).

In the 2022 World Risk Report, out of the top 10 countries at the most risk of natural disasters owing to climate change, weather events and others, four are small states. The intensity of the damage can sometimes be severe; in some cases, damages have amounted to over 70 per cent of GDP. For instance, Dominica lost an estimated 225 per cent of its GDP in material damage from Hurricane Maria in 2017 (UNCTAD, 2022a). Vanuatu was hit by two devastating cyclones in a short period of time – Tropical Cyclone Pam (2015) and Tropical Cyclone Harold (2020) – both of which were classified as category 5 and each causing damage equal to 70 per cent of the country's GDP (Government of Vanuatu, 2015; 2020).

4. Strengthening resilience in Commonwealth small states

Small states face unique challenges in building resilience because of their limited resources and their vulnerability to external shocks. However, focusing on economic diversification and climate change adaptation could be effective strategies for small states to employ to enhance their resilience. Economic diversification can help small states strengthen their resilience and achieve sustainable development. Climate change adaptation is also crucial for small states, since these countries are often the most vulnerable to the effects of climate change. By investing in sustainable, regenerative and climate-resilient industries and infrastructure, small states can reduce their vulnerability to the impacts of climate change and build a more sustainable and resilient economy for the future. There is also a vital role for the global community in facilitating effective financing frameworks for climate adaptation efforts in small states, and in progressing on climate-mitigating pledges.

4.1 Economic diversification

Strategies like promoting entrepreneurship, offering attractive corporate tax incentives, developing niche industries, diversifying the tourism industry and investing in digital technologies are crucial for the Commonwealth small states to help them diversify their economies. **Governments play a critical role in facilitating economic diversification through the implementation of policies, legal frameworks and institutional reforms** that foster a favourable business and investment climate. These measures include reducing trade barriers, offering incentives for emerging sectors, promoting research and development, and fostering innovation. Governments should establish transparent and robust legal frameworks to safeguard investors' rights, ensure fair competition and provide stability for businesses. Institutional reforms aimed at streamlining bureaucracy and combating corruption enhance transparency and efficiency in the economic system. Furthermore, to support economic diversification, governments should prioritise capacity-building programmes to cultivate a skilled workforce and provide financing initiatives for emerging sectors. In addition, it is important to highlight the role of the international financial institutions (IFIs) in helping small states diversify their economies; these institutions should provide financial resources, technical expertise and policy advice.

Promoting entrepreneurship, supporting small businesses, offering attractive corporate tax incentives and maintaining political stability are vital strategies for small states in diversifying their economies, attracting investment and stimulating economic growth. Cyprus stands out as an excellent example of a small state that has successfully fostered entrepreneurship; it ranks among the easiest places to conduct business, attributed to its strong rule of law and low corruption levels. As of 2019, its ease of doing business score reached 73.4, surpassing the average small states' score of 59.3 (World Bank, 2023a).

Furthermore, although in Malta the corporate tax rate stands at 35 per cent, shareholders have the option to claim a partial or full refund of the tax paid by the distributing company, which can reduce the effective tax rate to as low as 5 per cent. A similar low effective tax rate can be achieved by forming a fiscal unit. Dividends and capital gains from participation holdings qualify for a full refund or exemption. Another option for taxpayers is to benefit from the Notional Interest Deduction system, which allows them to deduct up to 90 per cent of notional interest from taxable profits and potentially reduce the effective tax rate to 3.5 per cent (KPMG, 2020). Jamaica serves as another successful example of a small state that has attracted substantial foreign investment. Net FDI inflows to Jamaica were 2.19 per cent of

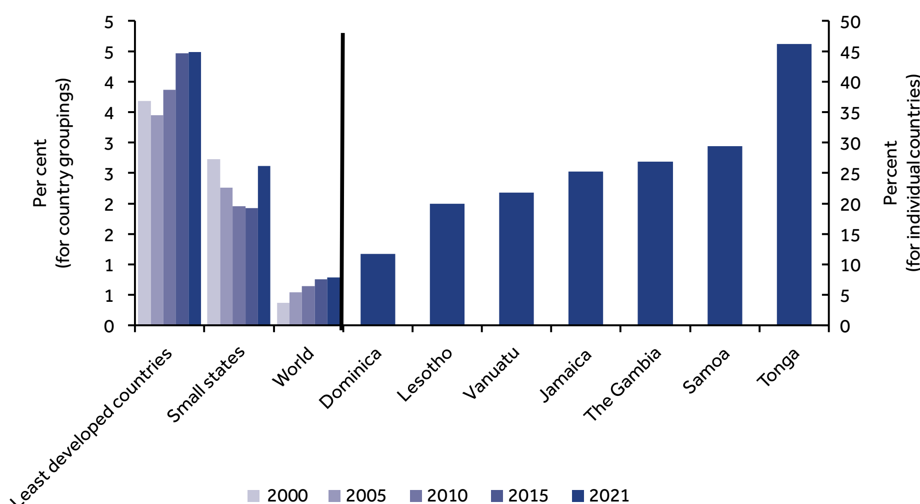
Box 1. Remittances as a facilitator of economic diversification in small states

Figure 4 shows that small states, in comparison with the world average, receive a much larger rate of remittances as a percentage of GDP. Furthermore, since 2015, small states have seen a dramatic increase in remittance inflows relative to the global average trend. Figure 4 also shows that, for countries such as Tonga, remittances are reaching a level close to 50 per cent of GDP. Samoa, The Gambia, Vanuatu and Lesotho are also in the high 20 per cents. These figures illustrate the importance of remittance inflows for small states, particularly during times of crisis, to support the economic resilience of families in paying for necessities such as education and healthcare and other basic living costs.

The Commonwealth Diaspora Investment Surveys carried out in 2018 for Jamaica and Fiji evidence the diaspora's desire to invest back in their country but show that several barriers limit their ability to do so. For example, while most of the Jamaican and Fijian diaspora respondents showed an interest in investing back home, over one-third of the Jamaican respondents and 40 per cent of the Fijian respondents reported having no current form of saving or investment in their home country, reflecting a large investment gap (The Commonwealth, 2018a; 2018b). Barriers to investment or setting up entrepreneurship activities range from lack of information on opportunities to governance issues.

To be able to move beyond a family's economic resilience, and to leverage remittances towards national economic resilience activities, such barriers must be overcome, and the facilitation and enablement of productive investment opportunities incentivised. Technology solutions that offer platforms for various forms of investment and vetted business partners are vital to improve the availability and awareness of investment options. Diaspora-specific tax incentives can be effective in attracting investment while encouraging the reinvestment of profits back into the home economy. Lastly, institutional co-ordination and planning with regard to incorporating diaspora issues into national development policies is key to achieve optimal and implementable strategies to capture the potential of remittances.

Figure 4. Remittances received by country group and highest receiving small states (% of GDP)



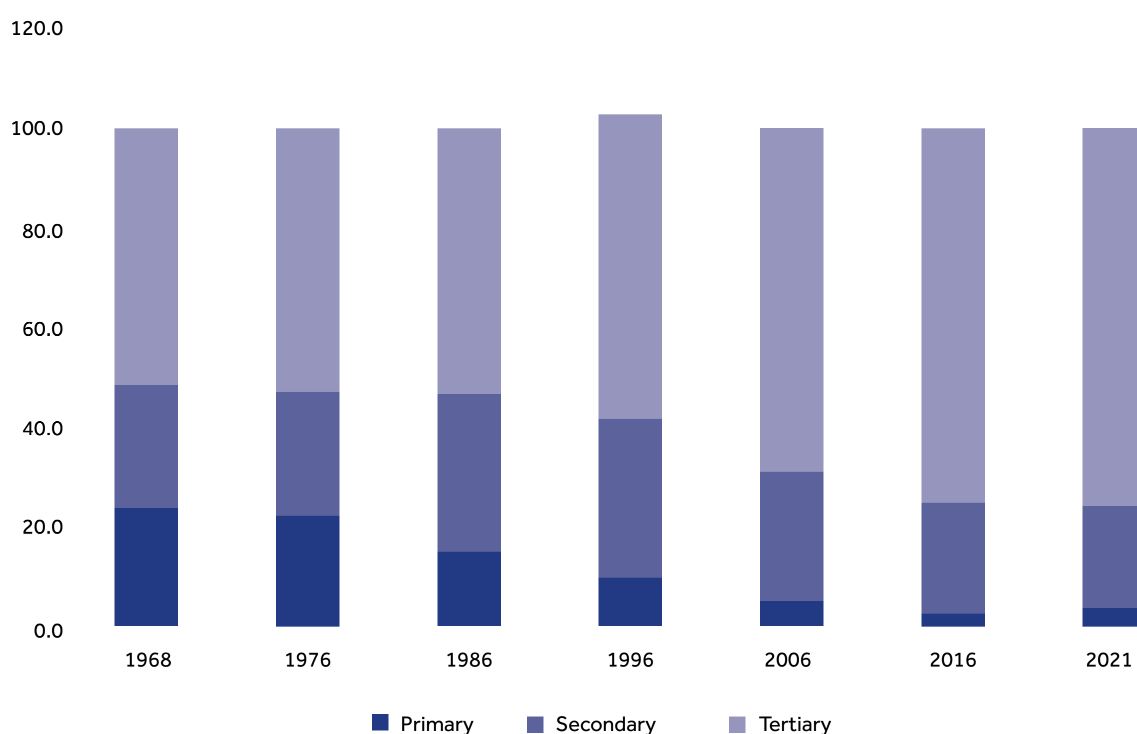
Source: World Bank (2023a)

GDP in 2021, compared with the average of -2.16 per cent of GDP for small states (World Bank, 2023a). In addition, as shown in Box 1, leveraging the extensive remittance inflows that small states receive towards productive investment can also offer a diverse and innovate opportunity.

Developing niche industries tailored to specific markets is another strategy that small states can implement to achieve economic diversification. This not only generates employment opportunities but also expands small states' exports. A good example of this approach is the development of sustainable agriculture practices and the promotion of value-added agribusiness. For instance, Grenada's investment in organic agriculture and nutmeg processing has positioned it as a leading nutmeg producer in the world. Similarly, Samoa's successful establishment of a flourishing coconut-based industry saw this experience impressive growth of 11 per cent from 2013 to 2018, creating thousands of jobs, particularly for women (Trade for Development News, 2018).

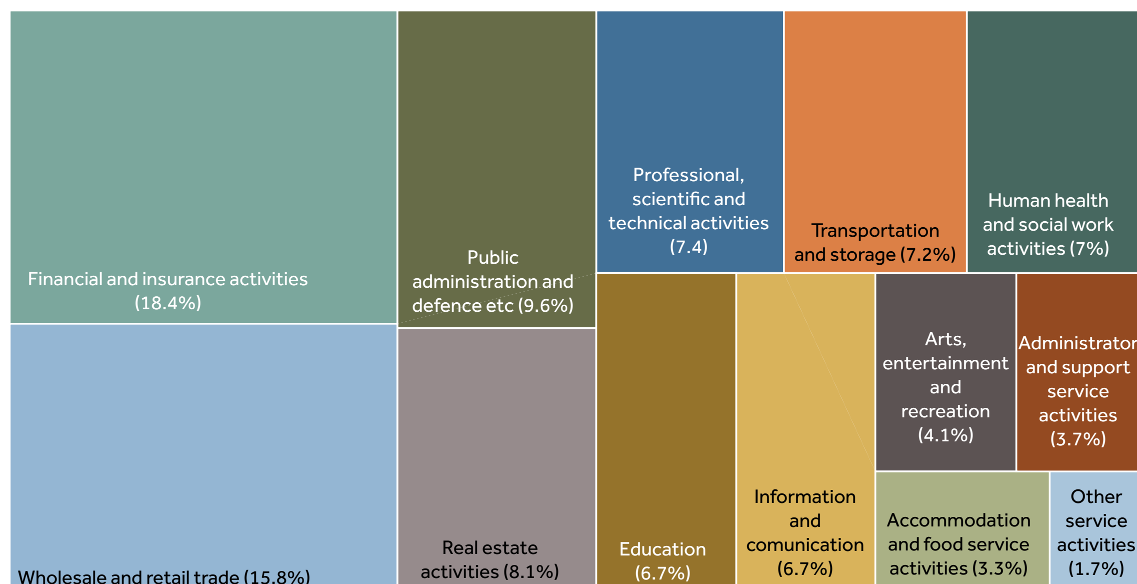
Mauritius has transitioned from a mostly sugar-dependent economy to a more diversified economy, encompassing textiles, tourism and financial services (see Figure 5a). As Figure 5b shows, Mauritius is renowned as one of Africa's most diversified economies, with textiles and clothing, financial services and tourism ranking as the top export sectors (UNCTAD, 2022b).

Figure 5a. Mauritius' structural economic transformation (1968–2021)



Source: Reproduced from UNCTAD (2022b)

Figure 5b. A breakdown of the services sector in Mauritius (2021)



Services oriented econimy: 75.6% GDP; employment: 351,300, 68.3% of total employment
ICT: 133.9 internet penetration; 155.25% mobile penetration and 850 companies
Financial services: 190 management companies, 19 banks, 1015 global funds
Wholesale and retail trade: 89,100 employment, 11.9% GDP

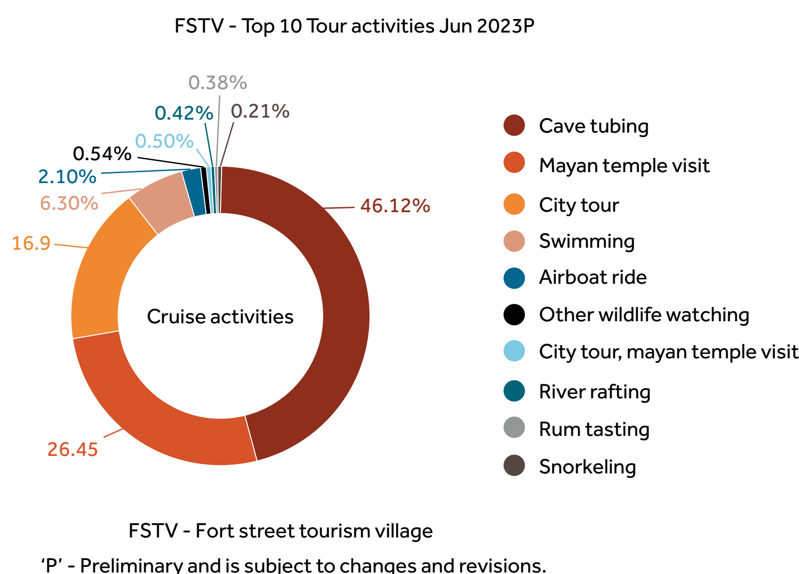
Source: Reproduced from UNCTAD (2022b)

Diversifying the tourism industry is vital for small states as it can significantly increase their competitiveness in attracting more travellers, generating employment and receiving substantial revenue, which can be used to diversify other sectors of their economies. Strategies such as prioritising ecotourism and sustainable practices to attract environmentally conscious travellers and developing adventure tourism activities for outdoor enthusiasts are crucial for a diversified tourism sector. Digital and virtual tourism experiences are also vital, as they can engage potential visitors before their arrival and promote cultural tourism to showcase rich heritage and traditions.

A successful example of a diversified tourism sector is Belize, which has focused on ecotourism, adventure tourism, cultural tourism and digital tourism. The country's online platforms offer pre-arrival exploration for interested visitors. Figure 6 highlights a range of exciting adventure tourism activities in Belize, such as cave tubing, airboat rides, river rafting and snorkelling (Belize Tourism Board, 2023). Furthermore, Belize has emerged as an excellent example in ecotourism, with several protected areas, including the renowned Belize Barrier Reef. The country also actively promotes cultural tourism, showcasing its rich history and culture through music, food and festivals.

Investing in digital technologies like cloud computing, e-commerce and mobile payments would diversify small states' economies and bolster their competitiveness in attracting foreign investment. According to UNCTAD, small states that have invested in digital infrastructure have witnessed higher levels of trade and foreign investment. For instance, having invested heavily in information and communication technology (ICT) infrastructure, Mauritius' ICT sector's contribution to nominal gross value added (GVA)

Figure 6. Tourism GDP in Belize, 2018 (%)



Source: Belize Tourism Board (2023)

increased by 6.7 per cent, from Rs 26,397 million in 2020 to Rs 28,174 million in 2021. This in turn led to a 12.4 per cent rise in FDI, from US$225 million to $253 million (Statistics Mauritius, 2021; UNCTAD, 2022c).

The IFIs play a crucial role in supporting small states that do not have sufficient resources to invest in digital technology and infrastructure. The IFIs can provide financial resources, technical expertise and policy advice to help these countries build their digital capacities and unlock the potential benefits that come with investing in areas like cloud computing, e-commerce and mobile payments.

Cultivating strong trade relationships with neighbouring countries, engaging in regional integration initiatives and focusing on sectors that can boost exports is an important strategy in the diversification of small states' economies. For instance, Fiji has established robust trade relationships with Australia and New Zealand while participating in free trade agreements with them (MFAT, 2021). To facilitate trade among African nations, the African Continental Free Trade Area unites 55 countries across the African continent, encompassing a total GDP of US$3.4 trillion and a population of 1.3 billion people (World Bank, 2020). Meanwhile, having identified agribusiness, tourism and creative industries as key sectors for economic diversification, the Caribbean Community (CARICOM) has established a trade agreement with the European Union, which provides duty-free access to the European market for CARICOM exports.

4.2 Climate change adaptation

As discussed earlier in this paper, it is clear that climate change is disproportionately affecting Commonwealth small states. As identified in the 2023 Global Risks Report, climate change is a more common key risk factor for small states than for other countries. Additionally, while small states often rank 'natural disasters and extreme weather events' as one of their top five risks, they have the least effective preparedness for such weather events (WEF, 2023). According to Our World in Data (OWiD), Commonwealth small states were responsible for only 0.27 per cent of the total global share of carbon dioxide emissions as of 2021 yet they suffer a much higher proportion of the costs and effects associated with natural climate-related disasters (OWiD, 2023). Previous estimates from

the International Monetary Fund (IMF) stated the annual cost of natural disasters for small states to be equal to 2 per cent of GDP, four times the cost for larger countries, and with 9 per cent of disaster-created costs exceeding 30 per cent of GDP (IMF, 2016). However, new estimates put this figure at 5 per cent of GDP annually, with many shocks costing multiples of that (World Bank, 2023b). This leaves small states with the pressure to finance long-term climate change adaptation to reduce vulnerability to future climate shocks, while maintaining fiscal buffers that are required in the event of natural disasters and overcoming resource redirection from other external shocks such as COVID-19.

To build climate resilience in small states, there are several non-exclusive approaches. Some approaches entail direct changes that small states themselves can make. This could include investment in climate-resilient infrastructure or adopting sustainable practices such as implementing the circular economy (CE) in depended-upon industry. Other approaches require a global effort.

Small states can invest in building resilient infrastructure that is inclusive and directly targeted to ensure poorer communities are protected and can maintain access to public and financial facilities in the event of a natural disaster. Key investment areas range from a focus on critical infrastructure and waste management to smart agriculture, coastal protection and the blue economy. But adaptation needs and plans vary. According to the IMF Climate Change Policy Assessments, Belize and Tonga have resilient transport infrastructure as the highest costed projects within their planned capital expenditures for climate adaptation, whereas Seychelles focuses on water security and Saint Lucia on its Disaster Recovery Programme (IMF, 2023). To ensure the continuity, integration and sustainability of such investment projects, domestic policies addressing and supporting similar climate adaptation issues should also be costed out under the same public financial management framework a single national adaptation strategy portfolio and included within national development plans. Not only does this integrated approach improve the governance and management of adaptation activities, but it can also make it easier for market assessments to be undertaken to identify which projects may be bankable or attractive to private investors.

Adopting a CE approach can help small states enhance their adaptation to climate change. Traditionally, adoption of a CE approach has been seen as helping in tackling climate change rather than in adapting to it; this has made it hard to encourage small states to adopt such an approach as they are rarely the main contributors to climate change. However, new research has revealed the important role that a CE approach could play in climate change adaptation, such as through slowing down nature degradation, improving soil health through regenerative agriculture, increasing flood resilience through better waste management, relieving freshwater stress and enhancing local resilience through a sharing economy that improves access to goods and services and reduces vulnerability to global supply chain shocks (Wang et al., 2022). Furthermore, circular nature-based solutions that use renewable resources, repurpose other resource streams and avoid by-products, such as Stockholm's integration of a green and circular urban plan into the built environment, can reduce the impact of heatwaves and more effectively manage surface water, while also improving the social wellbeing of the local population (Englund and Andre, 2021). Therefore, elaboration of ways to incorporate a CE approach into both new and existing climate change adaption strategies is integral to encouraging successful adoption.

Global commitments and collaboration are necessary on two fronts. First, countries around the world should be working together towards the common goal of mitigating climate change through lowering emissions. Second, a global effort is required to improve the availability and distribution of funds to help vulnerable countries build resilience against climate shocks and effectively recover after experiencing any natural disasters.

There are currently several climate financing frameworks to assist with climate resilience. The Green Climate Fund (GCF) aims to mobilise funding towards low-emission and climate-resilient development. The loss and damage fund established at the 27th Conference of the Parties aims to fill the gap that initiatives such as the GCF do not fill by aiding the poorest countries that suffer the most from climate change impacts. The Debt for Nature and Climate Swaps initiative allows countries to be relieved of debt if the foregone payment is spent on climate action projects; this has been utilised by countries such as Belize. The IMF's Resilience and Sustainability Trust provides poorer countries with affordable finance to manage macroeconomic climate risks. Alternative and innovative financing instruments such as green bonds, which focus on environmental projects, and blue bonds, which focus on water-related projects, are also ways in which countries can fund climate-related projects. Commonwealth small states such as Belize, Fiji and Seychelles have utilised and issued such bonds to support their climate resilience and sustainability projects.

Despite these financing frameworks, there remains a large financing gap, preventing the full implementation of climate change adaptation strategies within national development plans. Adaptation financing needs are estimated to be 5–10 times the flows available (UNEP, 2022). While there is climate financing available for small states, these flows are inadequate, imbalanced and unpredictable, and have complicated eligibility requirements, meaning mobilisation rates often fall short of the pledged amounts (UN, 2022). Furthermore, climate financing is often geared towards climate mitigation rather than adaptation, meaning the adjustment needs of small states to adapt have been under-funded by up to US$1 billion a year (IMF, 2016). Although climate-related shocks cost small state regions such as the Caribbean around $12.6 billion a year, small island developing states (SIDS) access very little climate finance – approximately $1.5 billion out of the $100 billion pledged to developing countries in 2019 (OECD, 2022). This becomes a particularly poignant statistic when we note that lack of financing is one of the most common factors limiting national-level adaptation (Robinson, 2018).

With global financing not hitting the mark, and given fiscal constraints, economic diversification, as discussed earlier, is vital for small states to reduce their vulnerability. However, the international community has an important role to play in aiding this economic diversification and supporting climate adaptation at the global level through a more collective, integrated and simplified approach regarding climate financing, so that those who are most affected by, but contribute the least to, climate change are able to adapt (World Bank, 2023b).

5. Conclusion

While promoting economic diversification is crucial for Commonwealth small states, it is not without challenges and long-term implications. Implementing strategies such as investing in digital technologies, developing niche industries, diversifying tourism and fostering entrepreneurship requires significant effort and careful planning. Governments must address barriers such as limited resources, regulatory hurdles and skill gaps if they are to effectively diversify their economies. Additionally, the transition from traditional industries to new sectors can lead to economic dislocation and job displacement, necessitating measures to support affected workers and communities. Moreover, the success of economic diversification efforts may take time to realise, requiring patience and sustained commitment.

Nevertheless, there are long-term benefits of economic diversification, and these include reduced vulnerability to external shocks, enhanced competitiveness and improved overall economic resilience. Examples from countries like Antigua and Barbuda, Fiji, Malta, Mauritius and Samoa highlight the success of economic diversification strategies in generating economic growth, creating employment opportunities, boosting trade and achieving resilient economies. By embracing diversification strategies and overcoming

challenges in the process, Commonwealth small states can pave the way for sustainable and inclusive growth in the years to come.

Building climate resilience is also fundamental for small states but, with climate adaptation requiring resources beyond what is available for many small states, it is vital that their voices are heard on the global stage. The joint United Nations–Commonwealth Small States Advocacy Strategy seeks to mobilise and galvanise international support and action to address the development challenges facing small states. Meanwhile, the Commonwealth Heads of Government Meeting scheduled for October 2024 will be hosted by the small state of Samoa – the first Pacific SIDS to host the event. It is expected that the issues discussed will include those that are affecting small states most, such as environmental challenges and building resilience. Furthermore, the upcoming SIDS summit 4th International Conference on Small Island Developing States to be held in 2024 in Antigua and Barbuda, will review the challenges facing small states, including in access to finance for climate adaptation and sustainable development through the adoption of a new Programme of Action for SIDS. Such events offer advocacy groups and small states an opportunity to make the challenges known and to have them considered as part of the global agenda.

The recent World Bank Climate Resilient Debt Clauses, announced at the 2023 Paris Climate Summit, under which vulnerable countries will pause debt repayments if they are hit by natural disasters, is a good example of an action taken following such advocacy. Initiatives like these are a welcome step in the right direction for small states, facilitating the freeing-up of resources to enable them to respond to their own urgent needs in times of disaster. However, while such work does help post-climate disaster, it still does not address the issue of financing for climate adaptation. As the long-term cost of inaction in the face of climate change is much higher than the upfront cost of adaptation, it is key to ensure the ability of small states to implement such initiatives before the vicious cycle of mounting costs and resource constraints sets in.

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