



AFRICAN DEVELOPMENT BANK GROUP  
GROUPE DE LA BANQUE AFRICAINE  
DE DEVELOPPEMENT

# COUNTRY FOCUS REPORT 2024

## SEYCHELLES

**Driving Seychelles' Transformation:**  
The Reform of the Global Financial Architecture







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The preparation of this report was led by Désiré Vencatachellum, Senior Director, Country Economics Department (ECCE), with Marcellin Ndong Ntah (Lead Economist, ECCE) as the project management Lead, IT support from Abir Bdioui (Consultant, ECCE), and administrative support from Tricia Effe Baidoo (Team Assistant, ECCE). Seychelles report was prepared by Temesgen Tilahun, Chief Country Economist and Walter Odero, Principal Country Economist under the guidance of Marcellin Ndong Ntah, Lead Economist for East Africa (RDGE).

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# ACRONYMS AND ABBREVIATIONS

<b>AfDB</b>	African Development Bank
<b>AEO</b>	African Economic Outlook
<b>CBS</b>	Central Bank of Seychelles
<b>CFR</b>	Country Focus Report
<b>CI</b>	Confidence Interval
<b>COVID-19</b>	Coronavirus Disease 2019
<b>CSP</b>	Country Strategy Paper
<b>DFI</b>	Development Finance Institution
<b>DP</b>	Development Partner
<b>ECCE</b>	Country Economics Department
<b>EFF</b>	Extended Fund Facility
<b>FDI</b>	Foreign Direct Investment
<b>FinTech</b>	Financial Technology
<b>GDP</b>	Gross Domestic Product
<b>GNI</b>	Gross National Income
<b>GoS</b>	Government of Seychelles
<b>GWh</b>	Gigawatt Hour
<b>HDI</b>	Human Development Index
<b>ICT</b>	Information Communication Technology
<b>IMF</b>	International Monetary Fund
<b>LNG</b>	Liquefied Natural Gas
<b>IPP</b>	Independent Power Producer
<b>IRENA</b>	International Renewable Energy Agency
<b>M&amp;E</b>	Monitoring and Evaluation
<b>MDB</b>	Multilateral Development Bank
<b>MPI</b>	Multidimensional Poverty Index
<b>MSME</b>	Micro, Small, and Medium-sized Enterprise
<b>MSW</b>	Municipal Solid Waste
<b>MW</b>	Megawatt
<b>NCCS</b>	National Climate Change Strategy
<b>NDC</b>	Nationally Determined Contribution
<b>NDS</b>	National Development Strategy
<b>NSO</b>	Non-Sovereign Operation
<b>PPP</b>	Public-Private Partnership
<b>PSIP</b>	Public-Sector Investment Programme
<b>PUC</b>	Public Utility Corporation
<b>RDGE</b>	East Africa Regional Development and Business Delivery Office
<b>SSA</b>	Sub-Saharan Africa

<b>SCR</b>	Seychelles Rupees
<b>SDG</b>	Sustainable Development Goal
<b>SFA</b>	Seychelles Fishing Authority
<b>SPTC</b>	Seychelles Public Transport Corporation
<b>UNDP</b>	United Nations Development Programme
<b>UNSPF</b>	United Nations Strategic Partnership Framework
<b>USD</b>	United States Dollar
<b>WDI</b>	World Development Indicator
<b>WEF</b>	World Economic Forum





# EXECUTIVE SUMMARY

Macroeconomic performance and outlook: Seychelles' recent growth has been robust. GDP growth was 5.5% in 2019, before an economic contraction by almost 12% in 2020 due to the effects of COVID-19 pandemic. GDP growth rebounded during the post-pandemic period peaking at 15.0% in 2022 but slowed down to just 2.5% in 2023. The outlook is positive. Monetary policy remained accommodative due to very low inflation rates averaging 3.1% over the 2020-2023 period, and with no significant threat of inflation pressure, the policy is likely to remain accommodative. Fiscal policy remained prudent, and the fiscal deficit narrowed from a peak of 15.8% in 2020 to 1.5% of GDP in 2022 due to the prudent policy and expenditure rationalization supported by economic recovery. The current account widened recently due to increased import value despite continued recovery in tourist arrivals and earnings. Seychelles should continue to focus on macroeconomic stability and enhanced economic diversification to accelerate structural transformation and reduce its vulnerability to external economic shocks and climate risks.

Structural transformation in Seychelles has been slow over the past decade. The share of agriculture remained around 2.5% of GDP from 2010 to 2021, while that of industry remained around 15% over the same decade. There has also been slow movement of labour from low to high productivity sectors, as employment shares of the key sectors, remained similar over the years. The financing needs and financing gaps for accelerating structural transformation in Seychelles are low compared with other peer countries. The Government's Vision 2033 and the National Development Strategy (NDS) 2024-2028 both articulate the need for accelerated structural transformation and have identified it as one of the key pillars and priorities. To accelerate structural transformation, it is recommended that Seychelles should: (i) develop efficient, cost effective, and green infrastructure, particularly energy and transport; and (ii) improve the business environment, particularly addressing the regulatory, institutional, access to finance and productive capacity constraints.

As regards domestic resource mobilization, Seychelles is one of the few countries in Africa that has managed to increase its revenue generation from within by reforming the tax regime and widening the tax base, as well as introducing new levies. Seychelles has significant potential for increasing its tax revenue collection, especially compared to the continental average and the best-performing economies in Africa. Currently, Seychelles' tax-to-GDP ratio hovers around 27%, which is relatively high for the country, but still leaves room for improvement particularly by widening the tax base through incentivising the informal sector. Investment trends in Seychelles have shown a fluctuating pattern, often influenced by the country's economic cycles and external shocks. Over the past decade, Seychelles registered investment levels of around 25%-30% of GDP, which is robust, but still falls short of the ideal threshold of 33% or more, needed to drive sustained economic growth. External resources have played a crucial role in financing Seychelles' economic development and structural transformation. Foreign direct investment (FDI) has been pivotal in the development of key sectors such as tourism, fisheries, and real estate, fostering economic diversification and job creation. Reforms to the international financial architecture such as those that consider the specific situations of island States' vulnerabilities, and reforms that enable Seychelles to access concessional resources, despite its high-income status, can significantly help Seychelles to enhance its access to financial resources, reduce borrowing costs, and improve economic resilience.





# GENERAL INTRODUCTION

Seychelles is an archipelago of 115 islands in the Indian Ocean, with a population of about 100,000 inhabitants (2023), a small land mass (455 sq. km), and a vast exclusive economic zone (1,374,000 sq. km). The country became a high-income economy in 2015. Its GDP per capita stood at USD 20,061 in 2023, up from USD 11,130 in 2008, despite the contractionary effects of the COVID-19 pandemic on GDP growth in 2020. Life expectancy at birth is relatively high by sub-Saharan Africa standards, rising to 75.0 years in 2023, up from 71.3 years and 71.7 years in 2021 and 2022 respectively (AfDB, 2024). Moreover, with a human development index (HDI) of 0.802 in 2023, Seychelles secured the 67th position out of 193 countries, firmly establishing itself among the countries in the very high human development category (UNDP, HDI Report, 2024). Despite such positive trends, the country faces unique development challenges related to its small domestic market, geographical remoteness, and insufficient diversification - challenges that have led to the country's significant vulnerability to external economic and environmental shocks.

This Country Focus Report (CFR) for Seychelles is prepared as part of the annual African Economic Outlook (2024) launched in May 2024 and the Regional Economic Outlook (REO) 2024 for East Africa. This 2024 edition of the CFR for Seychelles has three sections. Following this introduction, Chapter 1 discusses Seychelles' macroeconomic performance and outlook. Chapter 2 is focused on 'Taking stock of the country's structural transformation progress'. Chapter 3 discusses issues related to 'Financing structural transformation in Seychelles, and the need for reform of the international financial architecture'.





# MACROECONOMIC PERFORMANCE AND OUTLOOK

1

## KEY MESSAGES

- After an economic contraction by almost 12% in 2020 due to COVID-19, growth rebounded, peaking at 15.0% in 2022, but slowed down to 2.5% in 2023. However, the outlook is positive.
- Monetary policy remained accommodative with an MPR of 2.0 over the past two years before it fell to 1.75 in early 2024, due to the very low inflation rates at less than 3% since the pandemic, except in 2021 when it reached 9.8%. With no significant threat of inflation pressure, the policy is likely to remain accommodative. Fiscal policy remained prudent, and the fiscal deficit has further narrowed due to the prudent policy and expenditure rationalization supported by economic recovery.
- The current account widened to 8.0% of GDP in 2023 due to increased import value, despite steady recovery in tourist arrivals and earnings by about 6% compared to 2022. The country needs to ensure continued macroeconomic stability and economic diversification to accelerate sustainable, green, and inclusive growth.

## Introduction

This chapter presents an updated analysis of Seychelles' economic performance for 2023, including medium-term growth projections over the 2024-2025 period. It also assesses trends in key macroeconomic indicators and fiscal and monetary policies, as well as changes in domestic and international financial flows, investment, and public debt. The chapter also discusses the main downside and upside risks to the outlook and provide policy options to foster high and resilient growth to support macroeconomic stability and economic transformation, as well as deal with shocks that have continued to buffet Seychelles.

### 1.1 Recent growth performance:

GDP growth peaked at 15.0% in 2022, but it dropped to 2.5% in 2023 amid continued global economic uncertainty and multiple shocks. Real GDP per capita growth also peaked at 14.4% in 2022 before dropping to 2.0% in 2023. On the supply side, GDP growth was driven by the services sector, notably tourism which has contributed the largest share to growth over the past two decades. Notably, the 12% contraction of GDP in 2020 and the 15.9% surge in GDP growth in 2022 are related to contraction (in 2020) and surge (in 2022) in tourist arrivals respectively. On the demand side, household consumption and investment in the hospitality industry were the key growth drivers. As a tourism-dependent economy, the economic performance and recovery of the countries where tourists come from (mainly the Euro zone, the Middle East, and Russia) plays a pivotal role in the country's growth performance, indicating Seychelles' vulnerability to external economic shocks.

### 1.2 Other recent macroeconomic and social developments

1.2.1 Monetary policy – Inflation –  
Exchange rate: Seychelles' monetary

policy has remained accommodative since the COVID-19 period to reduce the cost of credit and boost economic activity. Inflation significantly rose to 9.8% in 2021 from a low of 1.2% in 2020 due to the lagged effect of global supply chain disruptions amid the COVID-19 pandemic and global lockdowns since the first quarter of 2020. More recently, inflation has continued to decline – first to 2.6% in 2022, and then to -1.0% in 2023 – as domestic prices and supply of imported commodities improved and the Seychelles rupee (SCR) appreciated against the US dollar. The main drivers of the recent deflation were – moderation in global fuel and food prices (the country's main imports), decline in freight costs, and an appreciation of the SCR (owing to increased tourist arrivals). Given the low inflation rates, the Central Bank of Seychelles (CBS), in March 2024, maintained an accommodative monetary policy and further relaxed the monetary policy rate from 2 % to 1.75 %.

Seychelles has a flexible exchange regime, and the SCR has remained stable over the 2021-2022 period as it is determined by market forces. Exchange rate stability has been a key policy objective for the CBS under the country's floating exchange rate regime. The CBS uses foreign exchange auctions for the purchase and sale of foreign currency to ensure availability of foreign exchange and enhance liquidity management, but the exchange rate is mainly linked to the performance of tourism. On average, the SCR appreciated by 1.8% against the USD, while it weakened by 0.7% against the Euro (CBS, 2024). There are no key issues in the exchange rate management as the exchange rate is market-determined.

#### 1.2.2. Fiscal policy and public debt:

Seychelles had a modest fiscal surplus of 0.2% of GDP in 2019. However, in 2020, the budget balance deteriorated to a deficit of 15.9% of GDP, resulting in an increase of

High dependence on tourism earnings led to high growth volatility – contracting by almost 12% in 2020 due to COVID-19, rebounding to 15.0% in 2022 due to rise in tourism earnings before slowing down to just 2.5% in 2023 with moderate 4.2% over the next 2 years.



public debt from 59% in 2019 to 89.5% in 2020. Owing to the fall in economic activity, tax revenue declined in 2020 by 15% leading to a tax-to-GDP ratio of 27%, compared to an average of 32% over the previous five years, while public spending rose to almost 50% of GDP. The fiscal deficit narrowed to 5.6% in 2021 and to 1.5% in 2022 owing to improvements in revenue collection under a growing economy. The deficit slightly rose to 1.9% in 2023 as growth moderated compared to 2022.

The primary balance significantly declined to a deficit of 13.3% of GDP in 2020 compared to a surplus of 2.3% in 2019 due to the pandemic which led to an increase of social expenditure and a decline in revenue collection, as well as an increase in interest payments on debt following higher debt levels. Primary deficit declined sharply to 2.7% of GDP in 2021, but improved to a surplus of 0.5% and 1.0% of GDP in 2022 and 2023 respectively. The increase in the primary surplus in 2023 compared to that of 2022, as well as the deterioration of the overall fiscal balance, show that interest payment on debt declined significantly as the debt stock reduced.

The country's debt has been declining and remained sustainable over the past several years, though it hiked in 2020 due to the pandemic. At the end of 2023, the total public debt stock stood at USD 1,233 million, which was 2.9% lower than in December 2022 (CBS, 2024). The decline was mainly driven by a 6.8% fall in domestic debt resulting from reductions of 6.4% and 3.4 % in government securities and central government domestic loans, respectively. The aggregated stock of external debt stood at 29% of GDP at the end of 2023 compared to 31% in 2022. Seychelles' public debt, which had shot up to 81.1% of GDP in 2020 amid the COVID-19 pandemic, declined to 56.7%

in 2023 from 58.9% in 2022, amid strong recovery and prudent debt management, appropriate fiscal consolidation measures, and appreciation of the SCR.

One risk factor identified in the Debt Management Strategy (DMS) 2021-2023 was the country's heavy reliance on short-term maturing T-Bills that posed high likelihood of roll-over risks. The DMS 2021-2023 revealed that more than 85% of Seychelles' total debt that was due for redemption in 2021 was domestic, which could cause macroeconomic instability unless managed in a prudent manner. Cognizant of the need to reduce debt to a sustainable level in the medium term, the Government has prepared a (DMS), 2023-2026 to ameliorate the risks identified in the previous DMS. The most recent joint IMF and World Bank public debt sustainability analysis (DSA) for Seychelles (February 2023) assessed the country's debt as sustainable. In March 2024, Fitch Ratings revised the Outlook on Seychelles' Long-Term Foreign-Currency Issuer Default Rating (IDR) to Positive from Stable. The rating indicated that the revision reflected key rating drivers including fiscal outperformance, continued debt reduction, stabilizing tourism receipts, stable growth, multilateral funding support, and current account deficit.

**1.2.3. External position:** As a percent of GDP, the current account deficit narrowed from 10.4% in 2021 to 6.9% in 2022 amid continued improvement of tourism performance, but it widened slightly to 8% in 2023 due to increased import values. The main foreign exchange earners are tourism and canned fishery products, while imports include food, fuel and construction materials. Gross international reserves (GIR) in months of import coverage stood at 3.7 months in 2023.

**Table 1 : Selected Macro indicators, Seychelles**

	2019	2020	2021	2022	2023 (e)	2024 (p)	2025 (p)
Real GDP Growth	5.5	-11.7	0.6	15.0	2.5	4.0	4.3
Real GDP Growth per Capita	4.3	-12.8	-0.3	14.4	2.0	3.5	3.7
Inflation	1.8	1.2	9.8	2.6	-1.0	1.4	2.2
Overall Fiscal Balance, incl. Grants (% GDP) *	0.2	-15.9	-5.6	-1.5	-1.9	-1.5	-1.3
Primary Balance (% GDP) *	2.3	-13.3	-2.7	0.5	1.0	0.9	1.1
Current Account (% GDP)	-2.8	-12.5	-10.4	-6.9	-8.0	-7.2	-7.2
GDP per Capita (US \$)	17,889.0	13,113.5	13,993.3	19,212.2	20,061.6	21,294.5	22,362.9
Total Population (Millions)	0.1	0.1	0.1	0.1	0.1		
Life Expectancy at Birth (Years)	74.2	73.5	71.3	71.7	75.0		

Source: Data from Domestic authorities; estimates (e) and prediction (p) based on authors' calculations. AfDB Statistics Department, April 2024.

**1.2.4. Social developments:** Seychelles has strong social indicators. The country was ranked second after Mauritius in Africa and 67th out of 193 countries globally in the 2023/24 Human Development Index (HDI), ranking first in sub-Saharan Africa. Seychelles is on track to achieve most of the sustainable development goals (SDGs). All citizens have access to education at primary and secondary levels, with primary and secondary school enrolment rates at 98% and 77% respectively in 2022. There is almost universal access to reliable electricity (99.5%) and drinking water (93%) although electricity is almost fully generated from fossil fuels. The female-to-male labour force participation ratio is about 90%, while there is low level of poverty and income inequality. The Gini index stood at 32.1% in 2018. Based on the 2019 survey data, estimated poverty is low

at 0.5% in 2022/23, while unemployment is estimated to have remained low at 3% in 2022 and 2023 (UNDP, 2024). The country's social assistance provisions are also very adequate, and ensure that the unemployed and pensioners are not subject to extreme poverty. Notwithstanding its robust and comprehensive social protection system, the country's ageing population has exerted pressure on the pension fund, leading the authorities to increase the retirement age from 63 to 65 years from January 2023. Despite these achievements, areas of slow progress include youth unemployment, estimated at 16.5% for 15-23 years group, compared to an overall unemployment rate of just 3% in 2022. Furthermore, the 2019 Global Health Security Index points to major weaknesses in Seychelles' capacity to prevent, detect, and respond to biological threats.

### **Box 1.1: Impact of tighter international financial conditions (transmission channels)**

The impact of tighter international financial conditions on Seychelles, a small island State, can be profound due to its economic structure, which is too dependent on tourism and fisheries, climate change risks, and reliance on external financial flows, particularly foreign direct investment (FDI). As global interest rates rise and financial markets become tighter and more risk-averse, Seychelles faces increased borrowing costs. This affects its public debt servicing, which already constitutes a significant portion of the national budget. Despite its current sustainable debt level and debt management strategies, it should be noted that the country had experienced a painful and costly debt default history during the 2008 global financial crisis. Higher interest rates on new debt issuances or refinancing can strain fiscal resources, potentially necessitating policy measures that could slow down public investment, restrict the country's sustainable growth path, and reverse its achievements in poverty reduction and other socio-economic developments. Additionally, higher global interest rates can deter FDI flows into the country, stalling key projects in tourism, fisheries, and other vital sectors. They can also make it difficult for the country to effectively implement its National Development Strategy (NDS) 2024-2028, which has adopted the transformation agenda as one of its key pillars.

The transmission channels of tighter global financing conditions directly impact the country's external sector. Seychelles' economy is highly dependent on tourism, which is sensitive to global economic trends. Tightening international financial conditions can lead to weaker demand for tourism products and slow down growth in its key tourism markets, thereby reducing tourist arrivals from these countries and foreign exchange earnings. This, in turn, can heavily affect its current account position (that is widening the deficit) put significant downward pressure on the SCR, and significantly increase the country's debt stock in terms of the SCR. It can also lead to inflationary pressures due to higher import costs. Given that the country is heavily import-dependent for food and fuel, the rising import costs can threaten food security in the country. The reduced inflow of foreign currency could also impact the capacity of local businesses to finance their operations and expansions, thereby further stifling economic growth and competitiveness. The private sector may therefore not be able to play its potential pivotal role of being an engine for sustainable growth.

Moreover, the banking sector in the country may also experience tighter liquidity supply as global financial conditions affect the country's aspirations to being a global hub for digital financing, and the cost of international transactions will rise as the conditions can negatively affect correspondent banking relationships. Banks may also face higher costs for external financing, which can be passed on to borrowers as higher interest rates on loans. This, in turn, can curb the growth of credit to the private sector, limiting consumer spending and business investment. Additionally, the risk of capital flight increases if investors seek safer, higher-yielding investments elsewhere, leading to greater volatility in the financial markets and destabilization of the local economy. These risks highlight Seychelles' vulnerability to external economic shocks, as witnessed during the 2008 global financial crisis, hence the need to maintain a robust economic policy to mitigate external shocks.

## **1.3 Macroeconomic outlook and risks**

### **1.3.1 Outlook (Economic growth – Inflation – Fiscal and External position):**

The medium-term outlook is positive, despite some downside risks. Real GDP growth is projected to improve to 4.0%

and 4.3% in 2024 and 2025 respectively, amid sustained performance of tourism supported by contributions from fisheries, ICT, and financial services in line with the priorities of the new NDS 2024-2028. Real GDP per capita growth is projected to improve to 3.5% and 3.7% in 2024 and 2025 respectively. Tourism and fisheries

will continue to be the key growth drivers, but opportunities in knowledge intensive services, including digital finance and ICT, will also contribute. Inflation is projected to remain low at 1.4% and 2.2% in 2024 and 2025 respectively. Given the projected low inflation rates over the medium term, the monetary policy is likely to remain accommodative. The exchange rate is projected to remain largely stable, though the SCR might slightly appreciate in 2024 and 2025 driven by good performance of the tourism sector.

Overall, fiscal deficit is projected to slightly narrow to 1.5% and 1.3% in 2024 and 2025 respectively, as a result of the country's fiscal consolidation efforts and continued GDP growth. Debt is projected to decline further to 54% by 2026, as the country's fiscal strategy seeks to keep total debt-to-GDP ratio on a declining trajectory towards a target of below 50% of GDP by 2030. The primary balance is projected to decline slightly to 0.9% in 2024 before improving back to 1.1% of GDP in 2025 owing to steady economic recovery and a declining trajectory of the total public debt stock. Fiscal deficits are financed mainly by domestic borrowing. The current account deficit is projected to slightly narrow and stabilize at 7.2% in 2024 and 2025, with steady tourism recovery. GIRs are projected at about 4.0 months over the 2024-2026 timeframe in line with the authorities' target, as tourism arrivals and earnings from the sector remain buoyant. The current account deficit is financed by FDI, primarily towards hotels and related activities.

**1.3.2. Risks to the medium-term positive outlook:** The positive medium-term outlook is subject to some downside and upside risks. The major sources of downside risks include a weakening global economy due to extended multiple global shocks, as well as climate change risks and high youth unemployment due to skills

mismatch. These risks will be exacerbated by geographical remoteness and small population size that increased costs of imports and exports, thereby imposing a higher tariff on trade.

Despite these downside risks, there are also some opportunities that can be unlocked to accelerate sustainable growth and climate risk resilience. These include effective implementation of the new NDS 2024-2028 that is focused on addressing the fundamental challenges mentioned above. The entry into force of the African Continental Free Trade Agreement (AfCFTA) will open additional market opportunities for Seychelles' companies, thereby enabling them to use economies of scale while attracting new sources of tourists from the African continent. On the social front, the efforts to address weaknesses in the education system, particularly TVET, will narrow the skills gap and mismatches, thereby improving overall productive capacity and reducing Seychelles' dependence on foreign expertise.

#### **1.4 Policy options to foster high and resilient growth**

Fostering macroeconomic stability through the accommodative monetary policy stance should be maintained, as there are currently no immediate risks of higher inflation outside of the CBS' target. The fiscal policy should remain prudent, focusing on expenditure rationalization and enhanced domestic resource mobilization, while ensuring debt sustainability. These should be complemented by actions that focus on economic diversification and accelerated structural transformation and resilience, including continued search for innovative climate change financing that encourages the private sector and Seychelles' global development partners to participate and improving the business environment. Focus should be on MSMEs



to enable them to play their pivotal role as the engine for growth, value addition, and job creation. The constraints on private sector growth that need immediate attention include access to finance and access to climate-friendly smart energy generation and transmission. Effective implementation of the NDS 2024-2028, through its six pillars including the focus on the transformation agenda and education, could address several of these challenges.



# TAKING STOCK OF THE COUNTRY'S STRUCTURAL TRANSFORMATION PROGRESS

# 2

## KEY MESSAGES

- Structural transformation in Seychelles has been slow over the past decade. Agriculture's share remained around 2.5% of GDP from 2010 to 2021, while that of industry stood at around 15% over the same period. There has also been slow movement of labour from low to high productivity sectors, as the country has already transformed from agrarian (plantation based) economy to services, particularly a tourism-dependent economy.
- The financing needs and financing gaps for accelerating structural transformation in Seychelles are low compared to other peer countries. The overall financing gap for accelerated structural transformation is very low for Seychelles, lower than 1% of GDP, by 2030, compared to countries like Burundi (43%), Libya (85%), and Mauritania (81%).
- The Government's Vision 2033 and NDS 2024-2028 both articulate the need for structural transformation and have identified it as one of the key pillars and priorities. Fostering structural transformation requires: developing efficient, cost-effective, and green infrastructure, particularly energy and transport; and improving the business environment by addressing the regulatory, institutional, and avoidable finance and productive capacity constraints.

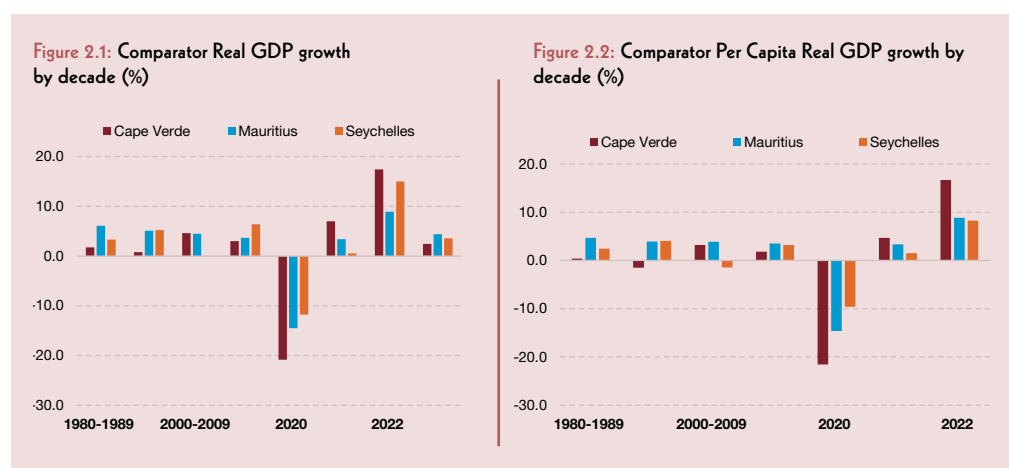
## Introduction

This chapter presents a comprehensive overview of recent progress in Seychelles' economic transformation amid a changing world. It identifies key trends in transformation and outlines its characteristics, and estimates the financing needs to fast-track structural transformation. It also takes a historical perspective and adopts a forward-looking approach to fast-track progress in structural transformation, comparing, whenever possible, Seychelles' performance to that of Africa and other peers and drawing lessons for the future. The chapter also assesses the impact of socio-economic, financial, governance, and external factors on Seychelles' structural transformation. The chapter finally presents the financing needs and gaps for effective structural transformation.

## 2.1 Taking stock of Seychelles' structural transformation process

**2.1.1. Dynamics of per capita GDP growth:** Seychelles' per capita GDP stood at about USD 17,889 in 2019, but it declined to USD 13,114 in 2020 amid the COVID-19 pandemic and the resulting GDP contraction by almost 12%. Comparing Seychelles with two selected peer countries (Cape Verde and Mauritius) shows that average real GDP growth rate over the past four decades was higher than that of Cape Verde but lower than that of Mauritius, specifically in the decades prior to 2010-2019 when Seychelles grew faster than both countries.

Seychelles' real GDP contraction in 2020 due to COVID-19 was also the lowest (Figure 2.1).



Source: AfDB, ECMR, 2024

With an annual population growth rate of around 0.5%, the dynamics of per capita GDP growth is determined mainly by the dynamics of GDP growth. Real GDP per capita growth was slower than for Mauritius, but faster than for Cape Verde over the past four decades, but lower than the two countries in 2021 and 2022 (Figure 2.2).

Over the first two decades under review, real GDP and real GDP per capita growth

rates remained between those of Mauritius and Cape Verde, as the country was evolving from a predominantly agrarian economy to a service-based economy (particularly tourism), following the opening of the country's national airport in 1970s. However, during the third decade, real GDP growth declined sharply to almost zero and real GDP per capita contracted (Figure 2.2) mainly due to the 2008 global financial crisis, when Seychelles defaulted on payment of its international debt.



The country had to struggle to meet its international payments and new inflows of financing dried up until it managed to secure debt restructuring deals with its creditors that needed commitment to structural adjustment needs. AfDB played a critical role through its partial credit guarantee in the restructuring arrangements. Seychelles currently has the highest per capita income in sub-Saharan Africa at USD 20,062 in 2023 (AfDB, AEO 2024).

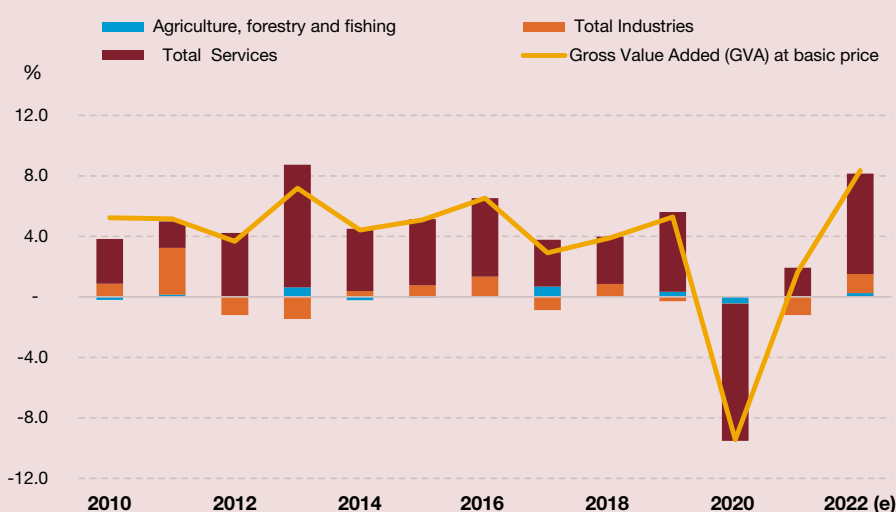
It went up from around USD 344 in 1970 and USD 2,080 in 1980 to almost USD 15,000 in 2015, leading the country into a high-income status. Sustainable and green growth strategies and policies will, through accelerated economic diversification, remain key for the country to maintain its high-income status. Cognizant of this, the country's Vision 2033 and NDS 2024-2028 both focus on economic diversification and transformation as key pillars of the country's future development and climate change resilience.

## 2.2 Seychelles' structural transformation: Drivers, bottlenecks, and opportunities.

**2.2.1. Seychelles' structural/economic transformation:** Structural transformation in Seychelles has been slow over the past decade. Agriculture's share remained around 2.5% of GDP from 2010 to 2021, while that of industry remained around 15% over the same decade. Within industry, manufacturing's share remained stagnant, with a slight decline from 10.5% in 2012 to around 8.3% in 2021. Consequently, the services sector remained dominant, rising from 82% to 84% over the same period. Within the services sector, tourism's share remained high at around 27%. There has also been slow movement of labour between sectors of differing productivities – that is from low productivity sectors, such as agriculture, to high productivity sectors, such as the emerging knowledge-intensive sectors of ICT services or high value creation manufacturing. Agriculture's share of employment remained around 1% between 2012 and 2018, and that of manufacturing at around 9%, while employment's share for emerging sectors such as finance and IT services remained at 5%-6% over the same period.

Structural transformation in Seychelles has been slow over the last decade but requires lower financing for acceleration at only 1% annually to 2030 compared 81% for Mauritania with similar conditions.

Figure 2.3: Contribution to real GDP growth by activity (%)



Source: AfDB Statistics Department

Small domestic market, insufficient availability of skilled labour, low access to financing, high electricity cost, and climate risks hamper structural transformation.

The dominant services sector has also been the key determinant of overall growth dynamics over the past several years, particularly services related to tourism and accommodation. Economic growth performance for some years has been volatile amid the country’s vulnerability to external economic and climate shocks. Volatility of growth in the dominant services sector, particularly tourism and accommodation-related activities were reflections of the volatile global economic growth.

Figure 2.3 presents sector contributions to GDP growth over the 2010-2022 period. As shown, growth in the services sector (dominated by tourism-related activities) remained the key driver of overall economic growth as no significant economic transformation was observed over the past decade. Accordingly, the main drivers of recent growth were primarily activities in tourism, including the” accommodation and food services” (which grew by 5.5 % in 2022 over 2021), “construction” (2.0%) information and technology” (1.9%) and” wholesale and retail” (1.3%). The services sector, particularly tourism, remained the

main driver of structural transformation or lack of it as it remains dominant and with little or no change in its composition. However, with the key pillars of NDS 2024-2028 being the” economic transformation agenda,” modern and improved public services”, and “skills development”, further economic transformation is likely to be driven by emerging and knowledge-intensive activities within the services sector, such as digital financial services, high-value tourism activities, smart transport, and ICT.

Seychelles has a relatively high level of ICT Development Index (Figure 2.4). This puts the country on a competitive advantage of accelerating economic diversification and structural transformation in the immediate future, as ICT enables productivity enhancement and competitiveness. The authorities are also currently working on an assessment of the country’s tourism capacity to find ways of higher value addition in the sector and ensuring sustainability. This is important because, coupled with the effects of climate change, the high frequency of tourist visits to some islands is contributing to environmental degradation. In this regard, the country recently (August 2023) introduced an environmental tax on tourism payable by every tourist daily. This environmental levy will enable the Government to mobilize additional resources to finance environmental projects and sustainable tourism.

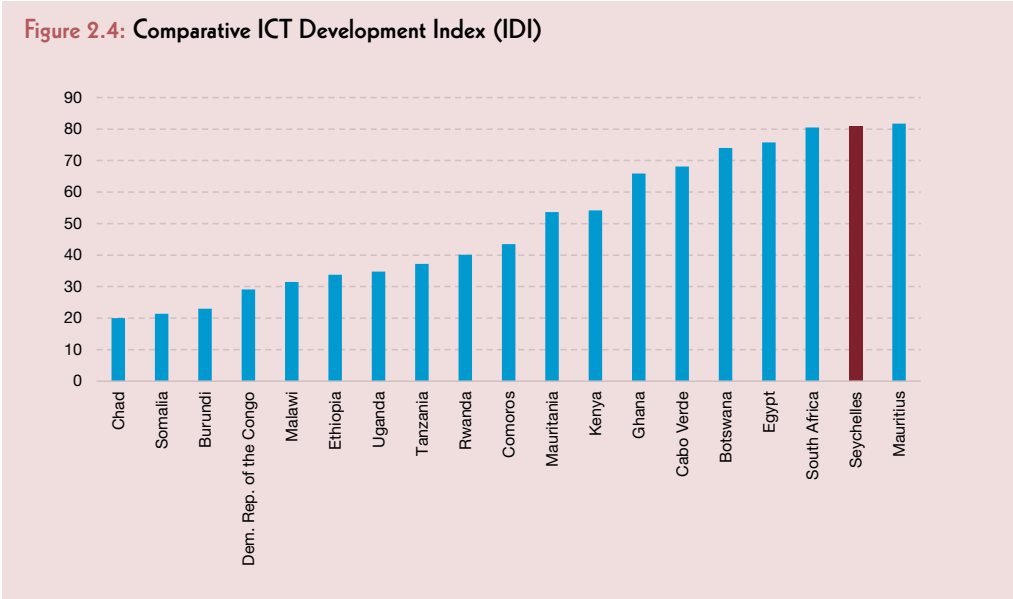
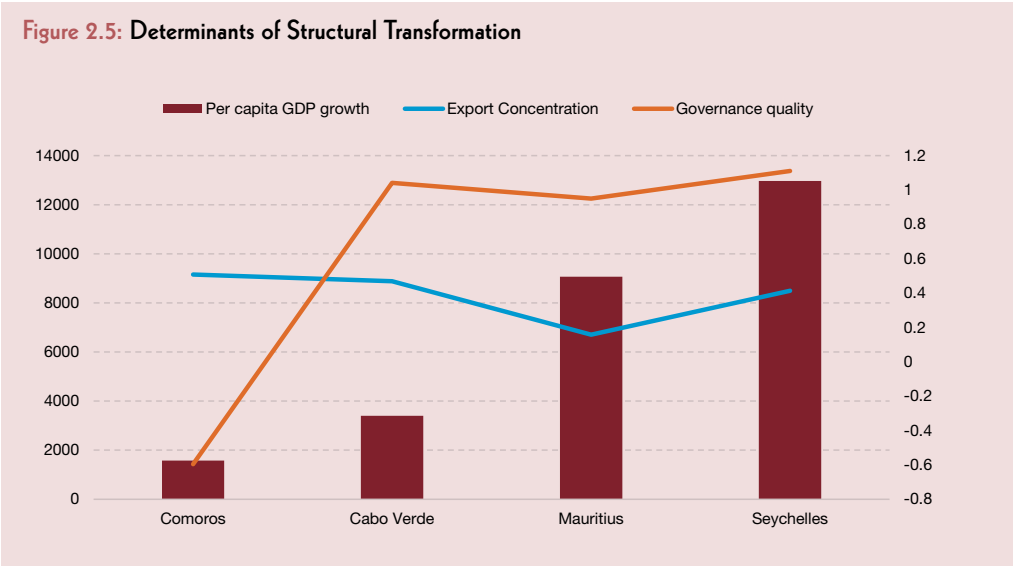


Figure 2.5 presents comparative determinants of structural transformation indicating that governance quality and relatively low levels of export concentration are key for accelerated economic transformation. As regards the structural transformation path, Comoros is structurally

developing (with low governance quality and lowest GDP growth than the other three. The other three countries are considered as structurally developed (AfDB data) confirming the notion that better governance quality is supportive of accelerated growth and transformation.



To clearly understand how the Seychelles can contextualize its way forward to accelerate its transformation, it is important to note that successful structural transformation involves four main features: (i) a falling share of agriculture in output and employment; (ii) a rising share of urban economic activity in industry and modern services; (iii) migration of rural workers to urban areas; and (iv) a demographic transition in birth and death rates that leads to slower population growth.

With regard to the four main features, for Seychelles: (i) agriculture's share has already been historically low once the country transformed from an agrarian society based on plantations to a tourism-dependent economy in the early 1970s; (ii) services' share in the country's GDP has been dominant; (iii) economic activities have remained literally concentrated in urban areas, particularly in the largest

island, Mahe, while all other islands except three are inhabited; and (iv) the population growth rate is already too low, as the population is ageing and the base is also small (around 100,000 total population). In this context, therefore, all the four features have already materialized, or are there already. However, given the low level of economic diversification, including the concentrated market for the country's export and tourism, Seychelles continues to be very vulnerable to external shocks. In addition, despite the slow pace of economic transformation in recent years, the main area of focus for Seychelles is economic and environmental resilience, and therefore any economic transformation strategy needs to revolve around economic and climate change resilience. One universal key outcome of structural transformation is a rising standard of living and significant poverty reduction, which Seychelles has already achieved.

**Box 2.1: Learning from the successful experiences in supporting growth and structural transformation in Seychelles**

Structural transformation has been a focus of the development profession since the 1950s, and there is ample evidence of developing and emerging economies successfully enhancing the living standards of their populations and achieving increased productivity. The literature and development history of successful economies indicates three key lessons: (i) Structural transformation has been the main ingredient for poverty eradication in all societies, accompanied by rising productivity in all sectors (agriculture and non-agriculture) and achieving food security; (ii) In the early stages of the process, structural transformation widens labour productivity gaps in agricultural and non-agricultural sectors and puts pressure on the rural economy to adjust and modernize – pressures that are translated into visible policy responses altering agricultural prices. Agricultural surpluses in rich countries amid artificially high domestic prices translate into very low world agricultural prices in world markets, undermining the focus on the sector in poor countries; and (iii) Despite the decline in the relative importance of agricultural products, economic growth and structural transformation will require major investments in the agricultural sector itself – a seemingly paradoxical outcome – but the investments are needed for food security and poverty reduction. Using appropriate policy responses to this paradox and focusing on food security for their population, East and South-east Asian countries managed to address this paradox, while Africa did not. Contextualizing these lessons to Seychelles' case therefore requires that: (i) Seychelles maintains the already achieved very low poverty incidence, but as the country remains vulnerable to external economic and environmental shocks, strategies to ensure economic resilience through economic diversification away from the traditional tourism and fishery sectors remains key. These are clearly articulated in the Government's Vision 2033 and NDS 2024 - 2028; (ii) While labour productivity and the sector's ability to transfer labour to other sectors remain low, the country needs to address several constraints, particularly access to financing for small farmers and linkages of the sector with other sectors, such as tourism and manufacturing. In this regard, addressing sector-specific business environment issues will attract investment into the sector and ensure better food security. The focus areas should therefore include addressing sector impediments related to access to finance by providing targeted financial services and creating market linkages between the agricultural and non-agricultural sectors; and (iii) Consistent with the third lesson indicated here from the literature, policy makers need to incentivize investment in agriculture to complement those mentioned in (ii) above. The focus on smart and climate- resilient agriculture in Vision 2033 and the NDS are key, and effective implementation of the NDS is likely to achieve this.

**2.2.2. Key bottlenecks to fast-track structural transformation:**

Demographic challenges are some of the key impediments to the country's transformation. The total population is small (around 100,000 inhabitants), which limits availability of differing skills needed for an advanced economy. Moreover, the ageing nature of the population, projected to accelerate further over the next few years, coupled with a declining fertility rate and increasing life expectancy, will likely increase the overall dependency ratio, and given the generous social security and pension

system, this will create a significant fiscal pressure on the economy. As a small island State, climate change risks also hamper the transformation pathway in Seychelles. Rising sea levels, hurricanes, and changes in rainfall patterns are additional impediments, as demonstrated by the December 2023 heavy rainfall and flooding that significantly damaged infrastructure and disrupted economic activity.

The informal sector is very large, and this can also put a brake on the pace of structural transformation. According to



the 2020 Report on informal employment in Seychelles, by the National Bureau of Statistics, the number of people working in the informal sector is estimated at 8,204, representing about 17 % of workers. The report further indicates that out of this working population, 74% were men. There is therefore a significant portion of income earners difficult to tax, which offers an opportunity for increasing tax revenue for the Government. As income earners from the informal sector enterprises are not paying any taxes, and they are not contributing to the pension system, they may end up being subjected to extreme poverty. Such a huge informal sector also means that providing the needed business development support services by the Government is difficult, thereby reducing the economy's entrepreneurial capacity. Seychelles therefore needs to design and implement strategies to encourage informal sector businesses to formalize.

Financing constraints, particularly for MSMEs, have been among the biggest challenges faced by Seychellois businesses. According to the World Economic Forum's Global Competitiveness Report 2017, access to financing has been cited as the most problematic factor for doing business in Seychelles (cited by 24.1% of businesses), followed by tax rates (cited by 11.2% of businesses), (IMF, 2023). Interest rates are also relatively high. The average lending rate increased recently by 30 basis points in 2023 to 9.62% compared to its level in 2022. Although banks are well capitalized, liquid, and profitable, nonperforming loans were relatively high at about 7.8% of gross loans in 2023, well above the 3.0% in 2018–2020, probably leading to banks becoming more risk-averse to some groups of borrowers. Financing constraints therefore can act as impediments to structural transformation. The country needs to design policies to address the constraints through provision of business finance, financial literacy,

and other capacity development for MSMEs to increase their understanding and knowledge of access to the various financial products accessible to them.

### **2.2.3. Drivers to accelerate structural transformation in Seychelles:**

Analysis using multi-decades data, AfDB (AEO, 2024) shows that structural transformation is key to reducing poverty and inequality and enhancing living standards. The analysis applies an exploratory regression approach on an unbalanced panel comprising 48 African countries from 2000-2019 and concludes that the “main pull” factors of Africa's structural transformation include a competitive exchange rate system, well-defined and functioning institutions, and gross fixed capital. Stringent labour market regulations act as “push factors”. The conclusion applies to the case of Seychelles too as demonstrated in the previous sections. Structural transformation over the previous decades has enabled Seychelles to achieve its current high levels of socioeconomic development indicators such as the second highest HDI in Africa, very low poverty level, and low inequality as indicated in the Gini coefficient. In this regard, to further improve and retain social development in Seychelles, understanding its main drivers will enable policy makers to identify and prioritize the relevant policy actions.

The continental-level analysis shows that: (i) natural resource dependence does not significantly drag structural transformation; (ii) currency undervaluation (overvaluation) enhances structural transformation, and therefore a competitive exchange rate is crucial for structural transformation; (iii) stringent labour market regulation is likely to hamper structural transformation; and (iv) well-defined and functioning institutions can positively drive structural transformation by reducing transaction costs and information externality. The latter result aligns with Mensah et al (2016),

which found that “institutions, governance, and fiscal reforms are essential drivers of structural transformation in Africa”; and (v) capital accumulation also drives structural transformation.

The findings are consistent with the case in Seychelles. First, the exchange rate regime in Seychelles is market-determined and free-floating; the value of the SCR therefore depends on the supply (mainly a result of the tourism sector performance and FDI) and demand (as the country is a heavily import-dependent for fuel, food, construction materials, etc.). This market-determined exchange rate policy has made resources allocation optimal, thereby facilitating the country’s transition from an agrarian economy to a service-dominated economy over the past four decades.

Second, labour market policies are relatively flexible and, as a result, overall unemployment rates have been lower than most African countries. In fact, the country heavily relies on foreign labour due to skills mismatch. Providing work permits and access to jobs for foreign workers (estimated at more than 17,000 in 2021 for a total population of 100,000) has enabled the country to minimize the impacts of skills mismatch and skills gap in the labour market. Currently, the authorities are working on TVET-focused training and other initiatives to address the skills gap in the local labour market and reduce a relatively high youth unemployment. Youth unemployment is almost three times the overall unemployment rate, despite the country’s high level of HDI co-existing with a significant presence of foreign workers. The country’s human development is also strong with a Human Development Index (HDI) value of 0.802, securing the country a 67th position out of 193 nations globally, and first in Africa,

and thereby putting Seychelles as the only African country in the very high human development category. Its labour market flexibility therefore had enabled the country to accelerate its structural transformation, despite its underlying challenges of small population and small market size.

Third, Seychelles has strong and functioning institutions with well-defined missions and mandates. The World Bank’s 2021 worldwide governance indicator shows that Seychelles scored 1.6 and 0.9 respectively in control of corruption and governance effectiveness compared to -0.7 and -0.3 for Kenya and 1.0 and 0.0 for Cabo Verde.

Finally, the gross capital formation has also been high in Seychelles, increasing (though volatile) from 19% of GDP in 1987 to 40% in 1996, and 47% in 2022, which might have supported the structural transformation process in the country (World Bank, WDI data). Moreover, the country has an open trade policy, which can facilitate structural transformation, and the recent AfCFTA adoption can improve its access to a larger continental market. The country’s advancement is also supportive of further economic diversification and transformation of the economy. As indicated earlier (Figure 2.4), the comparative ICT development index shows that Seychelles has the second highest score, following Mauritius. The quality of public infrastructure is also among the best, though ageing, and supports the transformation aspiration. Energy access is almost universal (99%), and the country is working towards more renewable energy generation away from its current fossil fuel-based power system. It therefore follows that Seychelles needs to strengthen these drivers of transformation to further its economic diversification and transformation process.

**Box 2.2: Potential and existing opportunities in Seychelles for: (i) non-renewable natural resources; (ii) potential in agriculture and agribusiness; and (iii) investment opportunities in renewable energy**

Seychelles' non-renewable natural resources offer several potential and existing opportunities, particularly in offshore oil and gas exploration. The country's exclusive economic zone (EEZ) covers a vast area of the Indian Ocean, which is believed to hold significant hydrocarbon reserves. The Government has been proactive in promoting exploration activities by entering into agreements with international oil companies and implementing favorable regulatory frameworks. Successful discoveries and subsequent extraction of oil and gas could provide a substantial revenue stream, boost employment, and reduce the country's reliance on imported fuels. However, the environmental impacts must be carefully managed to preserve Seychelles' pristine ecosystems, which are crucial for tourism and fisheries.

Agriculture and agribusiness in Seychelles, though limited by land availability, hold untapped potential for enhancing food security and diversifying the economy. Innovations in sustainable farming practices, such as vertical farming, hydroponics, and organic agriculture, could overcome the challenges posed by limited arable land. Developing value-added agribusinesses, like the processing of tropical fruits, spices, and fisheries products, can create new revenue streams and reduce dependency on food imports. Additionally, government initiatives aimed at supporting local farmers through subsidies, training programmes, and access to finance can stimulate the sector, making it more resilient and productive. The promotion of agrotourism, where visitors can experience farm stays and local food production, also presents a unique niche market. Cognizant of this, and to support food security and create linkages with other sectors, the authorities have started to focus on smart agriculture systems.

Investment opportunities in renewable energy are significant in Seychelles as the country seeks to transition to a more sustainable energy system. With abundant sunshine and wind resources, Seychelles is well-positioned to harness solar and wind power. The Government has set ambitious targets for renewable energy adoption, aiming for 15% of energy from renewables by 2030. Public-private partnerships and foreign investment in solar farms, wind turbines, and energy storage solutions are being actively encouraged. Moreover, Seychelles' participation in international climate finance mechanisms, such as the Green Climate Fund, can provide the necessary capital for large-scale renewable projects. These investments not only reduce greenhouse gas emissions and dependency on imported fossil fuels, but also create green jobs and contribute to the global fight against climate change.

## **2.3 Finance to fast-track Seychelles' structural transformation**

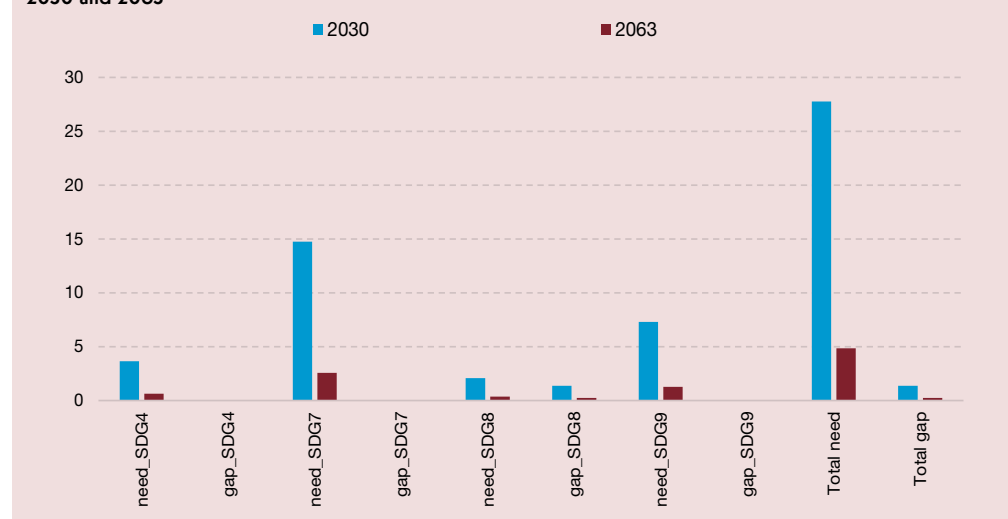
### **2.3.1. Structural change strategy in the national development plan:** Seychelles is committed to enhancing its

structural transformation and economic diversification as clearly outlined in its long-term development aspirations and medium-term development strategy. Vision 2033 and NDS 2024-2028 both indicate that the country aims at attaining a better diversified economy by enhancing

contributions from the emerging sectors such as ICT, digital financial services and high value creation initiatives in the traditional sectors, including tourism, manufacturing, and agriculture. NDS 2024-2028 aims to address the country's developmental challenges through six strategic priorities which are interconnected: (i) a modern public service; (ii) a transformative economic agenda; (iii) a healthy nation; (iv) promotion of law and order; (v) a modern education system aligned with future needs; and (vi) environmental sustainability and climate change resilience. The updated nationally determined contributions (NDCs) submitted to the United Nations Framework Convention on Climate Change in 2021 commits the country to a greenhouse gas emission reduction target of 26.4% compared to a business-as-usual scenario level by 2030. This clearly indicates that the medium-term focus is aligned with accelerating structural transformation and effective implementation and financing of NDS 2024-2028 is pivotal to further accelerating transformation, as indicated by its Pillar II, namely a "transformative agenda"

**2.3.2. Financing needs and financing gap:** It should be noted that the relatively higher real GDP growth achieved by Seychelles will contribute to the transformation process, as it will facilitate resource mobilization for the vision towards a transformed economy. Particularly by reinforcing the country's focus on economic transformation as one key pillar of its NDS 2024-2028, and the hitherto experience of the country in innovative financing mechanisms for climate change and sustainable growth. Overall, Seychelles is an early starter of SDG implementation and the alignment of its Vision 2033 and NDS towards these international targets has made the financing needs for accelerating economic transformation much lower than for the other African countries. However, despite an overall satisfactory or on-track achievements of the SDGs, it should be noted that the financing needs for achieving SDG 7 (Affordable and clean energy) and SDG 9 (industry, innovation, and infrastructure) are relatively more significant (Figure 2.6).

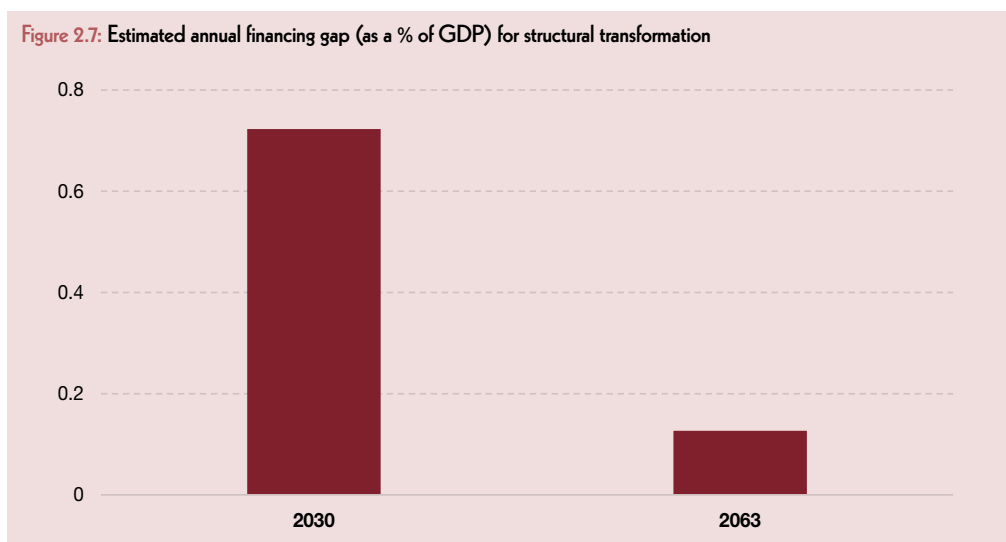
**Figure 2.6: Estimated annual financing needs and gap to fast-track structural transformation in Seychelles by 2030 and 2063**



Similarly, the overall financing gap for accelerated structural transformation is very low for Seychelles, lower than 1% of the country's GDP by 2030 and 2063 (Figure 2.7). These figures are very low by most sub-Saharan African standards, such

as 43% for Burundi, 85% for Libya, 81% for Mauritania, and even 1.3% for Mauritius in 2030. However, the figures decline to 7.5%, 15%, 14.2% and 0.2% respectively by the AUC Agenda 2063 target year.

Figure 2.7: Estimated annual financing gap (as a % of GDP) for structural transformation

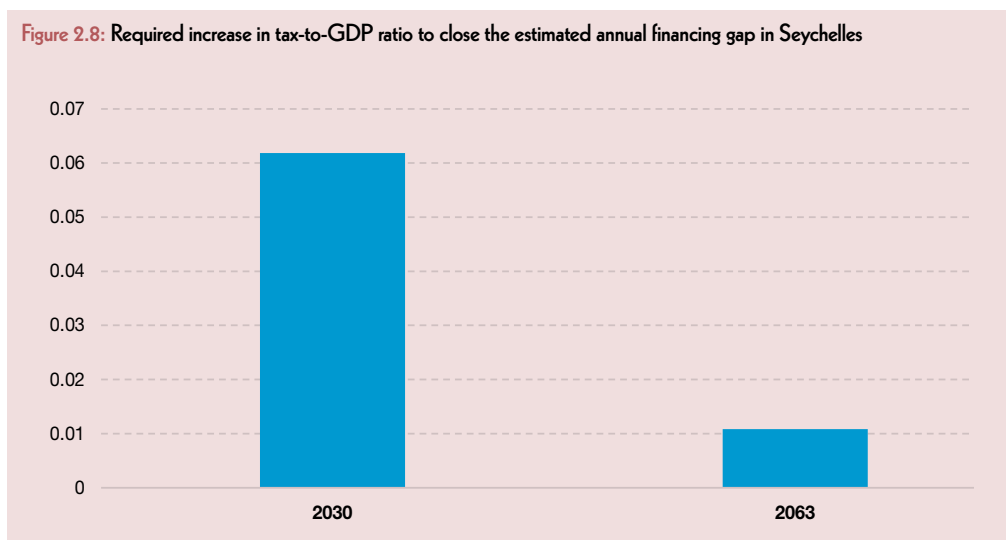


### 2.3.3. Closing the financing gap through domestic resource mobilization

The low financing need for accelerating structural transformation for Seychelles, complemented by its innovation and transformation-focused strategies clearly indicate very low requirement for increasing the country's tax to GDP ratio. This implies that efforts to be made towards increased domestic resources mobilization are lower than in other countries. Seychelles can, therefore, accelerate its economic transformation without much difficulty,

particularly in terms of the need for additional taxes to fund the financing gaps. The required additional tax-to-GDP ratio for accelerated structural transformation for Seychelles is estimated at just 0.06% of GDP by 2030, which shrinks further to just 0.01% by 2063 (Figure 2.8). These figures are very low when compared to other countries in such as Comoros - 8% (2030) and 15% (2063)), Cabo Verde - 18% (2030) and 21% (2063), Djibouti - 27% (2030) and 31% (2063), and Mauritius - 20% (2030) and 21% (2063).

Figure 2.8: Required increase in tax-to-GDP ratio to close the estimated annual financing gap in Seychelles



Proper implementation and financing the NDS 2024-2028, improved availability of the needed infrastructure, and other complementary factors such as appropriately skilled labour force should be put in place to accelerate the country's transformation. In such a scenario, high-

end tourism, together with emerging knowledge-intensive activities such as ICT and financial services, as well as high value-added manufacturing will likely be the key growth and transformation drivers over the medium term.



Seychelles, therefore, needs to maintain its focus on economic diversification and sustainable structural transformation and enhance GDP and employment shares of emerging sectors such as digitization, and high value addition industry. Fostering structural transformation in the case of

Seychelles requires: (i) developing efficient, cost-effective, and green infrastructure, particularly energy and transport; and (ii) improving the business environment, particularly addressing constraints on access to financing and skills.

### **Box 2.3: Bank support to economic transformation in Seychelles**

The African Development Bank has been a trusted partner and financier of development projects that has been supporting economic transformation of Seychelles since 1977 when the country joined the Bank Group. The support instruments have included budget support operations that provide financing to support various reforms that create macroeconomic stability, reform the business environment, and improve the country's public financial management (PFM). The Bank also provided technical assistance through a MIC Trust Fund grant that provided training in entrepreneurship and entrepreneurial management for more than 500 businessmen and women. The Bank is also currently financing technical assistance for the blue economy MSMEs and value chains development using a FAPA trust fund. The Bank also provided support through several knowledge products that study specific sector or thematic areas, such as a policy for measuring Seychelles' economic diversification and structural transformation (AfDB, 2019), the need for innovative financial sector and services for economic diversification (AfDB, 2023), and assessment of the COVID-19 pandemic impacts on selected productive sectors of the economy (AfDB, 2021). The Bank is also currently providing technical assistance for the assessment of an integrated resource planning and policy options in the energy sector, and for advancing a TVET programme to address skills mismatch in the country, as well as a study to assess the capacity of the tourism sector for economic diversification. In addition, the Partial Risk Guarantee Project that was approved in 2009 has supported Seychelles in restructuring its debt, following its default amid the global financial crisis in 2008.

## **2.4 Concluding remarks and policy recommendations**

The pathway to structural transformation in Seychelles can be achieved through collaborative efforts between the various stakeholders, particularly the Government, MDBs, and the private sector. The following are some desirable actions for the various stakeholders.

**(a) The Government:** Should continue focusing on effective implementation of the transformative agenda and economic diversification outlined in NDS 2024-2028 and coordinate its activities with other

players to secure the needed financing and technical support. It should also address key impediments to private sector growth, such as the skills mismatch, access to financing, and high cost and environmentally unsustainable energy generation. It should also continue its commitment to prudent fiscal and monetary policies to sustain macroeconomic stability. It is also important to design business environment policies that provide adequate incentives for the informal sector to formalize through sensitization and capacity building for the informal sector players and provide better access to start-up capital and financing for business expansion on affordable terms.

The country's industrial policy needs to identify areas of comparative advantage and niche areas such as coconut and cinnamon manufacturing, complemented by smart agriculture that is linked to the tourism services.

**(b) The private sector:** Should play a collaborative role in terms of value addition, investment, and job creation using the incentives and support provided by an improved business environment during implementation of NDS 2024-2028 and Vision 2033. The sector can also support economic transformation through company-sponsored skills development programmes, partner with smaller businesses and MSMEs through appropriate mechanisms, such as sub-contracting arrangements, and involving them in the supply chains for intermediate inputs.

**c) The regional institutions:** Institutions, such as RECs to which Seychelles is a member, can spur the country's transformation by supporting Seychelles to integrate better with its peers in continental Africa. They can provide policy advice and technical assistance in terms of effective follow up and achievement of specific membership convergence criteria relevant to the RECs. This can enable the country to access a wider market, including through the AfCFTA.

**d) The DFIs) and MDBs:** Need to coordinate their activities and support to avoid duplication and enhance resource efficiency. This will help identify mechanisms for providing financing through grants, loans and TA, while also enhancing institutional capacity building in the country.



# FINANCING STRUCTURAL TRANSFORMATION IN SEYCHELLES: THE NEED FOR REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

## KEY MESSAGES

Seychelles has made notable strides in increasing its revenue generation through comprehensive tax reforms and the introduction of new levies, such as the tourism levy aimed at enhancing environmental resilience and climate risk mitigation. Despite these efforts, Seychelles' success in domestic resource mobilization lags behind some of the best-performing African economies. With a tax-to-GDP ratio of around 30%, Seychelles performs well but has the potential to improve by learning from high-efficiency models within the continent, such as robust electronic tax systems.

There is significant potential for Seychelles to increase its tax revenue collection by enhancing tax administration efficiency, broadening the tax base, and reducing tax evasion. Leveraging technology for better compliance and targeting under-taxed sectors like the informal economy could further boost revenues. Adopting best practices from other African nations, such as South Africa and Mauritius, which have tax-to-GDP ratios exceeding 35%, could help Seychelles improve its tax collection capabilities.

The Government of Seychelles is actively implementing reforms to enhance fiscal sustainability and bridge the tax gap. These include adopting advanced digital tax systems, widening the tax base by targeting under-taxed sectors, and integrating the informal economy into the formal tax system. Strengthening the legal framework for better enforcement and compliance, along with taxpayer education and support, are crucial steps in these efforts.

## Introduction.

The chapter presents Seychelles' external financing need for achieving structural transformation while dealing with the threat of climate change. It uses Bank estimates of financing needs and gaps to fast-track structural transformation (AEO2024) and finance climate actions (AEO2022 and 2023) respectively by 2030. Using Bank estimates, the chapter assesses the country's capacity to increase the tax-to-GDP ratio to close the financing gap for fast-tracking structural transformation by 2030 and 2063 and motivates the need for reform of the international financial architecture. The chapter also discusses some potential benefits for Seychelles following reform of the current international financing architecture and suggests the role IFIs should play in supporting the achievement of sustained development and the SDGs, as well as other relevant targets in Seychelles. Finally, the chapter proposes some actions to make the global financial architecture more fit-for-purpose for accelerated structural transformation in Seychelles.

It should be noted that with a declining availability of financing from international financial markets, the role of domestic resource mobilization is pivotal. However, with a small population and market, the current global financial architecture makes it difficult for Seychelles to close the financing gap. In this regard, given its small GDP size and population, the SDR quota and head-rooms are small. Seychelles therefore seeks to work together with global partners so that climate change resilience be a complementary and successful show case in Seychelles given the country's commitment in this area and its experience in taking proactive measures. Addressing economic and environmental vulnerability remains at the forefront of the country's strategic orientation for better diversification and climate change resilience. Moreover, as a high-income economy, Seychelles does not have sufficient access to concessional financing. It is, therefore, cognisant of the fact that the global financial system should be revisited so that small island states, such as Seychelles, can obtain better access to financing to accelerate their transformation.

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As a high-income economy, Seychelles does not have sufficient access to concessional financing. Reforming the global financial system is necessary so that Small Island States such as Seychelles can get better access to financing to accelerate their transformation.

### 3.1 Seychelles' stand on the reform of the international financial architecture

Seychelles is very cognizant of the potential benefits of reforming the international financial architecture in a manner that considers the unique developmental challenges of small island States Vision 2033 and medium-term development strategies articulate the importance of collaboration with development partners and other stakeholders towards a diversified and structurally resilient economy. In this regard, the NDS 2024 – 2028 aspires for the country to attain its 2030 target of an environmentally sustainable, inclusive, and climate-resilient economy, with prudent collaboration with development partners.

Seychelles is expected to benefit from reform of the international financial architecture to raise external resources required to fast-track its structural transformation through resources that consider its unique characteristics as a small island state that is vulnerable to external economic and environmental shocks. The reform should also reward, rather than punish, the country for its success in attaining a high-income status. The country needs support to maintain such a status through additional resources for a better diversified economy. Given that the country has called for the use of MVI which considers the unique challenges of small island states, reform of the international financial architecture and the IFIs should also address such vulnerabilities. The credit rating agencies

also need to re-visit their methodology as regards their risk profiling of such countries by laying more emphasis and weight on the countries' policy stance and commitment to sustainable and resilient economic progress over a longer-term perspective.

### **3.2 Mobilizing additional resources for Seychelles' structural transformation**

As discussed in Chapter 2, the financing gap for fostering transformation in Seychelles is relatively small. However, there is room for mobilizing additional resources for more to be done. In particular, expanding domestic resource mobilization, improving the business environment through reforms that address impediments to private sector development such as access to finance, skills development, and green infrastructure (e.g. renewable energy generation).

As regards domestic resource mobilization, Seychelles is one of the few countries in Africa that has managed to increase its own revenue generation by reforming the tax system, widening the tax base, and introducing new levies such as the tourism levy introduced in August 2023. Seychelles has significant potential for increasing its tax revenue, especially when compared to the continental average and the best-performing economies in Africa. Currently, Seychelles' tax-to-GDP ratio hovers around 30.5%, which is relatively high for the region (compared to 13% in Kenya), but still leaves room for improvement to rise to the high-income OECD average of 33%. By enhancing tax administration efficiency, broadening the tax base, formalizing the informal sector, and reducing tax evasion, Seychelles can align more closely with these top performers. In addition, leveraging technology for better compliance and tapping into under-taxed sectors, like the informal economy, could boost revenue. Further improvement in tax collection efficiency can be unleashed by

enhancing electronic tax systems that can increase its tax collection capacity.

The Government of Seychelles is actively implementing several reforms to bridge the tax gap and enhance fiscal sustainability. Key among these reforms is the implementation of more robust tax compliance measures, including the adoption of advanced digital tax systems to improve efficiency and reduce evasion. Efforts are also being made to widen the tax base by targeting under-taxed sectors and integrating the informal economy into the formal tax system. Strengthening the legal framework to ensure better enforcement and compliance, along with providing taxpayer education and support, are crucial steps. Furthermore, reforms aimed at improving the efficiency of tax administration and reducing bureaucratic red tape are required to create a more taxpayer-friendly environment. These measures, coupled with efforts to combat corruption and increase transparency, are vital for bridging the tax gap and boosting revenue collection.

The contribution of external resources is also pivotal in financing structural transformation in Seychelles. International aid, particularly official development assistance, has traditionally supported critical infrastructure projects and social programmes. Foreign direct investment (FDI) has been pivotal in the development of key sectors such as tourism, fisheries, and real estate, as well as in fostering economic diversification and job creation. Moreover, concessional loans and grants from multilateral organizations like the World Bank and the African Development Bank have facilitated significant public sector investments that improve the business environment and thereby crowd in private investment. Seychelles has also secured grant resources from the Abu Dhabi Development Fund and the Government of India that are financing solar PV energy



plants. The country aims to finance its climate resilience infrastructure through concessional financing, even though it has faced challenges in translating these ideas into bankable projects. However, strategic partnerships to attract more FDI, increased access to concessional financing, and enhanced engagement with international development agencies are essential in mobilizing additional external resources and driving more rapid and inclusive economic growth.

Seychelles continues to make efforts to mobilize green investments for sustainable growth. In May 2023, the Government of Seychelles approved the Seychelles Investor Map document. Through the map, the Government has identified as green power production, eco-tourism development, and agricultural export, along with four other venture possibilities, as investment priorities open to local and foreign investors. In the green power production sector, the Government identified three types of investments that will benefit the country - the installation of photovoltaic systems on rooftops, the establishment of off-grid photovoltaic systems, and the building of floating photovoltaic systems. In the tourism sector, investments are needed in eco-tourism and value chains. Another priority area in the tourism sector relates to cultural activities, with tourists seeking more cultural experiences. The Government is calling on investors to create businesses that will provide such products and activities. In the fisheries sector, which remains the country's second top economic pillar, investors are encouraged to focus on fish processing and cold storage. The map also identifies potential for the export of certain agricultural products such as vanilla and cinnamon

### 3.3 Dealing with Seychelles' debt

As pointed out earlier, Seychelles'

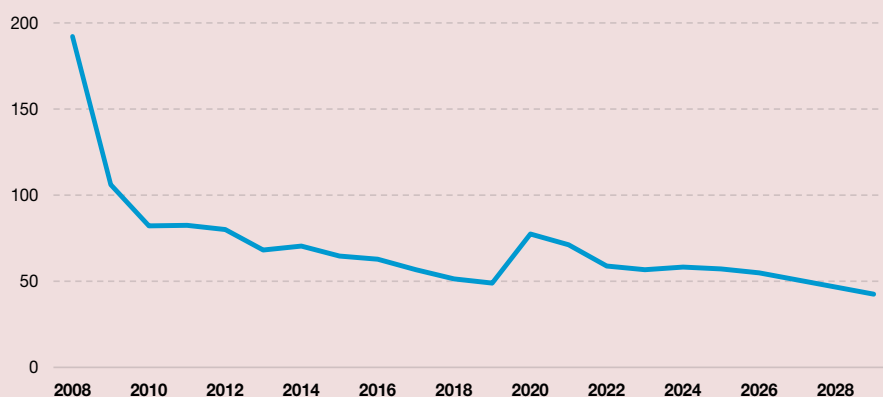
vulnerability due to its small population, market size, and geographic location have made it challenging for the country to generate the resources needed to sustain its development. Insufficient economic diversification and structural transformation have been persistent challenges to the country's economy – as they weaken the opportunity for sustainable and inclusive growth. Over the past few years, external debt has emerged as a crucial source of development finance for Seychelles, supporting the nation's economic growth and structural transformation. As a small island economy, with limited domestic resources, Seychelles has increasingly relied on concessional loans and financial assistance from multilateral and bilateral lenders. Support from the development partners, including a Partial Credit Guarantee (PCG) from the African Development Bank, enabled Seychelles to come out of its debt default during the 2008 global financial crisis through debt restructuring. It was the same financing source that enabled the country to cope with the global COVID-19 pandemic, when the country's tourism sector was hardest hit, and the financing needs shot up.

The Government is aware of the need to continuously lower debt in the medium term and has prepared a Debt Management Strategy (DMS) 2023-2026 to address this concern. According to the CBS (Annual Report 2023), at end-2023, the public debt stock stood at USD 1,233 million, which was 2.9% lower than that in December 2022. As a percentage of GDP, total public debt declined from 69% to 60% over the same period. The decline was mainly driven by a 6.8% fall in domestic debt. The aggregate external debt stock stood at 29% of GDP at end-2023 compared to 31% of GDP in 2022. Seychelles' public debt, which had shot up to 81.1% of GDP in 2020 amid the COVID-19 pandemic, has declined to 64.4% of GDP in 2023 owing to faster than expected economic recovery, strong

debt management strategy, appropriate fiscal consolidation measures, and significant appreciation of the SCR. The borrowed funds have also been essential for financing large-scale infrastructure projects, enhancing public services, and addressing critical development needs. For instance, loans from the World Bank and African Development Bank have funded

renewable energy projects and improved health care and education infrastructure. The strategic use of external debt has enabled Seychelles to pursue development objectives that would be unattainable with domestic resources alone, thereby reflecting the importance of international financial support in its economic planning.

**Figure 3.1: Trend of General government debt (% of GDP)**



Source: IMF data

A risk factor identified in the DMS 2021-2023 is the country's heavy reliance on short-term maturity T-Bills that pose high likelihood of roll-over risks as it reveals that more than 85% of total debt amounting to SCR 5.7 billion that was due for redemption in 2021 is domestic. There is, therefore, need to considerably bring down the redemption profile of short-term domestic debt to better align it with that of external debt, which comprises longer-term instruments. An emerging concern could be the level of foreign debt service costs. However, the total domestic debt currently accounts for most of the debt stock, representing 53.3%, while the external debt accounts for 46.7%. The debt management strategy is designed to consider the risk of external debt distress.

prudent borrowing as well as the recent focus on domestic resource mobilization for development financing, debt is likely to remain sustainable. The authorities have adopted a debt management action plan to continue the downward trajectory of the country's debt level and bring the total debt to GDP ratio to less than 50%, before 2030. The most recent Fitch Ratings (March 2024) revised the Outlook on Seychelles' Long-Term Foreign-Currency Issuer Default Rating (IDR) to Positive from Stable. The revision reflected key rating drivers including fiscal outperformance, continued debt reduction, stabilizing tourism receipts, stable growth, multilateral funding support, and current account deficit.

### 3.4 Financing climate action

The most recent joint IMF and World Bank public debt sustainability analysis (DSA) for Seychelles (February 2023) assessed the country's debt as sustainable. Given

Climate change risks have significantly affected the path to structural transformation and growth over the past several years amid the country's location as

an island state. Frequent floods, hurricanes and rising sea levels have at different times affected businesses and livelihoods. The most recent flooding in December 2023 shows the importance of climate actions, as well as adaptation and mitigation strategies. Consequently, Seychelles has several initiatives and actions to address the situation. It is committed to including climate change considerations in plans and strategies across all key sectors by 2030.

The updated nationally determined contributions (NDCs) submitted to the United Nations Framework Convention on Climate Change in 2021 commits the country to a greenhouse gas emission reduction target of 26.4% compared to a business-as-usual scenario level by 2030 and a net-zero emission target by 2050. In 2014, the Government launched the Seychelles Blue Economy Vision to promote ocean-based sustainable and resilient development as a pathway to the country's shared prosperity, indicating that it has embraced the "blue economy" concept as an organizing principle to drive growth further, while not only preserving but also building the natural endowment. The national blue economy roadmap, seeks to protect and recover ocean ecosystems and biodiversity. It ensures that existing ocean industries (e.g. shipping and bunkering) cause minimal environmental impact and meet the highest sustainable practice standards. It integrates cross-sector land use planning and coastal zone management, increases sustainable use of bio resources (biotechnology, marine ecosystems services). It outlines plans for natural disasters and adapt to climate change, increase surveillance of offshore waters. It brands Seychelles as a "blue tourism" destination, and foster knowledge development. These goals are fully aligned with the UN Sustainable Development Goal 14: "Conserve and sustainably use the oceans, seas and marine resources for sustainable development".

Accordingly, the estimated cumulative financing needs for Seychelles to respond adequately to climate change range from USD 1.12 billion to USD 1.38 billion, averaging USD 1.25 billion, from 2020 to 2030. Put annually, this comes to about USD 124.9 million, with lower and upper amounts of USD 111.7 million and USD 139 million respectively (AfDB, AEO 2022). Adaptation costs are estimated at USD 388 million, or 30-31% of Seychelles' total needs. However, adaptation needs are most likely to be underestimated due to lack of data and technical expertise to estimate the true cost of adaptation measures, including the uncertainty of future carbon emissions and how these will influence adaptation needs. Mitigation accounts for 26% of the estimated needs in 2020-2030, which is equivalent to around USD 332 million.

Loss and damage costs due to climate change are projected to range from USD 397.4 million (in the low warming scenario) to USD 662 million (in the high warming scenario). Climate finance inflows towards this financing needs have been rising recently. In this regard, Seychelles received over 2010-2020, USD 432.3 million of climate finance mobilized by developed countries, averaging USD 52.1 million per year. Climate finance inflows have increased annually by 29.2% on average over the same period, ranging from USD 9.5 million in 2010 to USD 55.9 million in 2020, after a 15% decline to USD 44 million in 2019 from its level in 2018. In 2010-15, the country received USD 171.8 million of climate finance (or USD 28.6 million annually), compared to USD 260.5 million in 2016-2020 (or USD 52.1 million per year). Out of the USD 432.4 million in 2010-2020, a total of USD 274 million was allocated to adaptation finance, while mitigation actions received USD 261 million in total. Cross-cutting finance, which covered both climate adaptation and mitigation actions, amounted to USD 103 million in 2010-

2020. Based on the assumption that the Seychelles will continue to receive the same annual amount of climate finance as it received in 2016-2020 (USD 52.1 million per year), the resulting financing gap would amount to an average of USD 72.8 million a year in 2020–2030, which is a significant amount, given the country's geographic location as an island state vulnerable to climate change, and thereby greatly limiting the country's capacity to build climate resilience.

The Government of Seychelles has several initiatives and instruments to ensure a climate-resilient economy, for which it is partnering with its development partners, including innovative climate financing and public investments. In the energy and transport sectors, it seeks collaborative financing to achieve its specific targets of switching 30% of vehicles from use of fossil fuels to electricity by 2030, increasing the use of solar energy, and converting power generation to liquefied natural gas (LNG). Consequently, in 2021, Seychelles finalized a strategic plan with specific targets of climate change adaptation programmes in transport, energy, and infrastructure. It also introduced the world's first debt refinancing for ocean conservation because of which a third of Seychelles' ocean is guarded from climate change and unregulated economic exploitation. The 2020 budget also proposed several tax measures and levies that would encourage more use of electric vehicles to reduce emissions. Amendments to the Environment Protection (Ozone) Regulations, which entered into force on 1 January 2020, imposes levies on imported refrigerant gas/equipment that exceed 100 Global Warming Potential (GWP), further restricting their imports into the country to curb emissions from this source. The Government has also developed policies and strategies, including National Climate Change Policy (2020), the Nationally Determined Contribution (2015, updated in 2021), and the Public-Sector Investment

Programme (PSIP). Overall, the national policy and strategies outline priority investments to transition the country to a low-carbon economy, while meeting its target of having 15% of its energy coming from renewable sources by 2030.

### 3.5 Policy recommendations

Financing for small island states such as Seychelles requires greater attention and priority due to their high vulnerability to environmental shocks like flooding and cyclones. To build resilience, there is need to strengthen green financing mechanisms and increase investments in key sectors such as the Blue Economy, coastal infrastructure, and renewable energy. Additionally, these vulnerable island countries need to enhance their capacity to identify climate change risks, develop and implement climate-related policies and strategies, and coordinate financing from development partners and global stakeholders for climate change mitigation and adaptation.

Seychelles should focus on fortifying its meteorological and research institutions to continually assess climate change risks and inform national policymakers. Integrating climate change considerations into long-term national development strategies, sector strategies, and budgeting processes is essential. Given the heavy dependence on fossil fuels and high fuel import costs, there is a strong economic rationale for Seychelles to transition entirely to renewable energy. The country has considerable potential for renewable energy, particularly from solar and wind sources.

A more nuanced and context-specific DSA would better capture the unique vulnerabilities and economic realities of small island developing states, potentially resulting in more favorable debt assessments and terms. If credit

rating agencies incorporated a broader set of indicators, including resilience to shocks and sustainable development efforts, Seychelles might benefit from improved ratings. Higher credit ratings could lower the risk premium on sovereign debt, reducing interest rates and making borrowing more affordable. The reform

would enhance Seychelles' capacity to finance development projects at a lower cost, fostering economic growth while maintaining debt sustainability. Improved access to concessional financing and more accurate risk assessments would enable Seychelles to implement long-term development strategies more effectively.

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