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The diversification dilemma: Structural vulnerability and policy frontiers in small states: A case study of Seychelles

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Abstract: Small Island Developing States (SIDS) demonstrate that high income can exits alongside deep structural fragility. With Seychelles as a case study, this paper demonstrates how a 'triple bind' limits diversification: (1) intrinsic small-state constraints of scale, remoteness, and narrow resource bases; (2) a high income classification that limits access to concessional, long-term finance needed for high-risk, transformative investments; and (3) increasing climate change impacts that threaten critical core sectors (tourism, fisheries) as well as the primary diversification pathway, the Blue Economy, and create complex 'blue monocultures.' Building on the diversification, product-space and small-state literatures, the paper outlines the path-dependent development of Seychelles, exploring macro-structural inflexibilities in trade and debt, and evaluating policy responses relative to capacity and governance bottlenecks. Comparative evidence from Mauritius and the Maldives illustrates the importance of institutions and human capital in enabling geography-agnostic diversification and the risks of debt-driven, sector-concentrated growth. The paper urges moving from income-based eligibility to a Multidimensional Vulnerability Index (MVI), along with institutional change, counter-cyclical buffers, and tailored enhancements for non-marine tradable services in SIDS. The redefined goal of diversification, which is resilience, enables the strengthening of domestic institutions and the redesign of global SIDS financing to structural income to reflect vulnerabilities rather than solely income.

Keywords : Blue Economy; climate risk, economic diversification, Maldives, Mauritius, Seychelles, Small Island Developing States (SIDS), structural vulnerability

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Introduction: The paradox of prosperity in small states

The Republic of Seychelles exemplifies a development paradox. Located in the Indian Ocean, the Republic of Seychelles consists of 115 islands, has the highest GDP per capita in Africa, and has been qualified as a "high-income" economy" by the World Bank since 2015 (World Bank, 2025; African Development Bank, 2024). Seychelles has grown economically since its independence in 1976. Its per capita output has increased approximately seven times since the post-subsistence level, due mainly to the strategic development of the tuna fishing industry and high-end tourism (Moody's Analytics, n.d.). Yet, and for these economic successes, the Republic of Seychelles economy has a narrow and frail basis, making it highly susceptible to multiple external shocks (Agathine n.d.; UK Government 2025; AFD 2023). This economic paradox sets the challenge of economic diversification for Seychelles and for many other SIDS (Small Island Developing States).

For Small Island Developing States, diversification is not only a policy strategy, but a vital matter of survival and resilience. Being and remaining economically concentrated, especially in tourism or primary commodities, increases vulnerability to negative impacts of global recessions, swings in commodity prices, and geopolitical tensions (IEO-IMF, 2022; McIntyre et al., 2018). The COVID-19 pandemic starkly and devastatingly illustrated this phenomenon. When international borders closed in March 2020, tourism in Seychelles, responsible for over half of Seychelles' GDP, "disappeared." (Agathine, n.d.; Guillotreau et al., 2023). The consequences included a macroeconomic crisis of "epic proportions," a GDP contraction of close to 12%, a drastic decrease in foreign exchange earnings, public debt escalating from 57% to 94% of GDP in a single year (Agathine, n.d.; Guillotreau et al., 2023; Muhumuza et al., 2021). Events of this nature reinforce concerns about the extreme risks and over- reliance on a single sector and diversification strategies (Muhumuza et al., 2021).

The primary research question the paper attempts to address is:

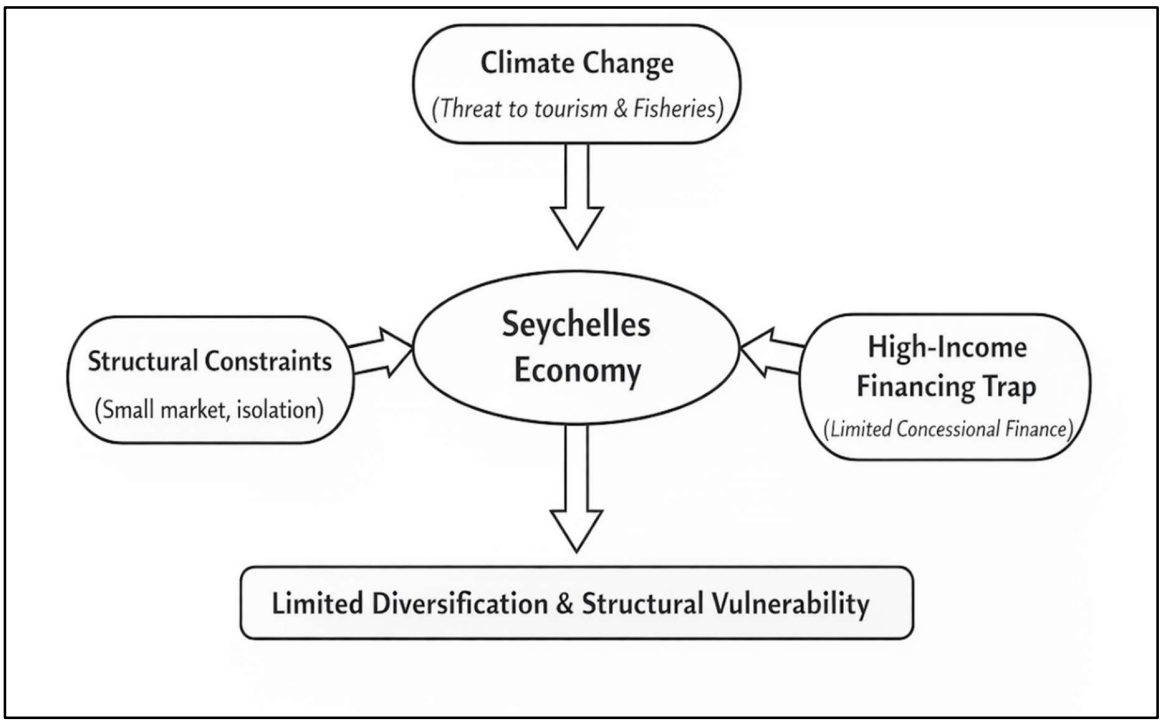
Why has Seychelles, despite its relative wealth, stable governance and policy proactivity, not meaningfully diversified its economy?

This paper argues that a "triple bind" of interrelated constraints explains Seychelles' lack of progress on diversification. First, there are the structural vulnerabilities to SIDS that are definitional and universal: a small, fragmented domestic market that prevents the realization of economies of scale; geographic isolation and remoteness; a small resource endowment; and weak institutional (UN-DESA, 2010; IEO-IMF, 2022). Second, diversification is not explained by the "high income vulnerability trap." For Seychelles, the classification of a high income country is paradoxically limiting, as it closes the avenues of concessional finance and aid targeted for large, long-term, and commercially risky investments critical for diversification (Agathine, n.d.). Compared to other developing countries, SIDS are more economically vulnerable and face a critical mismatch between development needs and access to the appropriate financing (UK Government, 2025). Finally, there are the direct impacts of the climate crisis, which is predicted to exacerbate challenges to sectors that are the lynchpins of Seychelles' economy (tourism and fisheries) and primary diversification strategy (the Blue Economy) (Agathine, n.d.; IMF, 2024). There are no indications that this will stabilize and reverse during the coming years.

The policy consequence of this trap, therefore, is that Seychelles derives a policy environment within which its national ambitions will perpetually be at odds with structural realities.

The use of per capita income as the primary measure for assessing the level of development assistance potentially overlooks the country-specific acute, multidimensional vulnerabilities such as for Seychelles. Because of this, SIDS have increasingly called for the adoption of a Multidimensional Vulnerability Index (MVI) as a means of calibrating the level of international support to the realities on the ground. This is the primary claim of the paper.

Figure 1: The 'Triple Bind' Framework of Structural Vulnerability in Seychelles.



Source: Author's conceptualisation.

This paper aims to contribute to this thesis by following this structure. Section 2 discusses the theoretical literature on economic diversification and structural transformation, along with the specific challenges confronting SIDS. Section 3 then analyzes the economy of Seychelles, discusses the history of the country, and describes the contemporary macroeconomic structure. Section 4 analyzes the policy framework for diversification, particularly Seychelles' flagship policy Blue Economy, focusing on the value-added critical approach. Section 5 analyzes the persistent question of internal, external, and ecological challenges that limit these policies. Section 6 discusses the comparative position of Seychelles with the other two countries, Mauritius and Maldives, to highlight the lessons that Seychelles can learn. Section 7 presents the concluding remarks that synthesize the findings and outlines the proposed policy for Seychelles, other SIDS, and the global aid architecture.

The diversification imperative for small states: A theoretical review

For development economists, the theory of economic diversification is positive, particularly in the context of achieving sustainable development, building resilience, and improving living standards. For small states, especially small island developing states (SIDS), the case for economic diversification is not just preferable but indispensable. Their particular structural features make extreme degrees of economic vulnerability and economic overconcentration become perilous. This chapter articulates the theory of economic diversification, evaluates the small states' advantages and disadvantages concerning it, and constructs the analytical framework for the Seychelles case study.

Structural transformation and economic development

At its core, economic development is synonymous with structural transformation, which involves the sustained reallocation of a country's productive resources – labour, capital and land – from low- to high-productivity economic activities (IMF, 2018). Traditionally, this reallocation has involved a progression from agriculture to manufacturing and, in the final stages, to services (Sacerdoti et al., 2005). Such transformations produce static and dynamic gains. The immediate increase in economy-wide productivity that results from the movement of labor into more productive sectors generates static gains, while dynamic gains are the result of the more complex activities the economy generates over time and the positive externalities they produce from skill upgrading and innovation (IMF, 2018). For developing countries, fostering this transformation, where productivity gaps are especially pronounced and where modern economic enclaves exist alongside a largely traditional economy, is arguably the most important objective of development policy (IMF, 2018).

The benefits and drivers of diversification

Through economic diversification, structural transformation takes place. This takes place when an economy produces and exports a wider variety of goods and services, thus transforming and moving away from a narrow focus, or dependence, on a few economic activities. Outside dependencies are addressed in literature, and its economic theories outline two important benefits of diversification.

In the first place, the "portfolio effect" sees diversification as part of a risk management strategy. Extreme reliance on a few commodities or a single service sector like tourism, suggests a large part of the economy is open to demand shocks and price volatility. This balance changes when a country broadens their exports. It hedges terms-of-trade adverse shocks, thus, stabilizing exports and domestic output. This is important in the creation of a predictable environment for investments and long-term growth. The study of small states shows the more their economies are diversified, the lower their output volatility is. In terms of productivity and learning, the "dynamic effect" sees diversification as part of the primary steps that ignites growth.

The incorporation of new products and services into an economy's production basket reflects the acquisition of new technologies and the need for new skills and competencies (McIntyre et al., 2018). "Cost discovery" and entrepreneurial investments into new activities stimulate structural changes, particularly in the long-term growth of economies with fewer local sources of innovation (IMF, 2018). Studies show that export diversification positively correlates with economic growth and can result substantial increases in a country's productivity growth (McIntyre et al., 2018).

The inverted-U hypothesis and its implications for SIDS

The value of diversification is unquestionable, particularly in the early stages of development, but the correlation between diversification and income is not always straightforward. Some early research noted an inverted U relationship: as countries increase in levels of income, their economies become more diversified, but only to a certain point. Countries with per capita incomes of approximately between $9,000 and $20,000, will no longer increase the complexity of their diversification, but rather, will focus on a few, high productivity sectors (Acemoglu & Zilibotti, 1997).

The empirical research seems to get to the contradiction of competing theories. For Low income countries, the frameworks that lead to diversification and growth focus on risk. Countries with limited capital cannot invest in multiple sectors of the economy as they face high fixed costs and sector concentration. Once they accumulate capital, they will invest in more sectors that provide risk diversification. At higher levels of income, neoclassical trade theory will be more dominant. Wealthier economies that are more opened on the trade front will concentrate their investments on the sectors where they have a comparative advantage and will focus on the sectors that provide agglomeration economies, and scaled economies to increase their productivity, Acemoglu & Zilibotti (1997).

For SIDS, there is a paradox in trying to apply this theory to explain local economic activity. Similarly to a number of SIDS or Seychelles, High Income status may be obtained without undergoing the full broad based and subsequently also failing to achieve the full development curve. Instead of broad-based development the country focuses on a high intrinsic and durable commodity. This serves as the basis for the aforementioned assertion. It does not indicate an advanced condition, but rather a state of premature specialization for the country as high income is accompanied by considerable structural weaknesses of an economy characterized as low and undiversified. This is also compounded by the theories of economic "complexity" which would espouse the notion of diversification, albeit it gradually as countries shift into "near" products of the "product space" which are products that require akin capacities (Hidalgo et al, 2007). The adjacent possible for a SIDS is further constrained by the fact that their capability is often very narrow and highly specialized (especially in tourism services). It is also worth mentioning that the theoretical "jumps" to be made in the economy are to newly advanced manufacturing which is highly unrelated or high order services that are also considered as "complex" and are knowledge based. These are gaps which will not be able to be filled by organic and market led systems, thus economic entrapment.

Inherent constraints on diversification in SIDS

SIDS' responses to these pressures differ from those of larger developing countries. The pressures have resulted and continue to result numerous and different barriers to transform the economy and move to new economic activities. A lack of productive diversification and limited capacity to transform economically has vexed SIDS. The Rio Earth Summit was followed by attempts across multilateral agencies to address the issues. Since 1992, there have been published efforts outlining these issues in detail in SIDS focused work (UNCTAD, 2021).

SIDS have a geographical disadvantage. The impacts of this disadvantage include limited domestic markets and a lack of a productive economy that could result in economies of scale. Dispersed geographical territory generates isolation from major markets. As a result, there are high transaction costs associated with trade, particularly the transport and logistic costs (UK Government, 2025; World Bank, n.d.; Kandžija & Gržan, 2014). Low-resource countries are forced to concentrate economic activities in a few sectors. The sectors of focus usually include tourism and primary commodities, thus becoming highly dependent on fishery trade (IEO-IMF, 2022; UN-DESA, 2010). Thus, an average SIDS economy is over 70% dependent on trade, unlike the 50% for Least Developed Countries (UK Government, 2025). This extreme dependence exposes SIDS to high external shocks. Additionally, Skilled human capital shortages, limited Institutional and administrative capacity, and restricted access to technology, data, and analytical capabilities (IEO-IMF, 2022; UN-DESA, 2010; UNDRR, n.d.; McIntyre et al., 2018) affect public

sector effectiveness and inhibit private sector innovation on SIDS. Recent scholarship further reinforces that structural vulnerability in small states is not simply a function of size, but of the interaction between economic concentration, exposure to global shocks, and institutional capacity (Choppy, 2025).

A SIDS economy commonly comprises small domestic capital markets, limited access to international finance, and elevated public debt (World Bank, n.d.; UK Government, 2025). They also depend on volatile external flows such as foreign direct investment (FDI) and remittances (UK Government, 2025; World Bank, 2024). At last, SIDS are disproportionately exposed to natural disasters and environmental degradation on the front lines of climate change. Staggering economic losses are inflicted by hurricanes and sea-level rise. SIDS, on average, incur a disaster-related loss of 2.1% of their GDP annually, a rate seven times higher than other countries (UK Government, 2025; UNDRR, n.d.).

The Seychellois economy: A trajectory of concentrated development

The contemporary economic structure of Seychelles is the product of a distinct historical trajectory, shaped by its colonial past, post-independence policy choices, and inherent geographical realities. This history has forged an economy characterized by high income but also by extreme concentration and a deep-seated path dependency. Understanding this evolution is crucial for contextualizing the nation's current diversification challenges.

From plantation to paradise: An economic history

The Seychellois economy was based on the plantation system and the exploitation of enslaved labour (Seetanah et al., 2011; World Bank, 2013), which for most of the period was on the economic periphery, first under French rule and then under the British colonial order. The economy was defined during the pre-World War II period primarily on the copra and cinnamon plantation and the agricultural trade of these two items (World Bank, 2013). In the Seychelles modern economic history, it would be hard to overlook the economic significance of the first international airport opened in 1971 (Seychelles Consulate Hong Kong, n.d.; Moody's Analytics, n.d.). With the construction of this piece of infrastructure and the accessibility of the Seychelles islands, the country's first economic asset, unspoiled natural beauty, was opened. The economic priorities of the country also transformed with the rapid expansion of the tourism industry. The traditional plantation economy with its low wages, and poor investment returns, became the focus of rapid economic decline (World Bank, 2013).

After the 1976 independence, the Seychelles first established a one-party socialist system from which it transitioned to a multiparty democracy under the new constitution of 1993 (World Bank, 2013). This era was described by the state-led development model, and was characterized by considerable public sector dominance. As early as 2013, the World Bank noted that the early 2000s economic model focused on concentrated expansion of the economy, culminated in lower foreign reserves, large foreign public debt, and unsustainable fiscal deficits. Seychelles defaulted on foreign debt in 2008 when public debt peaked at 192% of GDP (Abdel-Latif et al., 2025; World Bank, 2013). Subsequent IMF supported economic reform focused on fiscal consolidation, liberalizing Seychelles economy, and public debt reform of the floating exchange rate was immediate, and these reforms provided the Seychelles economy stabilization and the opportunity to grow, focused growth still awaited expansion to reach more of the economy.

As noted by the World Bank (2013), the concept of "path dependence" can be seen clearly in the Seychelles' tourism sector. With time, the tourism industry created a self-sustaining and self-reinforcing cycle. The government placed disproportionate focus and resources on tourism, treating the industry as the primary engine of growth, notwithstanding its contributions to foreign exchange earnings, income, and public revenue. Other sectors were productive, but underfunded and underdeveloped, often absorbing the risk of public financing without being fully supported, and developing as 'zombie' sectors.

This focus on tourism shaped a narrow development trajectory for the Seychelles, and increased reliance on the sector heightened the structural weaknesses of the economy. The lack of public and developmental spending in the tourism-adjacent economy has further exacerbated the reliance on and the structural weaknesses of the economy. Seychelles' paradox of attaining high-income status and the lack of public and developmental spending outside tourism has further reinforced the structural weaknesses of a tourism-centered development model.

Macroeconomic profile: The twin pillars

The Seychelles economy is still dominated by its "twin pillars": tourism and fisheries. The services sector as a whole constitutes approximately 84% of GDP, with tourism as its centerpiece (African Development Bank, 2024; Moody's Analytics, n.d.).

Tourism: This sector is the primary driver of the economy. Directly and indirectly, it is estimated to account for more than 50-70% of GDP and employs between 26% and 30% of the labour force (Seychelles Consulate Hong Kong, n.d.; Moody's Analytics, n.d.). The performance of the entire economy is inextricably linked to the ebb and flow of tourist arrivals and their spending, which in turn depends on the economic health of its key source markets, primarily in Europe (World Bank, 2025; Seychelles Consulate Hong Kong, n.d.).

Fisheries: As the second pillar, the fisheries sector is vital for both export earnings and domestic employment. It indirectly funds a sizable amount of government revenue regardless of the latest statistics (Seychelles Consulate Hong Kong, n.d.; Agathine, n.d). With a contrastable population of 27% active in listed government occupations, Seychelles vast Eastern Cooperative Economic Area (EEC) region of 1.4 million square kilometers is one of the richest tuna regions worldwide and is the base for Seychelles government registered industrial seafood (Seychelles Consulate Hong Kong, n.d.). Seychelles government registered industrial seafood and tuna fishing enterprises write-off over 90% of encompassed inland value for Seychelles reserve bank operational processing and directly managed exportation (Seychelles Consulate Hong Kong, n.d.; Agathine, n.d.). According to official government statistics, Seychelles exhibits a high degree of structural dependence on external sectors; domestic value addition contributes less than 3 percent to national accounts. This limited productive base is further reflected in the country's heavy reliance on imports, with over 90 percent of consumable goods sourced from abroad. (African Development Bank, 2024; Moody's Analytics, n.d.; Agathine, n.d.). (African Development Bank, 2024; Moody's Analytics, n.d.; Agathine, n.d.).

Trade, debt, and external position

Seychelles demonstrates an open economy with persistent current account deficits and structurally deep economic burdens. With a trade to GDP ratio, higher than the global average, it shows the country's high dependence on the global economy, World Bank, 2018. Seychelles' export structure

shows the concentration that can occur within sectors. Primary trade data can be skewed, but an examination of exports clearly shows the dominance of the fisheries sector. For instance, in 2021, exports under the "Prepared Meats" (primarily canned tuna) and "Seafood" categories accounted for the largest share of Seychelles' domestically produced exports (Seetanah et al., 2011). Seychelles also derives a total export value from re-exports, particularly "Ships & Boats" and "Oil & Mineral Fuels" (Seetanah et al., 2011). This is because of Seychelles' strategic positioning as a transshipment hub and offshore vessel-registered country. Re-exports do contribute to the national income, but they do little to expand the domestic productive base. This economic ontology of re-exports, combined with the observable re-exports diversification, gives a misleading impression of structural change since the productive economic structure is still concentrated in the fisheries sector.

The current account deficits that the country has record on a regular basis can be attributed largely to the high costs of importing food, fuel, and capital goods for the tourism industry and for the country's population overall (Seychelles Consulate Hong Kong, n.d.; African Development Bank, 2024). Most of these deficits are covered by foreign direct investments (FDI), a large portion of which is directed toward the development of the region's hospitality sector and tourism support facilities (World Bank, 2025; Seychelles Consulate Hong Kong, n.d.).

The level of public debt, and therefore the level of risk it brings, is still significantly high. This is largely a result of the 2008 reforms which introduced a high period of successful fiscal consolidation that was unfortunately disrupted by a high surge of debt after the COVID 19 pandemic. This high debt, which has only cooled slightly and is still high, limits the government's fiscal space for investments in long-run resilience and diversification (World Bank, 2025, Agathine, n.d.; World Bank, 2013).

Policy in paradise: Seychelles' pursuit of a diversified future

Considering its economic weaknesses, the Government of Seychelles aims to diversify its economy. This objective is primarily seen through its adoption of the "Blue Economy" approach as a key development model. This strategy seeks to exploit the country's large sea territory sustainably, shifting from conventional fishing and other activities to identify new opportunities for growth. Besides the marine focus, Seychelles continues to pursue diversification in other important facilitating sectors such as renewable energy and financial services.

The Blue Economy: A new development paradigm?

According to Seychelles, the concept of the Blue Economy involves the sustainable and integrated development of ocean resources in a manner that balances the economic, ecological, and social dimensions of the development triangle (Government of Seychelles & Commonwealth Secretariat, 2018; Rocliffe et al., 2022). This perspective was formally accepted in the Blueprint Blue Economy Strategic Framework and Roadmap in 2018, where the government described its vision as, 'to develop a blue economy as a means of realizing the nation's development potential through innovation, [and a] knowledge-led approach' (Government of Seychelles & Commonwealth Secretariat, 2018; Department of Blue Economy, Seychelles, n.d.).

Targeted sectors within the Blue Economy

The government's plans for attention in this development framework include the following:

Fisheries: The government's focus is to move up the value chain instead of exporting just raw or semi-processed tuna. This includes advancing local processing, developing a local tuna fishing fleet to capture more value domestically, and exploring sustainable aquaculture and mariculture as potential diversified seafood production (Government of Seychelles & Commonwealth Secretariat, 2018).

Tourism: For this focus area, Seychelles tourism is shifting from the "sand, sun, and sea" tourism model to higher-value niche markets, including ecotourism, marine recreational tourism, and integrated tourism marketed for sustainability (Government of Seychelles & Commonwealth Secretariat, 2018).

Growth potential has been recognized within the Seychelles economy and includes: offshore wind and tidal energy marine renewables, marine biotechnical innovation with marine sourced novel compounds, and the strategic development of Port Victoria into a transshipment port with integrated maritime services (Government of Seychelles & Commonwealth Secretariat, 2018).

Diversification beyond the Blue: Renewable energy and financial services

Recognizing the risks of concentrating even its diversification efforts within a single ecosystem, Seychelles has also pursued development in other key areas.

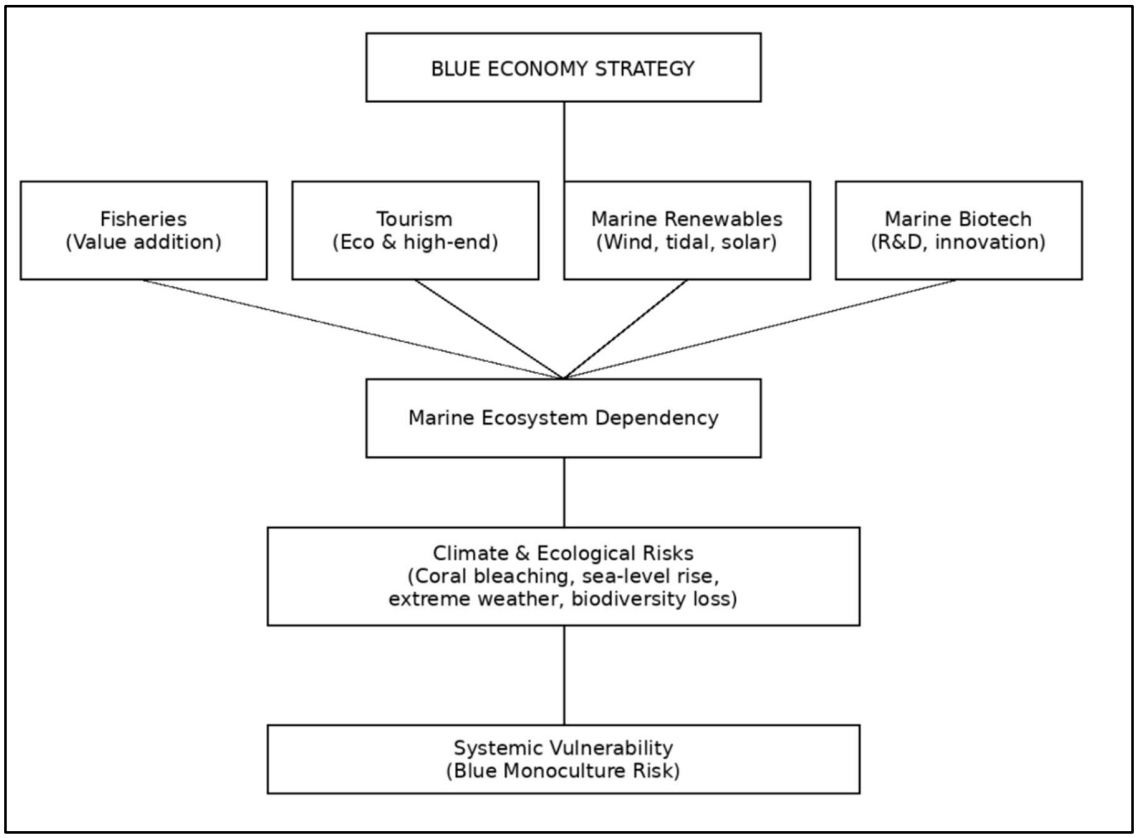
Renewable energy: Seychelles faces a significant economic and fuel import security burden, as over 95% of its electricity is produced from imported fossil fuels. Consequently, the government has implemented a plan to increase the share of renewables in Seychelles' energy mix to 15% by 2030, with an ultimate goal of becoming fully powered by renewables (SDG Fund, n.d.). Ongoing and planned key projects that fall under this initiative include the 5 MW solar farm on Ile de Romainville, the Port Victoria Wind Farm, and the recent issuance of tenders for innovative floating solar PV and battery storage systems. These initiatives are intended to address the country's economic climate and vulnerability to fuel price shocks as well as its climate obligations under the Paris Agreement.

Financial services: To this day, Seychelles wants to be recognized as an international financial hub and began venturing towards this goal in the 1990's by establishing an offshore financial sector (World Bank, 2013). While this sector remains to be an insignificant part of the economy in comparison to tourism, the improvement of the sector's regulatory frameworks have been consistent, and the constructed frameworks have been thorough and comprehensive. The most recent pieces of legislation, the Financial Consumer Protection Act and the Virtual Asset Act, aim to build trust in the sector and ensure competitiveness in the new technological financial landscape to attract more investment.

These policies are indeed impressive and ambitious, but what are some likely structural weaknesses? The Blue Economy policy is, of course, consistent with other policies that promote "sustainability," but may be more of a "deepening" specialization focus within the marine domain rather than a "broadening" to unrelated other sectors of the economy. It aims to extract more value from the marine and coastal tourism, develop new marine-based industries, and capture more value from the fisheries. The concern is a more sophisticated "Blue Monoculture" may be created. All major economic pillars will still be dependent on a highly fragile and single ecosystem. Severe

system shocks, such as a major maritime pollution incident or a coral bleaching event, have the potential to undermine all components of the economy, despite the diversification.

Figure 2: Blue Economy strategy and systemic vulnerability in Seychelles.



Source: Author's conceptualisation

In addition, the gap between the ambition of the policy and the country's demonstrated potential is significant. The policy's proximity to knowledge-intensive sectors like marine biotechnology and cutting-edge research and development is contradictory to the consistent and ongoing assessments from various international stakeholders regarding the Seychelles' skill shortages, weak institutional capacities, and public investment and civil service hiring bottlenecks (McIntyre et al., 2018; IMF, 2024; IMF, 2025). The evidence supports the strategy being pursued as a 'first-world' policy and the practical implementation as a 'small island' policy, which suggests that the most transformative elements of the strategy might remain, in all practice, fully aspirational.

Navigating the shoals: Enduring challenges to diversification in Seychelles

Despite a clear policy vision and proactive governance, Seychelles path to a diversified economy is fraught with formidable and deeply entrenched challenges. These impediments are not merely temporary setbacks but are structural in nature, stemming from a combination of internal constraints, external economic vulnerabilities, and accelerating environmental pressures. This

section analyzes these enduring challenges, which collectively form the "shoals" upon which diversification efforts risk foundering.

Internal structural constraints

Seychelles faces the most immediate barriers to internal economic diversification. The constraints within the economy and the institutions create reluctance within the state to effectuate its goals.

Capacity and governance: The constraints presented in the Seychellois economy repeatedly cited in literature primarily stems from limited human and institutional capacity. This is exhibited in the poorly executed capital expenditure budget, delays in structural reforms and high civil service recruitment and public procurement bottlenecks (IMF, 2024; IMF, 2025). By extension, these barriers slow down critical public and diversified sector investments. Moreover, the private sector is characterized by a lack of cohesion, owing to the multitude of associations which in turn, results in the absence of coordinated policy collaboration and sector strategy (Muhumuza et al., 2021).

Physical and infrastructure limits: The geographical limits of Seychelles as an archipelago with small land mass Seychelles faces limits on the infrastructure. Land is only available on a limited basis when it comes to new industry and large-scale agricultural development. This limits development on public infrastructure projects as well (Agathine, n.d.). Providing public services and utilities on a dispersed island geography is expensive, and high relative costs to businesses can result (World Bank, 2024, UN-DESA, 2010).

Labour market dynamics: The Seychellois unemployment rate remains low, suggesting a Sevilla labour market is available (Seychellois Consulate, Hong Kong, n, d; African Dev. Bank, 2024). Construction and tourism, which are heavily reliant on foreign labour, indicate there are local skill deficits in these areas (Moody's Analytics, n.d.). This is particularly detrimental to the development of the new, knowledge-focused sectors in the Blue Economy, which need a talented, technically and scientifically trained workforce. This workforce is currently unavailable.

External economic vulnerabilities

Seychelles is exposed to elusive external environmental factors and is hypersensitive to these external changes. This has been demonstrated over time, with profound and lasting impacts to the Seychelles economy. Global Shocks and Geopolitical Spillovers are fundamental to Seychelles economy. This has been demonstrated primarily during the COVID-19 pandemic, which was the ultimate test of vulnerability for the Seychelles economy. This led to near-total collapse of tourism, explosive public debt, a severe economic contraction, and a reversal of years of hard-earned fiscal consolidation for the country (Guillotreau et al., 2023; Agathine, n.d.; Muhumuza et al., 2021). Clearly, the pandemic demonstrated the potential of a single external shock to wreak havoc on the country’s economy. In the same way, other geopolitical events such as the Ukraine War and the subsequent attack by Russia, have visible impacts on Seychelles economy and it’s predatory global trade prices as Seychelles is a country that imports over 90% of its goods (African Development Bank, 2024; IMF, 2024; Agathine, n.d.).

Another risk factor relates to the proximity of key source markets for the industry - mainly Europe (World Bank, 2025; Seychelles Consulate Hong Kong, n.d.). An economic contraction in Europe results in lower tourist volume and reduced spending, which is likely to worsen due to anticipated weak growth in the European economy in 2024 and 2025 (World Bank, 2025; IMF, 2025).

Debt, fiscal space, and the reactionary debt cycle also adds to Seychelles problems. These risks manifest in an unfortunate cycle of consequences. An external shock, such as the pandemic, generates the need for the government to implement large-scale fiscal measures to protect an economy (Muhumuza et al., 2021; World Bank, 2013). This leads to the accumulation of public debt (Agathine, n.d.). Attention will need to focus on macroeconomic stability and debt consolidation, which in turn will trigger the entire fiscal planning cycle to divert attention to the stunted strategic cuts intended for the long-run; investment in education, new industries, and infrastructure is ignored so that the country can diversify. Poor long-run planning is the result of the country being constantly reactive to crises, diverting attention to the loss of resilience in the economy.

Climate and environmental pressures

Perhaps the most insidious and existential challenge is the accelerating impact of climate change. Climate change for Seychelles is not a distant threat but a present and mounting reality which acts as a "threat multiplier" for all other vulnerabilities (UK Government, 2025).

Yet, Climate change is a direct threat to the core economic sectors. It directly assaults the foundations of the "twin pillars." Rising sea levels, coastal erosion and increasing frequency and intensity of storms pose risks to the infrastructure of coastal tourism including hotels, airports, and roads (Agathine, n.d.). Simultaneously, the rising sea temperatures inflict coral bleaching and the vibrant ecosystems that attract and support the tourism industry and sustain the fisheries that underpin the country's primary export (Agathine, n.d.). The consequences of climate change operate as a direct and constant drain on economic potential and public finances.

Direct emergency spending on recovery and reconstruction as a result of the extreme weather events and unseasonable flooding in December 2023 causes unplanned budget expenditure, debt, and other economic consequences (IMF, 2024). This undermines the diversification agenda in two important ways: one, public funds needed for strategic investments are diverted, and two, the degradation of the natural capital on which the Blue Economy strategy relies. Climate change will always negatively affect the country's asset base and hinder the country's attempts to establish a more resilient future.

Diversification for the Seychelles involves complex policy challenges which require more than a simple policy solution. Unlike the other constraints, these challenges must interact to produce feedback loops, thus reinforcing vulnerability and, in the process, degrading the prospects of achieving a sustainable form of structural transformation.

Discussion: Lessons from Seychelles in a comparative SIDS context

While the issues that Seychelles encounters are not exceptional, the development challenges experienced by Small Island Developing States are Seychelles specific. Nevertheless, SIDS have taken different approaches to the same challenges, leading to different results. A comparative analysis of the experiences of the two other Indian Ocean islands – Mauritius and the Maldives – enables us to extract important lessons regarding the facilitators and barriers to successful economic diversification in small states (see Table 1).

The Mauritius "miracle": A contrasting path of structural transformation

Due to a well-diversified upper middle income economy status with prosperous textiles, tourism, financial and business services, Mauritius has been a role model to the SIDS. The country, based on World Bank and Sacerdoti's data, moved from a sugar monocrop economy to an upper-middle income economy. However, like Seychelles, Mauritius is small and remote. Unlike Seychelles, Mauritius has a better economic development track.

Multiple contributions can be attributed to the 'Mauritius success'. The establishment of an export-oriented manufacturing base without relying on the country's 'sun and sea' natural resources was a major feat.

Mauritius' success in diversification was not accidental but the result of deliberate and sequenced policy choices supported by strong institutions. The country pursued export-oriented industrialisation through the establishment of Export Processing Zones (EPZs), leveraging preferential trade access and low-cost labour to build a manufacturing base. Crucially, this strategy was underpinned by sustained investments in human capital, including universal education and skill development, which enabled movement into higher value-added sectors over time. Equally important was the presence of credible and stable institutions that facilitated policy continuity, regulatory predictability, and effective state–private sector coordination. In contrast to Seychelles' path-dependent reliance on tourism, Mauritius adopted a multi-sector strategy that consciously reduced dependence on any single sector. This suggests that diversification in small states is less a function of geography and more a function of institutional capacity and policy sequencing.

Reading about Seychelles, the contrast becomes even more apparent. Small, open economies, as measured by their high trade-to-GDP ratios, are illustrative examples (World Bank, 2018) of how this economic openness can be used in distinct fashions. While Mauritius used it to attain structural diversification in manufacturing, finance, and other sectors, Seychelles employed this openness as an extensive specialization for importing capital, labour, and goods to deepen her reliance on her existing geographical advantage of tourism and fisheries. Seychelles' reliance on economic openness to attain specialization portrays how economic openness can be used as a tool for structural diversification. The Seychelles case points to the incompleteness of open crashed economic policies. What determines the degree of economic open policies is the extent to which they can be manipulated into building substantially different and new economic structures.

The Maldives parallel: A cautionary tale of concentrated vulnerability

The Maldives presents a closer and more cautionary parallel to Seychelles. Like Seychelles, it is an archipelago nation whose economy is overwhelmingly dependent on high-end tourism, which directly and indirectly drives the majority of its GDP (Roy, 2025; Islamic Development Bank, 2022). It faces an almost identical set of challenges: a narrow economic base, high dependence on imports, significant external vulnerabilities, and an existential threat from climate change and sea-level rise (World Bank, 2024; Islamic Development Bank, 2022; Roy, 2025).

In contrast to its stated policy goals, economic diversification in the Maldives remains a distant objective as the economy continues to be concentrated on tourism (Roy, 2025; Gentile et al., 2023). Economic "Blue Economy" initiatives in sustainable fishery development and other sectors as an attempt to change this focus on tourism also continues unfulfilled (The President's Office, Maldives, 2025; Gentile et al., 2023). Maldives considerable infrastructure development, financed by external debt, which Roy (2025) notes as the primary reason the IMF cites high risk of debt distress, coupled with structural fiscal imbalance, further contributes to economic

vulnerability. This serves as a caution of what Seychelles should avoid: the risks of large public investment financing, which remains high in the absence of a solid fiscal base, coupled with volatile economy.

How development projects can hinder financial stability is illustrated by the Maldivian experience. This is a direct consequence of failing to address the underlying problem of concentrated economic power.

Table 1: Comparative political economy of diversification in selected SIDS

Dimension	Seychelles	Mauritius	Maldives
Economic Structure	Concentrated in tourism and fisheries	Diversified across manufacturing, tourism, and services	Concentrated in tourism
Diversification Outcome	Limited diversification	Successful diversification	Limited diversification
Role of Institutions	Capacity constraints and bottlenecks	Strong and credible institutions	Governance and fiscal challenges
Development Strategy	Blue Economy (marine-focused)	Multi-sector diversification	Tourism-led growth with limited diversification
Key Risk	Structural vulnerability and external shocks	Exposure managed through diversification	High vulnerability due to concentration and debt
Overall Trajectory	Premature specialization	Structural transformation	Persistent concentration

Re-evaluating the Blue Economy model and the primacy of institutions

The findings from Mauritius indicate that the most resilient SIDS are those that manage to construct economic pillars apart from fragile natural resources. The Seychellois and Maldivian examples demonstrate that development frameworks predicated exclusively on the further exploitation of the seas and coastline, even if framed within a sustainable 'Blue Economy,' will fall short of addressing the problem of economic concentration. The Blue Economy will undoubtedly help predict and manage sustainably appreciating resources within a development framework, but it is unlikely to be a bulwark against the systemic ecological shocks that adversely impact the global ocean ecosystem.

This brings us to a final and most important point: the quality of institutions may be the single most important factor. In considering Seychelles, Mauritius, and the Maldives, one must bear in mind that these countries share similar geography and similar structural constraints. The most plausible explanation for their differing trajectories in development is the long-term quality of their governance and institutions.

Mauritius's successful integration of a well-balanced social contract, the establishment of a trustworthy regulatory framework for the financial sector, and the effective international trade relations exemplifies maturity on the institutional level, and such maturity has been crucial to success (World Bank, 2018; Zafar, 2011). Conversely, the reports regarding the Seychelles always seem to highlight weaknesses in institutions, such as capacity and constraints in public investment,

as main obstacles to necessary reform (IMF, 2024; IMF, 2025). This, in turn, points to the fact that the "secret sauce" to achieving diversification has very little to do with resource endowment and, rather, the patient and gradual undertaking of constructing institutions that are effective, credible, and resilient.

Conclusion and policy implications

Seychelles economic history provides a compelling cautionary tale on the limitations faced by Small Island Developing States when attempting to gain economic diversification. This paper argues that Seychelles exists in a 'triple bind' comprising intrinsic structural weakness, a high-income designation that paradoxically limits possible financings, and a climate crisis that is deepening and is, most likely, the worst economic crisis of all. The high standard of living attained by Seychelles is laudable, but, to the extent that the economy is built on tourism and fishery, it is weak and, therefore, highly conditional. The primary diversification strategy, ambitious Blue Economy roadmap, is built on the innovative idea of sustainability, but it will deepen reliance on a single, vulnerable marine ecosystem, and that is definitely not a strategy for moving economic reliance away from the economically precarious tourism and fishery sectors.

There is no question that Seychelles is 'prematurely specialized' and trapped in a deteriorating cycle of shock, response, and debt. 'Crisis management' is a primary repeating theme of economic strategy and it pre-empts the long-term investments needed in primary economic sectors that will lead to true economic resilience. The case studies of Mauritius and the Maldives reinforce the structural constraints faced by SIDS, whilst showing that the outcomes of such constraints can, indeed, be divergent. The Mauritian Case illustrates that geography-agnostic sectoral economic growth is possible aided by the nexus of institutions and investments in human capital. The parallel case of the Maldives illustrates the risks of high indebtedness and over economic concentration.

The findings used in this case result in specific actionable recommendations that could be applied to the Seychelles, the rest of the SIDS, and the global framework for international development that is geared towards them.

Policy implications for Seychelles

Shift from the Blue Economy: Managing Seychelles' Blue Economy sustainably is a vital influential element of the country's success. However, the Seychelles Blue Economy, which is the management of the country's marine resources. Gaining insights from the potential of the global digital economy, Seychelles should attempt to develop online resources, digital infrastructure, e-services commerce, remote work, Seychelles business tourism, e-regulations and Seychelles global digital market. It may develop a novel, non-climate, and non-tourism economy and employment source to sustainably manage the Blue Economy.

Transform Seychelles human and institutional capital: When diverting the economy with blue and digital components, Seychelles should radically re-prioritize public resources to the education system, technologically advance the economy, and the public e-services to lower public sector bottlenecks. Designing the education system to develop and enable technological, financial, and scientific human capital in the economy should be a mission goal.

Design counter-cyclical buffers: Breaking the "shock-response-debt" cycle needs to develop institutional tools that manage the volatility capacity of public resources. It means to set sustainably managed primary surpluses in times of strong tourism, which will be November to mid-April, to develop a capital reserve to manage the tourism down seasons. This fund could promote economic support during downturns without taking on additional debt and high levels fiscal space for long-term investments.

Policy implications for SIDS and the international community

Advocate for the Multidimensional Vulnerability Index (MVI): One of the most crucial reform international policies for SIDS would be the adoption of the MVI, replacing or supplementing the per capita income, as the primary criteria for accessing concessional finance and development. The MVI would help Silenced income rated countries utilize and borrow subsidized funds and aid. The Seychelles "high income vulnerability trap" exemplifies the ridiculousness of penalizing equity sensitive countries for sustaining income growth and ignoring the extreme exposure and shocks these countries face. It is crucial for SIDS to present advocacy to the UN, WB, and IMF as a block.

Move from project finance to capacity building: Shifting the focus from financing individual projects, which is the current trend of international partners, to long-term collaborative directed assistance for institutional capacity building and the financing aid would be a more positive structural approach. Merline (2022) states that structural assistance would involve embedding technical experts within ministries and aiding comprehensive educational and vocational training programs. The ability of a state to plan, execute and regulate is the foremost winding infrastructure to sustain while the state may line. Investments that improve financing pillars and remove state dependency are far higher in UNDRR (n.d.) compared to incentive spending, like infrastructure that the state may struggle to maintain

Scale up innovative and blended finance**:** An integrated financing approach is essential for addressing the combined issues of debt, climate vulnerability, and the need for diversification. SIDS need this approach to hinge on a blended financing modality

The global community should prioritize expanded and simplified access to Debt-for-Climate and Debt-for-Nature swaps, Sovereign Blue and Green Bonds, and Blended finance which uses public money to alleviate risks and encourage private investment in sustainable and resilient sectors (Agathine, n.d.; UNDRR, n.d.).

Avenues for future research

This analysis can lead to further investigations in the following areas. First, the political economy of reform in microstates requires further investigation. Understanding the domestic political economy that enables and constrains the microstate's ability to implement one of the long-term diversification strategies would be valuable. Second, there is a need for quantitative analysis of the long-term economic and fiscal impacts of climate change on the Blue Economies of SIDS. Such analysis would provide policymakers with an estimate on the economic risks of marine-based concentration for the purposes of fiscal planning. Lastly, a formal analysis of the prerequisites for

the remote island economies to develop a digital services sector would deepen our understanding of how to provide Seychelles and similar countries a practical alternative development pathway.

SIDS like Seychelles face acute, but not insurmountable, challenges of diversification. This requires acknowledgment of the structural realities, an ambitious domestic policy agenda that puts a premium on the development of human and institutional capital, and a reform of the international financial system that is vastly more aligned to the needs of the most vulnerable countries in the world.

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