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Independent Evaluation Office
of the International Monetary Fund

IMF ENGAGEMENT WITH SMALL DEVELOPING STATES

EVALUATION REPORT **2022**

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The following conventions are used in this publication:

- An en-dash (–) between years or months (e.g., 2021–22 or January–June) indicates the years or months covered, including the beginning or ending years or months.
- A slash (/) between years or months (e.g., 2021/22) indicates a fiscal or financial year, as does the abbreviation FY (e.g., FY2021).
- "Billion" means a thousand million; "trillion" means a thousand billion.

FOREWORD

The IMF's engagement with its 34 Small Developing States (SDS) members is particularly challenging. These countries represent 18 percent of the Fund's membership and face distinctive economic vulnerabilities, not least related to natural disasters and climate change, while having very limited institutional capacity. The Fund can play a crucial role as a unique source of authoritative advice on macroeconomic management and valuable external financing, but doing so effectively requires recognizing these countries' special needs.

The evaluation finds that the IMF deserves considerable credit for having substantially stepped up its engagement with SDS members over the last decade. This improvement reflects several factors, including the considerable efforts made to develop specific staff guidance for Fund work on SDS, the increased attention paid to climate change and other macro-critical issues for these members, and the rise of capacity development work, underpinned by the strong role played by regional centers.

Nevertheless, the evaluation identifies a number of serious concerns that have adversely affected the Fund's overall value added and traction. Difficulties in staffing SDS country teams have contributed to high rates of staff turnover, affecting the depth of country knowledge and the continuity of relationships. The overall IMF financing architecture has not been especially well suited to the particular needs of SDS and their use of Fund resources has been substantially less than that by other emerging market and developing economies. In the area of capacity development, traction and impact have been hampered by institutional constraints in many SDS.

Based on these findings, the report proposes four broad recommendations and a number of specific suggestions. The four recommendations include a targeted recalibration of the overall approach to the Fund´s activities in SDS, operational steps to increase the traction of surveillance and capacity development work, proposals to make better use of the Fund's lending framework to address SDS needs, and further human resource and budgetary commitments to support SDS engagement.

I am pleased that Executive Directors broadly supported the IEO´s findings and recommendations and look forward to a strong implementation plan aimed at further strengthening the Fund's engagement with its SDS members.

Charles Collyns

Director, Independent Evaluation Office

CONTRIBUTORS

This report was prepared by an IEO team led by Cyrus Rustomjee and Miguel de Las Casas, and including Alisa Abrams, Sriram Balasubramanian, Yishu Chen, and Jiakun Li.

The external consultants were Michael Da Costa, Chris Lane, and Xavier Maret for the country case studies, and Lino Briguglio, Peter Heller, Domenico Lombardi, Xavier Maret, and David Marston for the thematic papers.

The team is grateful to Arun Bhatnagar, Amy Gamulo, Elena Pinillos, and Andrea Nicole Tumbaco for administrative assistance. The evaluation benefited from discussions with participants at several workshops and interviews with officials, academics, and private sector participants. However, the final judgments are the responsibility of the IEO alone.

The report was approved by Charles Collyns.

ABBREVIATIONS

AD	Area Department
AE	Advanced Economy
AFR	African Department (IMF)
AIV	Article IV
AML/CFT	Anti–Money Laundering/Combating the Financing of Terrorism
APD	Asia and Pacific Department (IMF)
CBR	Correspondent Banking Relationship
CCPA	Climate Change Policy Assessment
CCRT	Catastrophe Containment and Relief Trust
CDMAP	Capacity Development Management and Administrative Program
CMAP	Climate Macroeconomic Assessment Program
CSN	Country Strategy Note
DMD	Deputy Managing Director (IMF)
DRS	Disaster Resilience Strategy
DSA	Debt Sustainability Assessment
EBA	External Balance Assessment
ECCU	East Caribbean Currency Union
ECF	Extended Credit Facility
EF	Emergency Financing
EFF	Extended Fund Facility
EMDEs	Emerging Market and Developing Economies
EUR	European Department (IMF)
FAD	Fiscal Affairs Department (IMF)
FCS	Fragile and Conflict-Affected States
FSAP	Financial Sector Assessment Program
FSSR	Financial Sector Stability Review
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GRA	General Resources Account
ICD	Institute for Capacity Development (IMF)
IDA	International Development Association
IFI	International Financial Institution
LIC	Low-Income Country
LIDC	Low-Income Developing Country
LND	Large Natural Disaster

MAC	Market Access Country
MCD	Middle East and Central Asia Department (IMF)
MCM	Monetary and Capital Markets Department (IMF)
MIC	Middle-Income Country
MIP	Management Implementation Plan
MONA	Monitoring of Fund Arrangements database
ND&CC	Natural Disasters and Climate Change
PCDR	Post-Catastrophe and Debt Relief
PCI	Policy Coordination Instrument
PFTAC	Pacific Financial Technical Assistance Center
PRGT	Poverty Reduction and Growth Trust
PSI	Policy Support Instrument
RBM	Results-based Management
RCDC	Regional Capacity Development Center
RCF	Rapid Credit Facility
REO	Regional Economic Outlook
RES	Research Department (IMF)
RFI	Rapid Financing Instrument
RR	Resident Representative
RRR	Regional Resident Representative
RSN	Regional Strategy Note
RST	Resilience and Sustainability Trust
SB	Structural Benchmark
SBA	Stand-By Arrangement
SC	Structural Condition
SCF	Standby Credit Facility
SDR	Special Drawing Rights
SDS	Small Developing State
SGN	Staff Guidance Note
SIP	Selected Issues Paper
SOE	State-Owned Enterprise
SMART	Specific, Measurable, Achievable, Relevant, and Time-Bound
SMP	Staff-Monitored Program
SPR	Strategy, Policy and Review Department (IMF)
SSF	Small States Forum (World Bank)
STA	Statistics Department (IMF)
UCT	Upper Credit Tranche
VAT	Value-Added Tax
WEO	World Economic Outlook
WHD	Western Hemisphere Department (IMF)

EXECUTIVE SUMMARY

PRINCIPAL FINDINGS

The IMF deserves considerable credit for having substantially stepped up its engagement with its Small Developing States (SDS) members between 2010 and 2020. This is a group of countries that, while very small from the perspective of the global economy, represents 18 percent of the membership and faces persistent economic, environmental, and other forms of vulnerability that pose a special challenge for the IMF. The Fund's improved engagement with SDS over the past decade reflects a number of factors, including the considerable efforts made to develop specific staff guidance for Fund work on SDS relevant to their needs, the increased attention paid to climate change issues, and the rising resources on capacity development work and the strong role of regional centers (which have particular relevance for SDS). The commitment by Board members to champion the cause of SDS work at the Fund as well as the commitment by Management and staff to support these members in the face of continuing resource constraints have also contributed.

That said, the Fund's engagement with SDS has faced a number of serious challenges that have adversely affected its overall value added and traction. Key concerns include difficulties in staffing SDS assignments that have contributed to high rates of turnover; questions about whether the IMF lending architecture is well suited for SDS needs and capacities; and issues about limited institutional capacity in SDS to implement Fund advice and continuing political economy concerns about Fund conditionality.

IMF surveillance is greatly appreciated in SDS and generally considered by country officials as of high quality and well-tailored to their specific needs. Fund surveillance carries a heavier weight than in larger economies because in many SDS the Fund is the principal source of authoritative external macroeconomic analysis and advice, and because IMF surveillance

helps fill capacity gaps. The relevance of IMF policy advice to SDS has benefited from increasing attention at the Fund to climate policy issues, correspondent banking relations, and debt sustainability analysis, and has built on IMF analytical work as well as a growing body of external research on SDS issues.

However, the evaluation found several reasons for concern. Policy advice sometimes lacked actionability and specificity, particularly in areas beyond the Fund's core expertise but still macro-relevant, and access to useful tools such as the Financial Sector Assessment Program (FSAP) and Climate Change Policy Assessment (CCPA) (now replaced by the Climate Macroeconomic Assessment Program, CMAP) was limited. Surveillance was also hampered by low frequency of engagement and high turnover of mission chiefs). Small SDS country teams were challenged to meet standard Fund Article IV surveillance requirements and to apply complex diagnostic tools in view of data and other constraints faced by small states work. These factors reduced the continuity and depth of policy discussions and, ultimately, affected the traction of surveillance.

The overall IMF financing architecture has not been especially well suited to the particular needs of SDS and their use of Fund resources has been substantially less, on a relative basis, than that by other emerging market and developing economies. In particular, SDS made sparse use of Fund Upper Credit Tranche (UCT) programs, although where they did undertake UCT programs the completion rate was high, suggesting adequate support for implementation in the program context. These programs were largely aimed at fiscal adjustment and debt sustainability. During the evaluation period, no SDS requested a UCT program to address recovery from or resilience building for natural disasters and climate change.

Some of the factors behind this reluctance to use UCT programs are deep rooted and may be hard to remedy, including some authorities' aversion to Fund conditionality, particularly when alternative sources of official financing are available. Others fall clearly within the Fund's reach: low access levels relative to financing needs, the high administrative burden of negotiating and monitoring UCT arrangements, the short time frame for Fund-supported programs compared to long-term structural weaknesses, and limited understanding by potential users of the Fund's program framework, including non-financing programs.

By contrast, SDS have been more inclined to use IMF emergency financing, with no ex post conditionality, to help deal both with large climate- and weather-related disasters and with the COVID-19 pandemic. The Fund's capacity to provide large disbursements in the aftermath of a disaster has increased, but access is still quite limited relative to post-disaster financing needs, and repayment terms and conditions are often less attractive than financing from elsewhere. Around one half of SDS came to the Fund for emergency support in the wake of the COVID-19 pandemic but, given that SDS faced larger shocks relative to the size of their economies, the share of financing needs met by the Fund was smaller than for other members, and the need to deplete their international reserves cushions correspondingly greater.

IMF capacity development work is highly valued by SDS in terms of quality, quantity, content, and tailoring to country circumstances. Again, capacity development is particularly important to these countries, given the serious capacity constraints many of them face. The heavy reliance on Regional Capacity Development Centers (RCDCs), whose use SDS pioneered at the Fund, has been a driver of success. RCDCs were closer and more knowledgeable about local circumstances, they supplied the longer-term support these members needed, and they provided a degree of continuity in the Fund-member engagement that is much more difficult to achieve from HQ. RCDCs were not only successful in fulfilling capacity development needs; they also contributed to other IMF functions—palliating the scarcity of resident representatives in SDS and improving the institution´s reputation—and served as useful coordination centers.

The main concern with the capacity development provided to SDS has been insufficient traction and impact. A key obstacle to effective implementation was the limited absorptive capacity in many SDS, compounded in some cases by lack of ownership by officials. On the Fund's side, some concerns were raised regarding insufficient recognition of capacity constraints and the tendency to focus advice on first-best solutions. Increased provision of follow-up support could strengthen capacity development effectiveness, while systematic use of results-based management (RBM) output as RBM and the Capacity Development Management and Administrative Program (CDMAP) mature could provide useful experience relevant for capacity development allocation, capacity development design, and delivery and implementation.

The IMF has struggled to strike the right balance between resource constraints and the commitment to provide adequate support to SDS in all its areas of activity. Often, work on small states has been affected by high turnover and short tenure of staff assigned to SDS, including mission chiefs. Staff working on SDS felt personally rewarded by working on small countries, where their efforts made a tangible difference and were generally well appreciated by country officials. However, institutional incentives for staff to work on SDS assignments were poor, with lower performance ratings and promotion rates for economists working on SDS, contributing to low application rates and more rapid turnover. Use of co-desk assignments with larger countries to fill SDS positions diluted attention to staff's work on specific SDS. The use of staff from non-area and non-functional departments to fill out small country teams compounded problems with continuity of engagement. At the mission chief level, departments had less difficulty in recruiting for SDS assignments, as these can provide a useful career building opportunity, but the result again was limited tenures, as such staff moved on to seek promotion elsewhere. The small size of teams, the absence of functional department economists in missions, and the scarcity of resident representatives were also causes for concern.

RECOMMENDATIONS

Drawing on these findings, the evaluation offers four broad recommendations aimed at further strengthening the impact of the Fund's engagement with its SDS members, together with more specific suggestions for each broad category. These four recommendations cover a focused refresh of the overall approach, operational steps to increase the traction of surveillance and capacity development, suggestions to make better use of the Fund's lending framework to address SDS needs, and further HR and budgetary commitments to support SDS engagement. They are intended to be mutually reinforcing. The recommendations also aim to be SMART (Specific, Measurable, Achievable, Relevant, and Time-Bound). But to be truly effective, they will need to be accompanied by change in the Fund's institutional culture toward SDS to fully recognize the importance of such work for the institution, which will need to be led by Management and senior staff.

Recommendation 1. The Fund should pursue a targeted recalibration of its overall approach for engagement with SDS to strengthen the value added and impact of its work.

The recalibration would build on the strengthened engagement achieved during the evaluation period and seek to enhance the coherence and continuity of SDS work, while still leaving room for flexibility at the area department and country level. The recalibration would have two principal elements: a focused refresh of the SDS Staff Guidance Note (SGN); and steps to support more effective application of the SGN and other commitments in the implementation plan for this evaluation through mechanisms for internal coordination, engagement with the Board, and collaboration with partners.

Recommendation 2. Steps should be taken at the operational level to enhance the focus and traction of the IMF work on SDS in the areas of surveillance and capacity development.

Actions would aim at further adapting processes and tools for the SDS context, deepening integration across Fund activities, better recognizing domestic constraints, and increasing support for implementation.

Recommendation 3. The IMF should consider how to use its lending framework in ways that better address the needs and vulnerabilities of SDS.

Three suggestions are provided, consistent with the principle of uniformity of treatment: greater attention to growth and resilience outcomes in UCT programs, care to implement the newly designed Resilience and Sustainability Trust (RST) to take account of SDS needs and institutional constraints, and increasing access limits under the large natural disaster window for countries with robust macroeconomic frameworks and strong governance standards.

Recommendation 4. The IMF should adopt further HR management and budgetary commitments to increase continuity and impact of staff's engagement with SDS.

Such steps would aim at improving incentives to work on SDS assignments, reduce turnover, avoid gaps in coverage, minimize disruptions from handovers, and strengthen Fund presence on the ground.

BUDGETARY IMPLICATIONS

The recommendations build on initiatives to strengthen IMF engagement with SDS during the evaluation period through further targeted actions to maximize efficiency and value added in the use of resources currently applied for SDS work, and seek to build on existing commitments already included in management implementation plans (MIPs) for other evaluations. Nevertheless, some initial “set-up costs” are expected in implementing the recommendations, for example to update the staff guidance note. In addition, some longer-term increases in resources may be justified in specific areas, such as strengthening field presence, including by building up the role of regional resident representative offices and by providing for somewhat more use of resource-intensive diagnostic tools like CMAP, FSAPs, and Financial Sector Stability Reviews (FSSRs). On the other hand, there could also be some offsetting savings in travel costs from increased use of virtual engagement as well as in-the-field staff, from increased use of regional and cluster approaches to surveillance work, and from greater reliance on partnerships in areas that are macro-critical but where the Fund does not have deep expertise.

1

INTRODUCTION

The IMF defines 34 member countries as Small Developing States (SDS). They comprise a heterogeneous group but share many similar characteristics and vulnerabilities that pose particular challenges for development and macroeconomic stability, and therefore for the Fund's engagement. Some of these characteristics are associated with their small population and economic size, their institutional and human resource capacity constraints, and social issues. Some are geographical in nature, like remoteness, insularity, and, crucially, their extreme vulnerability to natural disasters and climate change (ND&CC). In addition, SDS are relatively open, making them more susceptible to macroeconomic volatility, commodity price fluctuations, and disruptions in world markets, and their domestic financial systems are typically shallow, with often weak regulatory and supervisory institutions.

This evaluation considers how effectively the IMF has supported its SDS members given these countries' distinctive vulnerabilities and needs.[1] The evaluation focuses on the period from 2010 to 2020, during which the IMF's framework for engaging with small states was substantially overhauled and the Fund also paid increasing attention more generally to issues such as climate change and disaster resilience that are particularly relevant to SDS. While most of the activity evaluated took place before the outbreak of the COVID-19 pandemic, due attention is paid to those aspects of the Fund´s initial response to this crisis, which was especially damaging for SDS economies. The evaluation also provides information on developments in 2021 and early 2022 relevant to SDS work, although it does not seek to evaluate the experience beyond the evaluation period.

The key objectives of the evaluation are to: (i) assess how well the IMF's core operations—surveillance and policy advice, lending and non-financial program support, and capacity development activities—were adapted to the specific challenges facing SDS; and (ii) assess the evolving institutional framework and procedures for the IMF's engagement with SDS, including its strategic approach, toolkit, and human resource management. It considers the value added from the modification to the Fund's framework during the evaluation period and the extent to which long-standing concerns about IMF engagement with SDS—including about the traction of IMF advice, the suitability of the Fund's analytical toolkit, the limited use of IMF financing, and the high turnover of staff teams working on SDS—have been addressed. The evaluation offers findings that could also be relevant in strengthening the Fund's engagement with other members that face or will face similar challenges to those most acute now in SDS, including exposure to climate change and large natural disasters, as well as general lessons from SDS' experience on mission team turnover and knowledge sharing.

[1] Several evaluations by the IEO have touched on issues relevant for SDS, including *IMF Collaboration with the World Bank on Macro-Structural Issues* (IEO, 2020); *Growth and Adjustment in IMF-Supported Programs* (IEO, 2021)*; The IMF and Fragile States* (IEO, 2018); and *The IMF and Social Protection* (IEO, 2017). About one-third of SDS have featured as country case studies in previous IEO evaluations.

BOX 1.1. EVALUATION BACKGROUND PAPERS

Thematic studies

Four background papers analyze the Fund's work over the evaluation period in topics of special relevance for SDS: growth, climate change and natural disasters, fiscal policy, and financial sector issues. Two other papers assess specific aspects of the Fund's work on SDS, namely, capacity development and the initial response to the COVID-19 pandemic. Two further background papers explore internal organizational elements of the Fund's engagement with small states: human resources and the general policy framework for engagement. Finally, two additional background papers review (i) the internal and external literature on SDS, and (ii) the results of the two surveys conducted for the evaluation.

Country case studies

Country cases include a representative group of SDS, covering not only countries in all regions, but also diversity in terms of size, development stage, economic characteristics, and vulnerabilities, as well as experience with surveillance and lending engagement with the IMF. Grouped in three regional background papers, the 15 country cases include Antigua and Barbuda, Barbados, Belize, Cabo Verde, Dominica, Eswatini, Fiji, Mauritius, Micronesia, Montenegro, Samoa, Seychelles, Solomon Islands, St. Lucia, and Tuvalu.

A complete listing of the background papers and their authors is provided in Annex 5.

The evaluation draws on multiple information sources, including (i) an extensive review of external literature and internal IMF documents (including policy papers, research papers, surveillance and program documents); (ii) interviews with country authorities and IMF Executive Directors, Fund staff, development partners, and other international organizations; and (iii) surveys of country authorities and IMF staff.[2] The evaluation is based on a combination of detailed country case studies and a number of cross-cutting thematic studies (Box 1.1).

The rest of the report is organized as follows. Chapter 2 reviews the characteristics of small states that make them unique and shape their engagement with the IMF, while Chapter 3 explains the institutional framework in which that engagement takes place. Chapters 4 through 6 assess the Fund's performance on its three main activities in small states: surveillance, lending and program support, and capacity development. Chapter 7 evaluates the Fund's human resource management for engaging with small states. Chapter 8 summarizes the evaluation's main findings and offers recommendations.

[2] Unfortunately, the response rate for the survey of SDS country officials was quite low (de Las Casas and Balasubramanian, 2022b) and, therefore, the survey is only used as a secondary source of evidence.

2

KEY SDS CHARACTERISTICS

OVERALL CHARACTERISTICS

The IMF classifies as SDS those members with populations under 1.5 million, excluding advanced economies (AEs) and high-income fuel-exporting countries as listed by the *World Economic Outlook* (WEO). A total of 34 countries fall into this category (Table 2.1).[3] The IMF list of SDS differs from that of other international organizations. Most notably, the World Bank's Small States Forum (SSF) list adds eight countries with populations over 1.5 million but with similar characteristics to those of countries under the threshold and includes AEs and fuel exporters.

There is significant heterogeneity among SDS: 27 are island states, 5 are coastal, and 2 are landlocked. While they are concentrated in the Caribbean (12) and in the Asia and Pacific region (14), there are 7 in Africa and 1 in Europe. Fifteen are "microstates," with populations below 200,000, 6 of which have populations under 100,000. The smallest SDS has a population of 10,000. Ten SDS are considered to be fragile and conflict-affected states (FCS). In terms of income level, 11 are considered lower-middle-, 16 are upper-middle-, and 7 are high-income countries, according to World Bank criteria.[4] Currently, there are no low-income SDS.

While small states comprise a heterogeneous group, they share many characteristics and vulnerabilities as a result of their small population and economic size. These include narrow production bases, limited diversification of economic activity, output, and exports, and constrained human resources and institutional capacity. Their high dependence on international trade and narrow range of exports make them particularly susceptible to macroeconomic volatility, commodity price fluctuations, and disruptions in world markets, and amplify their exposure to terms-of-trade shocks and volatile trade tax revenues. Many experience high youth unemployment and elevated levels of migration by the highly educated, limiting the skills needed to drive sustained economic growth and development. Many, particularly Pacific small states, are remote, insular, and far from global trade routes and consequently are exposed to high trade-related transportation costs and dependent on fuel imports. SDS are also among the most vulnerable countries to ND&CC, with adverse impacts on growth and other macro-critical effects. The challenges arising from small population and economic size, remoteness, and limited human resource and institutional capacity are amplified for microstates with populations under 200,000.

[3] Andorra joined the Fund in October 2020 and is covered in this evaluation. It is classified as an advanced economy and is therefore not included in the IMF SDS list.

[4] In July 2021, the World Bank classified countries as follows: low-income countries (per capita income of $1,045 or less); lower-middle-income countries ($1,046–$4,095); upper-middle-income countries ($4,096–$12,695); and high-income countries ($12,696 or more).

TABLE 2.1. SMALL STATES AS CLASSIFIED BY THE IMF AND THE WORLD BANK

		AFR	APD	EUR	MCD	WHD
WB SSF (50)	IMF SDS (34)	Cabo Verde Comoros* Eswatini Mauritius São Tomé and Príncipe* _Seychelles_	Bhutan Fiji _Kiribati*_ Maldives* _Marshall Islands*_ _Micronesia*_ _Palau_ _Samoa_ Solomon Islands* Timor-Leste* _Tonga_ _Tuvalu*_ Vanuatu _Nauru_	Montenegro	Djibouti*	_Antigua and Barbuda_ The Bahamas Barbados Belize _Dominica_ _Grenada_ Guyana _St. Kitts and Nevis_ _St. Lucia_ _St. Vincent and the Grenadines_ Suriname Trinidad and Tobago
		Botswana (>1.5m) Equatorial Guinea (fuel exp.) Gabon (>1.5m) Gambia* (>1.5m) Guinea Bissau* (>1.5m) Lesotho (>1.5m) Namibia (>1.5m)	Brunei (fuel exp.)	Cyprus (adv.) Estonia (adv.) Iceland (adv.) Malta (adv.) _San Marino (adv.)_	Bahrain (fuel exp.) Qatar (>1.5m)	Jamaica (>1.5m)

Sources: IMF and World Bank.
Note: Microstates are shown in italics. * denotes FCS (fragile and conflict-affected states). AFR = African Department, APD = Asia and Pacific Department, EUR = European Department, MCD = Middle East and Central Asia Department, WHD = Western Hemisphere Department. Adv. = advanced economy. Fuel exp. = fuel exporter.

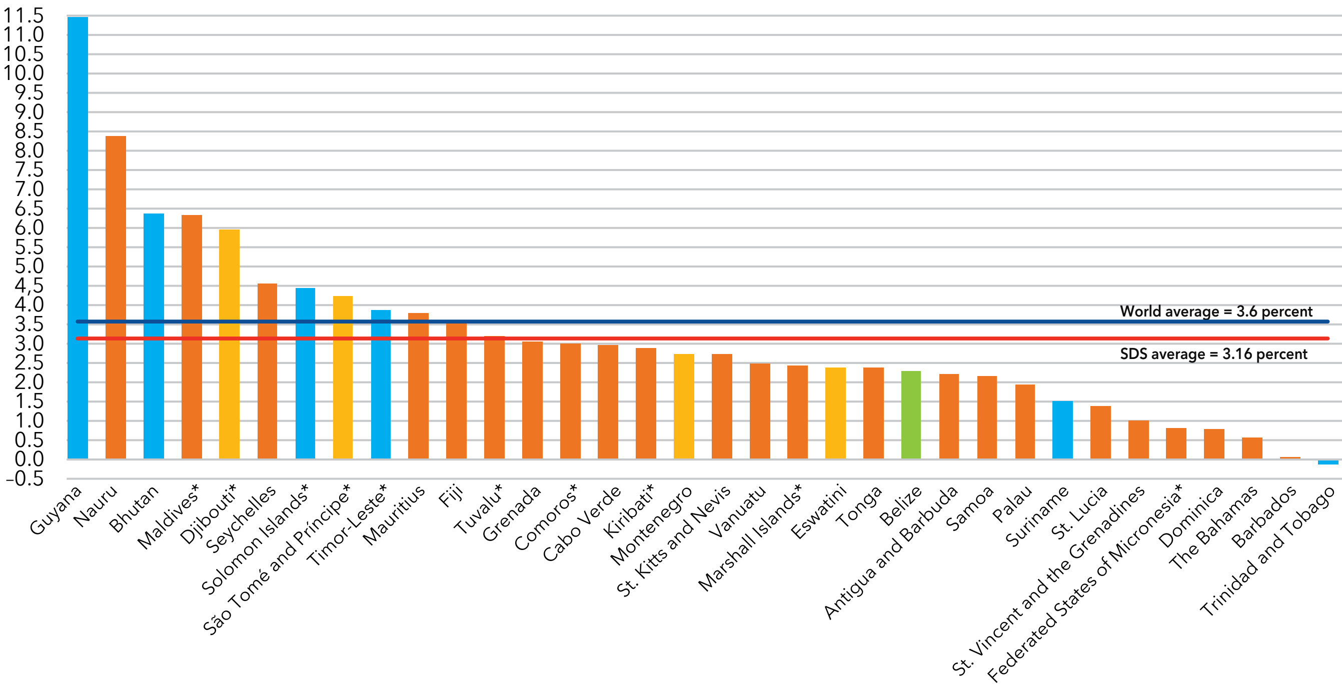
It is worth highlighting up front that there are also considerable variations across the three main regions containing SDS.[5] Caribbean SDS are highly concentrated and 9 of the 12 are islands. Caribbean SDS are typically characterized by higher levels of development (most of them qualifying as upper-middle-income) and institutional capacity, but also high public indebtedness—much of which stems from repair and construction work following hurricanes. Pacific SDS are all insular and while "concentrated" in the same region, they are distributed over a vast oceanic area, distant from each other and remote from neighboring continents. They are also generally smaller (including 8 of all 15 microstates) and more fragile (accounting for 6 of the 10 SDS considered FCS). Pacific SDS are on average less developed and more dependent on external assistance, with an average GDP per capita during the evaluation period around one third that of Caribbean SDS. African SDS tend to be larger; two of them are on the mainland and five are islands off the continent's west and east coasts.

GROWTH

SDS' small populations and economic size have challenged policymakers' efforts to achieve macroeconomic stability, well diversified resilient economies, and sustained growth. Since 1980, growth rates in SDS have persistently lagged those of other emerging markets and developing economies (EMDEs) and fallen short of the global average growth rate. Tourism-dependent SDS, microstates, and Caribbean SDS

[5] Of the 34 SDS, only Bhutan, Maldives, and Montenegro are located outside of these regions.

FIGURE 2.1. REAL GDP GROWTH ACROSS SDS, 2010–2020
(Average, in percent)



Sources: IMF; IEO calculations.
Note: * denotes FCS (fragile and conflict-affected state). Orange = tourism-dependent SDS; blue = commodity-exporting SDS; green = tourism-dependent and commodity-exporting SDS; yellow = others.

have tended to perform particularly poorly in comparison with other SDS and other country groups.

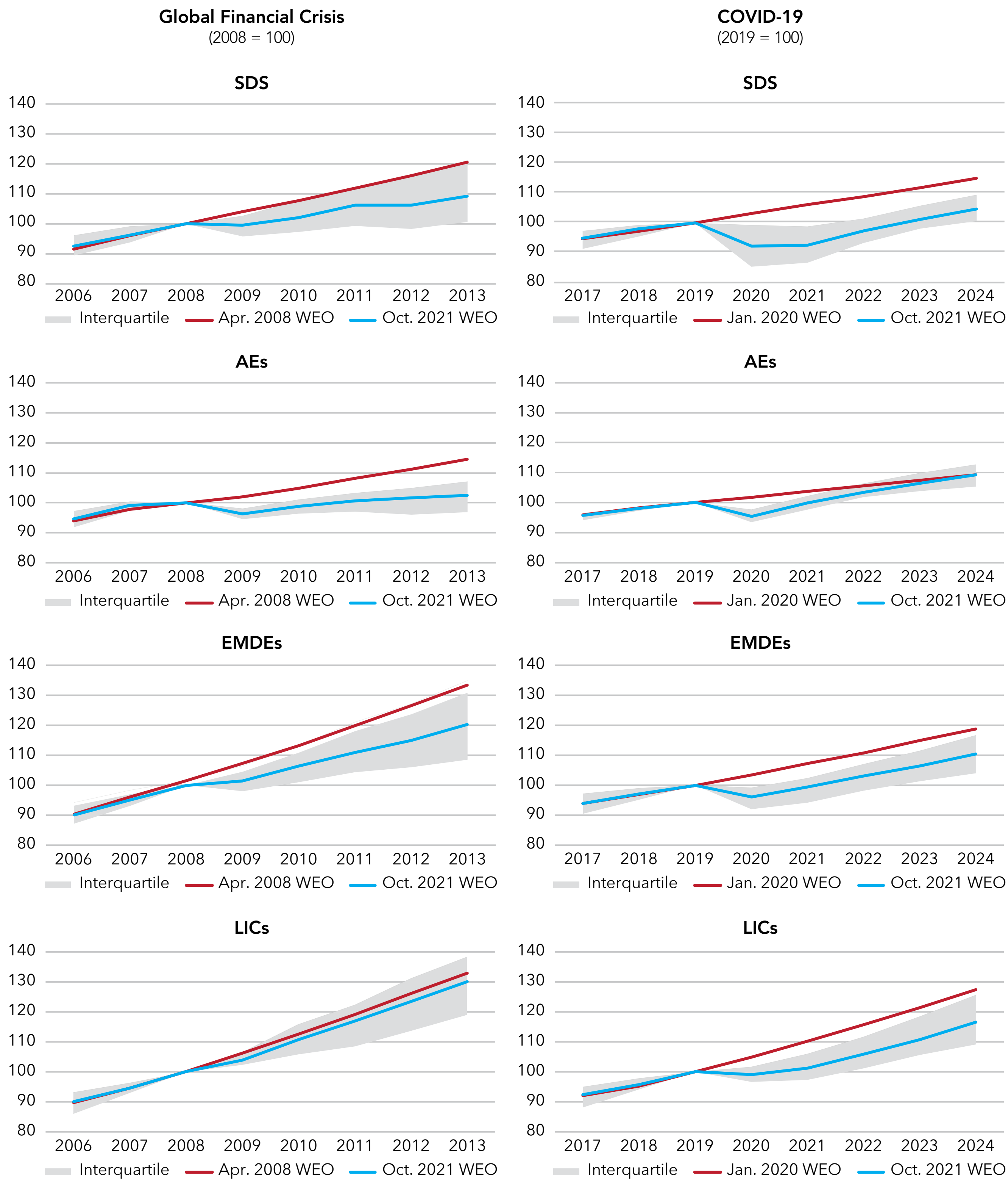
Over the evaluation period 2010–2020, growth experience varied widely among SDS and across SDS regions. Less than a third of SDS—mainly commodity-exporting SDS and a few tourism-dependent SDS (which comprise half of all SDS)—achieved growth rates higher than the global average (Figure 2.1). Of the 15 microstates, 10 experienced much lower growth rates than the SDS average. Among SDS regional groupings, growth rates were particularly low among Caribbean SDS. The Caribbean region has experienced stagnant growth for an extended period. During the evaluation period, GDP growth exceeded the SDS average in only 1 Caribbean SDS, while Caribbean members comprised 7 of 10 SDS with the lowest growth outturns.

SDS' growth performance has been particularly compromised by their proneness to exogenous shocks, particularly the impacts of the Global Financial Crisis (GFC) in the early part of the evaluation period and the COVID-19 pandemic at the end of the period as well as periodic natural disasters. A comparison of the experience of SDS, EMDEs, and low-income countries (LICs) found that SDS were hit much harder by both the GFC and, particularly, the pandemic than were these other groups (Figure 2.2). SDS' activity contracted more sharply, and SDS are expected to recover from the COVID-19 shock more slowly than other groups.

NATURAL DISASTERS AND CLIMATE CHANGE

SDS are among the most vulnerable countries to ND&CC. Indeed, the 2020 World Risk Index exposure to disaster risk ranks 9 SDS (4 Pacific; 3 Caribbean; 1 Africa; and 1 Middle East) among the top 15 countries most at risk in the world. Given their location, SDS are heavily impacted by natural disasters, particularly meteorological events such as tropical storms and hurricanes, especially in the Caribbean and Pacific regions. These events have increased in frequency since the 1980s. Specifically during 2010–2020, 124 natural disaster events were recorded in SDS, representing 3.3 percent of all natural disasters during this period.

FIGURE 2.2. EFFECT OF GLOBAL SHOCKS ON REAL GDP PATHS BY COUNTRY GROUPS



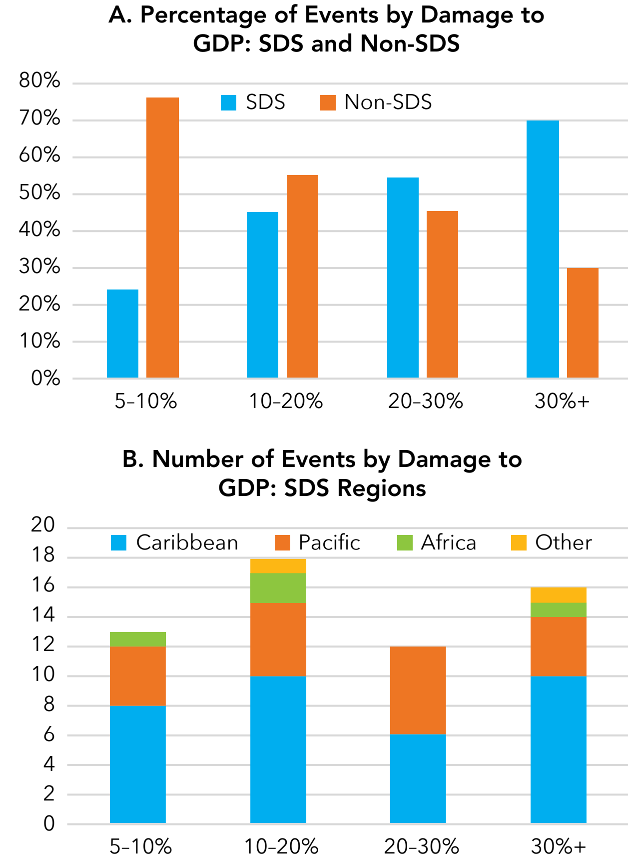
Sources: IMF WEO database; IEO calculations.

Given their small size, which precludes diversification to protect against location-specific shocks, SDS suffer much greater economic and human consequences from natural disasters, and experience them more frequently, than other economies (Lombardi and Rustomjee, 2022). Thus, such disasters have had severe macro-critical effects, including immediate economic disruption from disasters, sizeable contractions in output and exports, disaster-related expenditures for social needs and rebuilding, abrupt declines in fiscal revenues, and increased imports. At the same time, increased vulnerability translates into a need for ample policy buffers to provide resilience against disaster risks, including adequate official reserves, low debt levels, strong fiscal and external positions, effective insurance mechanisms, and reliable access to external financing.

In terms of GDP impact, SDS have been much more affected than non-SDS by almost all types of natural disasters.[6] Over 1960–2020, SDS experienced a higher share of the most severe natural disasters that occurred—55 percent of natural disasters with damages of 20–30 percent of GDP and 70 percent of natural disasters with damages of 30 percent of GDP or more (Figure 2.3, Panel A). Overall, most natural disasters occurred in Caribbean and Pacific SDS, including all natural disasters with damages of 20–30 percent of GDP and 14 of 16 events with damages of 30 percent of GDP or more (Figure 2.3, Panel B). In 2017, the Executive Board established a Large Natural Disaster (LND) window under the IMF's Rapid Financing Instrument (RFI) and the Rapid Credit Facility (RCF) with a 20 percent of GDP damage threshold to qualify for emergency financing under the window. Measured by this metric, SDS have experienced 28 natural disaster events of this scale since 1960, including 5 events during the evaluation period.[7] Based on incidence of large natural disasters since 2000, on average a large natural disaster could be expected to occur about once every two years among SDS members and about once every four years for non-SDS members.

SDS economies tend to be more vulnerable not just to natural disasters but also to climate change. One-third of SDS are highly vulnerable to climate change, which exacerbates the impact and frequency of natural disasters, particularly in the low-lying island states in the Pacific, as changing weather patterns have increased and rising sea levels heightened flooding risks (IMF, 2016a; World Bank and United Nations, 2010; Nurse and others, 2014). As a result, the harmful effects of natural disasters, as well as their relative frequency, have risen compared to the previous decade. Moreover, smallness is associated with high building costs per capita, particularly in infrastructural outlays, thus reducing the ability to adapt to climate change through infrastructure upgrades and redesign (Nurse and others, 2014).

FIGURE 2.3. NATURAL DISASTER EVENTS BY DAMAGE TO GDP, 1960–2020



Sources: International Disaster Database (EM-DAT); IEO calculations.

[6] When large natural disasters have hit, they have also typically affected a larger share of the country's population than in non-SDS, due to their populations being concentrated in a smaller terrestrial area. Since 2000, 6 of the world's 10 largest disasters, ranked by population affected as a percentage of total population, have occurred in SDS, including 3 Pacific, 2 Caribbean, and 1 African SDS. In 4 of these cases, 90 percent or more of the population were affected.

[7] After the evaluation period, St. Vincent and the Grenadines made the first request ever under the LND window of the RCF after a volcanic eruption on July 1, 2021.

FISCAL POLICY ISSUES

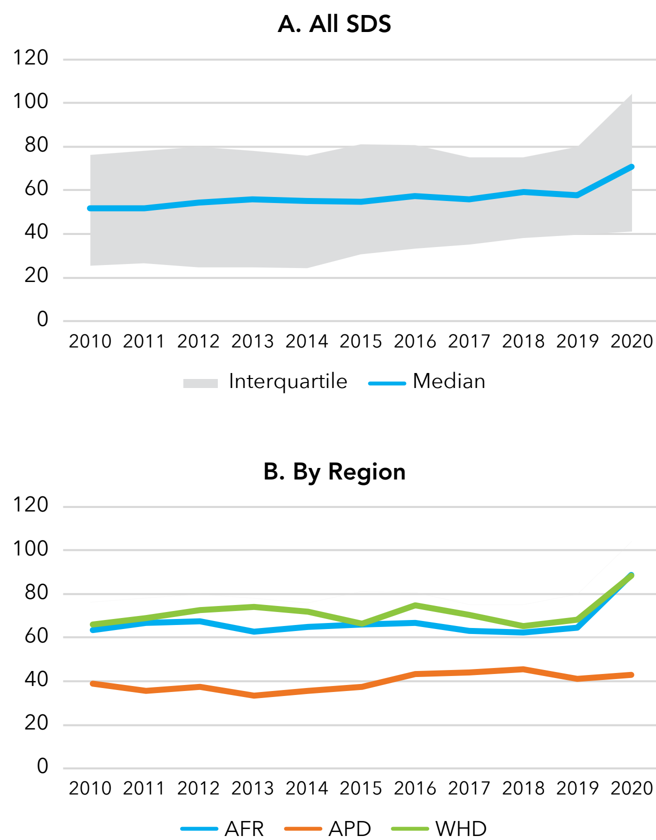
Lack of diversification and the concentration of small economically active populations specializing in a limited number of income-generating sectors have several important fiscal policy consequences for SDS (Heller, 2022). First, the economies of SDS are highly tied to the fortunes of their key sector, and thus potentially subject to significant volatility. Shifts in the commodity prices of key exports or in the global demand for tourism can have an outsized impact on real incomes and similarly outsized effects on fiscal revenue, given heavy reliance on taxes on the incomes derived from the key sector or on customs duties. Shifts in prices of major imported goods (such as oil) can quickly inflate government subsidies on consumption goods. And shifts in employment in the key sector may necessitate active government efforts to assist displaced workers. Almost all small states are also characterized by narrow tax bases and significant inequality in income and wealth, challenging efforts to raise sufficient tax revenues and often forcing reliance on external assistance (grants and concessional loans) or foreign investors. Moreover, ND&CC are likely to have a much more substantial effect on the fiscal position of an SDS than on a larger, more diversified economy and can throw the public finances of an SDS substantially off course from a previously satisfactory fiscal trajectory.

In addition, the costs of providing core public services are higher in SDS than larger states, particularly when the population is scattered over several islands or a considerable land or sea area. At the same time, the human capital of most SDS governments, including those engaged in managing the fiscal sector—formulating macro fiscal policy, collecting adequate tax and customs revenue, managing both the budget and a government's assets and liabilities, assembling fiscal statistics, appraising and managing investment projects, regulating and supervising state-owned enterprises (SOEs), and responding to fiscal and welfare shocks from natural disasters—are stretched thin. Their attention is largely focused on dealing with immediately pressing issues. Efforts to upgrade administrative capacity are hindered by emigration of many well-educated and trained employees. Systems for revenue and customs administration are often inefficient and not up to date.

SDS fiscal policy challenges have contributed to and been exacerbated by high and rising public debt ratios. The increases often reflected the costs of addressing damage due to natural disasters as well as fiscal slippages and were boosted further by the impact of the COVID-19 pandemic in 2020. Overall, average public debt to GDP ratios rose from 57 percent in 2010, at the start of the evaluation period, to 73 percent by the end of 2020 (Figure 2.4). By 2020, based on IMF Debt Sustainability Assessments (DSAs), 65 percent of SDS were assessed to be at high risk of or in debt distress, including virtually all the Caribbean SDS and several African and Pacific SDS (Annex 1).

Additional long-standing legacy issues complicating fiscal management include a lack of maintenance of vital infrastructure, the unsustainable financial position of public pension schemes, and, for some microstates (particularly in the Pacific), efforts to manage a looming "fiscal cliff" in 2024 when important grant transfers are scheduled to end.

FIGURE 2.4. PUBLIC DEBT, 2010–2020
(In percent of GDP)



Sources: IMF, WEO (October 2021); IEO calculations.

FINANCIAL SECTOR ISSUES

Financial systems in SDS are typically shallow, characterized by relatively low intermediation with large operating margins, limited competition, and limited lending opportunities (IMF, 2017a; and Marston, 2022). Relative to low- and middle-income countries, SDS in the Caribbean have higher lending spreads, Pacific SDS have larger liquidity and capital buffers, and all but Montenegro have substantially lower credit/gross domestic product (GDP) and loan/deposit ratios. Relatively low intermediation reduces the capacity of households and corporates to manage the shocks to which they are often exposed, amplifying the need for public intervention to deal with balance sheet strains, often with adverse debt implications. A resulting challenge has been fostering financial depth and inclusion while safeguarding institutional and systemic solvency.

Financial systems in SDS often operate in volatile macrofinancial environments. Limited private sector lending opportunities and the typical preferential treatment of sovereign public debt in regulatory frameworks for capital and liquidity have implied disproportionate lending to the public sector.[8] Given their inherent openness and intersection with the global environment through trade financing, remittance flows, and the prevalence of foreign intermediaries, financial systems in SDS are also predisposed to "inward" regulatory and operational spillovers.[9] Moreover, several SDS operate offshore financial centers and face particular challenges in complying with international standards, including in anti–money laundering and combating the financing of terrorism (AML/CFT) and tax transparency issues.

Small size also constrains the development of hedging instruments and markets including capital, equity, and bond markets. Risk diversification is challenging and difficult to achieve in economies with few potential borrowers, high openness, and little geographical or economic diversification. The challenges to ensuring adequate financial intermediation, including for cross-border flows, have been further amplified by changes to the regulatory environment, including to tighten requirements to guard against money laundering and terrorist financing that have threatened to sharply curtail correspondent banking relationships (CBRs).

Finally, access to financial services and efforts to strengthen financial inclusion are important priorities for SDS. Greater access provides a key channel to foster inclusive growth and serves as a shock absorber to mitigate the negative effects of real external shocks on macroeconomic volatility, while greater financial inclusion can reduce poverty and promote financial stability.

IMPACT OF THE COVID-19 PANDEMIC ON SDS

The incidence of COVID-19 in terms of cases and deaths in SDS was comparable to that in other middle-income countries (MICs)—lower than in AEs during the first year of the pandemic but accelerating during 2021 (Maret, 2022). Of the global cumulative COVID-19 cases and deaths, 0.2 percent were recorded in SDS through end-July 2021, most concentrated in a few countries. Contagion varied widely across SDS regions. Asia-Pacific SDS were much less affected than those in other regions, particularly in 2020, most likely because of their greater remoteness and early lockdown and containment measures. Higher aggregate infection rates since end-2020 reflected mainly the pandemic outbreaks in Maldives and Fiji, while other Asia-Pacific SDS continued to avoid such outbreaks. The pandemic was more widespread in Caribbean SDS but there were also large outbreaks in Cabo Verde, Eswatini, Montenegro, and Seychelles. Overall, more than 96 percent of all SDS cases were reported by 10 of the 34 SDS at end-2020.

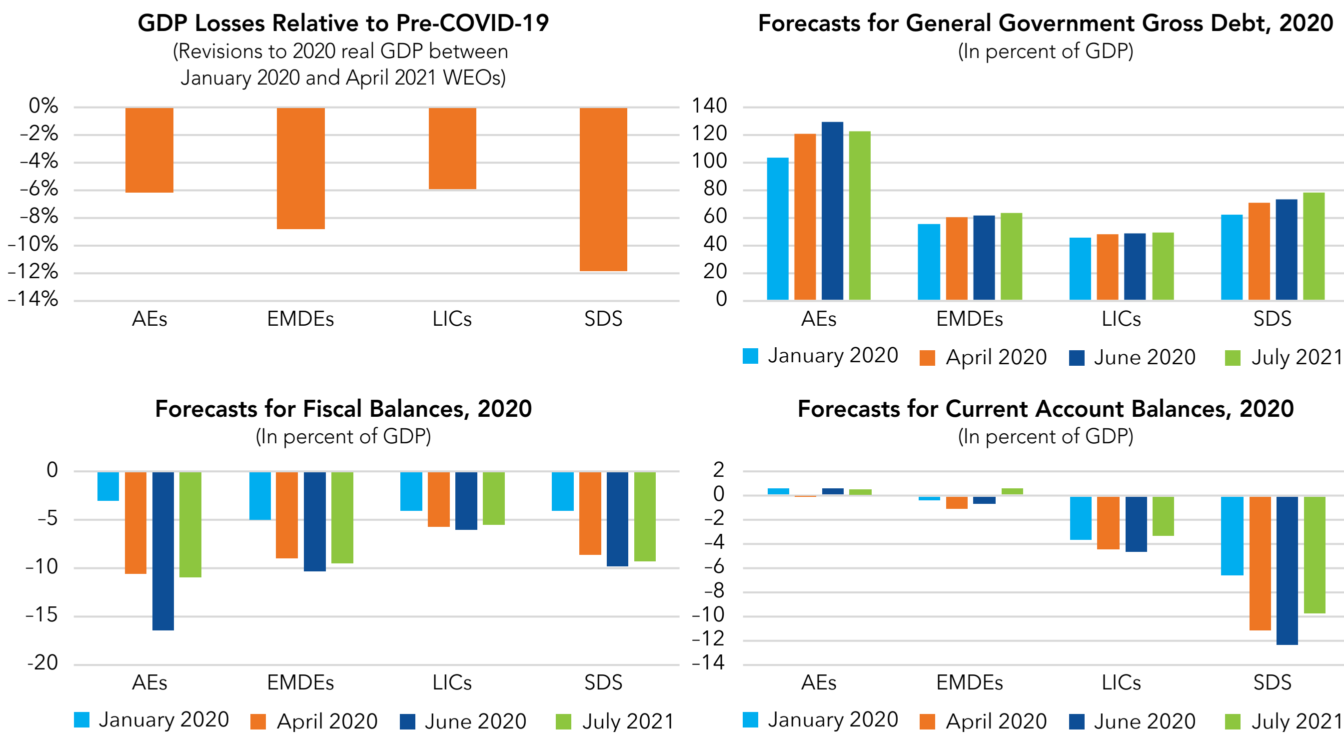
The economic impact of the pandemic on SDS was worse than on other country groups in 2020, the final year of the evaluation period, reflecting disruptions of trade, travel, tourism, capital flows, financing, and remittances. Compared to pre-shock baselines,[10] SDS were the most affected group (Figure 2.5). Their real GDP contracted by around 12 percent, significantly more than that of other

8 This exposure to the state inevitably links financial sector soundness closely to fiscal sustainability. Financial system vulnerability poses risks, in turn, for budgets (through potential bailout costs).

9 Between 25 percent (Belize) and 100 percent (Barbados and some Pacific islands) of branches or subsidiaries in the SDS are foreign.

10 Baselines are proxied by staff projections from the January 2020 *World Economic Outlook Update*.

FIGURE 2.5. COVID-19 IMPACT ON SDS



Sources: IMF, WEO database; IEO calculations.

EMDEs, their debt increased by 17 percent of GDP, their fiscal deficits went up by 5.3 percent of GDP, and their current account balance fell by 5.6 percent of GDP. The impact of the pandemic was greatest in the Caribbean SDS, with severe declines in GDP—in excess of 14 percent—in several countries, including Antigua and Barbuda, The Bahamas, St. Kitts and Nevis, and St. Lucia. Moreover, in some Pacific SDS, the effects of COVID-19 were compounded by other disasters, including in Samoa, which suffered from a severe measles outbreak in late 2019; and in Fiji, Solomon Islands, and Vanuatu, affected by Cyclone Harold in April 2020.

SDS economies began to recover in 2021, but the turnaround was less pronounced than in other regions, and prospects are for slower returns to pre-pandemic growth trends (see Figure 2.2). While recognizing the high uncertainty regarding the longer-term economic impact of COVID-19 and the extent of scarring and transformational changes, half of Caribbean SDS are expected to take at least four years to recover to pre-pandemic income levels, while half of all Asia and Pacific SDS will take three or more years to do so.[11]

[11] Vaccination rates are especially important for SDS given the relative weight of the tourism sector; on average 40 percent of the SDS population was partially or fully vaccinated by October 2021, compared with 45 percent and 70 percent in emerging markets and AEs, respectively.

3

INSTITUTIONAL FRAMEWORK FOR FUND ENGAGEMENT IN SDS

OVERALL FRAMEWORK[12]

Legal Mandate and Governance

IMF membership is available to any state that meets the eligibility criteria, irrespective of its size. As IMF members, SDS receive policy advice through regular IMF surveillance, have access to support from the Fund's full range of lending facilities and nonfinancial instruments, and benefit from the Fund's provision of capacity development. In line with the principle of uniformity of treatment, small state members should be treated similarly to other members in similar situations. There is no specific mention of SDS in the Articles of Agreement, in the conditionality guidelines,[13] or in the integrated surveillance decision (IMF, 2012b).[14]

The IMF's SDS classification is intended to define an operational group of member countries with particular needs, providing for targeted analysis to determine how the Fund can best meet those needs. The 34 members classified as SDS represent 0.13 percent of global GDP and 0.2 percent of global trade and global population. In the IMF, they currently account for 18 percent of the IMF's membership in number and close to 9 percent of IMF spending on country work, but they make up a much smaller fraction of the Fund based on quota share and voting power (Table 3.1).

TABLE 3.1. SDS FOOTPRINT, 2020
(In percent of global aggregate)

GDP	POPULATION	TRADE	IMF MEMBERSHIP	IMF QUOTA	IMF VOTING POWER	IMF SPENDING ON COUNTRY WORK
0.13	0.20	0.20	18.0	0.39	1.31	8.9

Sources: IMF; IEO calculations.

While SDS' aggregate quota share is only 0.39 percent, there are mechanisms in place to strengthen their representation within the IMF built into the Fund's governance system. The inclusion of basic votes, distributed equally among IMF members in addition to the quota-based votes, raises SDS' aggregate voting power to 1.31 percent. Moreover, the constituency-based governance framework of the IMF provides the SDS with greater scope for influencing decision-making at the Executive Board, where decisions are normally made by

[12] This section draws on Abrams (2022).

[13] https://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm.

[14] Note that for purposes of eligibility for the Poverty Reduction and Growth Trust (PRGT) and support from the Catastrophe Containment and Relief Trust (CCRT), there is a Board-approved definition of "small states," based on a population threshold (i.e., below 1.5 million).

consensus rather than by vote. SDS members are represented in 9 of the 24 constituencies, although most are concentrated in 4 constituencies. Constituencies with SDS members currently account for 28 percent of IMF quota and 30 percent of voting power. Both IMF staff and Offices of Executive Directors interviewees agreed that these constituencies actively brought attention to SDS concerns at the Board during the evaluation period. To strengthen the SDS voice further, in early 2012, a group of Directors representing SDS in the Caribbean, Pacific, and Sub-Saharan Africa established a working group on SDS. Overall, in interviews, SDS officials expressed satisfaction regarding their countries' representation at the IMF.

Certain small states qualify for the "small country exception," which enables access to IMF concessional lending by elevating the eligibility threshold for the Poverty Reduction and Growth Trust (PRGT).[15] At present, 19 SDS are eligible for concessional lending. The exception was originally approved in 2010 for countries with population below one million, as part of the criteria for eligibility for the newly established PRGT. The Board's intention with the exception was "to ensure uniformity of treatment for all members with similar vulnerabilities." Staff justified the exception noting that "[s]mall countries—including but not limited to small islands—are more vulnerable to shocks than large countries given their less diversified economies and exceptionally high degree of openness […] They also have smaller economies of scale, particularly in providing public services. To take into account the higher vulnerabilities facing small countries, the proposed entry and graduation criteria included higher income thresholds" (IMF, 2009). The population threshold was later raised to 1.5 million, and microstates defined as those with populations under 200,000, in 2012, "to extend PRGT eligibility to countries that share the key vulnerabilities of small states (limited diversification, openness, insularity, and susceptibility to natural disasters)" (IMF, 2012a).

Relatedly, while there are no low-income SDS (under the World Bank classification), Debt Sustainability Assessments (DSAs) for the 19 PRGT-eligible members are conducted using the IMF's DSA framework for LICs (LIC-DSA). All remaining SDS are assessed using the framework for market access countries (MAC-DSA). In 2021, the IMF endorsed modifications to the MAC-DSA, now known as the "Sovereign Risk and Debt Sustainability Framework for Market-Access Countries."

Beyond the "small country exception," SDS received no special treatment under the IMF lending framework, although they may benefit particularly from certain facilities where access is related to the size of a shock relative to GDP, given SDS' greater vulnerability to such shocks. This is a key consideration for these members since, as mentioned in the section in this chapter on Natural Disasters and Climate Change, three-quarters of the natural disasters that would qualify as "large natural disasters" under the LND window (i.e., damage greater than 20 percent of GDP) since the window was introduced in 2017, have occurred in SDS. In addition, the Post-Catastrophe Relief window of the Catastrophe Containment and Relief Trust (CCRT) (created in 2010 as the Post-Catastrophe Debt Relief, or PCDR, Trust) provides debt service relief to LICs in the face of extreme natural disasters, including those covered by the small country exception. To qualify, the shock must have directly affected a large portion of the population, normally at least one-third, and destroyed more than a quarter of the country's productive capacity, or caused damage judged to exceed 100 percent of GDP. In 2015, the IMF replaced the PCDR Trust with the CCRT, broadening the range of situations covered to include fast-spreading epidemics, and in 2020, the CCRT was revised further to better cover the circumstances created by pandemics.

In response to the COVID-19 pandemic, the Fund made a series of modifications to its overall framework, including to temporarily increase access to emergency financing, which facilitated a nimble response to SDS needs during the crisis (Maret, 2022).

Recently, the Fund has explored alternative options for enhancing financial support for SDS and other vulnerable members facing large financing needs to build resilience. Proposals to establish a multi-donor Trust Fund specifically for SDS did not receive sufficient support from the donor community. In the summer of 2021, the Managing

[15] Per the small country exception, countries are considered PRGT-eligible if (i) the sovereign does not have the capacity to access international financial markets on a durable and substantial basis; and (ii) per capita gross national income is less than twice the International Development Association (IDA) operational threshold for small states or less than five times the IDA operational threshold for microstates (IMF, 2013b).

Director announced that the IMF was exploring the creation of a Resilience and Sustainability Trust (RST) that would channel resources on a voluntary basis from the anticipated $650 billion SDR allocation. The purpose of the Trust would be to provide affordable long-term financing to support countries as they tackle structural challenges such as climate change, benefiting especially low-income and vulnerable MICs, including all SDS.[16] The trust would offer financing with longer maturities than traditional IMF financing and a favorable interest rate structure. To qualify for RST support, an eligible member would need a package of high-quality policy measures consistent with the RST's purpose and a concurrent financing or non-financing IMF-supported program (which could include a non-financing instrument, such as a Policy Support Instrument (PSI) or Policy Coordination Instrument (PCI), or a precautionary instrument, such as a Flexible Credit Line or Precautionary Liquidity Line) with Upper Credit Tranche (UCT)-quality policies. Design features of the RST were discussed with the Executive Board in January 2022, with the aim of securing approval of the Trust by the IMF–World Bank Spring Meetings in April 2022 and making it operational by the Annual Meetings in October 2022.

IMF Approach and Guidance to Staff on Engagement with Small States

During the evaluation period, increasing attention was paid to how to enhance IMF work on SDS, given rising recognition of the special needs of these countries, building on outside and Fund research.

In 2013, the Executive Board discussed a staff paper (IMF, 2013b) that presented proposals to strengthen the Fund's engagement with SDS. Directors concurred that the Fund's policy advice to these members and the ability to help strengthen the design and traction of economic adjustment programs should be informed by a strong analytical agenda and an active dialogue with authorities. In the paper, staff recommended tailoring the Fund's analytical tools to the needs of small states. The report highlighted a number of important priorities for IMF engagement with small states, including fostering improved growth; promoting debt sustainability; further developing financial systems; assessing the effectiveness of exchange rate policies; and helping small states manage volatility associated with natural disasters and other shocks. The paper also proposed that the Fund could sometimes play a coordinating role with other institutions, including through its resident representative offices; encouraged closer collaboration with other international institutions and development partners in meeting the needs of SDS; and stressed the importance of technical assistance and training in helping them build capacity.

Following the 2013 Board discussion, an initial Staff Guidance Note (SGN) on the Fund's Engagement with SDS was issued in 2014 (2014 SGN) (IMF, 2014). The note discussed the distinctive characteristics of small states and provided operational guidance to staff on how small country size should influence the Fund's surveillance and analytical work, IMF-supported programs, capacity development, and coordination with external development partners. The guidance note set out a new framework for IMF engagement, known by the acronym GROWTh, in which five key thematic areas were identified as likely to be especially important to the Fund's engagement with SDS (Box 3.1). The guidance note also mentioned that in applying the guidance, staff should continue to tailor their engagement to specific country circumstances. While the SGN did not provide distinctive guidance for various types of small states, it recognized the heterogeneous features among small states and referred to the SGN on fragile and conflict-affected states (FCS). The SGN also acknowledged that, in practice, many countries with populations larger than 1.5 million share small state characteristics, and that the guidance could also be relevant for such countries.

In 2016, the Board discussed a staff paper on Small States' Resilience to Natural Disasters and Climate Change and the Role of the Fund (IMF, 2016a). Directors agreed that the Fund had a role to play in helping these countries build resilience to natural disaster risks, while remaining within its mandate and in close cooperation with other international organizations. They saw merit in the Fund assessing macroeconomic policies in support of small state climate change mitigation and adaptation strategies on a pilot basis. Noting that SDS were less frequent users of

[16] The Fund has explored ways to develop an index that would better capture aspects of vulnerability that could provide the basis for access to Fund resources. However, a satisfactory formula was not found.

BOX 3.1. MAIN ELEMENTS OF THE GROWTh FRAMEWORK

The GROWTh framework, as revised in the 2017 SGN, focuses on five main policy issues for IMF surveillance and program work:

- *Growth and job creation.* Policies to strengthen growth and job creation are a priority. Staff teams should discuss growth issues for specific sectors and consult appropriately with other development partners. On job creation, the guidance note emphasizes that specific labor market institutions of SDS merit attention and that staff should investigate how public employment and public wages affect the labor markets.
- *Resilience to shocks.* Staff's macroeconomic analysis should give prominence to potential shocks, considering the appropriate balance between self-insurance, external insurance, and private sector involvement in risk reduction.
- *Overall competitiveness.* Structural inefficiencies such as high energy and transportation costs, limited private sector development, and labor market rigidities are key challenges to raising growth and improving competitiveness. Policy advice could cover structural reforms and facilitating domestic wage and price cuts, and consider the value of regional trade and cooperation for SDS.
- *Workable fiscal and debt sustainability options.* Staff will need to find the appropriate balance of fiscal consolidation while promoting growth, particularly in heavily indebted countries.
- *Thin financial sectors.* Priorities highlighted include deeper financial sectors, more competition, better service delivery, and strengthened oversight. The framework also notes that SDS have recently been challenged by unintended consequences through the disruption of correspondent banking relationships.

Source: IMF (2017a).

Fund arrangements than larger peers, Directors supported increasing the annual limit to the RCF and RFI in the case of large natural disasters, and many Directors supported the expansion of eligibility for the CCRT to members covered under the IMF small country exception. Directors also emphasized the role of Fund capacity building in helping small states build resilience to natural disasters and adapt to the challenges from climate change, underscoring the importance of leveraging regional technical assistance centers and further tailoring capacity building to the absorptive capacity and policy priorities of small states (IMF, 2016b).

In 2017, a revised SGN on the Fund's Engagement with Small Developing States (2017 SGN) was issued (IMF, 2017a), drawing on the 2016 Board paper on ND&CC as well as on a 2015 Informal Session on Macroeconomic Developments in Small States and a 2017 Board paper on enhancing the financial safety net in response to large natural disasters (IMF, 2017c). The revised version highlighted the need for integrating risks emanating from natural disasters in Fund analysis and drew attention to the different tools and practices already developed in the IMF, including the joint IMF–World Bank Climate Change Policy Assessments (CCPAs), incorporation of adverse shocks from disasters in DSAs, consideration of the transmission of shocks through macro-financial linkages, and the need for buffers to cope with this type of vulnerability. The 2017 SGN also provides a series of operational guidelines for surveillance and analytical work—including interdepartmental approaches and the provision to authorities of accessible tools—and recognizes that support for small states will need to involve other international institutions.

In September 2020, staff made an informal presentation to the Board on SDS prospects and Fund engagement beyond the pandemic, which discussed the COVID-19 pandemic's impact on SDS and discussed implications for Fund engagement. The presentation recognized that SDS had been severely hit by the pandemic and that economic recovery could be slow. It emphasized the need for IMF engagement beyond the pandemic to focus on: rebuilding buffers, enhancing resilience against ND&CC, increasing the focus on growth and competitiveness and reorienting capacity development work on emerging needs. It concluded that innovative solutions and close coordination with partners were needed to counter exceptionally large shocks, rebuild fiscal space, and build resilient infrastructure. Subsequently, staff circulated a note to the Board that explored options for enhancing Fund financial support to SDS through a dedicated Trust Fund, but, as already noted, this proposal did not gain sufficient support.

ORGANIZATIONAL BACKGROUND

During the evaluation period, overall management responsibility for IMF work on small states was assigned to a Deputy Managing Director (DMD), although responsibility for individual SDS and other small state member countries continued to be split among DMDs. A senior Strategy, Policy and Review Department (SPR) staff member led the work on the small states guidance note and during most of the evaluation period coordinated work on IMF policies on engagement with SDS working in close collaboration with area departments (ADs).

High-level agreements and initiatives between the IMF and other international organizations on SDS matters were limited during the evaluation period. The IMF maintained an Office of the IMF Special Representative to the United Nations throughout the evaluation period that was attached to SPR and was engaged in the 2014 SAMOA Pathway Conference. The IMF also participated in meetings of the World Bank Small States Forum during the evaluation period.

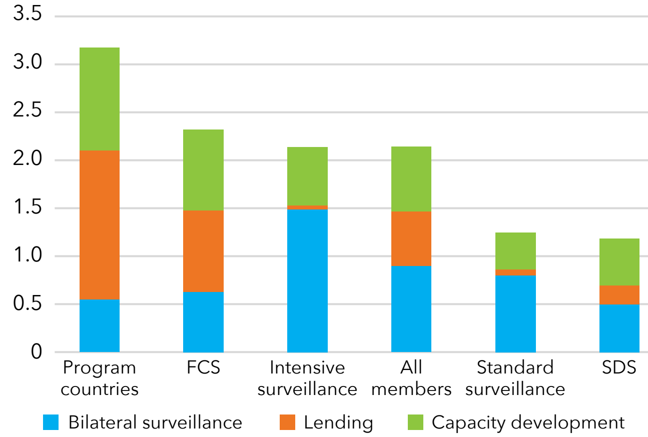
Direct engagement with small states has been handled through respective area (i.e., regional) and functional departments, each of which has taken different approaches to this work. In the Asia and Pacific Department (APD), at the beginning of the evaluation period, there was a Pacific Island Unit, a coordinating unit which functioned without dedicated resources. In 2014, this unit was transformed into the SDS Unit and dedicated resources were allocated. In 2016, the unit was elevated to the SDS Division and in 2019, it became the Pacific Islands Division, which is the largest division in APD in terms of number of staff. In the Western Hemisphere Department (WHD), at the beginning of the period SDS work was handled in two divisions, while by the end of the period it was spread across three divisions. In the African Department (AFR), SDS work was spread across a number of divisions. In many cases, AD staff also worked with regional development bank staff on SDS matters.

In 2011–2012, staff initiated an informal interdepartmental working group. The working group, which included staff from APD, WHD, and subsequently AFR and SPR, began to hold monthly meetings to share knowledge and produce and discuss analytical outputs on SDS. The working group engaged with the DMD responsible for SDS to brief on SDS developments and issues and garner support from management for SDS-related initiatives. It made ad hoc presentations to the Executive Directors' Small States Working Group, which was formed around that time, and also coordinated high-level events such as the Caribbean Breakfast at the IMF Spring and Annual Meetings. Later in the evaluation period, the working group developed a one-stop Knowledge Exchange intranet site on SDS matters, which is regularly updated. According to staff in IEO interviews, meetings of the interdepartmental working group waned in the latter part of the evaluation period, but it has become more active since the onset of the COVID-19 pandemic, seeking ways to help SDS address the economic costs of the pandemic.

The Fund devotes considerable resources to SDS work. In FY2020, total IMF spending on SDS amounted to $40.2 million, or slightly over 10 percent of the IMF's operational budget for country work. Spending per SDS averaged $1.2 million, compared to an average spending across the whole membership of $2.1 million and an average spending of $2.4 million per FCS, but only somewhat less than spending on a standard surveillance case ($1.3 million) (Figure 3.1). The share of spending on capacity development, as opposed to surveillance or lending, is significantly higher in SDS than average across the membership.

FIGURE 3.1. IMF AVERAGE SPENDING BY COUNTRY TYPE, FY2020

(In millions of USD)



Sources: IMF; IEO calculations.

4 SURVEILLANCE AND RESEARCH

OVERVIEW

Just under half of the IMF's country-level spending on SDS is for bilateral surveillance, including research (see Figure 3.1). In December 2020, 24 out of 34 SDS were on the regular annual Article IV (AIV) consultation cycle, while the rest were on a 24-month AIV cycle, including 6 of the 8 Pacific Island microstates. The average number of missions per SDS during the evaluation period varied considerably across area departments (ADs), with an average of 7.3 among SDS in the Western Hemisphere Department (WHD), 5.6 in the Asia and Pacific Department (APD), 5.8 in the African Department (AFR), and 9.0 and 6.0, respectively, in the European Department (EUR) and the Middle East and Central Asia Department (MCD), with variations largely due to differences in AIV mission cycles and to the presence of programs (which normally means that the country is put on a two-year AIV cycle).

Overall, SDS representatives appreciated bilateral surveillance and considered it to be of high quality. This finding was consistently supported by the 15 country case studies for this evaluation and the survey of SDS officials. Similarly, staff who responded to the evaluation survey took a generally positive view of Fund surveillance in SDS, with almost two-thirds of staff deeming IMF surveillance to have added value "to a great extent" (de Las Casas and Balasubramanian, 2022b).

In interviews, country officials indicated that Fund surveillance was highly valued for two reasons. First, given the lack of other sources of macroeconomic analysis, the Fund was often the only authoritative outside source of comprehensive macroeconomic analysis, advice, and forecasting in many SDS. Second, Fund surveillance helped to fill the gaps created by the limited internal capacity in most of these countries, with Fund staff additionally helping to develop the skills of young country professionals in macroeconomic analysis, financial sector diagnostics, and country risk analysis. The staff's independent analysis of developments and policies and its exchange of views on fiscal policy and financial risks were considered particularly useful. Country authorities also valued the analytical work done by staff on forecasting the trajectory of the economy and assessing debt vulnerabilities in the context of medium-term macro-frameworks, which helped to highlight emerging risks and policy gaps.

One concern raised by country officials related to the frequency of AIV consultations, particularly in the Pacific region, especially the six microstates. The 24-month AIV cycle was considered to have negatively affected the quality of Fund engagement, including surveillance, by limiting continuity of policy discussion, reducing traction of policy advice, and eroding the visibility of the Fund.

Officials were generally appreciative of the extent to which surveillance attention was well-directed to particular country concerns, reflecting application of the 2014 and 2017 SGNs. Nevertheless, perspectives on the extent to which policy advice was sufficiently tailored to the specific circumstances of SDS members varied across regions. Among African SDS, there was significant perception of lack of adequate tailoring, while among Caribbean SDS, authorities generally felt that tailoring of policy advice had been adequate but needed to adapt more fully to emerging priorities and place greater attention to improving outreach. In Pacific SDS, authorities felt that tailoring could be enhanced through more focus on the practical implementation of staff policy advice and the ways to achieve it, including with the provision of related technical assistance.

Across SDS in all regions, staff, Executive Directors and country authorities felt that efforts to tailor policy advice to country circumstances were impeded by frequent mission chief and country team turnover and poor handover procedures, which interrupted continuity of members' engagement with the Fund, limited the depth of understanding of a country's particular circumstances, and required relationships to be regularly rebuilt (see Chapter 7).

Besides tailoring, policy advice was considered by officials to be most useful when it was specific and actionable. This was the case with most of staff's fiscal policy and financial sector advice, but less so in the context of advice on growth-related structural policies. In the latter areas, authorities felt staff recommendations often tended to the generic and lacked specificity—for example, general recommendations to upgrade education and skills, or advice to pursue diversification to boost growth without specific suggestions on sectors into which diversification was feasible or how to encourage it. Achieving greater specificity of advice was hampered by the fact that most consultation teams were staffed by generalist macroeconomists with limited participation from functional departments (again, see Chapter 7).

While the evaluation found the overall quality of Fund surveillance and policy advice to be high, traction (in terms of influence on policy implementation) proved to be more limited and quite uneven. Evidence from country studies showed that traction of surveillance was greater in the more advanced SDS with larger absorption capacity, for example among some African SDS including Mauritius and Seychelles. Elsewhere, the traction of Fund advice was too often hampered by the limited capacity in SDS to absorb and advance initiatives to address underlying problems beyond the day-to-day challenges. At the same time, country authorities ascribed limitations to traction to insufficient recognition by the Fund of specific country characteristics including political economy constraints, the generic character of policy recommendations, the lack of advice on implementation, lapses in the Fund engagement because of the 24-month consultation cycle, high staff turnover, and weak outreach. Greater integration with Fund capacity development could also be helpful (see Chapter 7).

Staff felt that the quality of the data provided for surveillance was often a limiting factor on surveillance work although it did not constitute a critical deficiency in most cases. Over 80 percent of respondents to the staff survey thought that data constraints had limited the impact of their work to a great or moderate extent. Common problems reported by mission chiefs were the time taken to address data shortcomings and that reviewers were often insufficiently aware of the data inadequacies and the limits this posed on application of surveillance diagnostic tools and indicators. There were also regional variations in data quality and their impacts on surveillance. For example, in Caribbean SDS, while staff reports indicated that data were broadly adequate for surveillance, thorough analysis and targeted policy recommendations in employment and other social conditions were stymied by significant data gaps.

Internally, the 2014 and 2017 SGNs were considered useful by staff in setting out the core priorities for surveillance discussions. Some staff saw the SGN as a useful checklist of surveillance topics that matched the policy focus of country officials and provided adequate flexibility to tailor surveillance discussions to the particular circumstances of each country. However, others felt that the note could divert attention from macro-critical issues or others of increasing interest to authorities but were not explicitly covered.
In the Caribbean, officials highlighted several emerging issues of macro-relevance that deserved increased attention, including crime, social issues, central bank digital currencies, the effect of technology on the financial system, and the Blue Economy, while Pacific SDS highlighted the need to cover more sectoral issues.

AD staff also highlighted the need for more flexibility in the review process for SDS surveillance. They noted that, given time constraints, reviewers sometimes take a box-ticking approach and that staff turnover in reviewing departments could limit awareness of SDS circumstances. Reviewers could also show more flexibility to take more account of limited institutional capacity and data availability as well as the most relevant issues for analysis. AD staff also observed that there was very limited knowledge of or reference to the SGN by reviewing departments.

Experience with virtual engagement, which had greatly expanded since the COVID-19 pandemic, was mixed. Both staff and authorities generally agreed that virtual interactions hampered trust building and made communication less fruitful. Moreover, in some countries, communications were limited by the lack of high-quality internet connections, particularly when country officials themselves had to work from home. On the other hand, virtual communications did allow contacts to be maintained in the absence of travel and brought some advantages in that virtual engagement allowed for more frequent interactions and for the incorporation of more functional department specialists to discussions, although in the experience of some departments these additional participants at times lacked sufficient context to be very useful. Virtual engagement also improved, in some cases, coordination with other international financial institutions (IFIs), especially in countries where coordination had been less regular prior to the pandemic.

TOPIC-SPECIFIC ISSUES

The Fund's fiscal policy advice was regarded by officials as providing considerable value added to SDS.[17] Coverage was broad, including strengthening fiscal policy management, fiscal rules, fiscal responsibility legislation, debt sustainability, tax policy, and issues relating to SOEs and public-private partnerships. Surveillance attention to the fiscal policy implications of ND&CC, citizenship by investment programs, wages and salaries, public investment, pension policy, and public financial management also grew over the evaluation period. Fiscal surveillance and policy advice was supported by extensive research, policy guidance provided by the 2014 and 2017 SGNs, and country-specific analysis. Moreover, coverage was viewed as well-tailored to the country-specific challenges. Officials generally appreciated the Debt Sustainability Assessments (DSAs) of SDS, particularly after reforms to the DSA methodology were introduced to reflect greater sensitivity to climate-related risks, though there are still limitations in how the DSA methodology was implemented in the SDS context (see the subsection in this chapter on Debt Sustainability Assessments).

Notwithstanding considerable attention and the use of sophisticated analytical tools, the traction of Fund fiscal policy advice was uneven. In the tax policy sphere, for example, the introduction of a value-added tax (VAT) or reforms to an existing VAT occurred in eight SDS; and overall revenue performance improved for two-thirds of SDS. However, efforts to reduce wasteful and unproductive expenditure proved more difficult, although reductions in the public sector's wage share in GDP occurred in eight SDS. Beyond the issues already flagged of lack of capacity and the need for greater granularity of advice, implementation was also hampered at times by political resistance, underlining the need for taking full account of political economy constraints. Moreover, progress in achieving fiscal consolidation was often set back by the impact of natural disasters as well as challenges in handling the fiscal legacy issues mentioned above, particularly in some Pacific SDS.

Financial sector issues received substantial coverage in AIV consultations during the evaluation period.[18] There was, for example, ample attention to anti–money laundering and combating the financing of terrorism (AML/CFT) and correspondent banking relationship (CBR) issues—two emerging issues of major importance to SDS. Regarding AML/CFT, 98 percent of staff reports devoted at least one unique paragraph to either advocate for strengthening of frameworks or to report on progress being made. Similar attention was paid, especially in the second half of the review period, to CBR issues. In addition to 73 percent of staff reports referencing the issue, the Fund undertook a range of analytical work resulting in a note to staff in 2017 to help country teams discuss these issues in consultations and to guide data gathering to assess the impact on members. Advocacy initiatives included the Fund's active membership in the Financial Action Task Force, the Basel Committee on Banking Supervision groups and the Financial Stability Board.

[17] For a detailed analysis of the Fund's work on fiscal issues, see Heller (2022).

[18] For a detailed analysis of the work on financial sector issues, see Marston (2022).

There were, however, noticeable gaps in financial sector coverage. First, SDS were disproportionately underserved by the Financial Sector Assessment Program (FSAP), with only 8 SDS FSAPs among 122 FSAPs in the evaluation period, and only 2 other SDS FSAPs since the launch of the FSAP, despite evidence of traction and responsiveness to findings in SDS, often within a year of FSAP conclusion (see the subsection in this chapter on Debt Sustainability Assessments). In addition, there were two Financial Sector Stability Reviews (FSSR), which is a more limited diagnostic capacity development tool. Given challenges of financial deepening in SDS, the FSSR, with its focus on stability rather than developmental issues, has not proven to be a full substitute, although World Bank teams at times complemented the FSSR work by using the FSAP developmental modules. Second, in AIV consultations, issues associated with financial stability, macro-financial linkages and resilience were largely well treated, although much less attention was paid to development issues of particular importance and macrocritical in SDS, like inclusion and credit access.

Attention to ND&CC in surveillance work strengthened considerably during the evaluation period, especially with the introduction of two special diagnostic tools, the CCPA and the Disaster Resilience Strategy (DRS) (see the subsection in this chapter on Debt Sustainability Assessments).[19] While attention in the early years of the evaluation period to ND&CC issues was sporadic, the introduction of CCPAs in 2017 provided a galvanizing framework to improve coverage of climate issues in AIV reports and build analysis of ND&CC effects in the frameworks used for assessing macroeconomic policies. Internally, they helped build a critical mass of knowledge, organizing efforts and innovating on the delivery of surveillance. Externally, they served to strengthen engagement with partners and country authorities on macro critical issues. In the two DRS pilots, the broader DRS framework proved a useful, three-part policy framework for building resilience and costing resource needs, although the financial follow-through was not operationalized. Moreover, DSAs for SDS systematically included stress testing to account for the impact of natural disasters; and growth projections and fiscal policy advice were calibrated to reflect ND&CC concerns.

The approach to ND&CC in AIV consultations also evolved Fund-wide over the evaluation period. Periodic Fund-wide reviews of IMF surveillance early in the evaluation period emphasized the importance of tailoring advice to country circumstances, but did not pay much attention to the particular challenges of SDS arising from ND&CC. Following the 2014 SGN, the Fund's 2015 Guidance Note on Surveillance (IMF, 2015a) specified that surveillance in SDS should be tailored to their particular circumstances, including their vulnerability to natural disasters and initiatives to strengthen resilience, but provided limited specific guidance relevant to ND&CC. Staff were encouraged to utilize Risk Assessment Matrices as a structured framework for analyzing risk but natural disasters were not referred to as a risk despite their (increasing) frequency for this part of the membership. More recently, there has been a more thorough attempt to integrate climate change considerations into the surveillance framework. The 2021 Comprehensive Surveillance Review (IMF, 2021a and 2021b) recognized climate change as a "potentially existential threat with significant macroeconomic and financial implications" (IMF, 2021a, p. 20) for which meaningful policy actions were required.

On growth-related issues, country authorities generally welcomed advice in AIV consultations on the challenges faced by SDS in strengthening growth performance.[20] At the same time, they drew attention to the need for more granular advice on this area, including more detailed policy advice on approaches to diversification and developing new sectors of their economies, and further knowledge-sharing of experiences of other SDS facing similar growth-related challenges. Pacific SDS in particular considered the discussion of growth-related issues as being quite limited. This would seem to be an area where the Fund's traditional core expertise is likely to be stretched, suggesting a need for closer collaboration with development partners.

19 For a detailed analysis of the work on ND&CC, see Lombardi and Rustomjee (2022).

20 See Rustomjee, Balasubramanian, and Li (2022).

SURVEILLANCE TOOLKIT

The usefulness of various surveillance tools in the SDS context—including DSAs, FSAPs, FSSRs, CCPAs, DRSs, and External Balance Assessment (EBA)—varied across countries with different levels of development.

Debt Sustainability Assessments

DSAs were broadly perceived as useful, although too complex for some SDS (Heller, 2022). Two-thirds of SDS were subject to the LIC-DSA framework carried out jointly by the IMF and the World Bank, with the remainder subject to the DSA for market access countries (MAC DSA). Two-thirds of the latter group received the more detailed analysis for high-scrutiny market-access countries. In recent DSAs, coverage of debt vulnerabilities and their impacts on fiscal policy was extensive.

Reforms to the DSA methodology—both the LIC-DSA and the MAC DSA—over the evaluation period helped improve the quality of assessments of risks to fiscal policy brought about by debt accumulation. The ability to apply tailored shocks as a supplement to standard shocks broadened and enriched analysis of the potential impacts of shocks in SDS. Progressive improvements in the DSA methodology introduced more sophisticated ways to gauge the realism of debt projections for policies and the economic environment. Changes to the methodology also enabled projections to be stress-tested for the impact of potential unexpected shocks relevant to SDS, including natural disasters, SOE defaults, and the unexpected emergence of contingent liabilities. The use of tailored shocks also provided an opportunity to broaden coverage of the risks to debt sustainability by incorporating the impacts of climate change into DSAs, with staff able to incorporate some form of tailored shock to reflect the adverse impact on real growth from the impacts of climate change (e.g., drought, changed precipitation patterns) that occur more broadly over the medium term.

Notwithstanding these gains, scrutiny of recent DSAs in SDS also suggests some gaps in the making of these assessments and opportunities to further improve their utility. At present, the baseline scenario in most fiscal projections for SDS does not include the outlays for infrastructure maintenance or climate resilient investments warranted in the context of exposure to ND&CC shocks. This would be appropriate and could be facilitated by wider application of CCPAs. In addition, while the current DSA methodology allows for the possibility of combined shocks, it is increasingly important to introduce this approach more systematically in SDS DSAs, particularly in assessing risks in the context of multiple shocks and in the treatment of climate-related shocks, building on the heat-map approach currently used in the MAC DSA framework and adapting this for SDS, for example by including a standardized text box in DSAs on the fiscal consequences in the event that several severe risks were to materialize simultaneously.

The experience of many microstates suggests that providing the debt data required for the DSA exercise may be challenging, given their limited administrative capacity. This particularly applies to the borrowing of SOEs or loans from private or bilateral creditors for the financing of government investments. Simplification of the DSA framework for these microstates could help to alleviate pressure on authorities to supply necessary data, while retaining the core benefits derived from the periodic DSA exercise, including formal monitoring of the most important risks and threats to the projected fiscal path precipitated by unanticipated debt accumulation. A linkage of the DSA work in the context of surveillance with the application of other fiscal risk assessment management tools (of both the IMF and World Bank) may be particularly valuable in mitigating climate-related debt vulnerabilities.

Climate Change Policy Assessments

CCPAs were introduced in 2017 on a pilot basis as a collaborative IMF–World Bank effort. They assessed macroeconomic and sectoral aspects of climate change policies in countries particularly affected by climate change and took stock of a country's plans from the perspective of its macroeconomic and fiscal implications by providing a holistic assessment of the relevant policy framework. In so doing, they aimed to improve country prospects for attracting external finance and offer valuable policy input into their climate strategies.

Six pilot CCPAs were completed, all for SDS. A Fund review of experience with CCPAs in 2021 found that CCPAs had been most helpful in identifying financial, policy, and institutional capacity gaps; detecting linkages between climate change and the macro framework; and identifying the impact of climate change risks and to some extent facilitating national planning. CCPAs had also fostered collaboration within the national administration on climate change issues and had promoted engagement with international stakeholders.

For country teams, CCPAs enabled the building of a critical mass of knowledge on the impact of ND&CC effects, providing a base to leverage for policy analysis. CCPAs also offered a structured framework for engaging the World Bank and other partners, resulting in effective collaboration, in line with earlier IEO findings (IEO, 2020). However, in the absence of a CCPA, the Fund often just referred to World Bank work on ND&CC issues, without seriously integrating results in the macroeconomic framework.

The Fund is now in the process of enhancing its overall approach to climate policy work. In 2021, the World Bank decided to discontinue its participation in CCPAs and to prepare its own report (Country Climate and Development Report). Building on the CCPA experience, the IMF is currently developing a new diagnostic tool called the Climate Macroeconomic Assessment Program (CMAP) to analyze climate change policies and preparedness for climate-vulnerable countries. The Fund aims to scale up to 10 reports per year as inputs for AIV consultations. In July 2021, the Board discussed a staff paper on the IMF's climate strategy that explored the resource needs to scale up the Fund's climate work (IMF, 2021c). Directors supported a more comprehensive coverage of climate change–related policy challenges in AIV consultations, where macro-critical, as well as staff's proposal to regularly cover adaptation and resilience building policies for those countries most vulnerable to climate change. Directors also agreed that FSAPs should have a climate component where climate change may pose financial stability risks and stressed the importance of partnering with other institutions. In December 2021, the Board agreed to provide substantial additional resources to support the Fund's climate work in the context of a broader one-time augmentation of the IMF's budget to help the Fund deal with growing challenges.

Disaster Resilience Strategies

Building on the Fund's increasing attention to ND&CC issues, in 2019 a Board paper (IMF, 2019) developed an organizing framework for supporting resilience building in disaster-vulnerable countries. Emphasizing benefits of taking early actions to enhance resilience and against the backdrop of substantial underinvestment, the Fund recommended that vulnerable countries build disaster resilience through a three-pillar strategy aimed at structural, financial, and post-disaster resilience. The ensuing DRS could provide an organizing framework to assess and advise on financing needs associated with managing vulnerabilities related to natural disasters and help develop a country-owned resilience-focused document drawing on national processes, strategies, plans, as well as a CCPA (if available) and comments from key partners; and help integrate macro and micro reforms for building resilience and prioritizing policies and actions.

DRSs were completed for two members, both Caribbean SDS, and discussed by the Board in 2021. These reports were helpful in terms of developing an estimate of the cost of a climate-resilience strategy by providing a holistic and internally consistent framework for appraising the various interrelated components. The DRS exercises for these countries also triggered underlying administrative processes within their respective governments. They built upon—and brought consistency among—a wide array of domestic sectoral strategies, plans, and projects already launched by setting a common, unifying standard under which to appraise, amend, and then implement them. They also drew from—and successfully built upon—initiatives sponsored by multilateral institutions and development partners.

However, while the DRS reports benefited from a compelling analysis of the macroeconomics of resilience, drawing from Fund surveillance and underlying research, what was left unclear was how the partners—including the IMF, which had proactively supported the drafting of such documents—would follow up on the intended aims of the DRS in terms of providing financial support for the large investments required. In this regard, the new RST now being developed to channel part of the 2021 SDR allocation to support the needs of countries to build disaster resilience could provide an important step forward.

Financial Stability Assessment Program[21]

FSAPs as well as the new FSSR diagnostic tool were seen as very valuable when they occurred by providing granular well-tailored advice, but their use was quite limited in SDS. During the evaluation period, a total of eight FSAPs, five of which were updates of previous FSAPs, were completed for six SDS. All but one of these FSAPs were for countries classified as offshore financial centers.[22] FSSRs were conducted in two SDS. Thus, 25 out of 34 SDS have never had an FSAP or FSSR although the 6 East Caribbean Currency Union (ECCU) members benefited from the 2004 ECCU FSAP.

There could be scope to look for economies of scale to leverage the value of the FSAP tool to SDS by exploring regional or thematic approaches that could group several countries with similar issues together.[23] Greater use of the less resource-intensive FSSR could help deepen analysis of financial sector challenges in SDS but to be most relevant to SDS concerns would need to extend to macro-critical development as well as stability issues.

External Balance Assessment

Unlike these other tools, the introduction of the EBA-lite tool in 2015 proved to be of little use to surveillance in SDS.[24] Country authorities and staff commented that the tool was poorly understood and too complex for the needs of most SDS and provided little helpful guidance for policy assessment and advice. It added scarce value to country authorities due to data gaps and presented difficulties in interpretation in the case of dollarized/euroized economies. They suggested that a less mechanical and more eclectic approach to assessing external balances in SDS would be useful.

REGIONAL SURVEILLANCE

Regional surveillance provided the opportunity for cost effective analysis across SDS experiencing similar problems, helping to share lessons and encourage common approaches and solutions. All relevant ADs made efforts to conduct regional surveillance for SDS work but used different approaches.

Most formal were the annual consultations with ECCU conducted by WHD, which covered monetary and financial sector policy issues for the six member countries. This annual exercise was seen as helpful by staff and authorities in focusing on the common challenges in the currency union and the policies needed to address them. Recent ECCU consultations have presented research and tailored advice on climate change and on digital currencies. Teams have also consulted with regional public sector entities, while the Fund has also held regional seminars and events during the Annual and Spring meetings on regional-specific issues such as CBDC and CBR.

More generally, ADs conducted regional analysis on SDS issues on a more ad hoc basis, particularly in the departments' Regional Economic Outlook (REO), although each department took a somewhat different approach to such work. WHD included a regular sub-chapter in biannual REOs on recent macroeconomic developments in Caribbean SDS, providing a concise regular snapshot of key macroeconomic and growth-related policy challenges. APD also included content in biannual REOs, albeit much more sparsely, while substantially augmenting coverage of Pacific SDS' growth policy and related macroeconomic and structural policy developments through a generally biannual Small States Monitor. AFR featured periodic, detailed content on growth-related challenges in SDS, albeit without differentiating these members based on population size.

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21 FSAPs and FSSRs are classified as part of the IMF's technical assistance and not surveillance tools per se, except for the subset of members with systemically important financial sectors subject to mandatory financial stability assessments. Nevertheless, they are closely coordinated with, and inform, bilateral surveillance.

22 FSAPs were conducted for The Bahamas, Barbados, Mauritius, Montenegro, Samoa, and Trinidad and Tobago; all of these except Montenegro are classified as offshore financial centers (according to the list in IMF, 2015b).

23 For further details, see Marston (2022).

24 EBA-lite is a simplified version of the full External Balance Assessment (EBA) applied to 30 advanced and emerging market economies and is intended to be more appropriate for the circumstances of small and simpler economies.

Country officials felt that such regional analysis allowed member countries to share knowledge and learn about policy experiences in other countries, although they also emphasized that the unique characteristics of individual countries needed to be kept in mind when providing country-level advice. Staff felt that their research on regional issues had helped inform domestic policy considerations and bilateral policy advice, for example, contributing to Dominica's DRS. However, some staff felt that the balance of resource allocation between regional and bilateral surveillance had swung too far toward the regional and noted that research at the regional level had failed to develop much traction at the country level because it often did not have a clear connection to the immediate policy concerns of individual countries.

RESEARCH

The Fund's policies and guidance on SDS developed during the evaluation period and its bilateral surveillance policy advice was underpinned by a substantial body of internal research. Following a growing external (i.e., non-IMF) literature[25] on small states during the late 1990s and early 2000s, the Fund's analytical work on the specific challenges of SDS gained momentum in the 2010s, focusing on the macroeconomic challenges of these countries. Initially appearing mainly as IMF working papers, this work evolved over time to include several books and compilations of regionally oriented studies focusing particularly on Caribbean and Pacific SDS.

Much of the IMF's SDS research was focused on specific thematic areas of interest to SDS. Fund staff began exploring vulnerabilities to ND&CC effects in the 2000s and stepped up this work during the evaluation period. This research confirmed the finding that SDS are disproportionally affected by ND&CC effects and focused on those aspects most relevant to the Fund's mandate: the macroeconomics of disasters and recovery (including the incorporation of natural disasters' costs to macro projections and debt sustainability analyses), their impact on growth, and the need for resilience-building and disaster preparedness.[26]

Beyond the predominant fiscal element of the Board policy documents discussed in Chapter 3, staff developed during the evaluation period a significant body of research discussing the specific fiscal challenges of SDS, ranging from their sensitivity to natural disasters, the policy challenges of managing natural resource assets, and the fiscal management issues associated with small population bases. Together, these papers have provided a substantive foundation for the Fund's engagement on fiscal policy issues in SDS since 2013.[27]

IMF research to understand and address the unique challenges experienced by the financial systems of small states and the implications for broader economic resilience steadily intensified during the last decade. In the initial years of the evaluation period, this research centered on core macroeconomic and macro-financial challenges in shallow financial markets. The focus shifted in the middle of the evaluation period to conjunctural challenges facing SDS, particularly the assessment of climate shocks and the impact and management of regulatory spillovers in the form of the withdrawal of correspondent banking relationships. Research during the final years of the evaluation period was more solution-driven, dealing with issues like financial inclusion, the prospects for financial technology, and regional approaches to common issues in SDS.

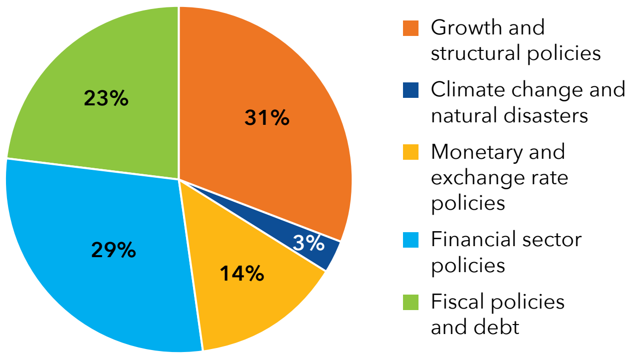
Much research on SDS is done by individual surveillance country teams and distributed in Selected Issues Papers (SIPs) issued as background to AIV consultation staff reports. The major policy issues covered in SDS SIPs were fiscal policy, financial sector, and growth-related policies, together with monetary and exchange rate policies and ND&CC (Figure 4.1). Over the evaluation period, 54 SIPs were prepared for SDS members, including 28 for Caribbean SDS, 13 for African SDS, 9 for Asia and Pacific SDS, and 5 for MCD and EUR SDS. Each of these SIPs typically included several separate notes, covering areas of special interest for SDS such as tourism, dollarization, export diversification, and debt—catalyzed by early efforts by the interdepartmental SDS working group.

25 For a review of the external literature on growth issues in SDS, see Briguglio (2022).

26 For further coverage of IMF research on ND&CC, see Lombardi and Rustomjee (2022).

27 For a detailed analysis of IMF research on fiscal issues, see Heller (2022).

FIGURE 4.1. POLICY ISSUES IN SDS SIPs, 2010–2019



Sources: IMF; IEO calculations.

Many of these pieces were of high quality and contributed to the depth and concreteness of analysis supporting the staff's policy recommendations, and as such were well appreciated by country officials. In some cases, traction was best served when the subject matter of SIPs remained on a broadly similar theme, especially when prepared for annual consultation cycles, with continuity of policy subject matter across a suite of SIPS serving effectively as building blocks in encouraging policy action (Marston, 2022). Despite an active research program in APD on cross-regional issues, the absence of SIPs for individual Pacific SDS has limited in-depth consideration of surveillance issues specific to the member country. These issues are linked in part to staffing constraints on SDS.

A number of reports with a regional focus were produced during the evaluation period. Acevedo and others (IMF, 2013a) argued that Caribbean small states, while sharing many features of other small states, have specific characteristics—both structural and policy-driven—that negatively affect their growth and fiscal balances. A more recent publication on Caribbean SDS (Alleyne and others, 2018) discussed policy options for promoting a sustained and inclusive economic growth, arguing that these economies need to improve their fiscal positions, thin financial markets, and monopolistic structures. Publications on Pacific SDS include Yang and others (2013), Tumbarello and others (2013), and Cabezon and others (2016). The latter discussed intrinsic factors affecting economic growth in these countries, including small populations and markets, remoteness, vulnerability to ND&CC, and narrow production bases.

COLLABORATION WITH PARTNERS

The extent and quality of cooperation with development partners working on SDS was mixed, varying widely across countries, regions, and institutions involved, and reflecting the personalities of the individuals in charge. In general, cooperation was better on the ground than in HQ, with IMF field staff making a big positive difference, and more intensive when countries were under a Fund-supported program. In many SDS, engagement with local institutions and donors—e.g., CDB, CCB, and Canada in the Caribbean, and Australia and New Zealand in the Pacific—was very active, not least through their engagement with Regional Capacity Development Centers (RCDCs). However, high staff turnover, both at the Fund and in other institutions, made collaboration more difficult.

Cooperation with the World Bank generally worked well in terms of consulting on work programs and top-line issues. The staff survey conducted for the evaluation revealed that the World Bank was the most frequent partner in SDS and 85 percent of respondents considered this collaboration effective.[28] However, interaction with the Bank was seldom very deep in terms of collaboration on research, analysis, or policy advice, consistent with findings of recent IEO evaluations (IEO, 2020; 2021). This lack of in-depth collaboration may have contributed to SDS frustration that the Fund does not provide much value added on important real economy issues, such as employment, diversification, or resilience building, in which tapping the expertise of the Bank and other partners could have helped to deepen the Fund's contribution. A potentially major setback to collaboration was the decision in 2021 for the IMF and the World Bank to have separate rather than joint climate change assessments. The new RST could provide a vehicle for closer collaboration on these issues, albeit in countries with interest in using the new facility.

The Fund participates in the Small States Forum, which holds regular meetings among its 50 members organized by the World Bank. However, there is ample room to deepen

[28] For further details, see de Las Casas and Balasubramanian (2022b).

the Fund's participation, to use it more effectively as a platform to present the institution's work on SDS and to explain the tools and resources available for this section of the membership. The Fund could also participate on a more regular basis in regional forums in the Caribbean and Pacific bringing together senior policymakers to discuss salient policy concerns.

OVERALL ASSESSMENT

Bilateral surveillance was widely appreciated by country authorities and considered to be of high quality. In the absence of alternative sources of macroeconomic analysis—especially for the most capacity-constrained SDS—Fund surveillance was often of paramount importance. Going forward, SDS' reliance on Fund analytical work and policy advice places a strong onus on the Fund to maintain these high standards.

Coverage of surveillance topics was generally seen as being in line with the staff guidance notes, helping to ensure relevant advice on the key fiscal policy, financial sector, and growth-related challenges facing SDS. Fiscal policy advice in particular coalesced closely around the particular fiscal policy challenges faced by SDS that were tourism-dependent, natural resource–dependent, benefiting from financial asset legacies, or structurally challenged. Nevertheless, some gaps can be identified, particularly in financial sector coverage, with relatively little attention paid to financial sector development issues such as access to credit and financial inclusion as well as to real sector topics related to economic diversification and growth. Greater attention could also have been given to some emerging issues with macroeconomic impact that have become important priorities for country authorities, including crime, employment, social issues, digital currencies, technology, and microeconomic issues. From this perspective, while the SGNs had value in guiding prioritization and serving as a useful checklist, future SGNs could provide more flexibility to adapt to newly emerging surveillance priorities.

Despite well appreciated and generally well-focused advice, the traction of SDS surveillance seems to have been uneven. Traction has typically been greatest in higher-income SDS with more developed institutional capacity, but less in others with more limited absorptive capacity. It has to be recognized that traction is affected by factors outside the IMF's control, including political economy circumstances. Nevertheless, a number of factors internal to the Fund also have affected traction.

More continuity of staff engagement could have helped increase the impact of surveillance work. While the frequency of missions was seen as satisfactory by most Caribbean and African SDS, Pacific micro-states considered the 24-month AIV cycle to have negatively affected the quality of Fund engagement. There is also evidence of reduced satisfaction with Fund surveillance engagement during the pandemic, which seems to have disrupted contacts despite use of virtual communications.
An amplifying concern discussed in Chapter 7 related to the high turnover and low tenure of mission chiefs and team members and a shortfall in handover procedures, which made it harder to build understanding of country conditions and develop strong relationships with local officials.

A related concern that may have impeded traction relates to the sometimes too generic character of Fund advice. Officials would generally appreciate more granularity and greater attention to how to meet country-specific implementation challenges. Two factors that may have contributed to a tendency for a lack of granularity are the high turnover of teams working on SDS, which limited detailed understanding of country circumstances, and the general limited involvement of the specialists from functional departments as either team members or part of the review process.

Effective use was generally made of the evolving array of surveillance tools to support surveillance in SDS, as Fund-wide reforms to aspects of the toolkit helped to allow more relevant application in the SDS context. Adjustments to the DSA methodology substantially broadened the coverage—and strengthened the quality of assessments—of risks to debt sustainability, a significant advance to many SDS that are at high risk of debt distress or have unsustainable debt levels, although there remain some gaps in application. Similarly, the introduction of the CCPA and DRS brought multiple gains to surveillance of ND&CC challenges in SDS, providing a framework to assess the broader macroeconomic implications and to bring in development partners such as the World Bank.

In other areas, the toolkit has been less valuable to SDS; they were generally underserved by the FSAP program and the EBA-lite proved too complex and of limited value. Recognizing the high cost of FSAPs and the need to focus scarce resources to the assessment of systemic financial systems, consideration could be given to alternative approaches for SDS, such as (i) more frequent use of a regional or thematic approach that focused on cross-cutting issues of SDS concern, in search of economies of scale; and (ii) adapting the FSSR tool to give greater emphasis to developmental and resilience aspects.

Data gaps were a limiting factor in surveillance work on many SDS, particularly for data-intensive diagnostic tools, including DSAs. The problem was made worse by the work-intensive and protracted data gathering process often required in SDS, combined with the relatively scarce resources available to country teams. To alleviate these pressures, ADs could make greater use of research assistants, providing mission chiefs and desk economists with more time to focus on tailoring advice.

Regional surveillance was widely appreciated by SDS members and was tailored to the particular regional challenges of Caribbean, Asia-Pacific, and African SDS. Differing modalities among ADs served an important purpose in tailoring but may have limited the opportunity to distill collective lessons of experience across SDS members. Going forward, there is scope for ADs to better share experiences and current practices in developing regional and common issues across regions in surveillance for SDS.

The quality of IMF bilateral and regional surveillance during the evaluation period benefited from the stepping up of research on SDS issues over the evaluation period, and for using this research to support its SDS policy analysis and guidance. However, the benefits of research for SDS work could be further enhanced, through closer links between country research and policy analysis, including through more strategic choice of SIP topics that are less generic and that allow for more granularity and better align with country-specific characteristics and challenges; by developing stronger and more concerted links between regional and country research, building on the strong body of region-specific research on SDS issues already developed by ADs and applying lessons and insights to individual country circumstances. There is also a need for more global research on challenges common to most or all SDS that more effectively draws together and shares policy lessons, data, and good practices, for SDS in all regions. Such challenges include macro-critical impacts of climate change; vulnerability to shocks, including trade- and natural disaster–related shocks; and the need for deeper and more sound financial systems. Finally, the quality of bilateral and regional surveillance for SDS could be enhanced through strengthened collation and consolidation of macroeconomic, financial sector, debt, climate, and other data, to facilitate analytical and research work on SDS and to promote cross-regional knowledge sharing.

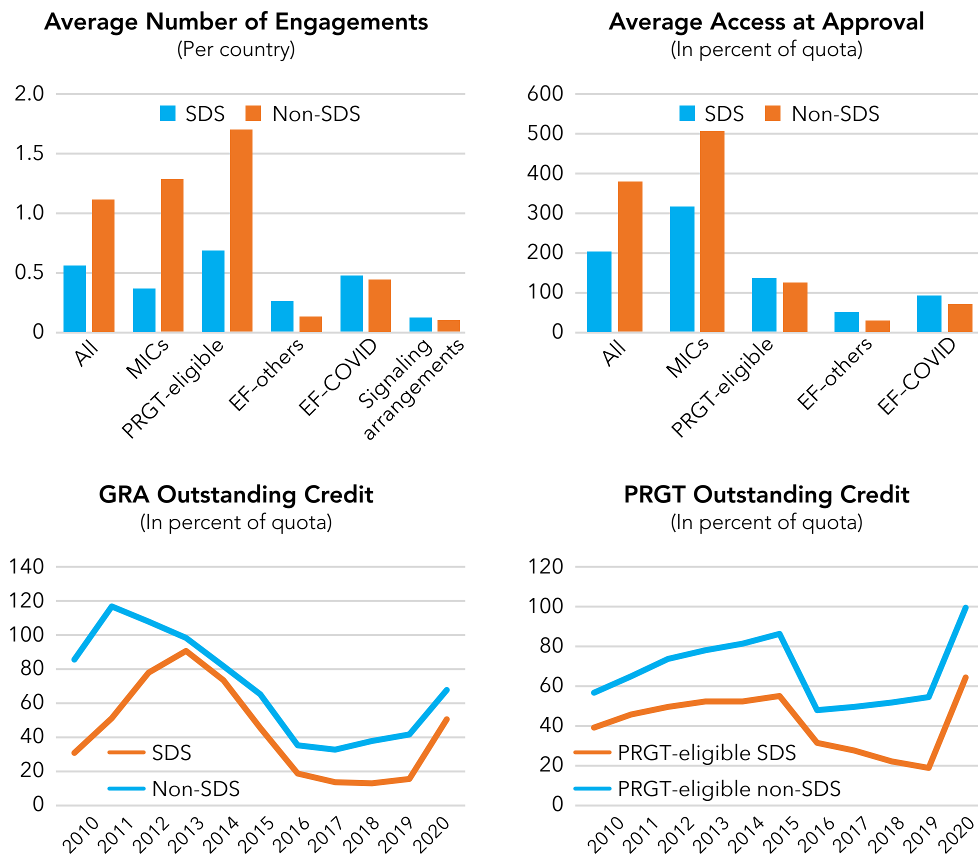
While collaboration with the World Bank and other international organizations and donors has worked reasonably well in most cases, there is scope for deeper engagement. Fund staff do not currently have the skill set to add much on some macro-critical issues, particularly in the real sector of the economy, which makes collaboration with other agencies paramount as a way of enriching the Fund's contribution. Moreover, recent institutional decisions on climate change could imply a step backwards. As observed in the recent evaluation of Bank-Fund collaboration on macro-structural issues (IEO, 2020), strengthening collaboration will require attention to how to incentivize collaboration both in the Fund and in partners as well as facilitating knowledge exchange. Simple tools like the creation and maintenance of multi-institution country platforms, where research projects, policy initiatives, timetables, and contact details could be shared, would be useful.

5 LENDING AND PROGRAM WORK

OVERALL USE OF LENDING AND PROGRAM SUPPORT

During the evaluation period, SDS utilized both Fund financial resources and non-financing instruments relatively sparsely. In total, only one-third of SDS made use of any form of Upper Credit Tranche (UCT) programs (including signaling instruments) during the evaluation period. SDS use of both General Resources Account (GRA) and Poverty Reduction and Growth Trust (PRGT) resources was less than half of use by non-SDS members in terms of total amounts relative to quota (Figure 5.1). Frequency of program use by SDS was about half that of non-SDS, and average access at approval was also substantially lower. SDS used Fund programs much less often than other (non-SDS) middle-income countries (MICs); use was somewhat higher for PRGT-eligible SDS. By contrast, SDS made greater use of emergency financing (EF), for dealing with both physical natural disasters and the COVID-19 pandemic, than other members. In terms of staff resources, only about one-tenth of spending for SDS was on programs, much lower than

FIGURE 5.1. PROGRAM AND LENDING SUPPORT, 2010–2020



Sources: IMF; IEO calculations.

the nearly 40 percent average for the whole membership (see Figure 3.1).

Requests for financial resources by SDS were for three broad purposes: (i) to support critical macroeconomic adjustment, fiscal policy and financial sector reforms, and initiatives to address structural constraints to growth; (ii) to manage the impacts of frequent and often large natural disasters, requiring access to fast-disbursing resources; and (iii) in the final year of the evaluation period, to help respond to the impact of the COVID-19 pandemic. The first of these purposes was met through Fund-supported programs meeting UCT conditionality while the latter two purposes were generally met using the EF facilities.

FUND-SUPPORTED PROGRAMS

Access

Between 2010 and 2020, SDS borrowed under 19 Fund-supported programs to help resolve their balance of payments problems while addressing growth and macroeconomic adjustment needs, particularly related to fiscal policy and financial sector issues (Annex 2). Twelve involved PRGT-funded arrangements (10 ECF and 2 Standby Credit Facility (SCF) arrangements) and 7 involved GRA-funded arrangements (4 Stand-By Arrangements (SBAs) and 3 under the Extended Fund Facilities (EFFs)). Fourteen were new arrangements entered into from 2010, while the remaining 5 were pre-existing arrangements that had commenced prior to 2010.

Overall access for programs during the program period averaged 202 percent of quota, much less than the 377 percent of quota for non-SDS. The gap was accounted for by GRA programs, where average access was 340 percent of quota for SDS and 504 percent of quota for non-SDS. By contrast, SDS received higher access in PRGT programs—134 percent of quota on average, compared to 100 percent of quota for non-SDS.[29] There was only one exceptional access case among SDS, compared to several very large non-SDS programs, partly explaining this discrepancy.[30]

The 19 arrangements were distributed among a limited number of SDS. Out of the 34 SDS, 23 had no experience of program engagement during the evaluation period. SDS members' interest in Fund program engagement also declined over the evaluation period. While there were seven ongoing programs at the start of the evaluation period, since early 2019 there have only been two active programs. The 11 SDS that had a program during the evaluation period are listed in Annex 3.

While SDS are highly susceptible to severe natural disasters incurring severe damage, no programs were initiated in response to any of the 124 natural disasters that occurred in SDS during the evaluation period, even in the five cases where SDS suffered natural disasters with impacts greater than 5 percent of GDP, or with the specific objective of building disaster resilience. Authorities generally preferred to use EF for immediate post-disaster needs and did not see the IMF UCT lending toolkit as being particularly well suited to the longer-term rebuilding challenges in the aftermath of a natural disaster. There were only two cases in which SDS requested program augmentation to meet financing needs following a natural disaster. A review of the incidence and scale of damages to GDP of natural disasters that occurred within two years of the start of a program suggests that there were limited reasons to seek program augmentation to support post-disaster relief, as most tended to inflict damages as a share of GDP of 2 percent or less.

SDS' use of Staff-Monitored Programs (SMPs) as well as signaling instruments, including the Policy Support Instrument and the Policy Coordination Instrument (PCI), was also limited.[31] Over the evaluation period, two African SDS used the PSI and PCI for policy support and for signaling purposes (Cabo Verde and Seychelles), while Eswatini and Comoros had SMPs. SDS did not use the

[29] Access levels under Fund arrangements depend on the size of the balance of payments need, the strength of the program and the member's capacity to implement it, and the member's debt sustainability and capacity to repay the Fund. Exceptional access under GRA and PRGT is subject to a member country meeting specific criteria.

[30] Exceptional access was provided to St. Kitts and Nevis in the 2011 Stand-By Arrangement.

[31] Use of the PSI and the PCI requires a judgement that policies meet the standards of a UCT program. This is not the case with an SMP, which is used to help a country establish a track record of policy implementation.

IMF's precautionary facilities (Flexible Credit Line and Precautionary Liquidity Line).

Evidence in the country case studies, notably interviews with country officials and staff, suggested that multiple factors, including both SDS-wide and country factors, accounted for SDS' decisions not to approach the Fund to request Fund program financing when faced by a balance of payments need:

- In some cases, country authorities considered that unsuccessful past program engagement and the risk of program failure due to limited capacity raised political concerns about stigma and fears that an off-track program could have a negative catalytic impact on external financing.
- Similarly, some countries were also reluctant to accept IMF conditionality. Officials raised concerns that conditionality eroded policy sovereignty and created the perception that governments seeking IMF conditional financing could not manage their affairs. Staff also recognized these factors during interviews.
- Officials also saw IMF-supported programs as being largely geared toward supporting adjustment rather than growth-related outcomes, which they felt reflected relative shallow coverage of such issues in policy discussions during surveillance.
- Access levels were considered too low relative to financing needs and the administrative burden of negotiating and monitoring. This was a particular challenge for some tourism-dependent SDS and SDS financial centers subject to large external shocks and for microstates, given their limited access levels due to very small quotas and low institutional capacity.
- Several authorities and some staff also cited the relatively short period of Fund programs, as a deterrent to requesting program support and suggested that longer-term arrangements, for example, lasting five to seven years, could incentivize greater use of Fund program financing, providing SDS more time to address structural weaknesses including the need to support long-term investment in disaster resilience.
- Availability of alternative sources of financing, from multilateral or regional institutions, on better terms (including grants) and less onerous conditions was often cited as the reason to avoid recourse to Fund programs. In many cases, these sources were accessed with the help of the IMF, including through use of Fund assessment letters that provided validation for the country's macroeconomic framework.
- In some cases, membership in a monetary union, including the ECCU and the West African Economic and Monetary Union (WAEMU), provided a policy anchor that lessened the need for Fund program engagement.
- In some cases, there seems to be a lack of awareness regarding the potential benefits of both financial and non-financial program support. While most officials interviewed reported good knowledge of Fund facilities, crediting Fund staff for conducting specific outreach on this issue, a few noted that they had only limited knowledge, in particular of the non-financial support instruments and the availability of precautionary programs.

Conditionality

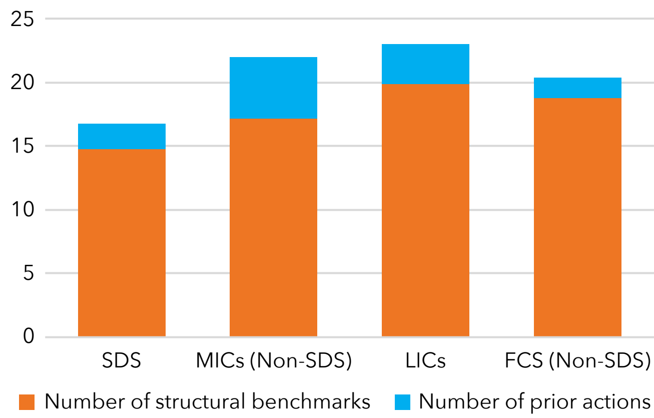
Data on structural conditionality shows some recognition of the lower institutional capacity of SDS compared to other members. Over the evaluation period, the 18 completed SDS programs had relatively few structural conditions (SCs) including structural benchmarks and prior actions, in comparison with programs with other MICs, fragile and conflict-affected states (FCS), and LICs (Figure 5.2). In terms of the depth of conditionality, SCs in SDS programs contained a somewhat higher share of low-depth SCs—almost half of all SCs—compared to those in other country groups and included the lowest share of high-depth SCs that might have brought about long-lasting changes to the institutional environment (Figure 5.3). In terms of content, SCs in SDS programs exhibited a somewhat higher share of growth- and efficiency-related SCs (although still quite low); and a higher share of fiscal SCs, but a low share of SCs related to vulnerability management. Regarding implementation of SCs, the share of SCs met in SDS programs was a little lower than in other MICs, identical to that achieved in LICs, and higher than in FCS.

In the case studies, the coverage of program conditionality was little remarked upon as an issue by SDS authorities, with the exception of the limits on non-concessional borrowing policy in PRGT-supported programs. Such limits were seen by officials, particularly in African SDS, as acting as a disincentive to requesting a program given the paucity of available concessional financing and as hindering investment and growth benefits of Fund-supported programs.

While programs paid considerable attention to fiscal policy and financial sector challenges in SDS, much less attention was paid to ND&CC issues (Lombardi and Rustomjee, 2022). Although program objectives and the design of arrangements were broadly consistent with addressing vulnerabilities to ND&CC, they were generally not integrated into the program's macroeconomic framework or conditionality, particularly in programs during the first half of the evaluation period. Over time, program documents tended to become more explicit about the appraisal of ND&CC-related vulnerabilities, as confirmed by a greater effort in terms of relating risks, objectives, and program design, particularly in countries that had benefited from CCPAs. Even then, however, program conditionality was not formulated with specific reference to ND&CC. This evidence points to unexploited potential for program design to respond to ND&CC-related vulnerabilities.

Similarly, program design paid limited attention to support disaster resilience–building policies. Most IMF-supported programs with SDS during the evaluation period were directed at addressing short-term policy adjustment needs, with little attention to encouraging longer-term ND&CC resilience building. This approach did not fully leverage the

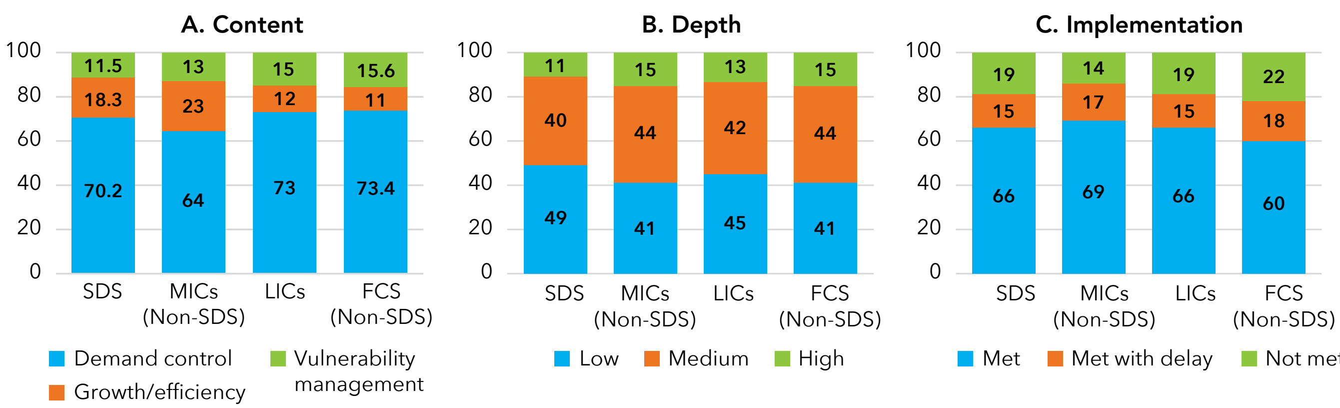
FIGURE 5.2. AVERAGE NUMBER OF STRUCTURAL CONDITIONS IN IMF-SUPPORTED PROGRAMS, 2010–2020



Sources: IMF, MONA (Monitoring of Fund Arrangements database); IEO calculations.

FIGURE 5.3. COMPOSITION OF STRUCTURAL CONDITIONS

(In percent)



Sources: IMF, MONA (Monitoring of Fund Arrangements database); IEO calculations.
Notes: Low-depth structural conditions (SCs) refers to conditions that would not, by themselves, bring about any meaningful economic changes although they may serve as steppingstones for significant reforms. Medium-depth SCs refers to conditions calling for one-off measures that can be expected to have an immediate and possibly significant effect, but that would need to be followed by other measures in order for this effect to be lasting. And high-depth SCs refers to conditions that, by themselves, would bring about long-lasting changes in the institutional environment.

knowledge generated by the substantial research and policy analysis developed by the Fund to better understand and support SDS in surveillance work.

Outcomes and Effectiveness

A substantial majority of programs with SDS—13 of 18—were successfully completed, a significantly higher proportion than in other country groups (Table 5.1). By contrast, four programs went quickly off track.

Among programs that were successfully completed, the SCF- and ECF-supported programs in Solomon Islands, the program engagement through several Extended Fund Facilities and PCIs in Seychelles, and the ECF in Granada were particularly noteworthy. They resulted in the restoration of macroeconomic stability and strong structural reforms (Solomon Islands), achieved a large fiscal adjustment and an exchange rate regime change (Seychelles), and effected quite ambitious SOE reforms (Grenada). Their success reflected their catalytic effect on external financing, close engagement by the country team, and good capacity development integration, as well as strong ownership by the authorities. They also provide a good example of effective Fund support through low access and precautionary programs that may be relevant to SDS facing protracted balance of payment problems or vulnerabilities to external shocks.

TABLE 5.1. PROGRAM PERFORMANCE, 2010–2020

	SDS	FCS[2]	LICs	EMs
Number of countries	**11**	**25**	**42**	**30**
Number of programs	**18**	**42**	**74**	**55**
Completed programs	13	20	49	30
As percent of total	72	48	66	55
Off-track programs[1]	1	10	11	14
Quickly off-track programs[1]	4	12	14	11
Precautionary programs	1	3	8	10
Exceptional access programs	1	0	0	20

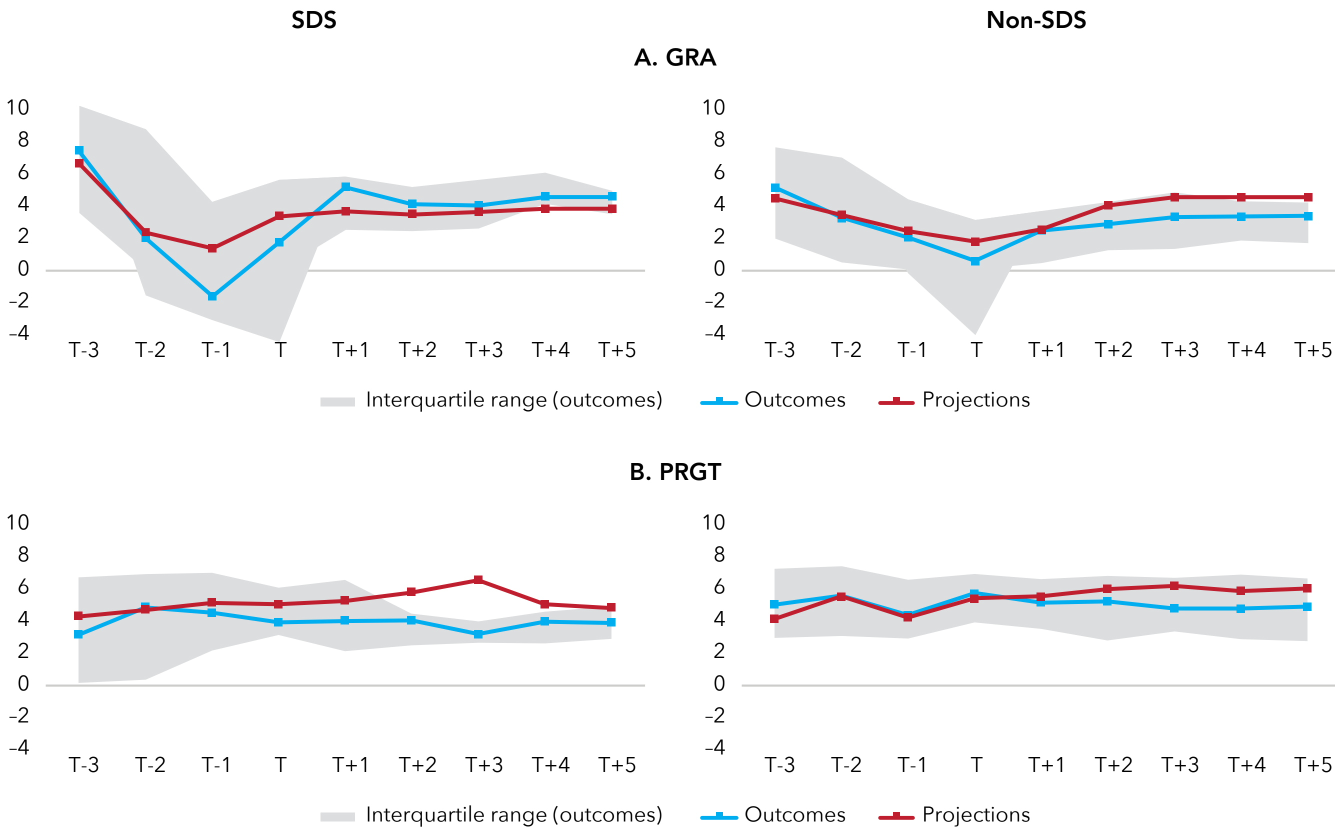
Sources: IMF, WEO; IEO calculations.
Note: EMs = emerging markets. Does not include programs continuing beyond the end of the evaluation period.
[1] Following the definition used by the 2018 Review of Conditionality, "off-track programs" refers to programs where at least two reviews were completed and at least two reviews were not completed at the end of the program; "quickly off-track programs" refers to programs where at most one review was completed and at least two reviews were not completed at the end of the program.
[2] Excluding SDS that are classified as FCS.

The effectiveness of program engagement in achieving overall stabilization objectives varied quite widely and depended critically on country circumstances and close IMF involvement. For example, in success cases such as Barbados and Seychelles (using GRA) and Cabo Verde, Grenada, and Solomon Islands (using PRGT), good results were underpinned by strong country ownership, effective domestic institutions, close engagement by the country team, and tight integration with capacity development support. By contrast, limited administrative capacity and lack of political will proved to be a limiting factor in the four programs that went quickly off-track. For example, in Eswatini, limited capacity was viewed as a key reason that the SMP went off-track quickly, with staff having been overoptimistic on what could be achieved. Even where successful, the case studies report a number of countries where country capacity was stretched. For example, in Cabo Verde during the recent PCI, the number and length of missions were viewed as excessive by country authorities, while in São Tomé and Príncipe, the ECF required frequent consultation with the minister of finance given the lack of supporting administrative staff.

Focusing on fiscal policy, Fund-supported programs played an important supporting role in restoring fiscal resiliency for a number of SDS, particularly for those that had entered the decade with unsustainable debt ratios. This was particularly the case for tourism-based economies, both in the Caribbean and among some African SDS. In most cases, resolution of debt issues occurred through carefully tailored debt restructuring operations with other lenders with the Fund providing technical support. In addition, in some countries, the programs ultimately catalyzed important policy reforms—in tax policy measures, in the adoption of formal fiscal policy frameworks and fiscal rules, and in the formation of savings or resiliency funds.

In relation to financial sector policy issues, Fund-supported programs focused attention on issues of financial stability, particularly institutional and systemic challenges to solvency, supervisory frameworks (including for anti–money laundering (AML)), and supervisory practices.

FIGURE 5.4. GROWTH TRAJECTORIES IN IMF-SUPPORTED PROGRAMS, 2010–2020



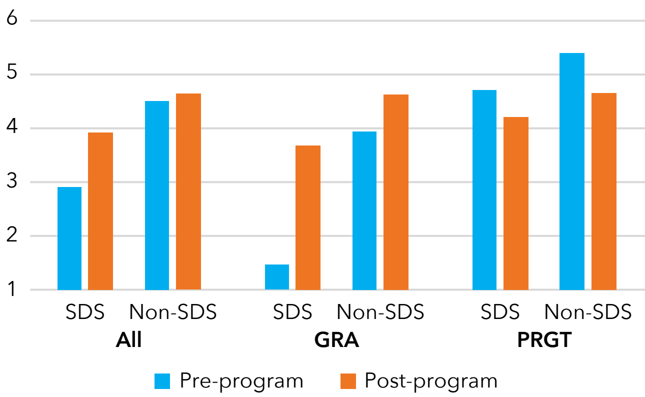
Sources: IMF; IEO calculations. Based on IEO (2021).
Note: All projections refer to initial program projections made at program approval (T). Outcomes and projections represent cross-country medians. Data availability is not uniform across periods mainly because post-program outcome data are not yet available for recently completed programs. Due to the presence of successor programs for some countries in the sample, there is overlap in the data presented over the period and, therefore, the results are not always fully consistent with those based on program periods only.

Programs were generally effective at achieving traction. There were noted improvements in financial stability indicators over the review period, all SDS with programs reported country appropriate legislative reforms, while almost three-quarters of SDS implemented new or strengthened anti–money laundering and combating the financing of terrorism (AML/CFT) legislation (Marston, 2022). Most program benchmarks—83 percent—gave attention to macro-financial considerations needed to strengthen financial stability. These included issues of bank solvency and arrangements for asset quality reviews, intervention, liquidation, and the workout of non-performing loans through a regional AMC and through strengthening supervisory frameworks, including for offshore financial center operations. Of the remaining benchmarks, 17 percent of the total focused on issues of resilience, including advancing work on credit bureaus and removing the minimum rate on saving deposits. Program engagement was also coupled with targeted IMF capacity support: where financial reforms benchmarks were included in programs, follow-up technical assistance and training was typically provided to help address capacity and funding challenges—for example, in programs for São Tomé and Príncipe and for the Solomon Islands. There was also a heightened degree of communication and intentional collaboration with partner IFIs and supporting agencies in the delivery of program benchmarks in the financial sector.

Growth outcomes in SDS programs were mixed. Figure 5.4 compares growth outcomes and projections for both SDS and non-SDS countries, while Figure 5.5 compares pre- and post-program growth performance. These charts show that GRA programs in SDS performed reasonably well on these dimensions, with growth outcomes modestly

FIGURE 5.5. GROWTH IMPROVEMENT IN IMF-SUPPORTED PROGRAMS, 2010–2020

(In percent; 2-year average)



Sources: IMF; IEO calculations. Based on IEO (2021).
Note: Whenever a country had two consecutive programs with less than two non-program years in between, those two programs are treated as a single one.

but consistently exceeding projections during and after programs, and considerably exceeding pre-program growth. However, for SDS with PRGT programs, growth performance was little changed during and after programs and fell well short of projections, which may in part reflect limited attention to growth-enhancing reforms.

The catalytic role of the Fund in encouraging external financing was seen as a particularly important objective for SDS. Fund financing proved catalytic in several instances, including in the African SDS of Eswatini, Cabo Verde, and the Seychelles. In Montenegro, country officials noted that the approval of use of Fund credit had given confidence to other private and/or official creditors and had generated a strong positive catalytic effect. In the Solomon Islands, a three-year low-access ECF arrangement, equivalent to 10 percent of quota in 2012, was successful in catalyzing donor financing, despite low access to Fund resources. Factors contributing to this included close engagement by the country team, good capacity development integration, as well as strong ownership by the authorities (Maret and de Las Casas, 2022).

Use of non-financing instruments and near-program engagement (in the form of intensified surveillance) also proved to be a useful signaling mechanism that helped catalyze additional external financing. In both Cabo Verde and the Seychelles, the PCI was seen as a valuable signaling instrument to financial markets and development partners as well as a useful tool to discipline policy and support implementation of structural reforms. In Montenegro and Eswatini, where the authorities faced debt vulnerabilities but sought to avoid program engagement for stigma or other reasons, intensified surveillance was adopted with staff reports signaling close Fund engagement in advising on detailed fiscal measures, backed up by significant technical assistance.

Within the Fund, SDS program work could be quite challenging because the usual approaches to program work may be highly demanding for countries with limited administrative capacity. Some AD staff in particular found the internal review process for program engagement lacking in appreciation for SDS circumstances and specificities, with a tendency to downplay capacity constraints, to go for first-best solutions, and to adopt a one-size-fits-all approach that was not well suited to SDS circumstances. Examples included Eswatini's 2011 SMP, where staff were overoptimistic on the fiscal consolidation that could be achieved, with the program quickly going off track, and in São Tomé and Príncipe, where the ECF required frequent consultation with the minister given the lack of supporting administrative staff (Lane and de Las Casas, 2022).

The timeliness of data also presented a challenge for some SDS, particularly in completing scheduled program reviews. For example, under the PCI, reviews can only be delayed by up to three months before an interim assessment update is required.

EMERGENCY FINANCING FOR NATURAL DISASTERS[32]

SDS showed a clear preference to use EF, rather than program financing, to deal with sudden exogenous shocks such as natural disasters or the COVID-19 pandemic. Between 2010 and 2019, SDS were granted EF on nine occasions to finance post-disaster recovery; six were PRGT-funded and three by a blend of GRA and PRGT resources (Annex 4). Access available averaged close to 50 percent of quota, higher than in previous decades, reflecting increases in access limits for EF. Between 1979

[32] This section draws on Lombardi and Rustomjee (2022).

and 2012, the share of quota drawn exceeded 25 percent of quota in only 3 of 16 arrangements, while from 2013 SDS drew at least 50 percent of quota in all EF drawings.

Both prior to and during the evaluation period up to the COVID-19 pandemic, most EF support was provided to address post-disaster recovery from severe tropical storms. Damages from natural disasters as a share of GDP where the country drew on EF support during the evaluation period ranged from 4 percent (St. Vincent and the Grenadines, 2011) to 96 percent (Dominica, 2015) (see Annex 4). Fund emergency financing support to these members averaged 5.8 percent of damages incurred, ranging from 1.8 percent (Dominica, 2011) to 10 percent of immediate flood-related damages (Dominica, 2015). As could be expected, higher access was associated with a higher share of financing of the disaster. On average, Fund emergency financing amounted to 1.7 percent of GDP; the highest access, granted to Vanuatu, was equivalent to 3.1 percent of GDP against damages of about 60 percent.[33]

The share of severe natural disaster events supported by Fund financing has increased over time. Cross-referencing the instances of Fund financing to SDS with the list of countries experiencing severe natural disasters with estimated damages greater than 10 percent of GDP shows that between 1979 and 1998, IMF financing was used to support only around 20 percent (5 of 27) natural disasters affecting SDS with damages greater than 10 percent of GDP. However, the new emergency facilities introduced from 1995 to support members' post-disaster recovery enabled the Fund EF to support around two-thirds of SDS experiencing severe natural disasters since 1998 (17 of 28), including 10 of 14 during the evaluation period. The higher access available under the LND window has only been used once, after the evaluation period.

Despite steady increases in access limits, the associated increased Fund share of natural disaster financing, and a steady rise in the share of severe events supported by Fund financing, SDS' relatively limited overall use of EF following natural disasters is noteworthy. Only 11 SDS have ever drawn on EF for natural disaster purposes, while 23 have never used Fund EF for these purposes. And among the 9 EF operations during the evaluation period, in only one case (St. Vincent and the Grenadines) did an SDS member request a further repeat use drawdown, even though these members experienced 14 further natural disasters within the permissible three-year repeat use drawdown period. Of these events, 11 natural disasters incurred damages of between zero and 2 percent of GDP and authorities may have felt that the procedural steps needed to apply for repeat use were not worthwhile. The three remaining natural disasters were much more severe. Among these, St. Vincent and the Grenadines requested an additional RCF drawing in 2011, six months after its first emergency operation following a second natural disaster event; and a further RCF/RFI drawing in 2014, to help support recovery from a third large natural disaster, very shortly after the 2011 RCF concluded. In the case of Dominica, the country was unable to make a repeat drawing because its cumulative access limit under the RCF had already been reached.

Among the approximately one-third of SDS that have drawn on EF in the context of natural disasters, authorities generally welcomed the speed with which the Fund responded to requests for EF following a disaster, noting that the Fund was typically prompt in sending missions and preparing Board documentation. They also appreciated the absence of ex post conditionality attached to EF, which helped facilitate access in very difficult economic and social conditions and helped to explain some increased interest to draw on EF relative to UCT programs in such circumstances. Officials noted the gradual increases in access limits to EF, although they did note that access was generally still quite limited relative to the scale of the disaster, which could be overwhelming for SDS, and could be easily exhausted in the event of repeat events. Nevertheless, they also appreciated that the Fund EF could play a catalytic role in encouraging external financing from other lenders and donors to bring financing benefits well beyond the extent of use of Fund resources.

[33] Prior to approval, Dominica's cumulative outstanding emergency lending amounted to 57 percent of quota compared to a limit of 150 percent. Staff considered access of 75 percent of quota under the RCF, equivalent to 1.61 percent of GDP, to be appropriate because total outstanding PRGT credit under emergency assistance instruments would increase to 132 percent of quota.

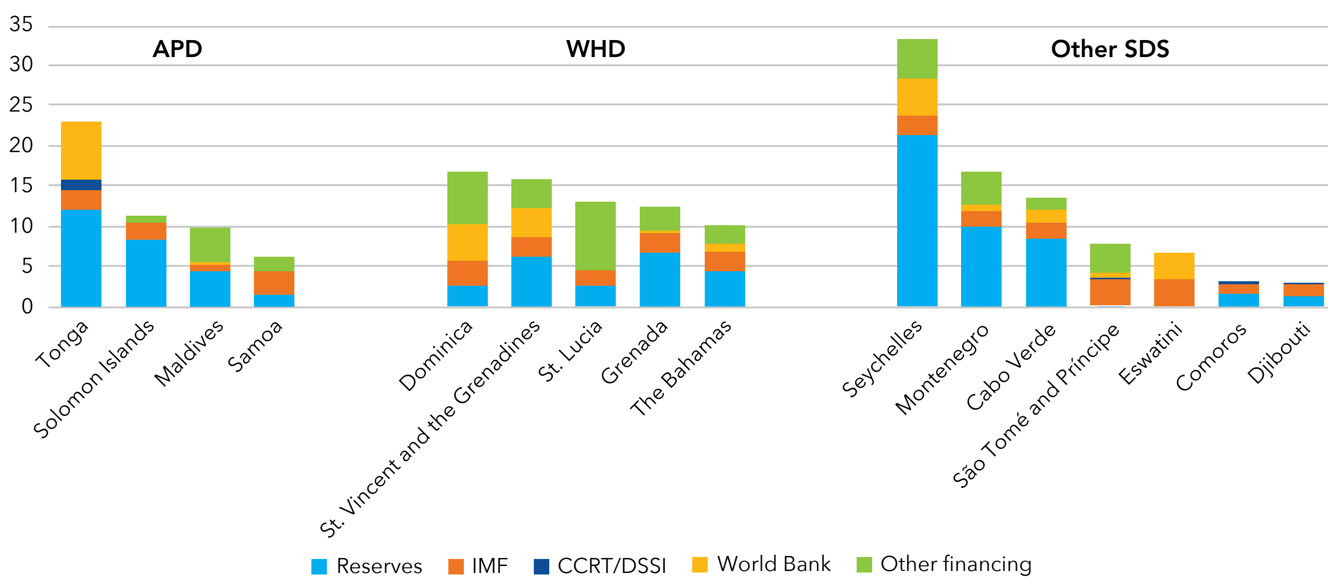
EMERGENCY FINANCING FOR COVID-19[34]

The Fund provided financial support to over half of SDS members in the early stages of the pandemic: a total of 19 lending operations from March 2020 to December 2020. Of these, there were 15 EF drawings for COVID-19 pandemic support to SDS in 2020, averaging SDR 33.5 million per drawing, with average access levels of 91 percent of quota, benefiting from the temporary increases in annual and cumulative limits for Fund emergency facilities in response to the pandemic. In two cases (Barbados and São Tomé and Príncipe), countries with existing arrangements benefited from augmented access (twice in each case). Additional support was provided to 4 SDS through debt relief under the CCRT for the Fund's poorest and most vulnerable members[35] while 12 SDS benefited from the G-20 Debt Service Suspension Initiative in which the IMF was actively engaged.[36] However, none of the SDS that used EF requested a new UCT program arrangement, no programs were approved over the period January 2020–June 2021, and only one new GRA arrangement has been approved since then.

The speed of disbursement of EF at the start of the pandemic was particularly impressive, with 12 SDS receiving assistance before end-June 2020. On average, the negotiations with the authorities of the 15 SDS requesting Fund emergency support took just 4 days, and the Board was able to approve the requests 21 days after the end of the negotiations. The streamlining of review procedures Fund-wide, the use of quasi-templates for policy notes and staff reports, and the clustering of requests for Board consideration (such as for Dominica, Grenada, and St. Lucia) all contributed to this positive outcome. At the same time, the short timeline to provide financial assistance prevented in some cases a full discussion of the outlook under different scenarios and there were disparities in the quality and presentation of the statistical tables.

[34] This section draws on Maret (2022).

FIGURE 5.6. MEETING SDS COVID-19 EMERGENCY FINANCING GAPS
(In percent of GDP)

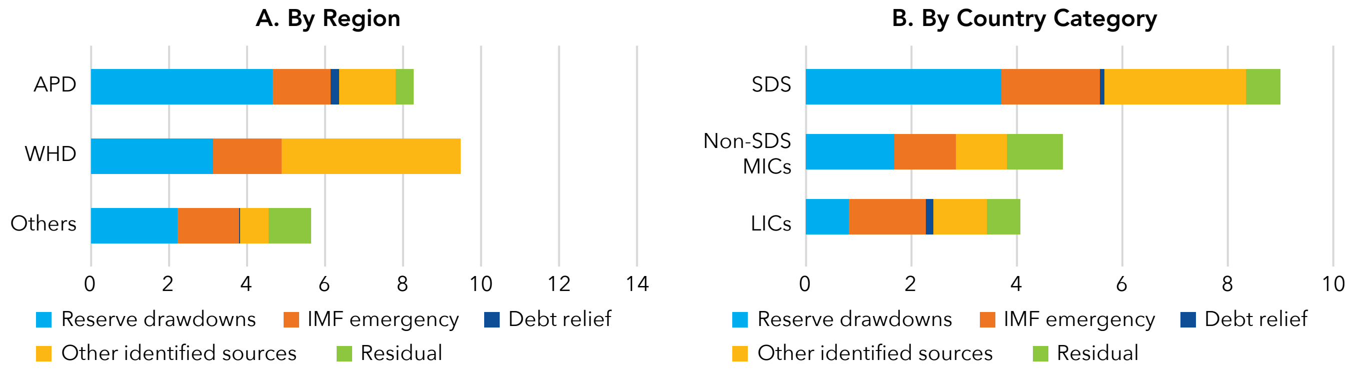


Sources: IMF; IEO calculations.
Note: Based on Board papers in support of EF requests.

[35] Comoros, Djibouti, STP, Solomon Islands). Source: IMF COVID-19 Financial Assistance and Debt Service Relief lending tracker," January 31, 2022, available at https://www.imf.org/Topics/imf-and-covid19/COVID-Lending-Tracker.

[36] Twelve SDS (Cabo Verde, Comoros, Djibouti, Dominica, Fiji, Grenada, Maldives, Samoa, São Tomé and Príncipe, St. Lucia, St. Vincent and the Grenadines, and Tonga). Source: IMF and World Bank, 2020, "Implementation and Extension of the Debt Service Suspension Initiative," Annex l. DSSI Eligibility and Participation, available at https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative.

FIGURE 5.7. FILLING THE COVID-19 FINANCING GAP
(In percent of GDP)



Sources: IMF, IEO calculations.
Note: Covers EF requests between March 2020 and August 2021.

The Fund's provision of EF during the pandemic contributed significantly to addressing the external and budgetary financing needs of SDS, but still only met a fraction of identified external financing gaps. The Fund's assistance to SDS was somewhat higher, in terms of percentage of GDP, than in other emerging market and developing countries benefiting from Fund's financing. On average, Fund support filled around 20 percent of anticipated financing gaps. The remainder was to be met by drawing down reserves and using other financing sources (Figure 5.6).

However, as discussed in Chapter 3, the COVID-19 pandemic caused considerably more economic damage to SDS than to non-SDS. As a result, projected external financing gaps averaged over 9 percent of GDP and overall Fund financing was expected to fill a smaller share of financing needs for SDS than for other members. This situation implied on average considerably greater use of own reserves to deal with the crisis (Figure 5.7).

While countries using EF were not subject to ex post conditionality, they did need to meet certain preconditions to qualify, in line with IMF lending guidelines that apply to all members. Three SDS requests for EF were not successful. In Antigua and Barbuda and in Belize, Fund staff found debt to be unsustainable and could not obtain adequate assurances that the members were on track to restore sustainability. In the third case (Mauritius), staff considered problematic some measures taken by the authorities in their COVID-19 response, including the scale of central bank bond purchases and transfers to the government.

Members seeking EF also had to satisfy governance safeguards. Growing concerns about good governance in using the Fund's resources led to an increased scrutiny of policy commitments in letters of intent accompanying EF requests and the introduction of additional safeguards in some cases. These safeguards were centered around (i) the audit and publication of results of crisis-mitigation spending within a year; and (ii) publication on a government's website of procurement contracts for crisis-related spending. It remains to be seen how well SDS with limited administrative capacity will be able to meet such commitments.

Notwithstanding needs, SDS proved reluctant to seek Fund-supported programs with higher access and UCT conditionality in response to the pandemic, even though this might have helped fill particularly large financing needs. No new program lending was approved in 2020 and only one since then (with Seychelles in August 2021), either for pandemic or other purposes, although the existing UCT arrangements with São Tomé and Príncipe and Barbados were augmented at the beginning of the pandemic. This seems to have reflected the usual factors discouraging SDS use of IMF programs mentioned in the previous section, exacerbated by the additional difficulties of negotiating a program during a period of turmoil as well as the availability of larger than usual access to EF.

Overall, EF during COVID-19 exhibited the same qualities and drawbacks as EF in general. It was highly appreciated by officials in terms of speed (faster than other institutions) and for its lack of ex post conditionality. As a result, it improved SDS perceptions of the Fund. It also had a welcome catalytic effect on other sources of external financing, as multilateral development bank budget support operations often relied on the IMF assessment of macroeconomic policies. On the negative side, access provided was relatively small compared to financing needs, and some countries were not able to receive support because of debt sustainability or policy requirements.

From the staff perspective, providing emergency financing to so many members, including SDS, in such a short period required great commitment and perseverance—and put a heavy burden on staff resources. To some degree, continuity of engagement helped: the period since the previous Board meeting averaged seven months and an average of three mission members participated in the missions that led to both Board meetings. However, in some cases, new mission chiefs were assigned and country teams had to be considerably expanded, so staff were required to quickly learn about new country circumstances and develop new relationships, adding to work demands at a difficult time.

OVERALL ASSESSMENT

During the evaluation period, the Fund's financial resources provided rapid emergency support to SDS facing large financing needs from periodic devastating natural disasters and more widely from the COVID-19 pandemic. This financing was provided mainly through the emergency facilities, benefiting from gradual increases in access especially in the later years of the evaluation period.

Nevertheless, the design of the emergency instruments has not been specially well suited to the particular circumstances of SDS. While use of emergency drawings in response to large natural disasters has grown, access is still quite limited relative to the scale of the economic impact of large natural disasters, with the result that the Fund has been able to provide only a relatively small share of post-disaster financing needs using emergency facilities. Use of Fund-supported programs could offer higher access but, in practice, countries chose not to use such programs with ex post conditionality as a source of financial support in the wake of a natural disaster, in part because of the high transaction costs involved as well as broader political economy concerns about conditionality, as mentioned above. Indeed, some countries experiencing large natural disasters chose not to request IMF financing at all, although they still counted on positive IMF assessments to support access to financing from other sources.

This experience raises the question of whether access limits under the Fund's emergency financing for dealing with large natural disasters could be increased further to provide greater flexibility to meet countries' needs after a large natural disaster. For example, the annual access limit could be raised above the current cap of 80 percent for a large natural disaster to 130 percent as was provided temporarily until end-December 2021 for COVID-19 pandemic support, while the cumulative access could be retained at 183.33 percent on a permanent basis rather than reverting to 133.33 percent at end-June 2023. However, it would clearly be important to ensure that countries seeking such higher levels of access under EF without ex post conditionality had the robust macroeconomic policy frameworks and governance standards to provide adequate safeguards and ensure capacity to repay. Realistically, many SDS would not meet such high standards.

SDS use of programs with UCT conditionality was much more limited than for other members during the evaluation period. Where these occurred, most were completed on schedule, suggesting that in this context adequate attention was paid to supporting implementation. These programs were pursued mainly to help countries deal with pressing stabilization needs related to fiscal imbalances and debt overhangs, and a number of GRA programs were quite successful in meeting these objectives and supporting growth as well. However, PRGT programs with SDS (like non-SDS) were prone to growth optimism and did little to help countries meet longer-term growth and climate resilience challenges. Overall, structural conditionality was used more parsimoniously in SDS programs than in programs for other countries; they were somewhat more oriented to growth, but such conditions also tended to be quite shallow.

While the Fund played substantially increased attention to ND&CC issues in surveillance, particularly using the CCPA and DRS tools, as described in Chapter 4, this work did not have much effect on Fund lending activities. Among CCPA countries, half of them did not approach the IMF for financing purposes, pointing to the limited role of CCPAs for mobilizing IMF financial support and underutilization of the critical mass of climate-related knowledge built through these assessments. A review of the two available DRSs suggested that they exhibited a similar risk of being underutilized, especially in helping to support access to Fund lending.

The envisaged RST to be approved by the 2022 Spring Meetings could provide an important opportunity to scale up use of Fund resources to support SDS' climate-related resilience challenges. Such access—which would be available in the context of a program with UCT-quality policies—would provide more resources on better terms, more aligned with the longer-term requirements of resilience building. However, given that only one-third of SDS made use of UCT programs during the evaluation period, it will be important to consider other obstacles to the use of UCT programs identified in this chapter in implementing this new initiative, including to overcome stigma and build close and trusted relationships, to help ensure administrative capacity to work effectively with the IMF in a program context, and to avoid unnecessarily burdensome transactions costs involved in designing and monitoring Fund programs.

As with surveillance activity, greater attention to working with partners in the program context could pay dividends. In fact, in designing the RST, care is being taken to foster a close working relationship with the World Bank in applying the RST to support climate change–related resilience issues. Similar attention could also be paid to working with the Bank and other partners to strengthen the growth-related content of IMF-supported programs more broadly, which would help to alleviate concerns that UCT programs pay inadequate attention to supporting stronger growth outcomes.

CAPACITY DEVELOPMENT[37]

CONTEXT

As described in Chapter 2, most SDS share relatively low levels of development and suffer serious constraints on their institutional capacity and human resources, especially in the Pacific region and in microstates. World Bank data[38] suggest that SDS institutional capacity is significantly lower than that of larger countries in a comparable income bracket and has shown only marginal improvements over the last decade. These constraints have long been recognized by the Fund and external experts as having serious negative effects on the economic performance of SDS, but the lack of institutional capacity and the small size of their administrations also affects SDS' capacity development absorption and implementation capacity, increases brain drain problems, and leaves institutions exposed to the risk of relying on a single key individual, hampering the retention of skills and the continuity in the relationship with the Fund.

Given their capacity constraints, SDS are avid consumers of capacity development support from the Fund and other development partners, making capacity development provision one of the most important dimensions of the Fund's work for this subset of the membership. Indeed, capacity development now represents about 40 percent of the Fund's spending on SDS, compared to about 30 percent for the whole membership (see Figure 3.1).

The provision of capacity development to SDS has a strong geographical and regional dimension. SDS are highly concentrated in the Pacific and Caribbean regions and most of them are islands, some in very remote locations. These characteristics make capacity development provision to SDS more difficult and costly than to other parts of the IMF membership and increase the advantages of regional delivery of capacity development and peer-to-peer learning. Beyond geography, the regional dimension of capacity development provision is strengthened by the many common characteristics and challenges SDS share and by the relevance of regional institutions, which are often capacity development recipients and play a role in knowledge retention and diffusion.

This regional dimension has led to a very prominent role of the IMF's Regional Capacity Development Centers (RCDCs) in the delivery of capacity development to SDS (Figure 6.1). Indeed, RCDCs were originally conceived to provide technical assistance to small island economies. The first one, the Pacific Financial Technical Assistance Center (PFTAC),[39] opened in Fiji in 1993 and provides capacity development support for 12 Pacific Islands.

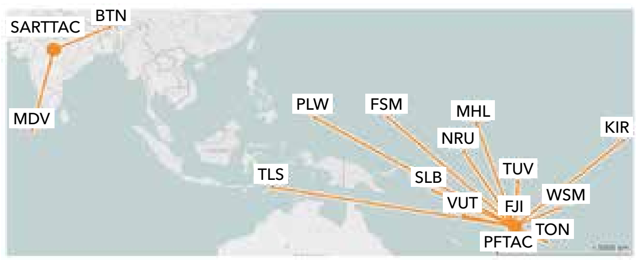
[37] This chapter draws on de Las Casas and Balasubramanian (2022a).

[38] Country Policy and Institutional Assessments and Worldwide Governance Indicators.

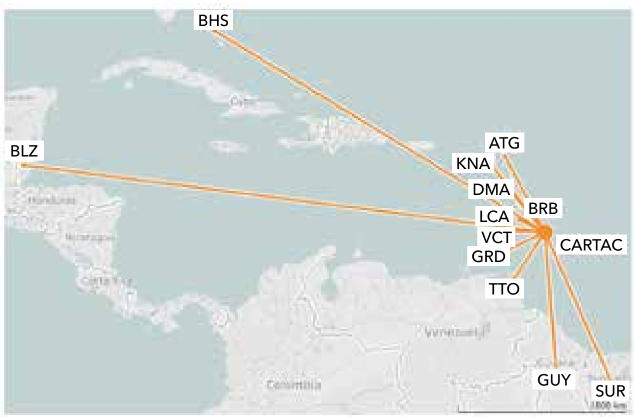
[39] PFTAC currently serves 16 countries and territories (The Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tokelau, Tonga, Tuvalu, and Vanuatu), of which 12 are SDS members.

FIGURE 6.1. GEOGRAPHICAL DISTRIBUTION OF SDS

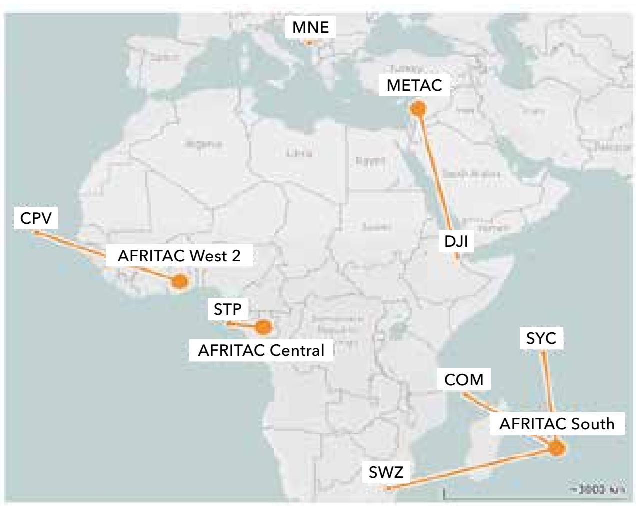
Asia-Pacific SDS



Caribbean SDS



African and Other SDS



Source: IEO (Tableau).

The second one, the Caribbean Regional Technical Assistance Center (CARTAC),[40] established in Barbados in 1999, supports 12 SDS in the Caribbean. These and other RTACs, especially AFRITAC South located in Mauritius, have been responsible for a growing share of all capacity development assistance to SDS. Regional Training Centers based in Singapore, Mauritius, and Kuwait also contribute to the provision of capacity development to SDS.

AMOUNT, QUALITY, AND CONTENT

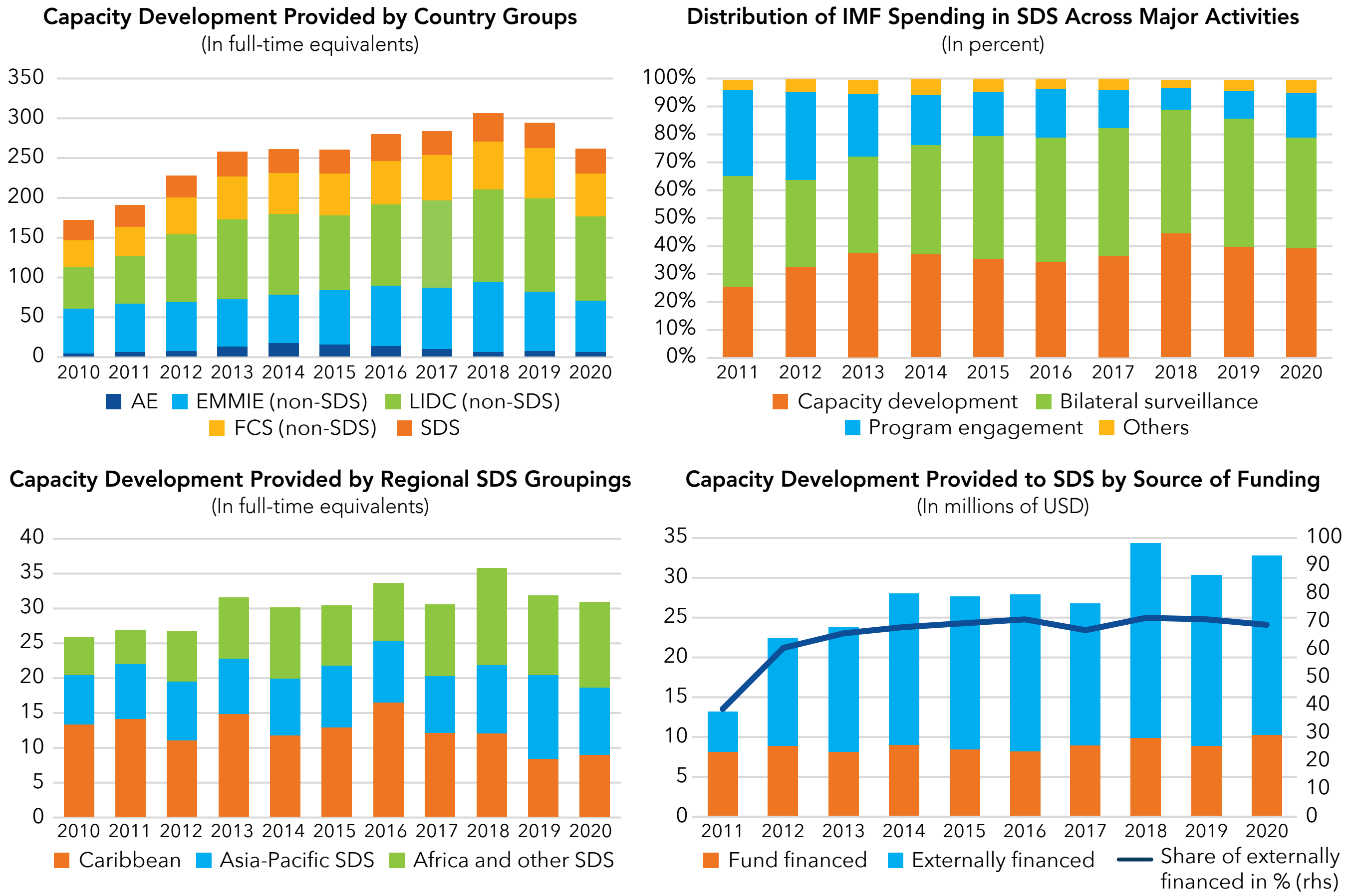
Both across the membership and in SDS, the resources devoted by the IMF to capacity development grew during the evaluation period, although there was a modest decrease in 2020, reflecting constraints on delivering capacity development during the pandemic (Figure 6.2). The bulk of the Fund-wide increase in capacity development went to low-income developing countries (LIDCs) and FCS, while the increase was less pronounced for SDS and larger economies in their income bracket (emerging market and middle-income economies). Indeed, while the Fund's spending on capacity development is a relatively high share of SDS country spending, it is considerably smaller in terms of dollars per country than for other members. During the evaluation period, the Fund spent on capacity development, on average, around $700,000 per year in each SDS, approximately half the expenditure in LIDCs, well below the amount devoted to each FCS ($1.16 million), and substantially less than the $850,000 devoted to emerging market and middle-income economies. Among SDS, the regional allocation[41] of capacity development shows that, starting from a lower level, Asian and especially African SDS received growing amounts of capacity development. The increase in capacity development delivery to SDS was entirely financed by the growth of external financing sources.

Given indivisibilities of capacity development project costs, small size does not necessarily translate into commensurately lower costs, but lower dollar spending necessarily translates into fewer capacity development projects per SDS than for LIDCs or other FCS. Nevertheless, officials consulted for case studies for this evaluation did not express

[40] CARTAC currently serves 23 countries and territories (Anguilla, Antigua and Barbuda, Aruba, The Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Curacao, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Maarten, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, and Turks and Caicos), of which 12 are SDS members.

[41] Countries are classified in three main groups for this analysis: Asia-Pacific SDS, Africa and other SDS, and Caribbean SDS.

FIGURE 6.2. CAPACITY DEVELOPMENT PROVISION AND FINANCING, 2010–2020



Sources: IMF (ACES-TIMS); IEO calculations.

that there was unfilled demand for capacity development among SDS given their internal constraints. Some staff members argued that ample availability of resources has led to the provision of too much capacity development to these members, exceeding their absorption capacity and generating very low impact.

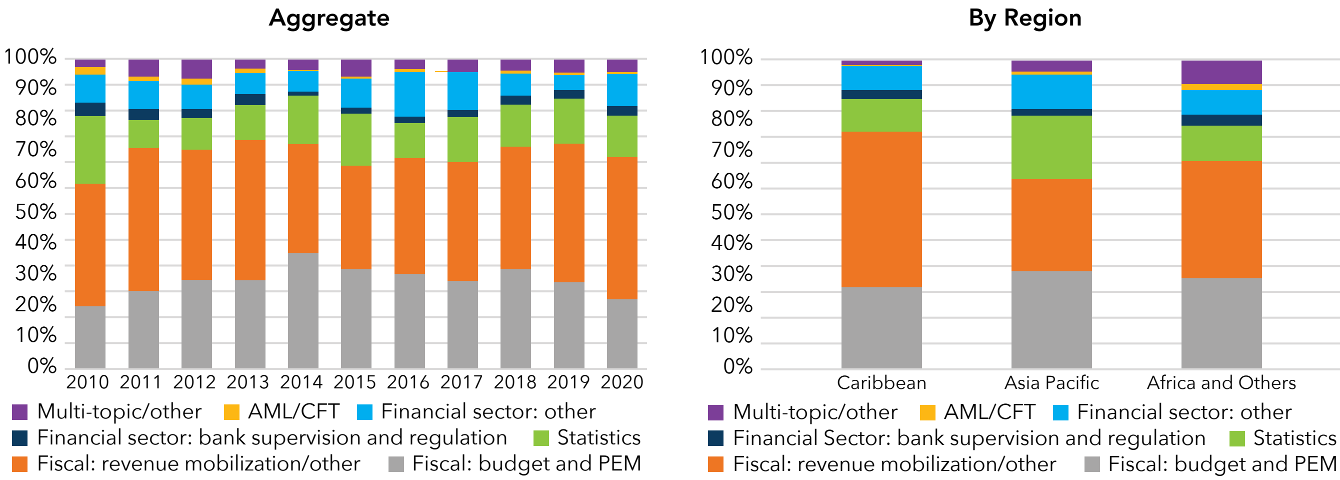
Generally, in case study interviews, recipients and providers considered capacity development of high quality and well-tailored to their priorities.[42] Satisfaction was generally highest with the support provided in the areas where the Fund has particular comparative advantage, e.g., public financial management, tax administration, debt restructuring, vulnerability assessments, monetary operations, bank oversight and resolution, and economic statistics (Figure 6.3). One concern, shared by several staff in ADs, was a tendency to recommend first-best solutions, when more "practical and humble" advice could have worked better and facilitated implementation. However, the large role played by the RCDC, staffed by experts very familiar with the region, helped to alleviate such risks (see discussion below).

Prioritization and allocation of the capacity development resources was generally quite well aligned with country interests. Steps taken to underpin ADs' responsibility for capacity development allocation and prioritization—including increased elaboration of Regional Strategy Notes

[42] The survey of authorities conducted for the evaluation also suggested that capacity development is perceived as providing more value added to SDS than surveillance and lending, and suggested a high level of satisfaction, especially regarding the expertise of the providers, the effectiveness of the capacity development, and its alignment with individual priorities (de Las Casas and Balasubramanian, 2022b).

FIGURE 6.3. THEMATIC DISTRIBUTION OF IMF CAPACITY DEVELOPMENT TO SDS, 2010–2020

(In FTEs, percentage)



Sources: IMF (TIMS); IEO calculations.

and Country Strategy Notes[43] and the broad consultation in the early preparation of capacity development missions—and the major part played by RCDCs helped in achieving this outcome.

However, authorities voiced concerns regarding the high dependence of capacity development for SDS on the availability of external funding, which could distort allocation of capacity development. They felt that middle-income, non-program SDS ranked very low on the list of Fund priorities and some requests could only be addressed thanks to the availability of earmarked external financing. Relatedly, while authorities did not express concerns regarding excessively supply-driven allocation of capacity development, some staff members mentioned that the dependence on donor financing introduced a supply-driven element. Rather than requesting support in the areas with most pressing needs, authorities would sometimes request the capacity development for which they knew funding was available.

DELIVERY MODALITIES AND RCDCs

One of the most salient features of the Fund´s capacity development provision to SDS was the widespread role played by RCDCs in serving SDS. This role was greatly appreciated by country officials. RCDCs not only were considered the "eyes and ears" of the Fund in SDS, palliating to some extent the scarcity of resident representatives lamented by SDS authorities, they often also enjoyed a better reputation than the Fund itself as understanding country conditions and being geared to meeting SDS needs, thus helping to generate a greater sense of ownership and augmenting value added. Moreover, RCDCs' contribution to the Fund's work in SDS is made at a relatively low cost to the Fund's own budgetary resources, as roughly 75 percent of their expenses are financed by RCDC donors.

The success of RCDCs is based on several dimensions. First and foremost, the capacity development they provide is considered better tailored, more pragmatic, and more responsive, due to their better understanding of the local and regional circumstances (including realism about absorption capacity), their proximity, and longer-term engagement of their experts. Secondly, RCDCs are to a large extent the custodians of the Fund's relationship with SDS; they provide continuity to the Fund's engagement by bridging the gaps between missions and alleviating the negative effect of the high turnover, and sometimes lack of experience of both HQ staff and officials. In doing so, they provide handholding and guidance, which is required for the successful implementation of capacity development in

[43] CSNs and RSNs provide medium-term context, objectives, and priorities for the delivery of capacity development. They articulate the thematic and geographical allocation of resources, as well as the identification of the most suitable delivery modalities. Their structure, content, and time-coverage is not standardized across departments.

most SDS. Day-to-day engagement, however, also poses concerns, including in some cases, the transformation of capacity building into capacity supplementation (which can prevent skills transfer), and the provision of excessive supply-driven capacity development, and making oversight and quality control from HQ more challenging.

RCDCs have also acted as effective coordination centers, not only of the regional provision of IMF capacity development, but also in organizing regional high-level conferences and working groups and, within the Fund, contributing to surveillance work and launching initiatives to exploit the wealth of knowledge, experience, skills, and opportunities available. The role of RCDCs as coordinators was highly appreciated by authorities and staff and extended beyond donors to development partners and regional institutions. Jointly with resident representatives and ADs, RCDCs have channeled countries' capacity development needs to other institutions when they were outside the Fund's areas of expertise and, in return, they have benefited from their relationships with regional institutions in terms of credibility and of cohesion of their work. Maintaining these efforts is important to address the occasional coordination issues occurring during the evaluation period, which were particularly detrimental to capacity development effectiveness in SDS, as they compounded their limited absorption capacity, including problems of overlap and oversupply of capacity development, poor sequencing, and sub-optimal distribution of responsibilities among providers.

Beyond RCDCs, SDS officials valued the provision of capacity development through several modalities, which allowed for better tailoring to country needs. HQ-delivered capacity development was generally perceived as providing valuable strategic guidance, while RCDCs were seen as providing advice more tailored to national conditions and support for implementation. Resident experts and longer-term provision were strongly preferred over one-off missions, as SDS required abundant implementation support. However, most officials recognized that adapting delivery modalities to each specific theme had yielded good results. IMF training courses—delivered regionally, at HQ, or online—were also appreciated, as they provided an opportunity to exchange views with colleagues abroad and to reach a high number of officials.

Remote delivery of capacity development, which intensified during the pandemic, was considered a distinct second best by SDS officials. While it can help relieve the physical remoteness problem and add flexibility, many SDS feared connectivity problems and a greater engagement gap. On the ground presence was clearly preferred and recognized, by authorities and staff, as a key factor, if not a sine qua non condition, for traction and effectiveness in SDS.

IMPLEMENTATION AND IMPACT

IMF capacity development is widely perceived in SDS as being useful, well delivered, and having a substantive impact. Perceptions vary, however, across levels of development, across regions, and across types of capacity development. More advanced SDS, especially in the Caribbean and Africa, are better able to benefit from the Fund's capacity development support. The areas of Fund-provided capacity development highlighted most often by authorities as achieving greater effectiveness and/or contributing to policy formulation, both in interviews and in the survey, include tax administration, public financial management, monetary operations, financial sector oversight, AML/CFT, and national accounts statistics.

Nevertheless, the case studies found numerous cases of insufficient or unsustained implementation, which diminished the impact of capacity development. The reasons for this lack of implementation were diverse. On the part of the authorities, implementation capacity constraints related to the characteristic limited institutional development of SDS were clearly the main issue. Such absorptive capacity constraints were compounded in some instances by weak political will and incentives, particularly when country ownership of the capacity development was limited. This problem was sometimes made worse by the authorities' ability to shop around alternative capacity development providers, given the variety of sources available to them in a crowded capacity development market. On the part of the Fund, the key challenge in SDS was providing the follow-up support for implementation of capacity development recommendations requested by country officials.

Beyond hindering capacity development in recipient countries, implementation and impact problems complicate capacity development allocation decisions at the Fund. Continued provision of capacity development when impact is limited raises concerns about the efficiency of use of scarce capacity development resources and increases the risk of excessive capacity supplementation. Against this, it must be recognized that the process of institution building is necessarily slow and subject to setbacks. In general, when allocating capacity development resources, the challenge is to find the right balance between countries' needs and their willingness to engage proactively (at the technical and political levels), taking into account countries' implementation track record.

One challenge in finding the right balance is that the Fund has only recently developed a fully functioning framework for systematically gathering information on capacity development and assessing its performance, including impact and effectiveness. Preliminary analyses of data from the results-based management (RBM)[44] system conducted by the IMF's Institute for Capacity Development (ICD) and the IEO suggest statistically significant differences in outcome scores, pointing to poorer results in SDS than non-SDS.[45] The average outcome implementation rating of projects (completed and ongoing) between 2013 and 2020 was 2.39 for SDS, lower than for AEs (2.65) and LIDCs (2.48), similar to the rating for EMMICs (2.39), and slightly higher that for FCS (2.34). However, the data is still too limited to support meaningful diagnosis and remedies. For SDS projects, only 10 objectives (9 percent of the total, 5 for completed projects and 5 for projects under implementation) and 127 outcomes (50 percent of the total, 30 for completed projects and 97 for projects under implementation) were rated. Nevertheless, there are high expectations regarding the potential contribution of RBM together with CDMAP as it matures and provides a more complete data source for analysis.

INTEGRATION WITH OTHER IMF ACTIVITIES

Effective integration, understood as the process of striving to make sure that the three main activities of the Fund—surveillance, program work, and capacity development—are mutually reinforcing and well-coordinated, is considered key for the traction and effectiveness of capacity development in SDS. Such integration is based on the interactions between capacity development experts and country teams, through the formal capacity development prioritization and planning process, informal consultations, and the participation of advisors in surveillance missions. These interactions are seen by staff as enriching and mutually beneficial, as they provide country teams with a level of specificity that is very difficult to achieve in the surveillance context, and capacity development experts benefit from the analysis of the overall situation and the challenges facing countries that country teams bring to the table.

Case study evidence suggested that such integration was most fully achieved in the context of a program, given the intensified engagement between the authorities and the Fund and the stronger incentives posed by clear short-term targets. In the absence of a program, evidence suggests that integration tended to increase over time and reached generally satisfactory levels by the end of the evaluation period, although it could still be improved.

The IMF's capacity development strategy has increasingly given country teams responsibility over the prioritization and planning of capacity development, in close coordination with capacity development providers. However, this responsibility has been fulfilled with varying degrees of success, depending on teams' workload and interests and on departmental policies and priorities. Country Strategy Notes (CSNs) and Regional Strategy Notes (RSNs) have proven pivotal documents to rationalize and plan capacity development provision in some cases, but their elaboration has been uneven across departments.[46]

Integration of capacity development with surveillance and program work is made more challenging by the lack of resident representatives (RRs) in SDS. Currently, only one of the 34 SDS member countries has its own RR.

[44] RBM was first introduced in the mid-2000s and required for all capacity development projects from 2017, but only effectively operationalized in 2021 with the implementation of the Capacity Development Management and Administration Program (CDMAP).

[45] For additional details, see Bassanetti (2021). Further analysis will be provided in the upcoming IEO evaluation of IMF capacity development work which is expected later in 2022.

[46] Since their conception in 2017, among the three departments containing most SDS, AFR has elaborated six RSNs and at least one CSN for each one of the SDS in the region. APD and WHD also have prepared six RSNs each, but there were no individual CSNs for the SDS in those departments. MCD and EUR have elaborated seven and five RSNs, respectively, but, while several CSNs were made for Djibouti, there was none for Montenegro.

In addition, 12 Pacific SDS are covered by the IMF's regional office in the Pacific Islands. Several authorities regretted the absence of a RR in their countries. Being part of the day-to-day business of ADs, physically on the ground with RCDCs, and in close contact with authorities, RRs are ideally placed to identify countries' needs. However, budgetary constraints have hampered greater access by SDS to individual RRs. The experience with regional resident representatives (RRRs), as opposed to the traditional country-specific assignments, has been positive but they have been spread thin across many countries.

In the absence of a RR, the RCDC leaders, appointed by the ADs, have sometimes played a useful role supporting integration. However, RCDC experts have occasionally seen themselves as autonomous, with little need to report to ADs, and have less knowledge of the Fund's culture and modus operandi. At the same time, there have been instances of integration being hampered by lack of coordination among the various interlocutors within a country's administration, leading to uncoordinated requests for capacity development at different levels.

Despite the symbiotic relationship between capacity development and surveillance, and the existence of room to polish and deepen it, it should be recognized that there are limits to integration. Under the Fund's organigram, surveillance and program work are the responsibility of ADs, as they have the required knowledge of Fund policies and operations across the board. RCDCs' employees are generally technical experts in their fields and, while they can provide valuable inputs for the surveillance process, they have no capacity to conduct surveillance or program operations. There are also limits derived from RCDCs' governance and their relationship with donors, as their financing is specifically intended for capacity development support and should not be diverted to surveillance activities.

OVERALL ASSESSMENT

Overall, IMF capacity development to SDS was highly valued and considered, both by authorities and Fund staff, as a fundamental contribution to building SDS' capacity. The capacity development delivered was regarded as of high quality, timely, adequate in amount, relevant, and well-tailored. However, it was not problem free.

The most entrenched issue was the limited implementation of capacity development advice, which resulted in weaker impact. While this is clearly an area of shared responsibility by the Fund and national authorities there are several steps the Fund could take, including: (i) strengthening ex ante consideration of recipients' absorptive capacity and ownership; (ii) reallocating resources away from new—and sometimes repeated—CD projects toward supporting the implementation of recommendations; (iii) rationalizing better and more forcefully the provision of IMF capacity development, taking into account not only needs, but also absorption capacity, incentives, and ownership; (iv) aligning the incentives of recipients, for example by increasing the degree to which capacity development provision is conditional on good-faith efforts to implement previous capacity development advice, and by using systematically RBM data as it becomes available to increase transparency on progress being made; and (v) deepening coordination with other capacity development providers, both at the national and regional levels, to minimize overlap, over-supply, and capacity development shopping, and to improve sequencing and quality.

As part of these efforts, the Fund should consider investing more of its own resources in RCDCs and regional resident representatives (with appropriate back-stopping) given that the value added of the resources devoted to capacity development provision in SDS is maximized when channeled through locally based staff in direct contact with country officials. This effect seems to be particularly strong in SDS, due to their high regional concentration and shared characteristics. Localized work by RCDCs and RRs is perceived by recipients as better tailored and implementable capacity development, but its benefits go beyond capacity development, strengthening other functions and improving the general relationship of the Fund with these members. At the same time, dedicating more resources to RCDCs and RRRs would allow them to expand their role in supporting surveillance (and program work when needed) and promote further useful knowledge exchanges within and across regions and among IMF departments.

Various steps could also be taken to maximize the value added of RCDCs. Clearer guidance and/or training to capacity development experts, explaining how best to engage with countries, clarifying duties (including delineation of capacity development provision vs. capacity supplementation), and explaining advisors' responsibilities vis-à-vis country teams, would go a long way in creating a more symbiotic relationship between capacity development and other functions, potentially expanding the contribution of experts to surveillance and program work. It would also be useful to develop a structure within the Fund to effectively manage the knowledge accumulated in RCDCs across regions. A simple coordination mechanism, with low budgetary requirements, would be the creation of a group with representatives from the existing SDS-related divisions, RCDCs, and ICD. Finally, consultations between country teams and RCDCs experts and the participation of the latter in surveillance missions could be more systematic. The experience during the pandemic has proven that more frequent contact can be effective through virtual means of communication.

Country teams and ADs' role in leading prioritization and planning of country capacity development work, with greater focus on end-results, should be strengthened, including by making more systematic use of CSNs and RSNs and building on the emerging results from RBM. This centralization of responsibility would help address concerns regarding absorption capacity assessment, dependence on donor financing and preferences, and supply-driven provision. Higher support and attention by ADs to this task would also help.

HUMAN RESOURCE ISSUES[47]

OVERVIEW

As discussed in previous chapters, given their capacity constraints SDS typically rely heavily on IMF staff for high-quality, sustained, and well-tailored macroeconomic analysis and policy advice. At the same time, for many SDS, the effectiveness of Fund engagement can be affected by wide geographical dispersion, long distance from IMF headquarters, and limited travel connections. All these factors present specific challenges to relationship building, continuity, and effectiveness of engagement, including traction of policy advice, and place a heavy onus on the Fund to ensure that country teams are adequately staffed and incentivized.

ADs have devoted a significant share of their resources to work on SDS. For example, 29 percent of WHD economists and 17 percent of APD economists have full- or part-time SDS assignments. There are no specific overall HR or budgetary guidelines and rules applying to SDS work. ADs with SDS members are responsible for developing their own approaches, including divisional structure, selection of mission chiefs, mission size, and staffing, within the broad set of IMF HR and budgetary procedures. In practice, this has meant distinct approaches being taken in the three main ADs with SDS members (AFR, APD, and WHD). And each department has responded to somewhat different specific circumstances of SDS covered and broader departmental considerations.

A distinctive feature of staffing for SDS work is that, across all ADs, SDS mission chiefs were typically at the A14 or A15 grade level, compared to A15–B3 for country work more generally. Otherwise, the distribution of SDS staff by grade level was similar to that in the Fund as a whole: the majority of economists working on SDS comprised staff at the A14 level, and the distribution of SDS economists by grade also closely matched the distribution of non-SDS staff, although the share of SDS economists in grades A11–A12 was somewhat higher than for non-SDS assignments. In terms of staff origin, very few Fund economists came from SDS.

Overall, Fund staff working on SDS were perceived to have the relevant skills and experience to support SDS. Country authorities generally praised the high quality of staff's analytical work, surveillance, and policy advice and for the efforts to tailor analysis to their specific needs and country circumstances. They praised the role played by mission chiefs, considering them highly skilled, professional, and dedicated to their work, with mission chiefs' knowledge of local conditions perceived to have grown over the evaluation period. Similarly, staff working on SDS assignments across departments were perceived by both country officials and IMF insiders to be skilled, experienced professionals.

[47] This chapter draws on Rustomjee, Chen, and Li (2022).

Notwithstanding the considerable commitment of staff resources and the high appreciation for the individual economists working on small states, work on SDS has been hampered by interrelated HR challenges related to high turnover, short tenure, small teams, and limited incentives. These issues are examined in the following sections.

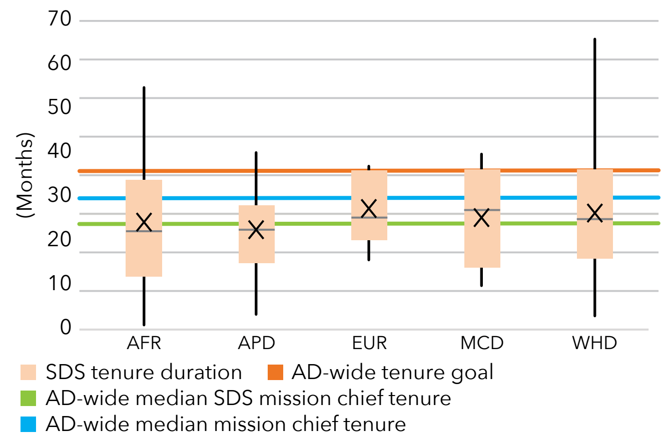
TURNOVER, TENURE, AND CONTINUITY OF ENGAGEMENT

In the country case studies, officials emphasized concern regarding mission chief and country team tenures that were too short, with too high turnover. They felt that too short tenures and frequent turnover interrupted continuity of members' engagement with the Fund, diminished the appreciation for country circumstances, meant that relationships had to be regularly rebuilt and, overall, weakened the traction of IMF engagement. These concerns also emerged in interviews with Executive Directors, showing lower levels of satisfaction with mission chief tenure, team continuity, and country assignment handover than for other countries. Similarly, the staff survey found that high staff turnover was a significantly more severe problem in SDS than in non-SDS. Two-thirds of staff thought that high turnover adversely affected SDS to a great or moderate extent.[48]

Indeed, data confirm that the median tenure of mission chiefs across all SDS was particularly low—only around 2 years compared to the Fund-wide average of 2½ years (Figure 7.1). Examples of very short tenures, of less than six months, occurred five times and there were only two occasions when mission chiefs served for five or more years. The IMF's Accountability Framework targets of an average three-year tenure for each AD was met by only 29 of 154 SDS mission chiefs between 2010–2020.

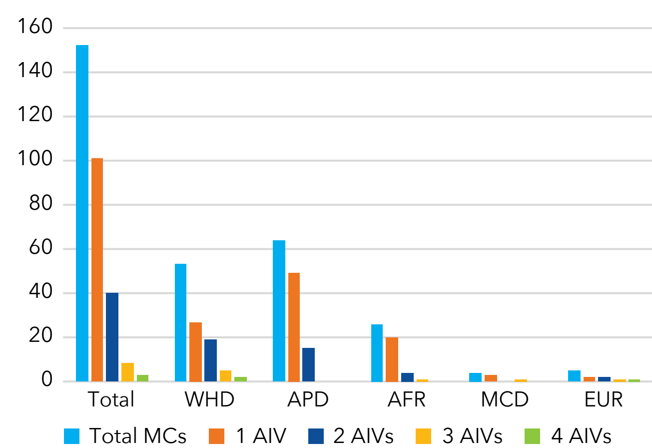
Short mission chief tenure went hand-in-hand with high mission chief turnover, and mission chief turnover was high throughout the evaluation period, across all ADs (Figure 7.2). Fund staff conducted 216 AIV missions to SDS between 2010 and 2020, led by 154 different mission chiefs. Two-thirds of SD mission chiefs (101 mission chiefs) led only a single mission to their designated SDS before moving to a new assignment. Of those that continued beyond a single consultation, 40 mission chiefs led only one more mission to the same SDS and there were only 11 instances in which the mission chief led 3 or more missions to their designated SDS. Mission chief turnover was particularly high for 8 SDS, with every AIV mission during the evaluation period led by a different mission chief. Particularly

FIGURE 7.1. SDS MISSION CHIEF TENURE BY AREA DEPARTMENT, 2010–2020



Source: AIV mission reports (2010–2020).
Note: Graphic for tenure duration indicates median (line in the box), average (cross in the box), interquartile range, and extremes of the distribution.

FIGURE 7.2. MISSION CHIEFS' NUMBER OF MISSIONS TO SAME SDS, 2010–2020



Sources: SDS AIV mission reports (2010–2020); IEO calculations.

[48] Other IEO evaluations have also raised concerns about high mission chief and staff turnover including reports on fragile states (IEO, 2018) and unconventional monetary policies (IEO, 2019).

notable was the absence of any continuity of mission chiefs in four Pacific microstates on a 24-month AIV cycle.

Gaps between a mission chief's end of service and the appointment of the successor also caused problems in maintaining continuity of Fund engagement with SDS. Over the evaluation period, these gaps lasted one month or more in two-thirds of SDS. Only 10 SDS experienced no gap in continuity of service of mission chiefs. Country officials viewed protracted gaps as a signal of disinterest by the IMF and lack of concern to ensure continuity in the relationship. During these periods, SDS authorities considered that they had no main interlocutor with the Fund and subsequently had to devote additional time to informing new mission chiefs of the particular issues and challenges faced by the country once they were appointed. All of this, they felt, eroded trust and the value for the authorities to invest in the relationship with the Fund.

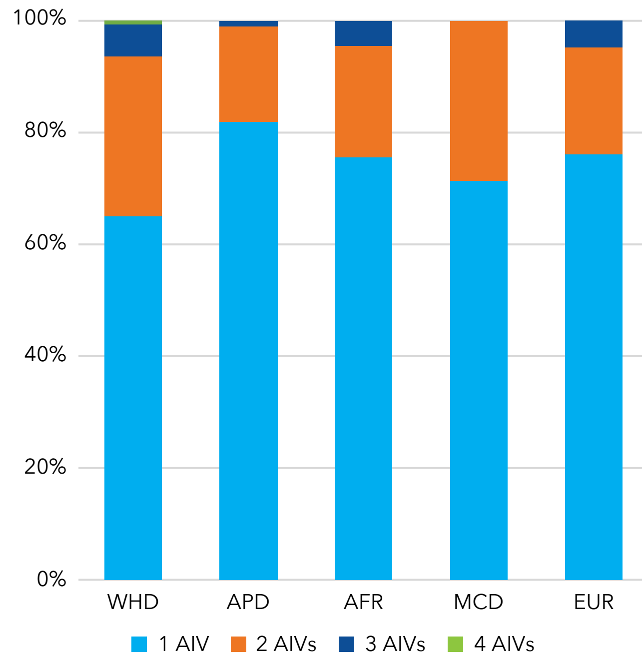
Similar to the experience with mission chiefs, turnover of AD staff on SDS was also high (Figure 7.3). Seventy-one percent of non–mission chief AD staff participated only once in an AIV mission to a specific SDS. This compares to a (still high) 52 percent for 20 large economies, estimated by an earlier IEO evaluation on advice on unconventional monetary policies (IEO, 2019).[49] A further 23 percent returned to the SDS for a second AIV mission, while only 6 percent participated more than twice. All ADs registered single-mission percentages of over 65 percent. Among ADs, the percentage of AD staff who returned for a second or further AIV mission varied widely, as follows: WHD (35 percent); MCD (29 percent), AFR and EUR (24 percent); and APD (18 percent).

INCENTIVES TO WORK ON SDS ASSIGNMENTS

Incentives to work on SDS assignments can be quite different between mission chiefs and team members. For a SDS mission chief, the assignment has typically been provided as a first opportunity for mission-leading experience and provides a desirable stepping-stone to career advancement. However, once mission-leading experience has been successfully gained, there are then incentives to move on to more visible assignments. Internally, all ADs acknowledged the need to lengthen the tenure of mission chiefs on SDS and took several actions to achieve this goal during the evaluation period, both directly by setting tenure goals and by incentivizing interest in the work, through dedicated efforts to strengthen the flow of institutional resources, knowledge sharing, and peer learning elaborated upon further below.[50]

By contrast, desk economists' incentives to take on an SDS assignment are less compelling. On the positive side, SDS economists reported professional rewards and a sense that

FIGURE 7.3. AREA DEPARTMENT STAFF TURNOVER IN ARTICLE IV MISSIONS TO SDS, 2010–2020



Sources: IMF; IEO calculations.
Note: Turnover refers to the share of all AD staff working on an SDS that participated in between one and four AIV missions to the same SDS.

[49] Unfortunately, comprehensive data have not been compiled on turnover or tenure of desk economists, even though a target of three years was set for such assignments following the IEO's evaluation of *The Role of the IMF as Trusted Advisor* (IEO, 2013). However, The Implementation Plan in Response to the Executive Board-Endorsed Categorization of Open Actions in Management Implementation Plans (IMF, 2021d) includes a commitment to enhance such monitoring.

[50] For example, as part of the department's key objectives and deliverables for FY2020, APD included in its Accountability Scorecard for 2020 a new departmental goal to extend MC tenure for small states from two years to three.

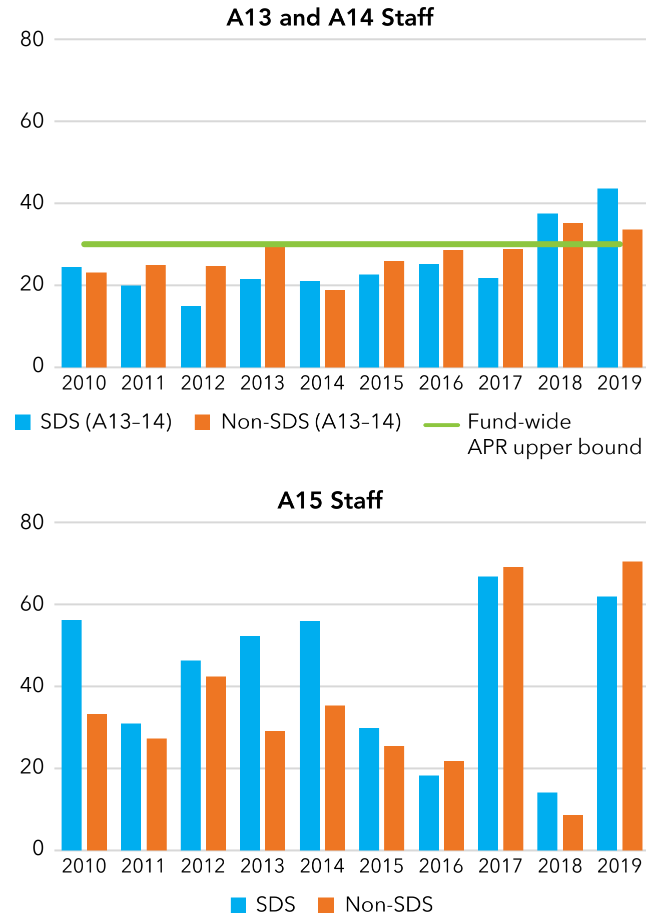
their work made a difference in a small country setting. However, staff voiced concerns regarding heavy workload, small country team size, limited country level data, and, for some desk economists, lack of resources. Staff also noted low visibility and insufficient recognition of SDS desk assignments for career advancement, with very few staff seeing long-term career paths in working on these countries. Indeed, there was some sense of stigma attached to working on SDS countries and a general preference to work on larger, systemic countries, which many staff saw as more important for career progress and which provided research opportunities with more readily available high-quality data. A survey of staff currently working on SDS was broadly consistent with evidence from interviews (de Las Casas and Balasubramanian, 2022b), although SDS-related experience was not considered by the majority of respondents as negative for career progress at the Fund.

To assess the incentives to work on SDS assignments, the evaluation compared experience among SDS and non-SDS staff using three metrics: staff performance ratings, promotions, and vacancy and application rates for SDS. Data on staff ratings suggests that staff working on SDS at A15 tended to be better rewarded compared to more junior SDS staff, through higher ratings (Figure 7.4). However, SDS staff at both the A13 and A14 levels generally fared less well in attaining the higher "Superior" and "Outstanding" performance ratings compared to their non-SDS peers. This contrast presumably reflects that A15s working on SDS uniformly benefit from the challenges and exposure of being a mission chief, combined with the fact that higher-performing staff have typically received the mission chief opportunities.

Turning to promotion prospects for grades A13–A15, staff working on SDS tended to be promoted less often than staff working on non-SDS assignments. Differences were most pronounced at the A13 level, while at A14 and A15, promotion rates were almost comparable among staff working on SDS and on non-SDS assignments (Figure 7.5).

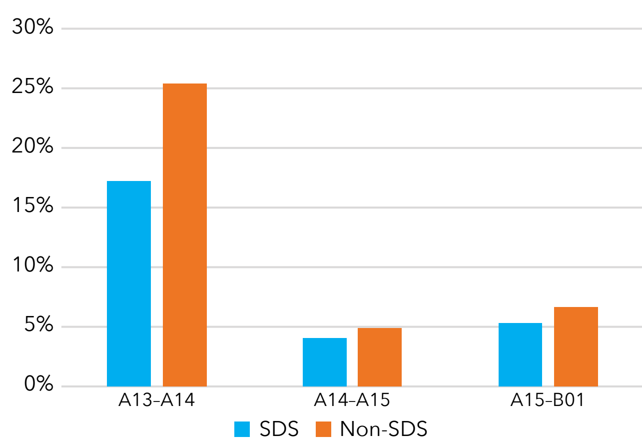
Evidence of slower rates of promotion among SDS staff accorded with staff perceptions that SDS assignments may offer limited career prospects, as well as with staff survey results on prospects for career progression when taking on an SDS assignment. Among survey respondents, just under a fifth of respondents thought that an SDS assignment

FIGURE 7.4. STAFF WITH "SUPERIOR" OR "OUTSTANDING" RATINGS, 2010–2019
(In percent)



Sources: IMF; IEO calculations.

FIGURE 7.5. PROMOTION OF STAFF WORKING ON SDS VS. NON-SDS ASSIGNMENTS 2010–2020
(In percent of total in each category)



Sources: IMF; IEO calculations.

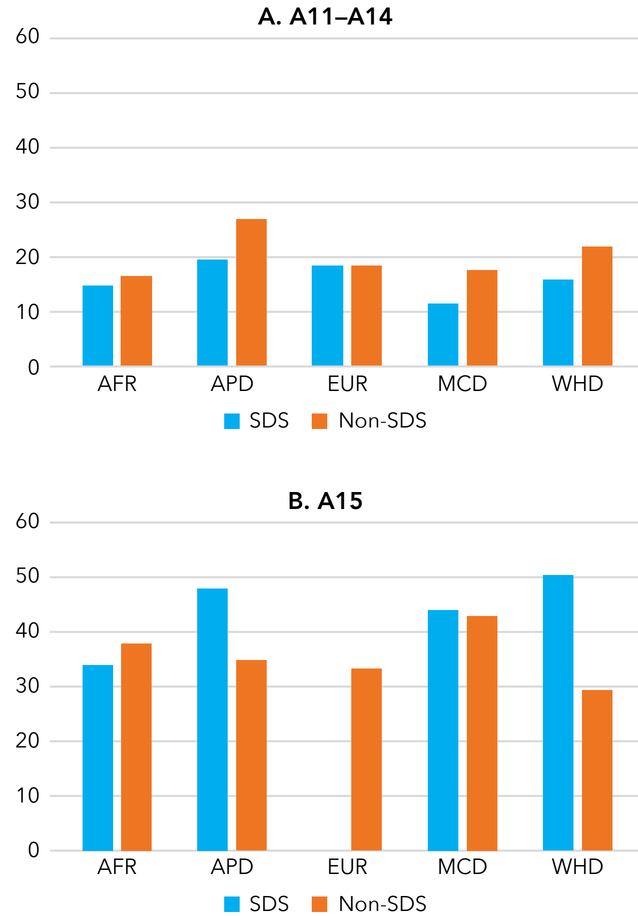
would negatively affect their career prospects at the Fund, about one-third were unsure, and only a quarter of the respondents considered there to be no difference on their career development between an SDS-related assignment and a non-SDS-related assignment. Staff who worked on an SDS assignment provided closely similar responses to those who had not worked on an SDS assignment.

The number of applications for vacant positions provides a useful indicator of the extent of staff interest in the position, as staff positions are openly advertised when they become vacant and applicants compete for these positions. The evaluation found that in the period 2016–2019, for vacancies at the A11–A14 levels, interest in SDS positions was on average about 20 percent less than for non-SDS positions, although application rates for SDS rose noticeably in 2020 and for the first time since 2016 exceeded levels of interest in non-SDS assignments (Figure 7.6). By contrast, A15 SDS positions attracted much higher interest throughout 2016–2020, with average numbers of applications (47 applications per SDS position), close to average numbers of applications for A15 positions in ADs (40 applications per non-SDS position).

ADs have taken steps to support staff in SDS mission chief assignments, helping to make the assignments attractive and providing support to newly fledged mission chiefs. For example, in 2015, APD delivered a two-day event with HRD for mission chiefs working on SDS, highlighting opportunities and challenges for mission chiefs and available support mechanisms, including toolkits, peer learning, interdepartmental collaboration, leveraging inter-departmental resources, and engaging with development partners. In 2017, APD also developed a comprehensive manual ("SDS Mission Chief Toolkit"), including information on intra-departmental resources, strategy and cross-country policy issues, analytical work, and outreach, and IT resources to manage engagement due to large distances between SDS and the regional hub in Fiji.

Interviews with staff with close experience of the practice of providing a SDS mission chief assignment as a stepping-stone to promotion suggested that this approach was effective in strengthening interest in such an assignment but also tended to exacerbate issues with short tenure and high turnover. Staff who were subsequently promoted to A15 level considered the experience of leading a mission to

FIGURE 7.6. APPLICATIONS PER POSITION, 2016–2020



Sources: IMF; IEO calculations.

an SDS to have enriched their knowledge and experience, but also felt that opportunities for career progress lay elsewhere once their term of service as an SDS mission chief had been completed.

As for SDS desk assignments, to help meet SDS staffing needs, both APD and WHD allowed for co-desk assignments, pairing a SDS desk assignment with a second assignment, which could be on another SDS or on a larger country, often in a different division altogether. In APD, almost 30 percent of A14 mission chiefs on SDS assignment were simultaneously serving as a co-desk economist for another country. This practice was even more prevalent in WHD, where about 61 percent of A14 mission chiefs working on an SDS assignment were also a co-desk economist on a second country. The prevalence of co-desk responsibilities in SDS meant that many staff in

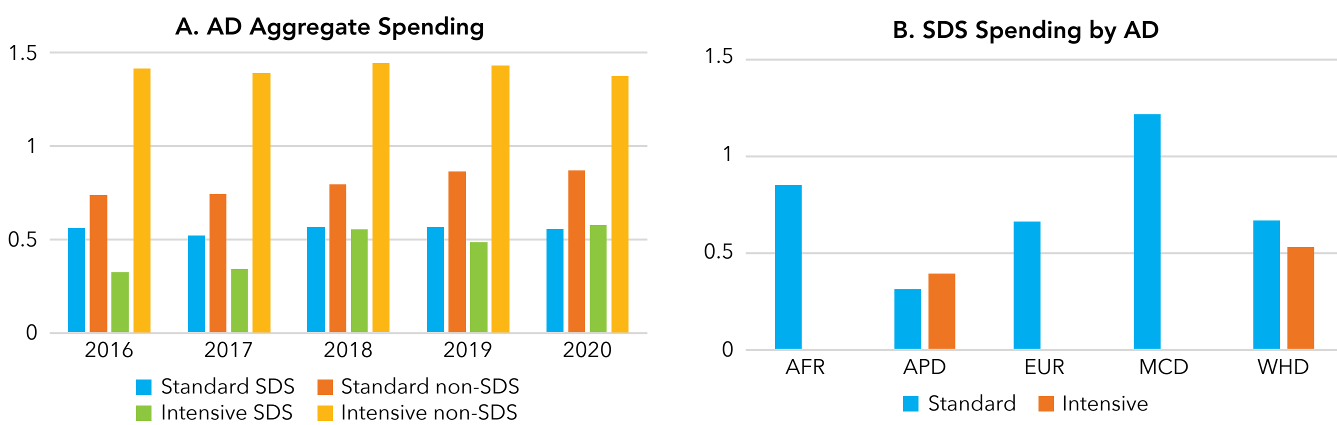
SDS country teams spent only a fraction of their time on the SDS in question. Indeed, some SDS teams are run on a skeleton basis until some months before a surveillance cycle begins. The staff survey found that only one-fifth of staff who responded devoted 100 percent of their time to a single SDS country. About half of respondents spent less than half of their work hours on their SDS assignments and more than a quarter of the respondents spent less than 25 percent of their time on SDS. Overall, this approach proved useful to address staffing issues but also had the effect of diluting staff time spent on SDS and created a sense that the assignment was less important.

An initiative announced in 2020 to establish a new career framework for fungible macroeconomists (staff at grades A11–A14) could further increase challenges for staffing many SDS. The framework, which is intended to support career planning and strengthen incentives to work on LICs and FCS, includes a provision, starting in July 2023, requiring a minimum of two years of operational experience in working on PRGT-eligible countries or FCS before fungible macroeconomists can progress to A15 level. Currently, 19 out of 34 SDS fall into these categories.[51] Several staff raised concerns about the impact of the new framework on incentives and motivation to work on the 19 SDS not included in the FCS/PRGT-eligible lists. Some highlighted that the new requirement has already had an impact, reducing the number of applications for some SDS assignments that are not on the FCS/PRGT-eligible lists; they suggested that to restore the ability of ADs to attract staff to work on SDS members, it would be necessary to include all SDS in the provision. However, other staff emphasized that there is high heterogeneity regarding the attractiveness of working on individual SDS (with higher-income SDS often being well-developed and in attractive locations), and therefore, not all of them would require the same treatment.

COUNTRY TEAMS

Budgetary data clearly show that surveillance resources per SDS were significantly lower than for other groups. On average over the five-year period FY2016–2020, on a per country basis, "standard" surveillance for an SDS member absorbed about 24 percent less than the average spending on "standard" surveillance per Fund member; and about 66 percent less than the average spent per Fund member on "intensive" surveillance (see Figure 3.1). MCD and AFR devoted the highest levels of spending per SDS on standard surveillance. In APD, spending per SDS on standard surveillance was particularly low, slightly less than half of the level of spending in WHD and in EUR; and just over a third of that in AFR (Figure 7.7).

FIGURE 7.7. AREA DEPARTMENT SPENDING ON SURVEILLANCE PER COUNTRY, 2016–2020
(In millions of USD)



Sources: IMF; IEO calculations.

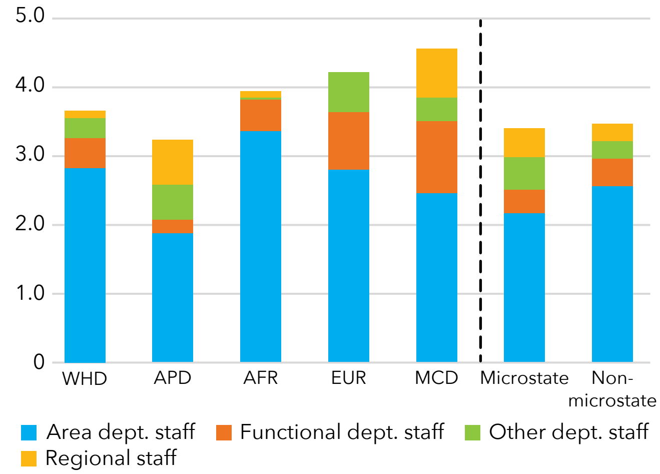
[51] These currently include 19 SDS classified as PRGT-eligible, of which 10 are also classified as FCS.

Departments reported that they had generally been able to staff surveillance work on SDS in line with overall guidelines from the IMF's Office of Budget and Planning, albeit with challenges in some instances.[52] In AFR, EUR, and MCD, SDS country teams typically comprised a mission chief (who usually had in addition another country or policy assignment), two desk economists, with at least one dedicated to the country and the second usually a shared resource. On missions, these country teams were supplemented by another staff member, typically a research assistant or a junior economist from the same department. In WHD, country teams comprised a mission chief and 2–4 economists, depending on the SDS; most economists had additional country assignments. In APD, country teams typically consisted of the mission chief and one or in some cases two desk economists, all with other assignments absorbing at least 50 percent of their time. When a country was in a program, in all ADs country teams also included at least one functional department economist (one from SPR, and possibly others from the Fiscal Affairs Department (FAD) or the Monetary and Capital Markets Department (MCM).

While systematic Fund-wide data on SDS country teams are not available, the evaluation estimated the size of SDS country teams based on a review of Board reports of all AIV missions to SDS between 2010 and 2020. Excluding mission chiefs, over the evaluation period country team size per AIV consultation averaged 3.4 staff per mission. The largest teams were assembled for MCD AIV missions (an average of 4.3 staff per mission excluding the mission chief). By contrast, in APD, team size averaged 3.1 persons (Figure 7.8). This low number partly reflected the prevalence of micro-states among APD SDS, where staffing is typically lower.

Functional department participation in SDS AIV consultations was quite limited (see Figure 7.8), although reportedly it increased in the context of virtual missions during the pandemic. On average, over 2010–2020 a functional department economist participated in about one in every two SDS AIV missions in WHD and in AFR and about one in every three SDS AIV missions in APD. SPR, FAD, and MCM provided two-thirds of these functional economists. Country authorities welcomed the participation of functional economists on AIV and program missions where it did occur, considering functional department staff to have specialist expertise relevant to providing more granular advice on addressing particular fiscal policy, growth-related, and financial sector issues and on challenges related to volatility and shocks.

FIGURE 7.8. SDS COUNTRY TEAMS: AVERAGE SIZE PER AIV MISSION, 2010–2020



Sources: AIV Reports (2010–2020); IEO calculations.
Note: Excludes mission chiefs.

Staff from other departments were included in country teams for SDS much more frequently than for non-SDS, a practice that helped fill gaps in country teams. During 2010–2020, approximately 5 percent of all staff participating in AIV missions came from departments other than area and functional departments. However, while useful as a stop gap, their participation exacerbated issues related to high turnover. Staff from other departments rarely returned on successor missions. In four instances, missions were led by staff outside of the AD itself, presumably attracted by the possibility of gaining mission leadership experience, but not providing any continuity of engagement.[53] In five other instances, except for the mission chief, no AD staff participated in the mission.[54]

[52] Country-specific and departmental practices are described in separate evaluation background papers, for selected SDS in APD (Maret and de Las Casas, 2022), WHD (Da Costa and Rustomjee, 2022), and AFR, EUR, and MCD (Lane and de Las Casas, 2022).

[53] AIV missions for Vanuatu (2011, led by staff from OMD); Kiribati (2018, RES), Micronesia (2017, STA), and Tuvalu (2018, SPR).

[54] AIV missions for Samoa (2017, 2019), Tonga (2013, 2017), and Tuvalu (2016).

RESIDENT REPRESENTATIVES

Resident representatives (RRs) generally played a very limited role in SDS work. In 2020, only one SDS (Barbados) benefited from an individual country RR—out of a total of 50 RR assignments Fund-wide. Most RRs are assigned to program countries, but even SDS with programs typically do not have RRs. Nevertheless, 12 SDS benefit from two regional resident representative (RRR) offices; one based in Fiji, covering 11 Pacific islands, and one in Vienna, covering Montenegro and other (non-SDS) countries. In addition to RRs and RRRs, regional staff also include RCDC coordinators and RCDC advisors when the location of the RCDC is an SDS (see Chapter 6).

Authorities generally praised the role played by Fund staff who were located locally or regionally, including RRs and RRRs, in strengthening the Fund's engagement with SDS.[55] They felt that RRs and RRRs played an important role in promoting visibility of the Fund, maintaining continuity in Fund engagement, providing hands-on advice to authorities and supporting coordination between the Fund, other IFIs and development partners.

Officials complained, however, that there were too few RR positions in SDS, particularly in program and near-program cases. A number of countries appreciated specifically the role played by the regional office in Fiji but observed that its staff were stretched quite thinly and did not meaningfully reduce problems of gaps in Fund engagement, especially in years between missions. Interviews with staff, including RRs and RRRs for SDS, corroborated authorities' views regarding the role and contribution of RR and RRR posts, in helping strengthen the quality and depth of Fund engagement with SDS and providing continuity to engagement, but also recognized that these posts were typically under-resourced.

OVERALL ASSESSMENT

The data and analysis presented in this chapter confirms the widespread perception that while IMF staff working on small states are well qualified and as committed as their colleagues on other assignments, IMF engagement on SDS is hampered by substantive challenges in staffing this work.

Overall, the continuity of Fund engagement with SDS members was limited by high mission chief and country team turnover and correspondingly short tenures over the evaluation period. Mission chief turnover was persistently high in all ADs and was a particular challenge among microstates and other members on a 24-month AIV cycle. To be sure, high mission chief turnover and low tenure are problems at the Fund more generally, but the problem was more acute for SDS, with the adverse consequences noted by country officials in interviews. At the same time, gaps in mission chief assignments occurred too frequently and attention is needed to systematically reduce and close these. In addition to lengthening mission chief and desk economist tenures, the lack of continuity problem could be palliated, to some extent, with more involvement of front office reviewers, who could serve as reservoir of local and regional knowledge and support mission chiefs, including through joining surveillance missions occasionally. More generally, more systematic handover procedures would be helpful to reduce the disruption from frequent mission chief turnover but cannot fully relieve the problem.

High turnover and short tenure observed for SDS related to the difficulties of incentivizing staff to work on these countries. For mission chief assignments, the opportunity to gain mission chief experience as a path to promotion was effective in attracting staff to such positions but also contributed to high turnover once such experience had been gained. Turnover was particularly high in APD when the mission chief was quite often someone from a different non-SDS division. This use of more junior but able economists as mission chiefs can provide a valuable way to fill the mission chief role—but should be combined with greater commitment to avoid one-off assignments and avoiding gaps in filling the position, as well as efforts to ensure that staff are well prepared for their first mission leading role—an area where departments have paid attention, but such efforts need to be regularly followed up.

Incentives to take up SDS desk positions were generally quite weak. Data on performance ratings, promotion rates, and number of applications for vacant positions all suggested that an SDS desk position was generally less positive for career progression than for non-SDS positions.

[55] RRs are AD staff. For purposes of engagement with members, SDS perceive RRs not as AD staff, but rather as staff who are regionally located and therefore more accessible to authorities.

There have been few initiatives to increase the attraction of an SDS assignment, other than to pair such an assignment with another larger country assignment. The recent decision to require that fungible macroeconomists have work experience on a PRGT-eligible or FCS country for A15 promotion could further complicate the task of recruiting for the 17 SDS desks that are not on either list.

In addition to high rates of turnover, SDS teams are also challenged by relatively small size, the high incidence of co-desk assignments, the limited role of functional department specialists, and the use of inexperienced economists from other departments. The prevalence of co-desk responsibilities among AD staff working on SDS has resulted in dilution of staff time spent on individual SDS and a sense that the assignment is less important. More functional department participation, at least in virtual form, could help address the appetite of SDS officials for greater expertise and granularity in advice identified in Chapter 4. Use of staff from other departments was generally a stopgap measure to fill mission teams and should be avoided if possible, as the value added is likely to be small and the participation of staff from other departments can send an adverse message to country authorities. Greater access to research assistant support could help to reduce the burden on country desks from normally routine data management tasks, which can be particularly onerous in the SDS context because of inadequacies in official statistics.

Where it occurred, the inclusion of staff from regional offices improved visibility, coordination and feel for local conditions, but RRs and RRRs generally played quite a limited role relative to non-SDS. Options to expand the contribution of these offices while limiting associated costs include creating more multi-country RR offices and augmenting staffing in existing RR and RRR resident offices, through the allocation of additional Fund staff economists as well as local economist staff located in each regional office. This could bring considerable benefits in strengthening continuity and relationships, by allowing for more regular participation in AIV missions and providing follow-up support between missions.

Overall, dealing with the challenge of too short tenure, too rapid turnover, and poor handovers in SDS is likely to be challenging. The steps taken to strengthen monitoring and reporting of these issues in the recent management implementation plan (MIP) to address such issues more generally in the Fund (IMF, 2021d) will be helpful to strengthen transparency and accountability. However, they will need to be reinforced for SDS in particular to ensure that SDS do not continue to languish at the lower end of the range on turnover issues, particularly given the added incentives recently provided for work on LICs and FCS in the new career framework for fungible macroeconomists by making such work required operational experience for promotion eligibility to the management level.

In addition to strengthening HR management, it will also be important to pay greater attention to raising the profile, attractiveness, and prestige of SDS work at the Fund to increase the incentives for staff to work on these assignments. Actions could include further steps to demonstrate strong senior Management appreciation of the importance and value of SDS work at the Fund and greater recognition that SDS work can sometimes be at the cutting edge of Fund work on important issues like climate change and resilience building.

8

KEY FINDINGS AND RECOMMENDATIONS

This chapter briefly recaps the evaluation's findings relevant to the Fund's main activities in SDS, as well as HR issues. It then makes some recommendations for how to further strengthen the IMF's contribution to its small state members.

FINDINGS

Overall, the IMF deserves considerable credit for having substantially stepped up its engagement with its SDS members over the decade covered by this evaluation. This is a group of countries that, while very small from the perspective of the global economy, represents 18 percent of the membership and faces persistent economic, environmental, and other forms of vulnerability that pose a special challenge for the IMF. Indeed, some of these vulnerabilities are growing, particularly those related to natural disasters and climate change (ND&CC), while continuing fallout from the COVID-19 pandemic has further compromised SDS economic prospects.

The Fund's increased contribution to SDS reflects a number of factors. First has been the considerable efforts to develop specific guidance for Fund work on SDS, identifying key areas where the IMF can support the special needs of small states. This work built on a growing body of research on SDS economic challenges, first outside the Fund and later inside. Second has been the Fund's increased attention to climate change issues more broadly, which in some respects was spearheaded by work on small states. Third has been the rising resources devoted to capacity development work and the strong role of regional centers, which have particular relevance for SDS. And fourth has been commitment by Executive Board members to champion the cause of SDS work at the Fund and the commitment by management and staff to support these members despite continuing resource constraints.

All this said, the Fund's work on small states has also faced a number of challenges that have adversely affected the overall value added and traction of the Fund's contribution to these members. First among these is difficulties in staffing SDS assignments, which has led to high turnover rates that have complicated efforts to assure the high quality of SDS engagement. Second is that the Fund's lending facilities do not seem particularly well suited for the needs and capacities of small states, offering few resources relative to financing needs and implying quite high transaction costs, which has contributed to the comparatively low take-up of Fund resources, particularly through Upper Credit Tranche (UCT) programs. Third is the relatively limited institutional capacity in SDS themselves to implement IMF policy and capacity development advice, as well as continuing political economy concerns about Fund conditionality that have deterred program engagement. Fourth is the challenge of intermittent interdepartmental coordination of IMF SDS work, particularly since success of initiatives to strengthen Fund engagement with SDS has sometimes been dependent on key individuals.

Surveillance

IMF surveillance is greatly appreciated in SDS and generally considered by country officials as of high quality and well-tailored to SDS specific needs. Surveillance work over the evaluation period drew on substantial analytical work conducted in the IMF, which, in turn, benefited from a body of external literature on small states that started growing in the late 1990s. Work on issues of central importance to small states—including for example on debt sustainability, climate change policies, and correspondent banking—was particularly appreciated by country authorities and benefited from application of surveillance tools like the Debt Sustainability Assessment (DSA) and Climate Change Policy Assessment (CCPA). SDS surveillance can be particularly important to these members because in many of them the Fund is the principal source of authoritative external macroeconomic analysis and advice and can help fill capacity gaps.

Despite the positive overall assessment of surveillance, the evaluation found several reasons for concern. Low frequency of surveillance engagement (especially in the Pacific region), the high turnover of mission chiefs and country team members, and insufficient attention to assignment handovers negatively affected surveillance by limiting continuity of policy discussions, hampering staff's understanding of country specificities, and eroding the visibility and reputation of the Fund. Small teams were challenged to meet a large number of standard Fund Article IV (AIV) surveillance practices and apply complex diagnostic tools in view of data and other constraints faced in small states work. While CCPAs and Financial Sector Assessment Programs (FSAPs) were appreciated when available, only a few countries were able to benefit from the in-depth treatment they offered. More generally, Fund advice sometimes lacked actionability and specificity, particularly in areas beyond the Fund's core expertise but still considered macro-relevant by the authorities, such as growth-related sectoral policies, but also in areas more central to the Fund's work given the limited participation of functional department experts.

Reflecting these constraints, the traction of IMF surveillance was mixed. More advanced SDS tended to benefit to a greater extent, while more capacity-constrained SDS sometimes struggled to absorb and follow through with the Fund's advice on addressing underlying problems beyond day-to-day challenges.

In light of this experience, there would seem to be scope to further adapt surveillance approaches and tools to the SDS context, while still satisfying Fund-wide surveillance requirements. This process could be guided by a refresh of the SDS staff guidance note (SGN). In particular, the SGN could place more emphasis on flexibility and attention to emerging issues that are macro-critical but not where the Fund itself has deep expertise. Reforms to the DSA methodology have significantly enhanced the DSA's relevance for SDS, but further attention could be given to how it can be best applied in the SDS context, including to emphasize the incorporation of infrastructure and climate resilience investment and to consider how best to apply the framework in microstates with particularly limited data and institutional capacity. Cost-effective ways should be found to apply climate change diagnostic tools (now known as the Climate Macroeconomic Assessment Program, CMAP) to a broader range of SDS given their particular relevance for these countries. It is also worth considering how to increase access to financial assessment and diagnostic tools like the FSAP and Financial Sector Stability Review (FSSR) and provide greater focus on macro-critical financial development challenges. Finally, the EBA-lite has proven of little value in SDS, given its complexity and data requirements among other reasons, suggesting the need for a less mechanical and time-consuming approach for assessing external balances in SDS.

Given resource constraints, achieving such an ambitious agenda for SDS surveillance will require willingness to innovate and commitment to working with partners. In particular, greater attention could be paid to developing regional and thematic approaches to SDS surveillance andrelated research. For example, in cases where policy challenges are common among SDS members, some FSSRs and CMAPs could be prepared in a regional or cluster rather than country framework, which would take advantage of cross-country synergies as well as gaining economies of scale. Also, there could be greater efforts to draw cross-regional lessons from work on common SDS issues being done in individual area departments (ADs), particularly macro-critical issues where the Fund has limited expertise.

Greater attention could also be given to working more closely with partner institutions totake better advantage of inter-agency synergies. This includes work on issues that can be macro-critical for SDS but where other international or regional organizations have much deeper expertise, such as diversification and sectoral issues. Effective ways need to be found for collaborating effectively with the World Bank on climate change issues notwithstanding decisions taken last year to stop working jointly on climate-related assessments.

Lending

Despite incremental evolution during the evaluation period, mainly repeated increases in access limits for emergency financing, the overall IMF financing architecture has not been especially well suited to the particular needs of SDS, and use of Fund resources by SDS has been substantially less (on a relative basis) than that by other emerging market and developing countries (EMDEs).

In particular, SDS made sparse use of Fund UCT programs under the GRA and PRGT, requesting them substantially less often than non-SDS. Some of the reasons for this reluctance are deep rooted and may be hard to remedy, including some authorities' aversion to Fund conditionality, particularly when alternative sources of official financing were available. Other factors fall more clearly within the Fund's reach: low access levels relative to financing need; the high administrative burden of negotiating and monitoring UCT programs; the short time frame for Fund arrangements compared to the time needed to address SDS' deeply rooted structural weaknesses; and limited understanding of the Fund's program framework, including for non-financial instruments.

In practice, where SDS did make recourse to UCT programs, the completion rate was considerably higher than for other groups of members, suggesting adequate support for implementation in the program context. The principal objectives of these programs were to achieve fiscal adjustment and address debt-sustainability problems, but GRA programs in particular also brought some growth benefits—PRGT programs, less so. No SDS requested a UCT program to address recovery from, or resilience building for, ND&CC. The recent initiative to design a Resilience and Sustainability Trust (RST) using rechanneled SDR resources could potentially provide a very valuable new instrument for SDS financing on attractive terms and longer duration for the reforms and investment needed to build disaster resilience, but it will be important that this new instrument be implemented in a way that facilitates use in the circumstances faced by SDS.

SDS have been more inclined to use rapidly disbursed IMF emergency financing (EF), with no ex post conditionality, to meet disaster needs, to help deal both with large climate- and weather-related shocks and with the COVID-19 pandemic. The Fund's capacity to provide larger disbursements in the aftermath of a disaster has increased, but access is still quite limited relative to post-disaster financing needs, and repayment terms and conditions are often less attractive than financing available from elsewhere. Partly as a result, only a limited subset of SDS have made recourse to EF after a natural disaster. Use of UCT programs could offer higher access but, in practice, countries chose not to use such programs with ex post conditionality as a source of financial support in the wake of a natural disaster. Indeed, some countries experiencing large natural disasters chose not to request IMF financing at all, although they still counted on positive IMF assessments to support access to financing from other sources.

SDS made much wider use of EF in response to the COVID-19 pandemic. While about a half of all SDS did not request EF, SDS drew on EF more than at any previous time and the loans were disbursed very quickly. This support was much appreciated by recipient SDS, although the amounts available were still quite limited compared to the scale of financing needs, even after the temporary increase in access limits. In fact, because SDS tended to face larger COVID-19-related shocks relative to the size of their economies, the share of financing needs met by the Fund were smaller and the need for SDS to deplete their international reserve cushions correspondingly greater. Two SDS with serious debt sustainability problems were not judged as eligible to draw.

This generally positive recent experience suggests that the Fund's responses to the pandemic—including the temporary increases in access limits and streamlined procedures—may hold lessons for how the Fund's EF architecture could be adapted to better serve SDS needs (and those of other members facing very large shocks too).

In particular, consideration could be given to allowing for some additional flexibility to offer higher access than the normal 80 percent of quota for large natural disasters to the 130 percent provided on a temporary basis during the COVID-19 pandemic. This additional amount could be made available specifically for countries with sound macro-economic policy and governance frameworks that provide robust safeguards for use of Fund resources. Similarly, cumulative access limits could also be increased to address challenges that may be faced by members with solid policy frameworks hit by repeated natural disasters or health-related shocks within a short period. Such adaptation to the EF lending instruments would provide some more room for the Fund to support countries that have high-quality policies but are faced by sudden very large financing needs from a natural disaster without compromising the principle that availability of emergency financing should not deter members that need adjustment measures and structural reforms to address their balance of payments problems from seeking a UCT program.

Capacity Development

The increasing concentration of IMF attention to SDS on capacity development work seems well suited to these countries' particular needs. SDS generally appreciated the quality, quantity, content, and tailoring of the capacity development support received from the Fund, which by and large responded to the institutional constraints faced by these countries. A concern is that the build-up of capacity development support has depended on external financing, which could constrain the allocation of capacity development and poses a risk that provision of such financing could come under strain.

The key role played by Regional Capacity Development Centers (RCDCs), which SDS pioneered at the Fund, has been a driver of success. RCDCs were closer by and more knowledgeable about local circumstances, they supplied the longer-term support these members needed, and they provided a degree of continuity in the Fund-member engagement that is much more difficult to achieve from HQ. RCDCs were not only effective in supporting capacity development work but they also contributed to other IMF functions—palliating the scarcity of RRs in SDS and improving the institution´s reputation—and served as useful coordination centers.

Nevertheless, implementation challenges still reduced capacity development traction and impact. A key obstacle to effective implementation was the limited absorptive capacity in many SDS, compounded in some cases by lack of ownership on the part of officials. As for the Fund, some concerns were raised by SDS officials regarding insufficient recognition of capacity constraints and the tendency to focus advice on first-best solutions, even when humbler advice would have been more practical. As results-based management (RBM) and the Capacity Development Management and Administrative Program (CDMAP) mature and provide a fuller set of data, they could provide useful insights on what works well for SDS to improve capacity development allocation, design, delivery, and implementation. Care will also be needed to ensure sustained funding for RCDC work on small states, which may require an increased contribution from IMF internal budgetary resources.

Human Resources

The Fund has spent considerable staff resources engaging with SDS, a commitment that remained broadly stable over the evaluation period. In the absence of specific HR or budgetary guidelines and rules applying to SDS, ADs with SDS members developed their own individual approaches to mission chief selection, mission size, and staffing, seeking to balance the commitment to provide adequate support for SDS with broader departmental staffing needs and resource constraints.

In practice, striking the right balance has been difficult, as work on small states has been adversely affected by high turnover and short tenure. Staff working on SDS assignments felt personally rewarded by working in small country settings where their efforts made a tangible difference. And their expertise, efforts, and commitment were generally well appreciated by country officials. At the same time, however, institutional incentives for staff to work on SDS positions were poor, with lower performance ratings and promotion rates for SDS economists at levels A13–A14 than their non-SDS counterparts, contributing to low application rates to SDS vacancies and more rapid turnover. This problem seems likely to be exacerbated by the special incentives to staff to work on LIC and FCS assignments in the new career framework for fungible macroeconomists. Use of co-desk assignments with other larger countries outside the division diluted staff attention to their work on specific SDS. The use of staff from non-area and non-functional departments to fill out small country teams compounded problems with continuity of engagement.

Departments have had less difficulty in recruiting A15s as mission chiefs for SDS assignments because such positions provide a useful stepping-stone to career progression—but the result has again been limited tenures and high turnover as staff look for promotion opportunities elsewhere. Two-thirds of mission chiefs led only a single mission before moving on to a new assignment, while more than a half of all SDS mission chiefs served less than two years. Moreover, significant gaps in mission chief assignments occurred in two-thirds of SDS.

Small team size and the limited skill sets of teams have also been a constraint. Teams typically do not include functional department economists, except in program situations, implying more limited capacity to provide granular advice. And teams seldom benefit from support from a dedicated resident representative who can help ensure adequate continuity ofengagement and appreciation for local conditions.

Addressing these issues within the Fund's institutional structure and limited resources is not a straightforward task as ADs seek to meet multiple staffing challenges. Steps on the HR front that could help include requiring greater commitment to ensure that mission chiefs spend a minimum of two years on an SDS assignment before moving on; greater commitment to avoid gaps in mission chief assignments and abrupt changes at critical moments; more sustained attention to improving handover procedures; increased recognition of top-notch and innovative SDS work in performance ratings and promotion decisions; and reduced use of co-desk assignments where the SDS assignment is seen as a second fiddle to another larger country assignment in a different division. In addition, a reviewed SGN could offer more practical guidance to staff on an array of policy, institutional, analytical, and management issues relevant to engagement with SDS, building on successful past initiatives—for example, APD's toolkit for mission chiefs.

Further consideration could also be given to the mix between HQ- and field-based staff. The successful experience with RCDCs would seem to suggest that increased budgetary resources for staffing regional resident representative (RRR) offices to support surveillance and program work would be fruitful, recognizing the high cost of individual country resident representatives in SDS. At the same time, experience during the COVID-19 pandemic has shown that greater use of virtual communications could help support continuity in the relationship between HQ-based staff with country officials and to bring in specialist expertise when needed. However, the pandemic experience also suggests that such virtual communications are not a full substitute for in-person connections.

As a complement to strengthening HR management and enhancing on-the-ground presence, it will also be important to pay greater attention to raising the profile and prestige of SDS work at the Fund to increase the incentives for staff to work on these assignments, particularly given recent steps to encourage work on LICs and FCS. In this respect, management and senior staff could play crucial roles to champion work on small states as making an important contribution to the Fund's mandate.

Implications for Enterprise Risk

Given their small role in the global economy, any shortcomings in the effectiveness of Fund engagement on SDS work do not raise substantial risks for the stability of the global economy or financial systems. However, given SDS' heavy reliance on the Fund for reliable external policy advice and capacity development support in macro-critical institution building, such shortcomings do certainly have consequences for the SDS themselves. There are also consequences for SDS from the limited fit of IMF financial instruments to SDS circumstances, although these are offset for many SDS by availability of alternative sources of external financing.

Recognizing the effective steps taken to strengthen IMF engagement over the evaluation period, such risks are assessed as moderate at the current time for most SDS (although somewhat higher for the more remote and geographically isolated SDS). However, such risks could rise over the years ahead in light of SDS vulnerability to climate change–related shocks, which seem likely to become even more challenging over time, and the uncertainty regarding the future course of the COVID-19 pandemic, especially for tourist-dependent SDS.

Moreover, the IMF is itself exposed to reputational risk if it is perceived as not paying adequate attention to the economic and financial needs of a substantial section of its membership. Such risks were probably low to moderate before the pandemic, mitigated by the Fund's significant efforts to address SDS concerns over the past decade. During the initial phase of the pandemic, the Fund's reputation benefited from the widespread use of IMF emergency financing, although there were concerns that access was small relative to the scale of the shock, particularly for SDS. However, reputation risks could well increase in the years ahead as SDS face increasing challenges and financial needs from climate change and continuing uncertainty from the COVID-19 pandemic.

RECOMMENDATIONS

Recognizing the substantial progress that has been made over the past decade in strengthening the IMF's engagement with SDS and the need to respect broader institutional constraints, the evaluation does not believe that a major overhaul of the Fund's SDS engagement is called for. Nevertheless, there is scope for some targeted recalibration of the Fund's work on SDS that would help to raise the value added and impact of this engagement while imposing limited additional budgetary costs.

Towards this end, the evaluation offers four broad recommendations together with specific suggestions in each category, which are intended to be mutually reinforcing. The four recommendations cover a focused refresh of the IMF's overall approach to SDS work; specific operational steps to strengthen the traction of surveillance and capacity development work; suggestions on how to make better use of the Fund's lending framework to serve SDS needs and constraints; and further HR and budgetary commitments to support continuity and impact of IMF engagement with SDS. Implementing these recommendations could also bring benefits for the Fund's work more generally through institutional learning on issues such as ND&CC, where SDS initiatives have often spearheaded the Fund's attention.

Recognizing the Fund-wide budgetary constraints and the competing demand for resources, these recommendations are primarily intended to maximize efficiency and impact inthe use of budgetary and HR resources currently applied to SDS work. They do not envisage a substantial, permanent increase in the budgetary envelope for this work. However, there would be some initial need for resources to update guidance and some longer-term need for additional resources in specific areas, including the recommended increase in the Fund's field presence in SDS, although there could also be some efficiency savings.

In putting forward these recommendations, it should be recognized that many of the concerns raised in this evaluation about the engagement with SDS are relevant to the Fund's work more generally, have been raised in other IEO evaluations, and have prompted past and ongoing efforts, including in management implementation plans (MIPs) for some recent IEO evaluations. Such issues include the need for greater granularity and country awareness for advice; deeper and more effective collaboration with partners; longer staff tenures in country assignments; and greater field presence. However, these issues seem to be particularly problematic in the context of SDS, given their relatively limited institutional capacity and the fact that they face a somewhat distinct set of issues, often requiring expertise beyond what is readily available in the Fund. Thus, actions already included in some recent MIPs will be relevant and helpful. Some additional commitments may be warranted to reinforce such actions for the SDS context, but should build on rather than duplicate existing MIPs, helping to mitigate the overall cost implications of the recommendations.

It is also worth stressing that while the concrete recommendations aim to be SMART (Specific, Measurable, Achievable, Relevant, and Time-bound) and involve mechanisms to strengthen coordination, to be truly effective there will also need to be a change in the institutional culture toward SDS to fully recognize the importance of such work for the institution. For this purpose, visible support and championing of SDS work by management and senior departmental staff will be essential.

Recommendation 1. The Fund should pursue a targeted recalibration of its overall approach for engagement with SDS to strengthen the value added and impact of its work.

The recalibration would build on the strengthened engagement achieved during the evaluation period and seek to enhance the coherence and continuity of SDS work, while still leaving room for flexibility at the area department and country level. The recalibration would have two principal elements: a refresh of the SGN and steps to support more effective application of the SGN and other commitments in the implementation plan for this evaluation through mechanisms for internal coordination, engagement with the Board, and collaboration with partners.

Aspects of the refresh for the SGN could include:

- Further attention to how best to integrate surveillance, lending, and capacity development work on SDS across the Fund and in individual countries. This would include guidance on how to make the most effective use of the new CMAP tool and of the RST financing to address climate vulnerabilities, taking account of the particular needs and institutional constraints of SDS. It would also provide guidance on use of tailored engagement strategies to promote synergies across all aspects of Fund engagement with SDS.

- Further attention to how best to apply the standard set of AIV surveillance requirements and diagnostic tools in the SDS context, recognizing SDS' limited data and institutional capacity, while respecting the Fund's legal framework.

- Consideration of how to bring Fund-wide skills and expertise to address SDS challenges. Cost-effective approaches to achieving greater involvement of functional departments in SDS work could be helpful in making more granular the Fund's advice on specific issues where deep expertise is particularly relevant.

- Additional emphasis on how best to coordinate work with partner institutions to maximize synergies and optimize the use of scarce resources. Priorities for coordination would include policy advice on macro-critical issues where other institutions have relevant expertise, maximizing the catalytic effect of IMF engagement, particularly financing for climate and resilience building.

- Advice on how best to foster strong and continuous relations with SDS members, including through new hybrid interactions and greater regional engagement.

Coordination mechanisms to support continuity, accountability, and momentum of SDS work could include:

- Tasking the staff-level interdepartmental SDS working group with a mandate to champion SDS work by the Fund, to provide advice on the design and application of the refreshed SGN, and to oversee the implementation of the MIP for this evaluation. The working group could be expanded to include capacity development departments as well as ADs and SPR, to take advantage of cross-departmental synergies.

- The working group would continue to report to management and engage regularly with the Board SDS working group and with external partners working on SDS issues, including the Small States Forum, inter alia, to report on progress being made under the implementation plan.

- The working group could contribute to and monitor the implementation of an SDS-focused research workstream on cross-cutting issues, as well as continuing to oversee efforts to develop and manage channels for internal knowledge sharing—including analytical work, best practices, data, and policy experience—across departments and regions.

- A commitment to a staff review of IMF engagement with SDS within five years, taking account of experience with implementation of the refreshed SGN and other steps taken under the MIP to strengthen Fund engagement with SDS.

Recommendation 2. Steps should be taken at the operational level to enhance the focus and traction of the IMF work on SDS in the areas of surveillance and capacity development.

Actions would aim at further adapting processes and tools for the SDS context, deepening integration across Fund activities, better recognizing domestic constraints, and increasing support for implementation.

Particular steps could include:

- Providing selective attention to current and emerging policy issues that may be macro-critical in the SDS context, including those highlighted by country officials (i.e., employment, growth, diversification, crime, climate change, resilience building, and financial sector development), and making it more operationally useful. Achieving this goal is likely to require closer collaboration with partners like the World Bank with deeper experience and expertise in such issues.

- Preparing tailored engagement strategy notes to foster greater integration and impact of surveillance, capacity development, and lending activities in specific SDS. To be cost effective, consideration could be given to doing this on a pilot basis or at the regional level for those SDS not covered by the new requirement for FCS.

- Increasing efforts to apply diagnostic tools in a manner suitable to SDS circumstances. It would clearly be useful to apply the CMAP to a broader range of SDS, given its particular relevance for these countries. It is also worth considering how to increase access to valuable financial assessment and diagnostic tools like the FSAP and FSSR, with particular attention to coverage of financial depth, inclusion, and resilience issues particularly relevant to SDS. To accomplish this in a cost-effective manner, it is worth exploring regional or cluster approaches for this work, combining multiple SDS. Application of data-demanding diagnostic tools including debt sustainability assessment and the EBA-lite could be further streamlined when applied to SDS, by better leveraging built-in flexibility, in recognition of their circumstances and constraints.

- Placing greater attention to SDS' institutional capacity constraints and political economy circumstances in providing capacity development support. Actions could include strengthening ex ante consideration of recipients' absorptive capacity and ownership; reallocating resources away from the design of new—and sometimes repeated—recommendations and toward more continuous implementation support (virtually as well as on the ground); more closely linking the allocation and provision of capacity development not only to countries' needs, but also to their implementation efforts and ownership, taking advantage of RBM data (as it becomes more systematically available) to increase transparency on progress being made; consideration of how hybrid capacity development delivery could be best applied; and deepening coordination of capacity development with partners, both at the national and regional levels, to minimize overlap, oversupply, and capacity development shopping, and to improve sequencing and quality.[56]

Recommendation 3. The IMF should consider how to use its lending framework in ways that better address the needs and vulnerabilities of SDS.

In particular, three suggestions could be considered, consistent with the principle of uniformity of treatment, that would aim at better meeting SDS' needs for Fund financing, including for resilience building and post-disaster financial support.

- Greater attention should be paid to growth and resilience outcomes in UCT-quality programs with SDS, including by drawing on expertise in partner institutions where needed to ensure appropriate coverage of important structural issues where the

[56] These issues will be explored further in a more general context in the upcoming IEO evaluation of IMF capacity development work, but they are all particularly relevant for SDS.

Fund itself does not have deep expertise. Such attention would not only make UCT arrangements more useful to achieving SDS goals but also reduce stigma concerns and support ownership. Actions would build on commitments included in the recent MIP for the evaluation of growth and adjustment in Fund-supported programs (IEO, 2022).

- Implementation of the newly designed RST should take account of SDS' particular needs and institutional constraints. In principle, the new RST could help (i) significantly scale up resources to support SDS in managing their vulnerabilities and in building resilience to respond to SDS' climate- and natural disaster–related challenges; (ii) better align IMF lending with the longer-term requirements of resilience building; and (iii) exploit diagnostics provided by CMAP. It will be important to ensure that in practice the requirement to pair RST use with a UCT-quality program provides the necessary reassurance that such resources will be well used in a sound macroeconomic framework to safeguard use of Fund resources without deterring use of this new source of financing by imposing a heavy administrative burden on a borrowing country with limited institutional resources for example, by providing on-the-ground implementation support.

- Access limits under the Fund's EF instruments for dealing with large natural disasters could be increased further, above the current cap of 80 percent of quota for a large natural disaster, to 130 percent as provided temporarily during the COVID-19 pandemic, for countries with robust macroeconomic frameworks, and governance standards needed to safeguard Fund resources. Such a change would recognize evidence from the evaluation that SDS in particular often face more frequent and larger shocks relative to their economic size and thus face larger financing needs relative to current access limits, but it could be designed in a way not to deter use of UCT programs for countries needing policy adjustment and reforms to address their balance of payments problems.

Recommendation 4. The IMF should adopt further HR management and budgetary commitments to increase continuity and impact of staff's engagement with SDS.

Such steps would aim at improving incentives to work on SDS assignments, reduce turnover, avoid gaps in coverage, minimize disruptions from handovers, and strengthen Fund presence on the ground.

- ADs need to make a greater commitment to reducing SDS mission chief turnover and avoiding gaps in mission chief assignments. Use of SDS assignments as an opportunity to gain mission chief experience for promotion should be constrained to staff willing to make an adequate commitment to SDS work, and not used as a one-off stretch assignment. Steps in the recently approved MIP for the Categorization of Open Actions exercise (IMF, 2021d) aimed at raising average tenure and improving handover procedures on a Fund-wide basis, are relevant here, but an additional commitment could be added to ensure that SDS do not continue to be at the lower end of the range for turnover metrics given the particular value of continuity in the SDS context.

- Incentives for staff working on SDS country teams should be strengthened by increasing recognition of staff performing well in such assignments; limiting use of co-desk assignments except where both desks are in the same division; encouraging greater use of functional department staff, including through more flexible virtual communications; and limiting use of stopgap measures, including participation of other departmental staff to fill mission teams.

- The attractiveness of SDS assignments could also be improved by increased use of research assistants for data gathering and processing, which are very time-consuming in SDS. This step would help alleviate data problems and provide desk economists with additional time to focus on SDS' policy issues.

- Depending on experience over the next two years in strengthening incentives to work on SDS, consideration may need to be given to adding some SDS still having trouble with recruitment to the list of countries that qualify as providing relevant operational experience for promotion eligibility in the new career framework for fungible macroeconomists.

- Given the demonstrated value of field staff for SDS work, some additional budgetary resources should be provided to expand the footprint of the IMF in SDS. A cost-effective option could be expanding the number of macroeconomist staff in existing or newly created regional offices and RCDCs, since separate country resident representative (RR) offices are costly. This would contribute to strengthening surveillance and capacity development functions (and their integration), support program work where relevant, facilitate the provision of follow-up support, increase the Fund's understanding of local circumstances, and contribute to deepening countries' familiarity with the Fund and trust building, reducing the stigma problem.

Budgetary Implications

As mentioned above, in making these recommendations the evaluation team has generally sought to build on initiatives to strengthen IMF engagement with SDS during the evaluation period, by proposing some further targeted actions to maximize efficiency and value added in the use of resources currently applied for SDS work rather than increasing the budgetary envelope. Moreover, some recommendations deliberately build on existing commitments already included in MIPs for other evaluations.

That said, inevitably there would be some initial "set-up costs" in implementing the recommendations, for example to update the SGN. In addition, some longer-term increases in budgetary resources would seem to be justified in specific areas, such as the costs of strengthening field presence, including by building up the role of RRR offices and by providing for somewhat more use of valuable but resource-intensive diagnostic tools like CMAP and FSAP/FSSRs. On the other hand, there could also be some offsetting savings in travel costs from increased use of virtual engagement as well as in-the-field staff, from increased use of regional and cluster approaches to surveillance work, and from greater reliance on partnerships in areas that are macro-critical but where the Fund does not have deep expertise.

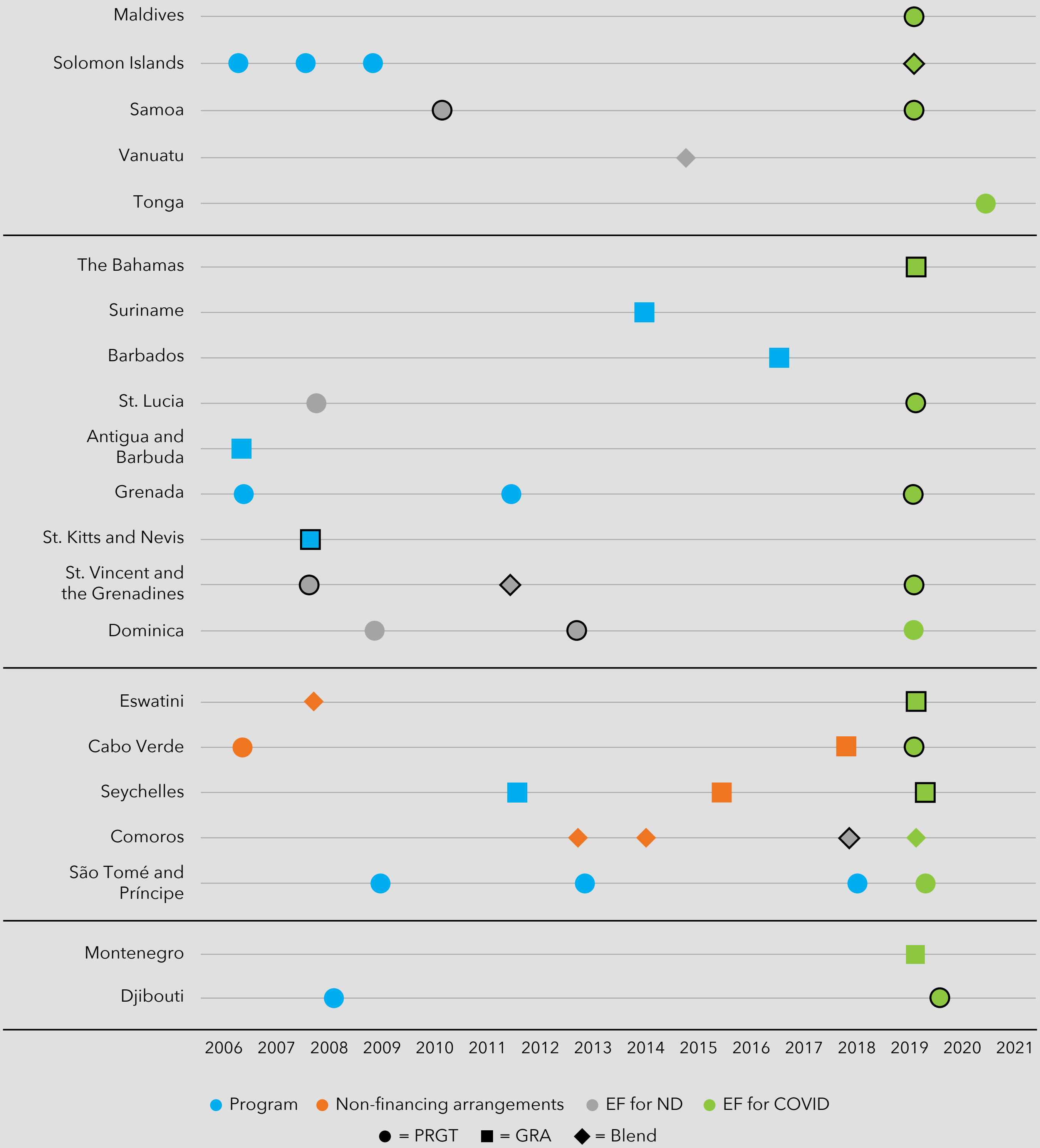
ANNEXES

ANNEX 1. SDS' RISK OF EXTERNAL DEBT DISTRESS

	2010	2015	2019	2020
Bhutan	Moderate (2009)	Moderate (2014)	Moderate (2018)	Moderate (2018)
Cabo Verde	Low (2009)	Moderate (2014)	High	High
Comoros	In debt distress	Moderate	Moderate	Moderate
Djibouti	High (2008)	High	High	High
Dominica	Moderate	High	High (2017)	High (2017)
Grenada	High	In debt distress	In debt distress	In debt distress
Guyana	Moderate	Moderate	Moderate	Moderate (2019)
Kiribati		High	High (2016)	High (2016)
Maldives	Moderate (2009)	Moderate	High	High
Marshall Islands		High (2013)	High (2018)	High (2018)
Micronesia		High	High	High (2019)
Samoa	Low	Moderate	High	High
São Tomé and Príncipe	High	High	In debt distress	In debt distress
Solomon Islands	Moderate	Moderate (2012)	Moderate (2018)	Moderate
St. Lucia	Moderate			
St. Vincent and the Grenadines	Moderate (2009)	Moderate (2014)	High (2016)	High (2016)
Timor-Leste	Low	Low (2013)	Moderate (2016)	Moderate (2016)
Tonga	High	Moderate	High (2017)	High
Tuvalu		High (2014)	High (2018)	High (2018)
Vanuatu	Low (2009)	Moderate	Moderate	Moderate (2019)

Source: IMF (DSA).
Note: Ratings are of the same year unless otherwise indicated in parentheses.

ANNEX 2. LENDING AND PROGRAM SUPPORT APPROVED DURING THE EVALUATION PERIOD



Sources: IMF; IEO calculations.
Note: Black perimeters denote access limits were reached.

ANNEX 3. IMF-SUPPORTED PROGRAMS* IN SDS, 2010–2020

SDS	TYPE	ARRANGEMENT	PROGRAM START DATE	PROGRAM END DATE
Antigua and Barbuda	GRA	SBA	6/7/2010	6/6/2013
Barbados	GRA	EFF	10/1/2018	9/30/2022
Comoros 1	PRGT	ECF	9/20/2012	12/31/2013
Djibouti	PRGT	ECF	9/17/2008	5/31/2012
Grenada	PRGT	ECF	4/17/2006	4/16/2010
Grenada	PRGT	ECF	4/18/2010	4/17/2013
Grenada	PRGT	ECF	6/24/2014	6/25/2017
Maldives	GRA	SBA	12/4/2009	12/3/2011
São Tomé and Príncipe	PRGT	ECF	3/2/2009	3/1/2012
São Tomé and Príncipe	PRGT	ECF	7/20/2012	7/19/2015
São Tomé and Príncipe	PRGT	ECF	7/13/2015	7/12/2018
São Tomé and Príncipe	PRGT	ECF	10/2/2019	2/1/2023
Seychelles	GRA	EFF	12/23/2009	12/22/2013
Seychelles	GRA	EFF	6/4/2014	6/3/2017
Solomon Islands	PRGT	SCF	6/2/2010	12/1/2011
Solomon Islands	PRGT	SCF	12/6/2011	12/5/2012
Solomon Islands	PRGT	ECF	12/7/2012	12/6/2018
St. Kitts and Nevis	GRA	SBA	7/2/2011	7/26/2014
Suriname	GRA	SBA	5/27/2016	4/6/2017

Sources: IMF; IEO calculations.
Note: ECF = Extended Credit Facility; EFF = Extended Fund Facility; GRA = General Resources Account; PRGT = Poverty Reduction and Growth Trust; SBA = Stand-By Arrangement; SCF = Standby Credit Facility.
* Excluding non-financing arrangements.

ANNEX 4. EMERGENCY FINANCING FOR NATURAL DISASTERS: SCALE OF DAMAGES AND FUND FINANCING, 2011–2019

SDS	EVENT	ARRANGEMENTS AND APPROVAL		DAMAGE AND AFFECTED POPULATION			FUND FINANCING			
		Board Approval	Facility	Losses (In USD)	Losses (In percent of GDP)	Share of Population Affected (In percent)	US Dollars (In millions)	Share of ND Damages (In percent)	SDR (In millions)	Share of Quota (In percent)
St. Lucia	Hurricane	1/12/11	RCF/ENDA	336	34	100	8.2	2.4	5.4	35
St. Vincent and the Grenadines	Hurricane	2/28/11	RCF	49	11	28	3.2	6.5	2.1	25
St. Vincent and the Grenadines	Flood	7/25/11	RCF	26	4	16	2.0	7.8	1.2	15
Dominica	Flood	1/11/12	RCF	32	7	NA	3.2	10.0	2.1	25
Samoa	Cyclone	5/15/13	RCF	210	30	7	8.6	4.1	5.8	50
St. Vincent and the Grenadines	Flood	8/1/14	RCF/RFI Blend	108	15	16	6.4	5.9	4.2	50
Vanuatu	Cyclone	6/5/15	RCF/RFI Blend	450	60	69	23.8	5.3	17.0	100
Dominica	Storm	10/28/15	RCF	483	96	40	8.7	1.8	6.2	75
Comoros	Storm	7/24/19	RCF/RFI Blend	150	13	41	12.3	8.2	8.9	50

Sources: Post-Disaster National Assessments, IMF; IEO calculations.

Note: ENDA = Emergency Natural Disaster Assistance; RCF = Rapid Credit Facility; RFI = Rapid Financing Instrument.

ANNEX 5. BACKGROUND PAPERS

BACKGROUND PAPER NO.	TITLE	PREPARED BY
BP/22-01/01	IMF Engagement with Small Developing States—AFR+2 Case Studies	Chris Lane, Miguel de Las Casas
BP/22-01/02	IMF Engagement with Small Developing States—Case Studies in the Asia and Pacific Region	Xavier Maret, Miguel de Las Casas
BP/22-01/03	IMF Engagement with Small Developing States—Caribbean Case Studies	Michael Da Costa, Cyrus Rustomjee
BP/22-01/04	IMF Engagement with Small Developing States on Growth Issues	Cyrus Rustomjee, Sriram Balasubramanian, Jiakun Li
BP/22-01/05	The IMF's Engagement on Natural Disasters and Climate Change Issues Affecting Small Developing States	Domenico Lombardi, Cyrus Rustomjee
BP/22-01/06	IMF Fiscal Policy Engagement in Small Developing States	Peter Heller
BP/22-01/07	IMF Engagement on Financial Sector Issues in Small Developing States	David Marston
BP/22-01/08	The Capacity Development Work of the IMF in Small Developing States	Miguel de Las Casas, Sriram Balasubramanian
BP/22-01/09	The IMF's Support to Small Developing States During the COVID-19 Pandemic	Xavier Maret
BP/22-01/10	The IMF Framework for Engagement with Small States	Alisa Abrams
BP/22-01/11	The IMF and Small Developing States: Human Resource Issues	Cyrus Rustomjee, Yishu Chen, Jiakun Li
BP/22-01/12	Economic Growth of Small Developing States—A Literature Review	Lino Briguglio
BP/22-01/13	IMF Engagement with Small Developing States: IEO Surveys of Country Officials and IMF Staff	Miguel de Las Casas, Sriram Balasubramanian

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STATEMENT BY THE MANAGING DIRECTOR

ON THE INDEPENDENT EVALUATION OFFICE REPORT ON IMF ENGAGEMENT WITH SMALL DEVELOPING STATES EXECUTIVE BOARD MEETING, MAY 6, 2022

I welcome the report of the Independent Evaluation Office (IEO) on IMF Engagement with Small Developing States (SDS), which finds a substantive and well-tailored Fund engagement with SDS across modalities over the last decade. I broadly agree that, going forward, the Fund's continuous high-quality engagement—cognizant of the unique characteristics and challenges faced by SDS—should help enhance traction with this group of members. With the Fund's agenda already well-oriented toward supporting SDS, including through new workstreams, I concur that a targeted recalibration of the Fund's work on SDS would be the most effective at this juncture. However, the four recommendations and their detailed suggestions must be weighed against their budgetary implications, which are inconsistent with the just-approved Medium-Term Strategy and Budget. The report and its recommendations should also be careful to not impinge upon areas that are still unfolding, such as the Resilience and Sustainability Trust (RST), crisis response, and capacity development (CD) provision, to avoid unnecessary duplication of efforts and ensure that a coherent and evenhanded framework is in place. I offer qualified and/or partial support to the recommendations, as discussed below, to serve better our SDS members.

The Fund has significantly stepped up its engagement with SDS over the last decade. In the aftermath of the Global Financial Crisis, the Fund increasingly tailored its toolkit to adjust to the unique characteristics and constraints faced by SDS, focusing on the members with the most pressing needs. The evaluation finds the Fund's engagement in the evaluation period was broadly of high quality, well-tailored, and appropriately adjusted to the evolving circumstances. The evaluation also reveals SDS have been well served within the perimeter of the IMF's mandate, framework, and resources, with outcomes in line with or better than in comparator groups. Over the past few years, the dialogue with SDS at the Fund and external fora (including the World Bank and other institutions) has further strengthened the relationship with this group of members. In addition, the Fund's flagship and regional reports as well as several Board policy papers have showcased SDS-related issues—including inclusive growth, climate change, and resilience-building—helping shape a significant body of knowledge to tailor and strengthen our SDS engagement. These actions have been in line with the Executive Board's calls for strengthening our engagement with SDS over the last decade, including in the context of the 2015 Board paper on Macroeconomic Developments and Selected Issues in Small Developing States, the 2016 Board paper on Small States' Resilience to Natural Disasters and Climate Change—Role for the IMF and the 2017 Board paper on Large Natural Disasters—Enhancing the Financial Safety Net for Developing Countries, among others.

With Fund engagement with SDS already strong and clearly on the right track, I concur with the evaluation that a major overhaul is not needed. There are several new workstreams that have already been launched, many of which are aligned with the special challenges of SDS. These include the RST, the Climate Change Strategy, the FSAP Review, and various Management Implementation Plans (MIPs) in response to IEO recommendations that have recently received Board endorsement. A targeted recalibration of the Fund's overall engagement approach would indeed be the most effective. Thus, I partially support Recommendation 1—particularly to refresh the SDS Guidance Note (SGN) and continue enhancing the coordination mechanisms—albeit with qualifications to remain cost-effective. While I agree with the need to strengthen the focus and traction of surveillance and capacity development, I can only partially support, with qualifications, Recommendation 2. I offer qualifications given that surveillance and its related toolkits must remain consistent with the Fund's policy frameworks and evenhandedness requirements. Budget constraints and the high-cost implications of this recommendation also play a role to my partial support, including in the current global environment, where the need for engagement on emerging (e.g., digital money) or unexpected issues (e.g., global tensions) also requires flexibility in prioritization of Fund resources.

I can partially support Recommendation 3, and with qualifications. I agree that there is room for exploring how Upper Credit Tranche (UCT)-quality Fund-supported programs may be better tailored to SDS, including by further accounting for growth and resilience objectives. I also consider it important that the [newly approved] RST addresses the needs of all eligible members, including SDS. This said, the specific recommendation is somewhat premature as the Trust is yet to be operationalized. I would note that staff has designed the RST with SDS as a key potential eligible group; eligible SDS members facing longer-term structural challenges could qualify for RST financing to help address such challenges and make significant progress toward strengthening their prospective balance of payments (BOP). For this objective to be met, it would be particularly important for SDS members to be able and willing to undertake sometimes difficult reforms to address their macroeconomic vulnerabilities in the context of UCT-quality programs. I do not consider that raising access limits for emergency financing (EF) is the right approach to help members deal with large BOP needs over the longer term—even those emerging recurrently from climate and weather-related disasters. For urgent BOP needs, the Large Natural Disaster Windows of the RCF and Rapid Financing Instrument (RFI) already provide higher access limits than other EF windows, which were recently raised; moreover, EF is meant to have a catalytic effect, not to fill emerging BOP gaps in full.

Finally, I partially support, with qualifications, Recommendation 4 to adopt further HR management and budgetary commitments to increase the continuity and impact of staff's engagement with SDS. While I restate my commitment to strongly support engagement with SDS in line with their special needs, several of the specific proposals can be addressed through various self-reinforcing measures already contained in the MIP on the Board Endorsed Recommendations Categorization of Open Actions, while others lack cost-effectiveness and may lead to unintended adverse consequences, including for staffing of others with macro-critical needs, such as fragile states (Table 1).

I provide below my detailed responses to each of the four recommendations in the evaluation. Prior to that, I would like to emphasize my agreement with the spirit of the recommendations made by the IEO, and the Fund's institutional commitment to SDS. In offering qualifications to these proposals, I seek to strike the right balance between meeting the valuable objective of enhancing engagement with SDS while keeping a strategic and comprehensive view, and fully leveraging our toolkits, structures and workstreams to avoid costly overlaps and duplications. I firmly believe in the importance of providing the needed time for key reforms that are at the core of the IMF's efforts to deliver needed support to its members; this includes the approval and implementation of the RST, the Climate Change Strategy, the FSAP Review, and recently endorsed MIPs, which already address several of the recommendations made by the IEO in this evaluation. I am also mindful of the fact that these recommendations carry substantial budgetary costs, while some of the proposals made to lower net costs (e.g., the use of regional or cluster approaches of CMAPs or FSSAs/FSAPs) are complex and are unlikely to generate the large savings suggested by the IEO; others, such as the higher use of virtual missions to offset the cost of more junior local staff, may have adverse consequences for the quality of engagement and the traction of our advice.

I would also remark that both Management and staff greatly appreciate the IEO's efforts and recommendations. In answering the Board's call for stronger engagement with SDS, I remain deeply committed to working constructively with the IEO, to learn meaningful lessons from its recommendations and implement them to further enhance the Fund's operations, frameworks, and results. In this context, I look forward to future evaluations that rely somewhat less heavily on perception-based surveys and interviews to substantiate recommendations, and to follow more closely the Board-endorsed recommendations in the 2018 Third External Evaluation of the IEO, which stressed the need to deliver shorter and sharper reports with parsimonious, concrete, and measurable recommendations. If the IEO continues to include assessments of implications for enterprise risk in its reports, it would be important that such assessments are based on a sound methodology, clear qualification criteria for risks, and systematically applied rating scales.

Following Board guidance,[1] staff is working on developing a framework for assessing risks from slippages in implementing IEO recommendations and ways to anchor it to the forthcoming institutional Enterprise Risk Management (ERM) framework. Joint efforts in all these areas should help us to continue to leverage IEO evaluations for the purpose of fostering change and continued improvement in the Fund.

RESPONSE TO IEO RECOMMENDATIONS

Recommendation 1. The Fund should pursue a targeted recalibration of its overall approach for engagement with SDS to strengthen the value added and impact of its work.

Summary of Detailed Recommendations:

- Update the SDS Staff Guidance Note (SGN) including : (i) guidance on integrating surveillance, lending, and CD work in SDS work, including by making use of the Climate Macroeconomic Assessment Program (CMAP) and the RST; (ii) application of Article IV (AIV) surveillance requirements and diagnostic tools for SDS; (iii) consideration of how to bring Fund-wide skills and expertise to address SDS challenges, including approaches for to further involve functional departments (FD) in SDS work; (iv) advise on how best to coordinate with partner institutions; and (v) advice on how to foster strong and continuous relations with SDS.
- Coordination Mechanisms could include: (i) tasking the staff-level interdepartmental SDS working group (SDS-WG) with a mandate to oversee SDS work at the Fund, update the SGN refresh and oversee this evaluation's MIP implementation; (ii) requiring the SDS-WG to continue reporting regularly to management and the Board working group,, as well as external partners, on SDS; (iii) tasking the SDS-WG to monitor the implementation of an SDS-focused research workstream on cross-cutting issues and continue to oversee knowledge-sharing; (iv) committing the SDS-WG to conduct a staff review of IMF engagement with SDS within five years, taking account of experience with implementation of the refreshed SGN and other steps taken under the MIP to strengthen Fund engagement with SDS.

I partially support this recommendation with qualifications.

I welcome the recommendation to update the Staff Guidance Note (SGN) on the Fund's Engagement with SDS, which was last updated in 2017. While the core issues and the GROWTH approach of the note remain relevant, the guidance will be refreshed for the current global context and evolving macro-critical priorities. The update will provide a natural vehicle to make several of the recommendations in the evaluation actionable and help energize internal coordination structures and dissemination of SDS knowledge. The SGN should help staff plan on priorities that guide effective engagement with SDS. This said, given SDS heterogeneity and broad resource and trade-off considerations, actual staffing decisions require flexibility and would be best left to relevant departments.

I concur on the need to foster strong collaboration with external partners; as this is being further mainstreamed for the World Bank Group in the recent MIP on Bank-Fund

[1] SU/21/139 of September 24, 2021.

Collaboration and other workstreams (e.g., climate), the SGN would be aligned to such superseding frameworks, while respecting the voluntary nature of inter-institutional collaboration with other partners.

I note, however, that the cost considerations of these recommendations, including of the SGN update, are non-trivial and are not envisaged in the Medium-Term Budget.

I agree, with some qualifications, with the proposals on internal coordination mechanisms, even if I do not concur with the view in the evaluation that internal coordination mechanisms have been uneven and dependent on key individuals. In particular, the staff's SDS Working Group (SDS-WG) will be closely involved in the refresh of the SGN, the MIP's preparation, and its follow up. The SGN update will provide an opportunity to further integrate members from Functional Departments, particularly those dedicated to CD provision, into the SDS-WG.

The SDS-WG will also continue to engage with the Board and external partners, prepare the bi-monthly brief for Management on recent SDS developments, and maintain its coordinating role on knowledge sharing and fostering the SDS-focused analytical agenda.

I do not agree with the proposed five-year review. This proposal seems duplicative given other regular evaluations and reviews that take place for surveillance (e.g., Interim Surveillance Review, Comprehensive Surveillance Review), lending (e.g., Review of Conditionality, Review of LICs Facilities), and CD. There are also new, expected regular reviews (e.g., RST Implementation) and the Periodic Monitoring Reports (PMRs) on actions in MIPs by the OIA, and follow-up evaluations by the IEO itself (e.g., Bank-Fund Collaboration review in three years). These already-planned and provisioned-for reviews can better link SDS engagement to the overall Fund strategy and will allow the Board to consider trade-offs, including vis-à-vis other members and priorities.

Recommendation 2. Steps should be taken at the operational level to enhance the focus and traction of the IMF work on SDS in the areas of surveillance, policy advice, and CD.

Summary of Detailed Recommendations:

- Provide selective attention to current/emerging SDS issues that are macro critical, i.e., including those viewed macro-critical by authorities.
- Apply diagnostic tools consistent with SDS circumstances, including by: (i) further streamlining the application of data-demanding diagnostic tools including debt sustainability analysis (DSAs) and the EBA-lite, by better leveraging built-in flexibility, in recognition of their circumstances and constraints, and (ii) increasing access to CMAPs, FSAPs, and FSSRs, for instance by exploring cluster or regional approaches.
- Preparing tailored strategy engagement notes for non-FCS SDS, possibly on a pilot basis.
- Place greater attention to SDS' institutional capacity constraints and political economy circumstances in providing CD support, by (i) applying ex-ante assessments of institutional capacity and ownership to CD deployment; (ii) linking allocation and provision of CD including to implementation and ownership; (iii) as it evolves, using Resource Budget Management (RBM) to increase transparency on CD progress; (iv) increasing hybrid CD presence; and (v) deepening CD coordination with external partners.

I partially support this recommendation with qualifications.

I endorse the view that surveillance and CD for SDS can—and should—be strongly tailored for SDS. The updated SGN will provide a natural vehicle to update the GROWTh approach based on evolving macro-critical challenges faced by SDS. This said, the coverage for Article IV Consultations would be guided by the Integrated Surveillance Decision, implying that core areas (exchange rate, fiscal, financial, and monetary policies) would be prioritized, and other areas included to the extent that they are assessed to be macro-critical on a case-by-case basis.

The recommendation to develop tailored "Strategy Engagement Notes" would be costly. Country engagement strategies are already expected to be rolled out in the context of the Strategy for Fragile and Conflicted States

(FCS), benefitting those SDS that are also FCS (i.e., 10 out of 34 SDS). In this vein, I see a case for additional Strategy Notes to be rolled out to SDS that are not FCS only on an as-needed basis.

I endorse the view that country teams could better leverage the built-in flexibility in core surveillance tools, such as the DSAs and the EBA-lite, to tailor more to SDS constraints. This is best achieved by strengthening guidance—including through the planned SGN refresh—on how to tailor to the characteristics and constraints of SDS. However, there is limited scope to streamline requirements for SDS for even-handedness reasons. Moreover, these assessments remain key to surveillance, given core mandates, Board-endorsed requirements at the time of the 2021 Comprehensive Surveillance Review (CSR), as well as lending. Data requirements for the DSA cover standard data from teams' macroeconomic projections and similarly for EBA-lite models. Moreover, the LIC DSF is jointly produced with the World Bank, and hence not entirely under the control of the Fund. Nevertheless, strengthening the technical support to country teams on these tools would be important in dealing with the constraints and challenges facing SDS.

The recommendation to expand FSAPs/FSSRs and CMAPs to SDS faces important resource constraints. I also note the voluntary nature of these CD activities, which rely strongly on members' request for assistance. FSAPs/FSSRs are often jointly conducted with the World Bank, so their expansion is not entirely at the Fund's discretion. Other structural issues also preclude a large deployment of these programs to SDS, even on a cluster or regional basis (e.g., regional FSAP's jurisdictional considerations). That said, the updated SGN is expected to provide guidance on integration of CD and surveillance and so it would lay out circumstances when CD should be identified as priority for SDS. With respect to issues related to climate change and resilience-building, these are expected to be addressed in expanded Article IV Consultations, building from Fund's CMAPs, the World Bank's CCDRs, and climate DSA modules, within the contours provided for in the Climate Strategy, and provisions in the Medium-Term Budget. The updated SGN would be in line with this guidance.

I concur with the need to attend challenges on CD but note that many of the issues raised are also common to non-SDS. To avoid a piecemeal approach that could be duplicative and costly, I recommend revisiting these issues in the IEO's forthcoming CD evaluation, which we expect will provide recommendations to encompass the gaps identified in SDS. This would include considerations on the merits of on-the-ground versus virtual missions (which often entail a loss in quality and traction for SDS) or meaningful approaches to better guide CD allocation.

Recommendation 3. The IMF should consider how to use its lending framework in ways that better address the needs and vulnerabilities of SDS.

Summary of Detailed Recommendations:

- Greater focus of growth and resilience outcomes in UCT-quality programs with SDS, drawing from external expertise and building on commitments included in the MIP on growth and adjustment in Fund-supported programs (IEO 2022).
- Implementing the RST taking into account SDS needs and constraints. This would entail (i) exploiting the use of CMAPs, and (ii) ensuring that the requirement to pair the RST with a UCT-quality program does not deter SDS use and lowering the administrative burden of UCT-quality programs by, for example, providing ground support.
- Raising access limits under for Emergency Financing (EF) instruments for dealing with large natural disasters (LNDs) for countries with robust macroeconomic frameworks and governance standards.

I partially support this recommendation with qualifications.

I support the recommendation to seek greater focus on growth and resilience outcomes in the context of UCT-quality programs with SDS. The recent MIP on Growth and Adjustment in IMF-Supported Programs already provides several actions for improving growth considerations in IMF-supported programs. The refreshed SGN would further elaborate on the appropriate tailoring of program design for SDS, building on the existing GROWTh framework. The new SGN would provide guidance to identify relevant, macro-critical drivers of external sustainability (such as climate change) and related solutions to help address external imbalances to guide program design and conditionality. The SGN would also provide guidance to teams on collaboration with other development partners, based on existing frameworks.

Regarding the recommendation on the RST, while I fully endorse its spirit, I see no need for further action at this time beyond implementing the framework just endorsed by the Board. The RST has been already designed to address the challenges and recommendations provided by the IEO. The proposed design articulates that policy priorities and conditionality will need to assess the technical capacity of potential borrowers. Thus, we need to allow operations to begin, gain meaningful experience, and then build on the design, based on lessons learned from the experience. For this, the RST already calls for a review in three years, or sooner if warranted, to course correct as needed based on experience. I agree that available CMAPs (and other relevant diagnostics) should be well-articulated in UCT-programs with climate-vulnerable SDS.

Regarding the second point in the recommendation, I observe that the RST design and broader efforts to enhance focus on growth and resilience in UCT-quality programs should support tailoring. At the same time, I do not agree that there is a high administrative burden of requesting Fund lending; I missed quantitative evidence that such administrative burden is higher at the Fund than in other IFIs, and stress that the Fund is relatively agile and focused on its lending activities, which often have a narrower footprint than that of other development partners. At the same time, I recognize that many members, including SDS, also need to balance this streamlined approach with strong implementation support, including on the ground. To this end, the RST design already envisages leveraging the synergies between the Fund's surveillance, lending, and CD to help in the design and implementation of the RST reform measures. Fund CD with a medium-term programmatic approach can play an important role in supporting RST reforms.

More generally, linking RST financing and a UCT-quality program is key to provide needed safeguards and address underlying macroeconomic imbalances in eligible members. It is encouraging that the evaluation shows that when SDS request Fund-supported programs, these tend to be completed at a more successful rate than for non-SDS; this bodes well for SDS with ownership and political will to engage in a Fund-supported program.

I do not support the proposal to raise access limits for EF. The IMF recognizes the challenges many SDS face due to frequent and relatively stronger shocks, including from natural disasters; moreover, these challenges may worsen in the future due to climate change. The IMF's work and that of many other expert institutions concludes that the sustainable response to deal with these challenges is a fundamental shift in how countries prepare for shocks and build resilience, and transition to structurally sound frameworks. Raising EF access risks disincentivizing countries from seeking UCT-quality programs that may be more appropriate to encourage this structural transformation and resilience-building that would help members better deal with such shocks.

Moreover, when considering the member's total financing needs, it is important to keep in mind that Fund financing is expected to play a catalytic role. I would also add that EF access limits play a key safeguard role inherent to Fund financing without ex-post conditionality. Of course, *emergency* situations caused by natural disasters triggering short-term BOP needs that can be resolved without the need for major policy adjustments are still expected to occur, and EF should help support them, in line with Fund policy; access limits of the Large Natural Disaster (LND) Window were recently increased with this in mind.

Recommendation 4. The IMF should adopt further HR management and budgetary commitments to increase continuity and impact of staff's engagement with SDS.

Summary of Detailed Recommendations:

- Commitment to reduce SDS MC turnover and avoid gaps in assignments.
- Stronger incentives to work in SDS.
- Limiting use of co-desk assignments except when both positions are in the same division.

- Encouraging greater use of functional department staff.
- Limiting the use of other departmental staff to fill mission teams.
- Increased use of research assistants (RAs) and research officers (ROs) to gather data.
- Depending on experience over the next two years in strengthening incentives to work on SDS, consider adding SDS experience to the promotion-eligible requirement list in the new career framework for fungible macroeconomists.
- Expanding the number of macroeconomists in regional offices and RCDCs.

I partially support this recommendation with qualifications.

I agree with the principle of this recommendation and see the call for continuous and adequate staffing of SDS teams as important. That said, I find the evaluation provides evidence that notwithstanding the small size and low spillover risks, SDS were increasingly better served by the Fund over the last decade, with SDS concerns more clearly identified and efforts made to find solutions, as evidenced by the growing body of high-quality research on SDS-specific issues, and the large share of SDS use of CD, among other efforts.

Ensuring appropriate staff turnover and assignment turnover that supports strong and continuous engagement with SDS is a legitimate concern. However, I note that this is also the case for other non-SDS members; given its importance, the issue is being addressed by the MIP on the Board-Endorsed Recommendations Categorization of Open Actions that was just endorsed by the Board. The MIP introduces an intermediate goal of 2.7-year median tenure for mission chiefs accompanied by measures to strengthen transparency and accountability, with reporting expected to track SDS as an explicit analytical country group, given its relevance. To avoid multiple overlapping initiatives, this MIP should be allowed to progress before SDS-specific measures are considered. Relevant Key Performance Indicators (KPIs) will be reported and closely monitored, including for SDS as a group.

Regarding the proposal to consider adding SDS to the promotion-eligible requirement list in the new career framework, I can support considering this after the planned two-year review of the implementation of this framework and a full assessment of the measures to increase tenure included in the MIP on the Board Endorsed Recommendations Categorization of Open Actions.

It is my view that the choice of increasing field presence and the introduction of specific incentives for staff to work on SDS are best decided by Area Departments (ADs), which face different challenges across regions.
These decisions have different implications both for operations (including cost-effectiveness) and for staff's career development; in addition, some of the proposals, such as the limits on the use of co-desk assignments may have adverse unintended consequences. Flexibility to choose modalities of engagement, including potentially fielding larger/more frequent missions instead of increasing junior field presence (as proposed), and/or increasing the share of RAs/ROs, should also be left to ADs. More broadly, ADs should retain flexibility in developing tailored solutions for the members in their region, given the heterogeneity of the group, which precludes providing one-size-fits-all approaches.

TABLE 1. THE MANAGING DIRECTOR'S POSITION ON IEO RECOMMENDATIONS

RECOMMENDATION	POSITION
1. The Fund should pursue a targeted recalibration of its overall approach for engagement with SDS to strengthen the value added and impact of its work.	PARTIAL AND QUALIFIED SUPPORT
2. Steps should be taken at the operational level to enhance the focus and traction of the IMF work on SDS in the areas of surveillance, policy advice, and CD.	PARTIAL AND QUALIFIED SUPPORT
3. The IMF should consider how to use its lending framework in ways that better address the needs and vulnerabilities of SDS.	PARTIAL AND QUALIFIED SUPPORT
4. The IMF should adopt further HR management and budgetary commitments to increase continuity and impact of staff's engagement with SDS.	PARTIAL AND QUALIFIED SUPPORT

FINAL REMARKS

To conclude, I want to firmly restate my commitment to the evaluation's end objective of supporting SDS. I thank the Executive Board for its commitment to support SDS—this has guided the Fund to secure important gains in its engagement with this group of members over the last decade, while setting it on the right path through a number of important forward-looking initiatives, already in train, that are of high relevance and impact to SDS. I also thank the IEO team for its thorough work and for the guidance provided, which will help us better serve SDS. This is an evolving process, in line with the IMF's ongoing mandate to adjust to member needs.

In that vein, I look forward to implementation of the new workstreams, many of which will help members tackle difficult challenges, which are particularly relevant for SDS. We will strive to better engage with SDS in a cost-effective manner, while ensuring our approach is both tailored and evenhanded.

THE ACTING CHAIR'S SUMMING UP

INDEPENDENT EVALUATION OFFICE—IMF ENGAGEMENT WITH SMALL DEVELOPING STATES EXECUTIVE BOARD MEETING 22/42, MAY 6, 2022

Executive Directors welcomed the report of the Independent Evaluation Office (IEO) on IMF Engagement with Small Developing States (SDS) and appreciated its insights and recommendations. They welcomed the report's finding that the Fund has substantially stepped up its engagement with its SDS members over the past decade, and that SDS country officials generally considered Fund surveillance and capacity development (CD) activities of high quality and well-tailored to their needs. At the same time, Directors noted the evaluation's findings of several challenges facing Fund engagement with SDS, including the suitability of the Fund's lending architecture to SDS needs and capacities, limited institutional capacity in SDS, difficulties in staffing SDS assignments, and political economy considerations. Against this background, Directors broadly agreed that based on the evaluation's findings, additional actions should be considered to strengthen the value added and impact of IMF engagement with SDS, although a major overhaul was not needed. Many Directors broadly supported the IEO recommendations and looked forward to the Management Implementation Plan (MIP) to implement them. Many other Directors broadly agreed with the partial and qualified support provided by the Managing Director's statement as a broadly balanced approach to addressing the identified challenges, ensuring appropriate tailoring while considering evenhandedness and resource constraints.

Directors broadly supported Recommendation 1 on pursuing a targeted recalibration of the Fund's overall approach for engagement with SDS to strengthen the value added and impact of its work. In particular, they supported a focused refresh of the SDS Staff Guidance Note (SGN) to take account of the current global context and evolving macro-critical priorities, and steps to support more effective application of the SGN and other commitments in the MIP through mechanisms for enhanced internal coordination, engagement with the Board, and enhanced collaboration with partners, particularly the World Bank, while underscoring that such coordination mechanisms should remain cost-effective. Many Directors supported the proposal for a review of Fund engagement with SDS within five years. Many other Directors agreed with the Managing Director's view that leveraging the several planned and provisioned-for reviews in the areas of surveillance, lending, and capacity development would be most appropriate to better link SDS engagement to the overall Fund strategy and address potential resource trade-offs and avoid duplication. A few of these Directors emphasized that these planned reviews should carve out analysis of SDS. Many Directors supported the development of an overarching framework for Fund engagement with SDS, although Directors agreed that a major overhaul on engagement with SDS was not needed, consistent with the findings in the evaluation. Many Directors emphasized the importance of tailored communication with SDS countries through active outreach. A number of Directors supported the formalization of IMF–World Bank collaboration on workstreams that are of critical relevance to SDS, with the Fund focusing on its areas of expertise and relying on external partners to complement and fill gaps.

Directors generally supported Recommendation 2 that steps should be taken at the operational level to enhance the focus and traction of the IMF work on SDS in the areas of surveillance and CD, noting the increased challenges posed by the uncertain economic environment and SDS vulnerabilities to climate change and natural disasters. On surveillance, Directors agreed that actions should aim at better leveraging flexibility in core tools for the SDS context, deepening integration across Fund activities, better recognizing domestic constraints, and increasing support for implementation. The SGN refresh should strengthen guidance in this area. Many Directors emphasized that diagnostic tools were useful in SDS and ensuring their tailoring to suit SDS will increase their impact. Directors noted that surveillance and its related toolkits must remain consistent with the Fund's policy frameworks such as the Integrated Surveillance Framework, evenhandedness requirements, macro-criticality, and medium-term budget constraints. Directors also highlighted the need to collaborate with the World Bank in this context. Many Directors concurred with the Managing Director on the need for flexibility in prioritizing Fund engagement and resources through surveillance and CD, including FSAPs/FSSRs and CMAPs, to ensure consistency with the medium-term budget and recent Board-endorsed strategies, and to preserve the ability to address emerging or unexpected issues. Many Directors were open to exploring the use of cluster or regional approaches, in cases in which these may prove to be cost-effective. A number of Directors supported a broader rollout of Country Engagement Strategies for non-fragile SDS; many other Directors considered that these notes could be rolled out on an as-needed basis for this group of SDS. A few Directors saw merit in applying CMAPs to a broader range of SDS. A number of Directors emphasized the need for an appropriate selection of SIP topics to add value to policy discussions. Directors observed that many of the issues raised on CD are relevant to a much wider part of the membership and could be considered in the forthcoming IEO evaluation of CD.

Many Directors broadly supported Recommendation 3 for the Fund to consider how to use its lending framework in ways that better address the needs and vulnerabilities of SDS, while many others agreed with the Managing Director's partial and qualified support.

Directors generally agreed that there is room to explore how UCT-quality programs may be better tailored to SDS, including through greater focus on growth and resilience objectives in Fund programs, in line with the recently approved MIP for the IEO Evaluation on Growth and Adjustment in Fund Programs, although a few Directors urged caution about setting explicit growth objectives. Directors also generally agreed that the newly approved Resilience and Sustainability Trust (RST) should address the needs of all eligible members, including SDS. Many Directors noted the need to consider how to leverage RST financing to address longstanding structural constraints and build resilience in SDS. A few Directors noted institutional constraints in SDS and saw room to alleviate the administrative burden of UCT-quality programs for these countries; a few others saw scope to use existing flexibilities. Directors supported first allowing RST operations to begin, and then reflecting on lessons learned during its initial review. A number of Directors emphasized that the planned 18-month interim review should commit to assessing whether the RST is providing and catalyzing meaningful support to SDS and propose adjustments, as necessary. Many Directors supported the recommendation to increase access limits under the large natural disaster window of the emergency financing instruments. Many other Directors, however, did not consider further raising access limits, a key safeguard to lending under the emergency financing instruments, to be the right approach, including as it could disincentivize the use of UCT-quality programs. Directors noted the need to build further awareness of the benefits of UCT-quality programs in SDS. Many Directors also called for the Fund to take advantage of the 16th General Review of Quotas to evaluate potential options to better align SDS access to Fund financing with their significant needs.

With regard to Recommendation 4 on adopting further HR management and budgetary commitments to increase continuity and impact of staff's engagement with SDS, Directors agreed with the need to take steps aimed at improving incentives to work on SDS assignments, reduce turnover, avoid gaps in coverage, minimize disruptions from handovers, and strengthen the continuity of Fund engagement with SDS. While noting the evaluation's finding that the issue of staff turnover and handover of assignments is more severe for SDS, Directors generally observed that this is also a concern for other non-SDS members.

Directors welcomed the MIP on the Board Endorsed Recommendations on Categorization of Open Actions, which aims to address many of these issues. Directors agreed that this MIP should be allowed to progress before considering SDS-specific measures in this area, with a number of Directors recommending consideration of SDS-specific initiatives following the planned two-year review envisaged in this MIP. A number of Directors suggested, however, that the promotion policy developed to incentivize staff working on fragile and conflict-affected states be extended to all SDS. A number of Directors also called for innovative and practical ways to increase the Fund's field presence. Many Directors acknowledged the need for flexibility in decisions by departments, such as incentives and specific staffing solutions, given the diversity of challenges across regions.

Overall, Directors noted that the recommendations and their detailed suggestions should be carefully weighed against their budgetary implications, including tradeoffs, and build synergies with ongoing workstreams. Many Directors saw scope for resource reallocation to accommodate the budgetary needs within the existing budget. Directors thanked the IEO for a comprehensive, thorough, and in-depth evaluation and detailed papers, even though a few Directors would have preferred a shorter and more concise main report, with greater focus on key lessons and main recommendations.

In line with established practice, management and staff will carefully consider today's discussion in formulating the MIP for Board-endorsed recommendations.

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