4. 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 I.1).

Box I.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 V.

5. The rest of the report is organized as follows. Section II reviews the characteristics of small states that make them unique and shape their engagement with the IMF, while Section III explains the institutional framework in which that engagement takes place. Sections IV through VI assess the Fund's performance on its three main activities in small states: surveillance, lending and program support, and CD. Section VII evaluates the Fund's human resource management for engaging with small states. Section VIII summarizes the evaluation's main findings and offers recommendations.

II. KEY SDS CHARACTERISTICS

A. Overall Characteristics

6. 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 WEO. A

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

total of 34 countries fall into this category (Table II.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.

Table II.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 Sao Tome & Principe* *Seychelles*	Bhutan Fiji *Kiribati** Maldives* *Marshall Islands** *Micronesia** *Palau* *Samoa* Solomon Islands* Timor-Leste* *Tonga* *Tuvalu** Vanuatu *Nauru*	Montenegro	Djibouti*	*Antigua & Barbuda* Bahamas Barbados Belize *Dominica* *Grenada* Guyana *St Kitts & Nevis* *St Lucia* *St Vincent & the Grenadines* Suriname Trinidad & 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. AFR=African Department, APD=Asia and Pacific Department, EUR=European Department, MCD=Middle East and Central Asia Department, WHD=Western Hemisphere Department.

7. 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 of them 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 in a fragile or conflict-affected situation (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.

[3] Andorra joined the Fund in October 2020 and is covered in this evaluation. It is classified as an advanced economy and 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).

8. While small states comprise a heterogeneous group, they share many similar 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 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 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.

9. It's worth highlighting upfront that there are also considerable variations across the three main regions containing SDS.[5] Caribbean SDS are highly concentrated and 9 out of 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 neighbouring continents. They are also generally smaller (including 8 of the total 15 microstates) and more fragile (accounting for 6 of the 7 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 of Caribbean SDS. African SDS tend to be larger; two of them are located in the mainland and five are islands off the West and East coasts of the continent.

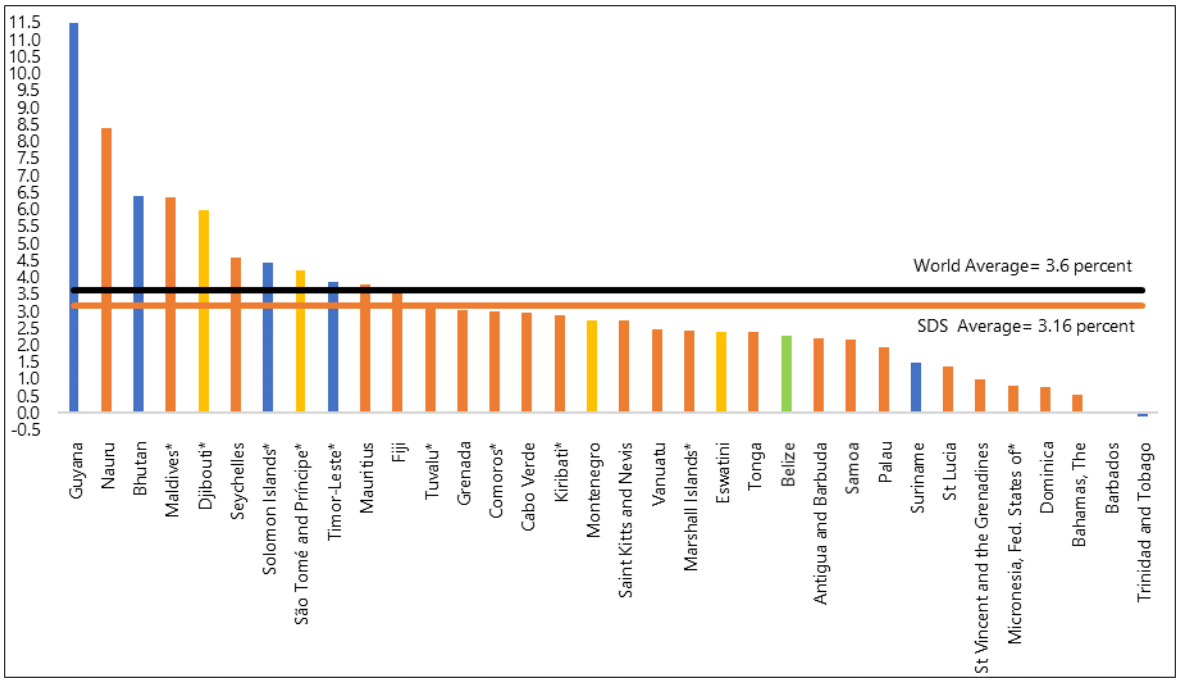
B. Growth

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

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

11. 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 II.1). Of 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.

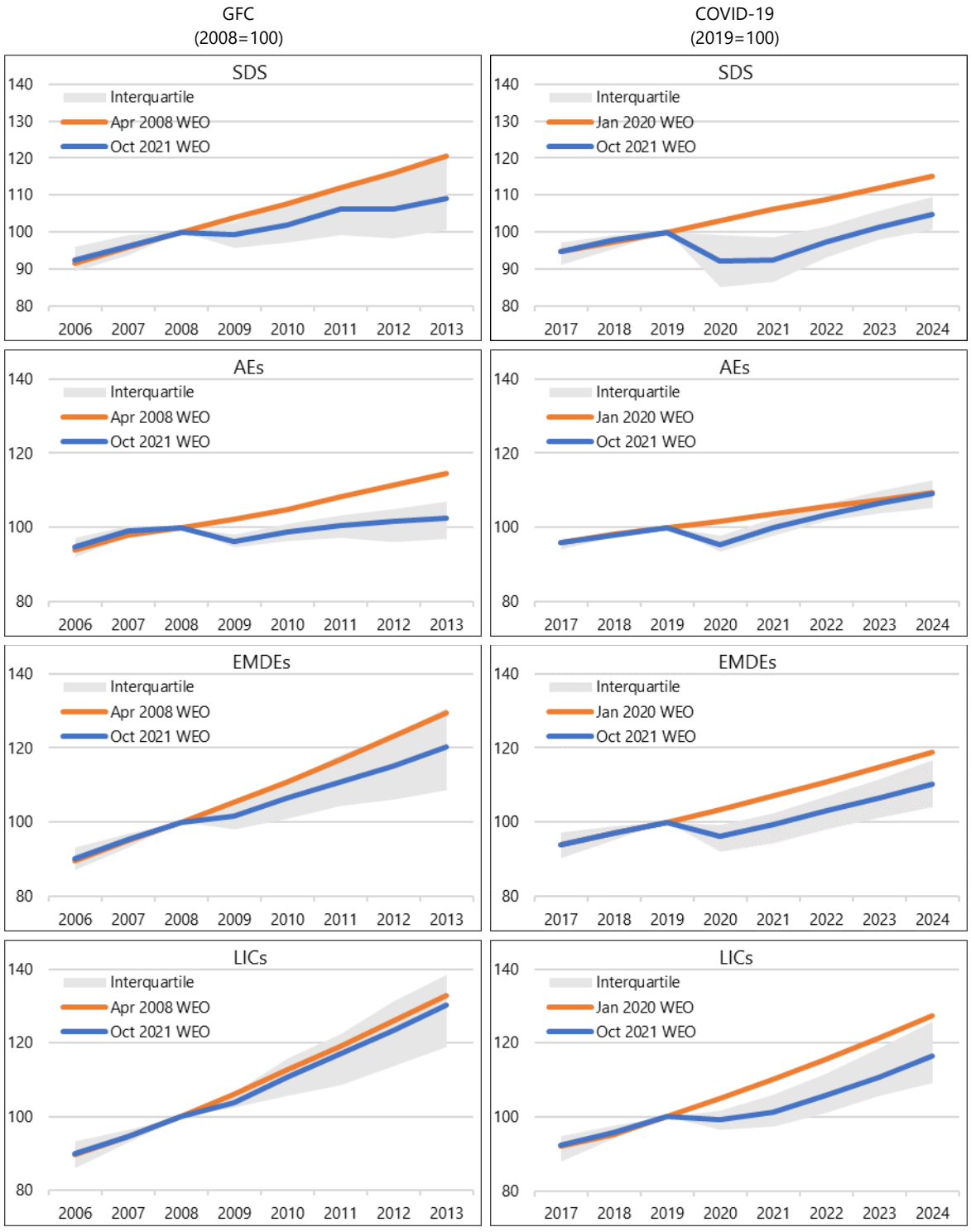
Figure II.1. Real GDP Growth Across SDS, 2010–2020
(Average, in percent)



Sources: IMF, IEO Calculations.
Note: *denotes FCS. Orange=tourism dependent SDS; Blue=commodity exporting SDS; Green=tourism dependent and commodity exporting SDS; Yellow= others.

12. 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 (NDs). A comparison of the experience of SDS, EMDEs, and low-income countries (LICs) found that both the GFC and, particularly, the pandemic had a much greater adverse impact on SDS than on the other groups (Figure II.2). SDS' activity contracted more sharply, and SDS are expected to recover from the COVID-19 shock more slowly than other groups.

Figure II.2. Effect of Global Shocks on Real GDP Paths by Country Groups



Sources: IMF; IEO calcuiations.

C. Natural Disasters and Climate Change

13. 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) amongst the top 15 countries most at risk in the world. Given their location, SDS are heavily impacted by NDs, 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 ND events were recorded in SDS, representing 3.3 percent of all NDs during this period.

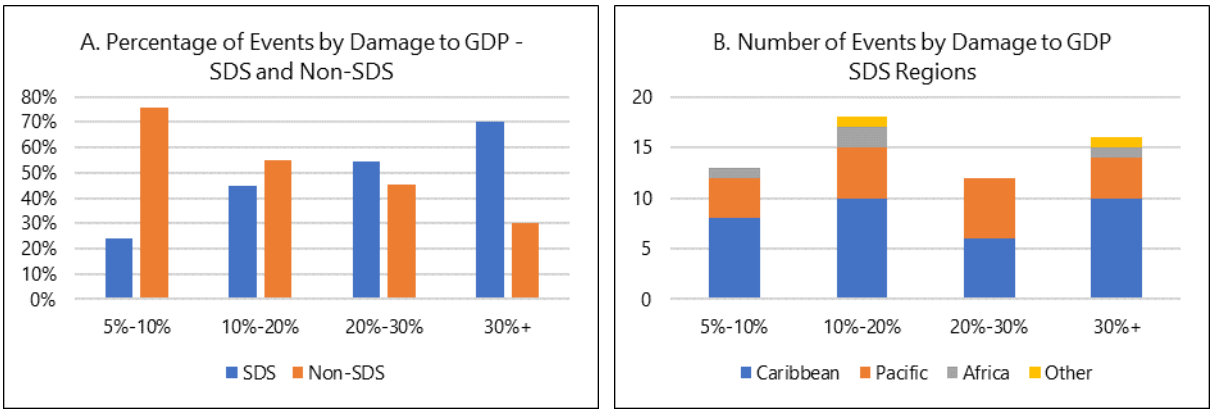
14. Given their small size, which precludes diversification to protect against location-specific shocks, SDS suffer much greater economic and human consequences from NDs, and more frequently, than other economies (Lombardi and Rustomjee, 2022). Thus, such disasters have had severe macro-critical effects, 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.

15. In terms of GDP impact, SDS have been much more affected than non-SDS by almost all types of NDs.[6] Over 1960–2020, SDS experienced a higher share of the most severe NDs that occurred—55 percent of NDs with damages between 20–30 percent of GDP and 70 percent of NDs with damages of 30 percent or more (Figure II.3, Panel A). Overall, most NDs occurred in Caribbean and Pacific SDS including all NDs with damages between 20–30 percent of GDP and 14 of 16 events with damages of 30 percent or more (Figure II.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 damage-to-GDP threshold to qualify for emergency financing under the window. Measured by this metric, SDS have experienced 28 ND events of this scale since 1960, including 5 events during the evaluation period.[7] Based on incidence of LNDs since 2000, on average an LND could be expected to occur about once every two years among SDS members and about once every four years for non-SDS members.

[6] When LNDs 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 the volcanic eruption on July 1, 2021.

Figure II.3. Distribution of Natural Disaster Events by Damage to GDP, 1960–2020



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

16. SDS economies tend to be more vulnerable not just to NDs but also to CC. One-third of SDS are highly vulnerable to CC, which exacerbates the impact and frequency of NDs, particularly in the low-lying island states in the Pacific, as changing weather patterns have increased and rising sea levels heightened flooding risks (IMF, 2016; UN, 2009; Nurse and others, 2014). As a result, the harmful effects of NDs, 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, so reducing the ability to adapt to CC through infrastructure upgrades and redesign (Nurse and others, 2014).

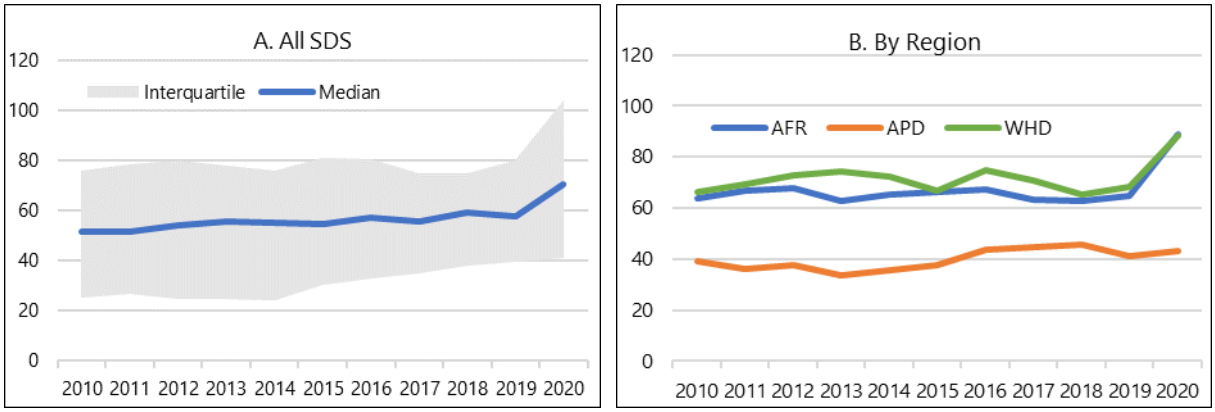
D. Fiscal Policy Issues

17. 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.

18. 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 significant 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 NDs—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.

19. 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 NDs 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 II.4). By 2020, based on IMF Debt Sustainability Assessments (DSAs), 65 percent of SDS were assessed to be at high risk of debt distress or being in debt distress, including virtually all of the Caribbean SDS and several African and Pacific SDS (Annex I).

Figure II.4. Public Debt, 2010–2020
(In percent of GDP)



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

20. 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.

E. Financial Sector Issues

21. Financial systems in SDS are typically shallow, characterized by relatively low intermediation with large operating margins, limited competition and limited lending opportunities (IMF, 2017; 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.

22. Financial systems in SDS often operate in volatile macro-financial 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.

23. 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).

24. 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.

[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] The proportion of foreign bank branches or subsidiaries in the SDS range between 25 percent in Belize to 100 percent in Barbados and some Pacific islands.

F. Impact of the COVID-19 Pandemic on SDS

25. 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 of them 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 while 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.

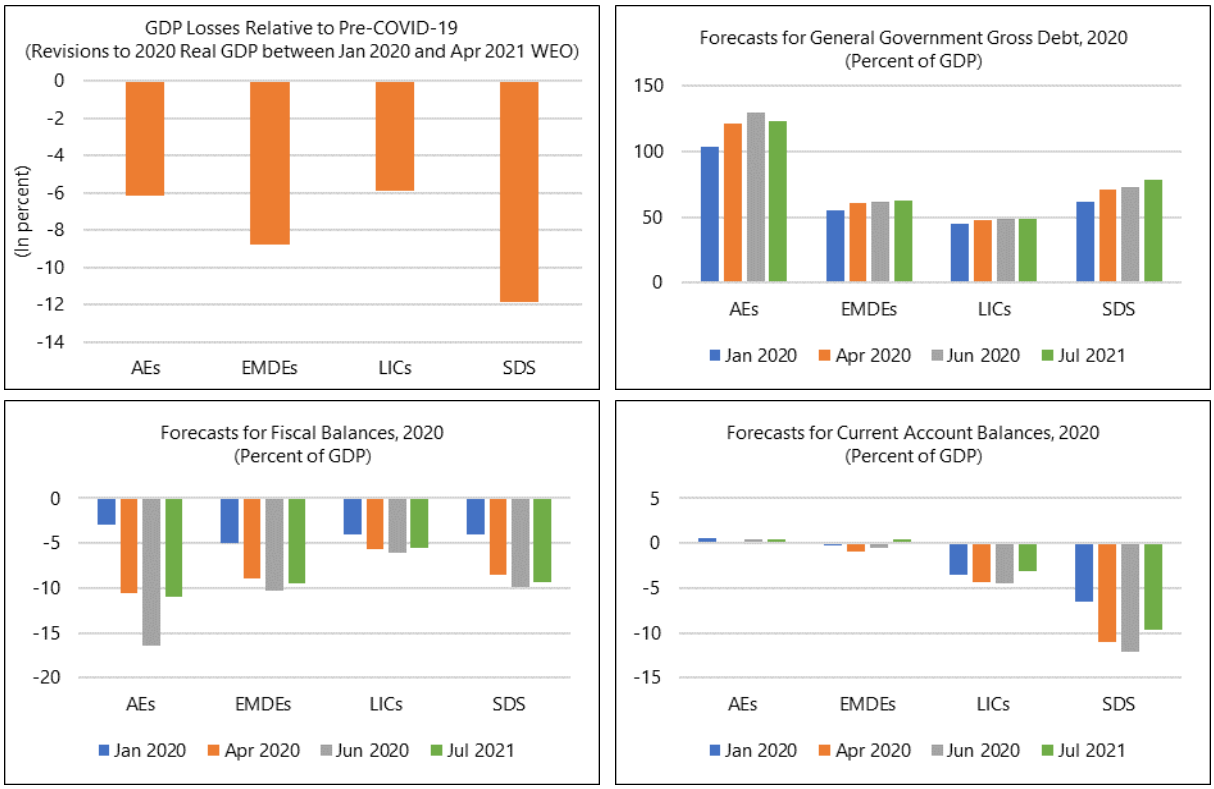
26. The economic impact of the pandemic on SDS was worse than on other country groups in 2020, the final year of the evaluation period, reflecting disruptions of trade, travel, tourism, capital flows, financing, and remittances. Compared to pre-shock baselines,[10] SDS were the most affected group (Figure II.5). Their real GDP contracted by around 12 percent, significantly larger than for other 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 plummeted 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 Fiji, Solomon Islands, and Vanuatu affected by Cyclone Harold in April 2020.

27. 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 II.2). While recognizing the high uncertainty regarding the longer-term economic impact of COVID-19 and the extent of scarring, and transformational changes, a half of Caribbean SDS are expected to take at least four years to recover to pre-pandemic income levels, while a half of all Asia and Pacific SDS will take three or more years to do so.[11]

[10] Baselines are proxied by staff projection from WEO January 2020 vintage.

[11] In terms of vaccination rates, which are especially important for SDS given the relative weight of the tourism sector, SDS had on average 40 percent of its population partially or fully vaccinated by October 2021, compared with 45 percent and 70 percent in EMs and AEs, respectively.

Figure II.5. COVID-19 Impact on SDS



Sources: IMF (WEO); IEO calculations.

III. Institutional Framework for Fund Engagement in SDS

A. Overall Framework[12]

Legal Mandate and Governance

28. IMF membership is available to any state that meets the eligibility criteria, irrespective of their 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 non-financial instruments, and benefit from the Fund's provision of CD. 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 the integrated surveillance decision (IMF, 2012b).[14]

[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 PRGT eligibility and eligibility for CCRT support, there is a Board approved definition of "small states", based on a population threshold (ie: below 1.5 million).