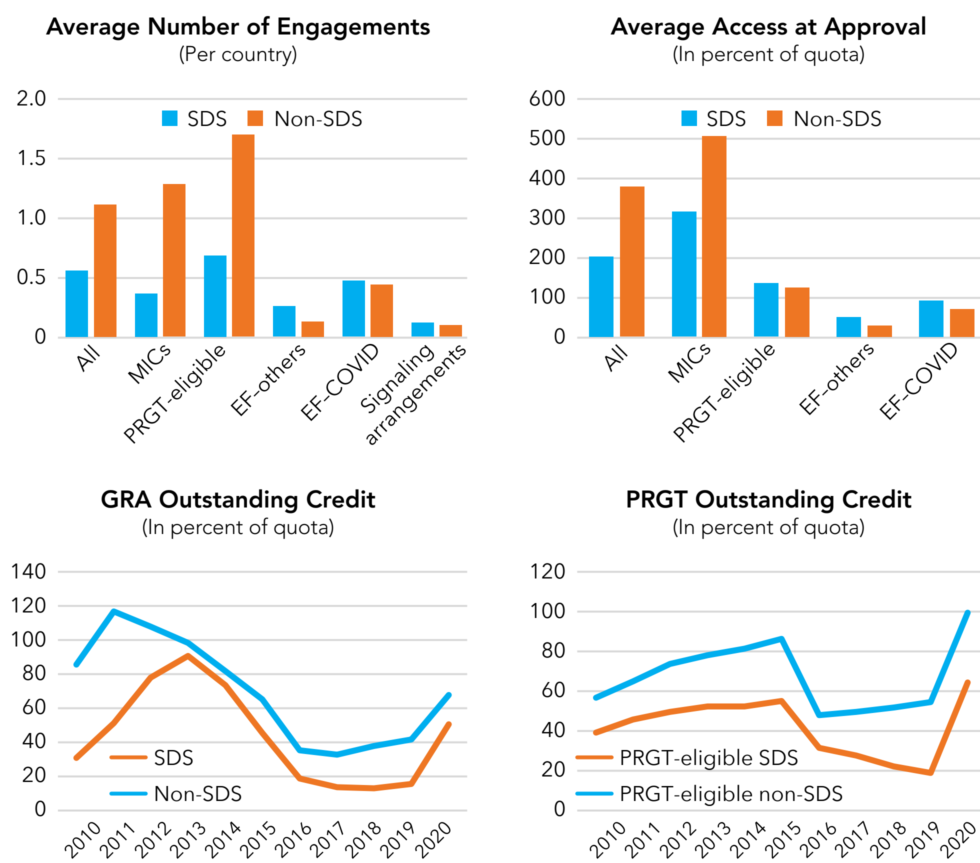
5

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

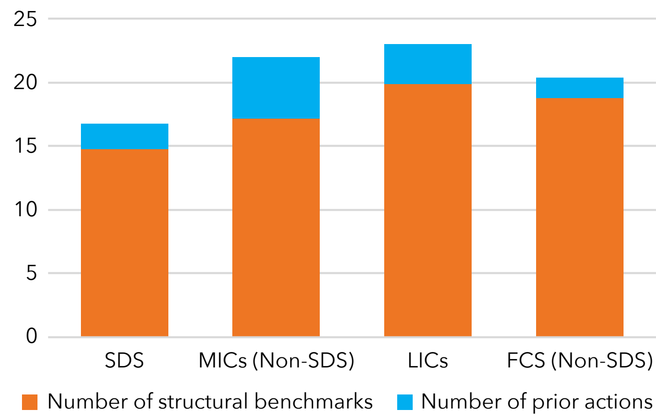
Data on structural conditionality shows some recognition of the lower institutional capacity of SDS compared to other members. Over the evaluation period, the 18 completed SDS programs had relatively few structural conditions (SCs) including structural benchmarks and prior actions, in comparison with 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.

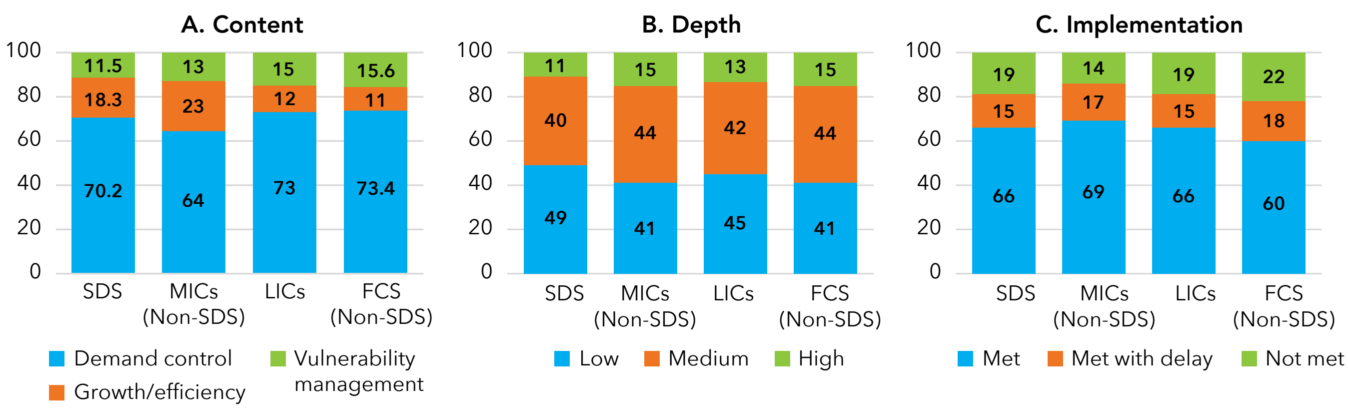
Similarly, program design paid limited attention to support disaster resilience–building policies. Most IMF-supported programs with SDS during the evaluation period were directed at addressing short-term policy adjustment needs, with little attention to encouraging longer-term ND&CC resilience building. 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

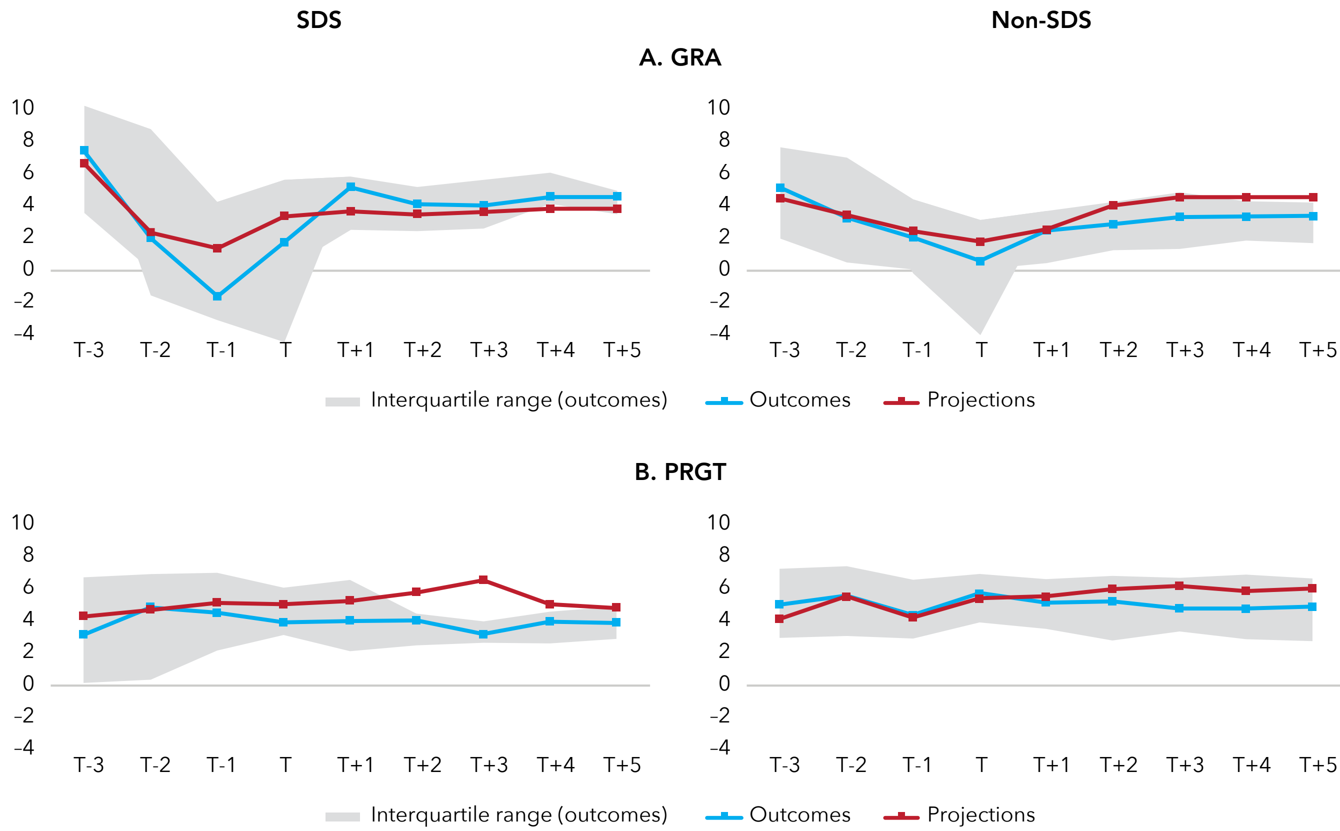
Sources: IMF, WEO; IEO calculations.
Note: EMs = emerging markets. Does not include programs continuing beyond the end of the evaluation period.
[1] Following the definition used by the 2018 Review of Conditionality, "off-track programs" refers to programs where at least two reviews were completed and 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



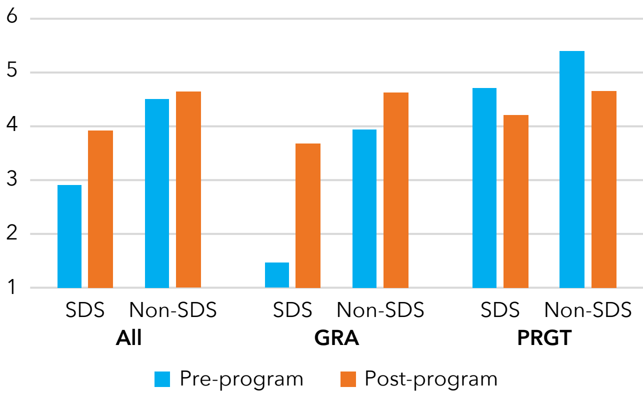
Sources: IMF; IEO calculations. Based on IEO (2021).
Note: All projections refer to initial program projections made at program approval (T). Outcomes and projections represent cross-country medians. Data availability is not uniform across periods mainly because post-program outcome data are not yet 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.

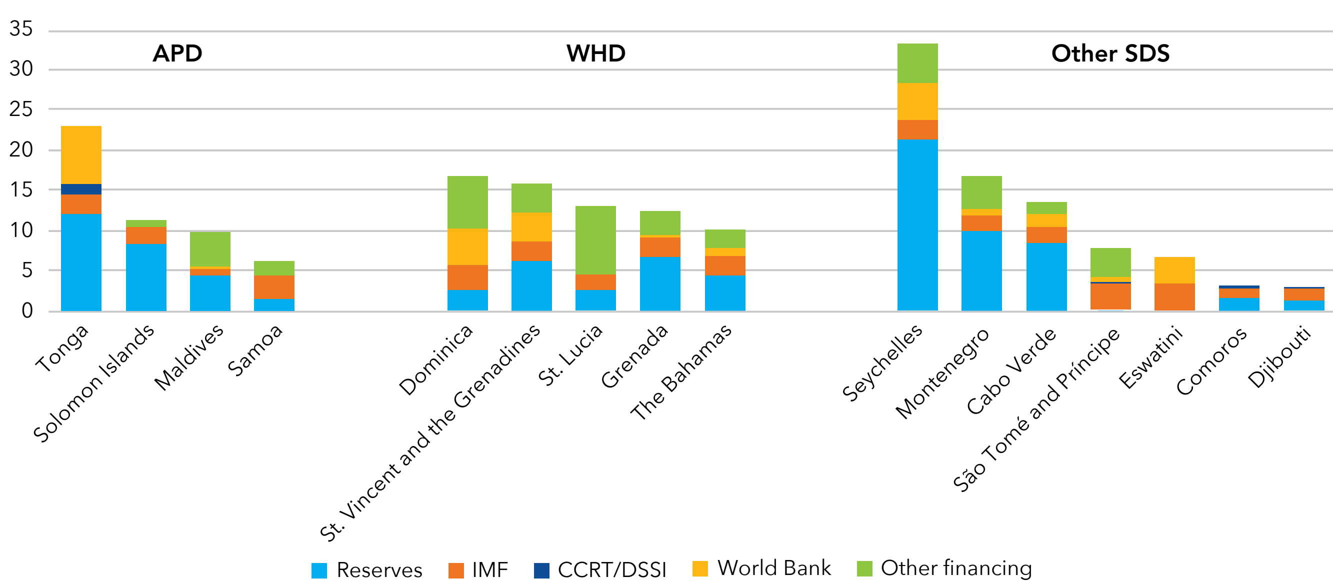
EMERGENCY FINANCING FOR COVID-19[34]

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)

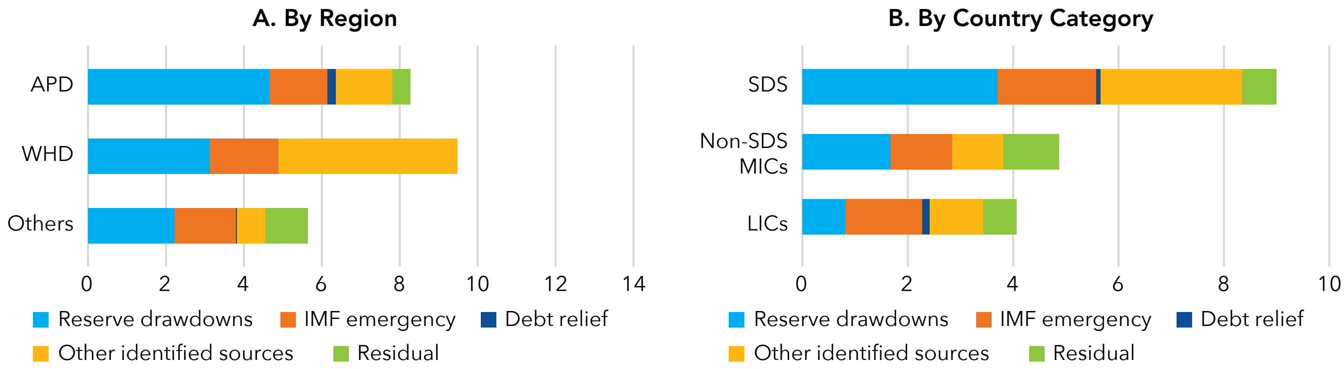


Sources: IMF; IEO calculations.
Note: Based on Board papers in support of EF requests.

[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.