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# BACKGROUND PAPER

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## **IMF Engagement with Small Developing States: Case Studies in the Asia and Pacific Region**

Xavier Maret and Miguel de Las Casas

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Asia and Pacific Region

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**ABBREVIATIONS**

ADB	Asian Development Bank
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
APD	Asia and Pacific Department (IMF)
BOP	Balance of Payments
CAB	Current Account Balance
CBR	Correspondent Banking Relationship
CCPA	Climate Change Policy Assessment
CD	Capacity Development
CDOT	Capacity Development Office in Thailand
CDF	Constituency Development Funds
COFA	Compact of Free Association
CPIA	Country Policy and Institutional Assessment (World Bank)
DRS	Disaster Resilience Strategy
DSA	Debt Sustainability Analysis
e-GDDS	Enhanced General Data Dissemination System
EBA	External Balance Assessment
ECF	Extended Credit Facility
EEZ	Exclusive Economic Zone
FAD	Fiscal Affairs Department (IMF)
FDIC	Federal Deposit Insurance Corporation
FIN	Finance Department (IMF)
FSAP	Financial Sector Assessment Program
FSM	Federated States of Micronesia
FSSR	Financial Sector Stability Review
FTE	Full-Time Equivalent
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GFS	Government Finance Statistics
GNI	Gross National Income
GRA	General Resources Account
HQ	IMF headquarters
ICD	Institute for Capacity Development (IMF)
IDA	International Development Association
KMU	Knowledge Management Unit (IMF)
LEG	Legal Department
LIC	Low-Income Country
LIC-DSA	Low-Income Country Debt Sustainability Analysis
MAC DSA	Debt Sustainability Analysis for Market Access Countries (IMF)
MC	Mission Chief
MCM	Monetary and Capital Markets Department (IMF)

PCI	Policy Coordination Instrument
PEFA	Public Expenditure and Financial Accountability
PFI	public financial institution
PFM	Public Finance Management
PFTAC	Pacific Financial Technical Assistance Center
PICs	Pacific Island Countries
PIMA	Public Investment Management Assessment
PRGT	Poverty Reduction and Growth Trust
RTAC	Regional Technical Assistance Center
RAC-ESF	Rapid Access Component of the Exogenous Shocks Facility
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
ROSC	Report on the Observance of Standards and Codes
SBA	Stand-By Arrangement
SCF	Standby Credit Facility
SDS	Small Developing State
SPR	Surveillance, Policy and Review Department (IMF)
STA	Statistics Department (IMF)
TA	Technical Assistance
UN	United Nations
UNCLOS	United Nations Convention on the Law of the Seas
UCT	Upper Credit Tranche
VAT	Value Added Tax
WEO	World Economic Outlook

## EXECUTIVE SUMMARY

This evaluation reviews and evaluates the Fund's engagement in five of the fourteen IMF members that are Small Developing State (SDS) in the Asia and Pacific region over the period 2010–2020, including the Fund's early response to the COVID-19 pandemic. The selected countries for this review are Fiji, the Federated States of Micronesia, Samoa, the Solomon Islands, and Tuvalu.

Asia and Pacific SDS share most of the economic characteristics of other SDS, including vulnerabilities to climate change and natural disasters. Their narrow economic base, small market size, and remoteness prevent economies of scale, which impairs competitiveness, market structures, and economic and financial development, but also affect their resilience to external shocks and delivery of public services.

Apart from Bhutan, all Asia and Pacific SDS are islands and three quarters of them are microstates or states in fragile and conflict-affected situations (FCS), highlighting their vulnerability to external shocks and weaker institutional capacity. The group had a mixed and diverse economic performances over the period under review. Growth was broadly restored to pre-Global Financial Crisis rates in a context of moderate inflation, but aggregate domestic and external balances deteriorated over the period with a buildup of the debt burden in the absence of effective adjustment. The COVID-19 pandemic exacerbated further these trends with a sharp recession in 2020.

This evaluation finds that surveillance activities in the five case studies were conventional, broadly satisfactory, and tailored to the priority issues faced by the countries, but continuity of dialogue and engagement was hampered by staffing issues. The focus on fiscal issues and natural disasters was to the relative detriment of other key thematic surveillance areas, such as growth, competitiveness, and the financial sector. Some issues of traction also arose from insufficient emphasis on implementation and discontinuity of engagement in the context of 24-month consultation cycles.

Asia and Pacific SDS had very limited recourse to Fund financial assistance over the period, although the experience with both program activities and emergency assistance was satisfactory. Emergency assistance operations in response to natural disasters and the COVID-19 pandemic proceeded quickly to the benefit of the member countries in need.

Capacity development (CD) activities in Asia and Pacific SDS were generally focused, demand-driven, and very appreciated by the member countries. The Pacific Financial Technical Assistance Center (PFTAC) provided the bulk of the Fund's CD activities in the region.

Given the findings from the country cases, the Fund's engagement with these SDS would benefit from:

- An overarching focus of surveillance activities on resilience to shocks.
- Greater continuity of engagement by eliminating the 24-month consultation cycle or by introducing interim consultations with briefing memos updating country reports.
- Strengthened surveillance of the financial sector, growth and sectoral policies, and resilience to natural disasters and adaptation to climate change, strengthening collaboration with other multilateral institutions as appropriate.
- Greater consideration of the institutional capacity of members to implement policies in the design of policy advice, further integration of CD and surveillance, and increased focus on policy implementation.
- Inclusion in Article IV reports of a detailed summary of policy recommendations to help authorities with implementation.
- Further provision of CD support to SDS member countries to facilitate the use of Fund-supported programs aimed at addressing macroeconomic vulnerabilities and resilience building issues, including through the use of non-financial, low-access, and precautionary programs.
- Adaptation of the lending toolkit to specific needs of SDS, such as access in the context of repeated natural disasters and state of fragility.
- Further CD activities on resilience building and macroeconomic analysis, to foster traction and improve policy design and implementation, possibly by increasing the resources available to PFTAC.
- Review budget constraints and human resources policies to improve staffing issues on surveillance and CD activities in SDS.

## I. INTRODUCTION

1. This paper reviews and evaluates the Fund's engagement in five—Fiji, Federated States of Micronesia (FSM), Samoa, Solomon Islands, and Tuvalu—of the 14 Small Developing States (SDS) in the Asia and Pacific region over the period 2010–2020, including the Fund's early response to the COVID-19 pandemic.<sup>1</sup> This selection of countries constitute a representative sample, covering a variety of relevant dimensions, including size, fragility, and exposure to natural disasters and climate change, and all aspects of Fund activities (see Annex I). The main objectives of the evaluation are to assess: (i) whether the IMF's core operations—surveillance, financial assistance, and capacity development—have been effective and tailored to address the challenges facing Asia and Pacific SDS; and (ii) how the IMF's institutional framework and procedures have contributed to these activities. This evaluation aims at drawing lessons that could help strengthen the quality and effectiveness of future Fund engagement with Asia and Pacific and other SDS.

2. Fiji and Samoa were the first Asia and Pacific small states to become members of the Fund in 1971 and Nauru was the latest in 2016. The eight microstates in the region (except Samoa) joined after 1984.<sup>2</sup> Asia and Pacific SDS account for 7 percent of the Fund's membership and have a cumulative quota of SDR 270.5 million, or 0.07 percent of the total, which is broadly in line with their relative weight in the world economy (IMF, 2021).<sup>3</sup> They have voting power equivalent to 0.47 percent of the total votes of the IMF Executive Board, where they are represented by five Executive Directors (IMF, 2021).<sup>4</sup> Despite their middle income per capita income, seven Asia and Pacific SDS are eligible for concessional financing under the Fund's Poverty Reduction and Growth Trust (PRGT) as a result of the IMF small country exception,<sup>5</sup> and four have access to blend financing under the PRGT and General Resources Account (GRA) facilities, while Fiji, Nauru and Palau have access only to GRA resources.

3. Asia and Pacific SDS have had limited recourse to Fund financial assistance in the past, despite being hit by numerous natural disasters as well as the pandemic. Since 2010, only

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<sup>1</sup> IMF SDS are defined as members that have a population below 1.5 million and are neither advanced market economies nor high-income oil exporting countries. Microstates are defined as SDS with a population below 200,000. The 14 SDS (*of which eight microstates*) in the Asia and Pacific region include: Bhutan, Fiji, *Kiribati*, Maldives, *Marshall Islands*, *FSM*, *Nauru*, *Palau*, *Samoa*, Solomon Islands, Timor-Leste, *Tonga*, *Tuvalu*, and Vanuatu. Annex II presents an overview of Asia Pacific SDS and their macroeconomic performance in the 2010s.

<sup>2</sup> Four Asia and Pacific SDS joined the Fund within 4 years of independence, and another four SDS joined the Fund between 5 and 10 years of independence.

<sup>3</sup> While the 14<sup>th</sup> General Review of Quotas doubled the amount of quotas to SDR 477 billion, the distribution of the quota increase across the Fund membership limited the increase of several Asia and Pacific SDS quotas to less than 100 percent.

<sup>4</sup> One Executive Director's office includes nine Asia and Pacific SDS in its constituency, and four other Offices of the Executive Director include Fiji and Tonga, Bhutan, Maldives, and Timor-Leste, respectively.

<sup>5</sup> For more detail on the IMF small country exception, see Abrams (2022).

Maldives and Solomon Islands have had economic programs supported by Fund upper credit tranche (UCT) facilities. In addition, five emergency financing operations were undertaken over the period 2010–2020, of which three in the context of the COVID-19 pandemic in 2020 and two in the context of natural disasters linked to cyclones.<sup>6</sup>

4. The IMF Asia and Pacific Department (APD) has surveillance and financial assistance responsibility for all Asia and Pacific SDS. APD has a dedicated Pacific Islands Division that originated as a departmental unit in 2014 and covers the eleven SDS in the Pacific, while Timor-Leste, Bhutan, and Maldives are covered by three other divisions respectively. The activities of the Pacific Islands Division are also supported by a regional resident representative office that is based in Fiji. Internal and published Fund documents related to surveillance and financial assistance are subject to an internal review process by functional departments, but the process for most SDS is usually limited to the Surveillance and Policy Review (SPR) and Legal (LEG) departments as other functional departments decline to review.

5. Asia and Pacific capacity development (CD) activities for Asia and Pacific SDS are the responsibility of IMF functional departments (e.g., Fiscal Affairs Department (FAD), Monetary and Capital Markets Department (MCM), Statistics Department (STA)) and the Pacific Financial Technical Assistance Center (PFTAC), located in Fiji, as well as the IMF Capacity Development Office in Thailand (CDOT) and the IMF Singapore Training Institute (STI).<sup>7</sup>

6. Following this introduction, Section II presents regional background, with a review of the main characteristics of Asia and Pacific SDS and their performance over the 2010–2020 period. Section III reviews the Fund’s engagement with the five SDS case studies in the context of surveillance, lending, and capacity development activities over the same period. Section IV draws together the principal findings and discusses possible improvements for more effective Fund engagement with the Asia and Pacific SDS going forward.

## II. REGIONAL BACKGROUND

7. Asia and Pacific SDS share most of the economic characteristics of other SDS, including vulnerabilities to climate change and natural disasters such as tropical cyclones, floods, and droughts (Annex 1). Apart from Bhutan, they are all island states in a vast oceanic extension and remote from neighbouring continents. Their narrow economic base, small market size, and remoteness not only preclude economies of scale, which impairs competitiveness, market structures, and economic and financial development but also affects their resilience to external shocks and delivery of public services. They are generally less developed and more dependent on external assistance than SDS in other regions, with an aggregate GDP equivalent of

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<sup>6</sup> These five emergency operations accounted for about 5 percent of all RCF/RFI operations approved by the Fund and 42 percent of the RCF/RFI operations approved within the Asia-Pacific Department (APD) over 2010–2020.

<sup>7</sup> For details on CD provision to SDS, see de las Casas and Balasubramanian (2022).

approximately one-third of the combined GDP of Caribbean SDS. The region also includes 8 of the 16 IMF microstates and 6 of the 7 SDS in the Fund's list of countries in Fragile and Conflict-affected Situations (FCS), exacerbating issues of institutional capacity.<sup>8</sup> Compared with other SDS regions, other unique features of the 14 Asia and Pacific SDS include their large maritime exclusive economic zones (EEZ),<sup>9</sup> the implementation of a regional fishing agreement with participation of 7 Pacific Islands since 1982,<sup>10</sup> and the Compacts of Free Association (COFA) between the USA and 3 of them (FSM, Nauru, and Palau). The Pacific islands are also exposed to El Niño oscillations that affect the migration of fish, a major resource for these islands which account for 30 percent of the world supply of tuna, and is associated with drought episodes.

8. Notwithstanding common features, Asia and Pacific SDS form a diversified group of countries. Their populations range from about 12,000 in Tuvalu to 1.3 million in Timor-Leste; the land surfaces vary from 21 km<sup>2</sup> in Nauru to 38,400 km<sup>2</sup> in Bhutan; the EEZs cover from 70,000 km<sup>2</sup> in Timor-Leste to 3.4 million km<sup>2</sup> in Kiribati; and their GDP range from \$0.05 billion in Tuvalu to \$12.69 billion in Fiji. They are small open economies: seven of them are classified as services exporters, mainly tourism destinations, another four are categorized as commodity exporters, two are diversified exporters, and one is a fuel exporter (Figure 1). Seven Asia and Pacific SDS use either the US dollar or the Australian dollar as legal tender, and six of them have no central bank.<sup>11</sup> The other SDS have pegged exchange rate arrangements. The financial systems of Asia and Pacific SDS tend to be small and shallow, and capital movements limited. Remittances are particularly important in Tonga (34 percent of GDP) and account for more than 10 percent of GDP in Samoa, Marshall Islands and Tuvalu. The six FCS have notable weaknesses in policy and institutional capacity that hamper policy and decision making.

9. Natural disasters and climate change are major risks for Asia and Pacific SDS.<sup>12</sup> Since 1980, Pacific SDS have suffered more natural disasters than other SDS regions and reported damages from 120 tropical cyclones.<sup>13</sup> Climate change also poses threats to the survival of several low-elevated Asia and Pacific SDS, such as Kiribati, the Maldives, the Marshall Islands, and Tuvalu, while threatening agriculture in higher-elevation islands such as Solomon Islands.

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<sup>8</sup> The six FCS are Kiribati, Marshall Islands, FSM, Solomon Islands, Timor-Leste, and Tuvalu (World Bank list, Fiscal Year 2021).

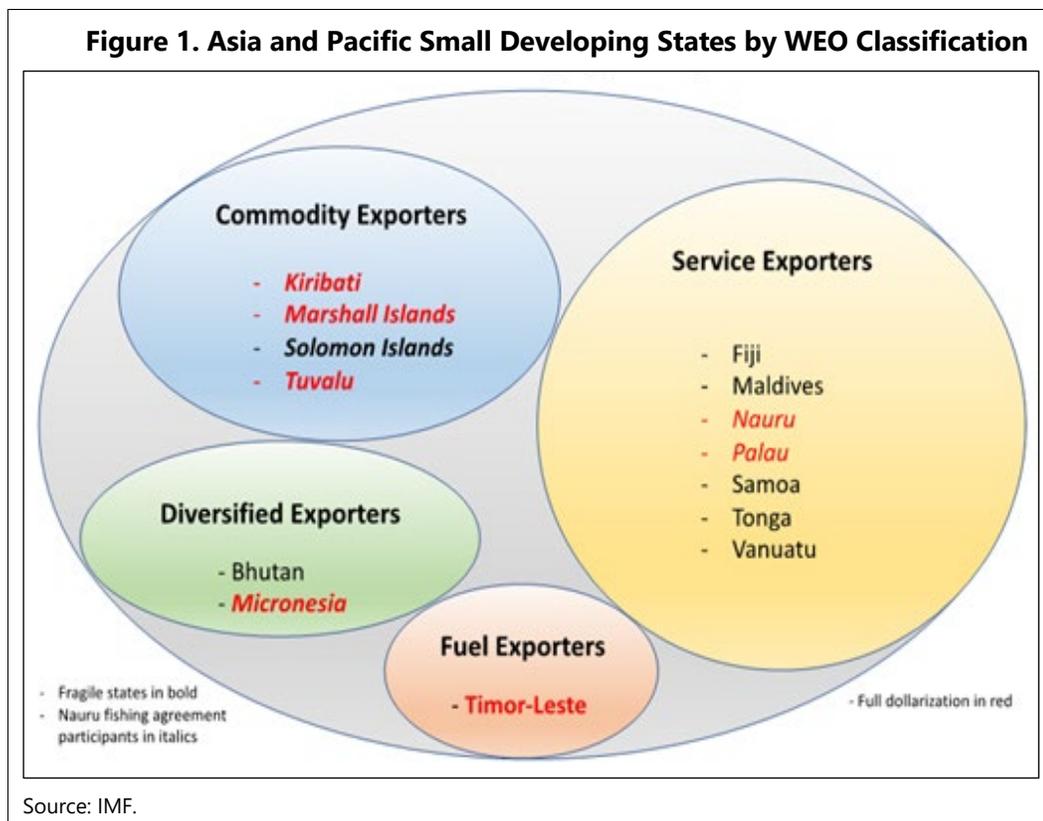
<sup>9</sup> EEZs, defined by the United Nations Convention on the Law of the Sea (UNCLOS), extend 200 nautical miles from shore, and grant the coastal state the right to explore and exploit, and the responsibility to conserve and manage its resources.

<sup>10</sup> Kiribati, Marshall Islands, FSM, Nauru, Palau, the Solomon Islands, and Tuvalu participate in the Nauru Agreement Concerning Cooperation in the Management of Fisheries of Common Interest.

<sup>11</sup> Kiribati, Nauru, and Tuvalu use the Australian dollar; the Marshall Islands, FSM, Palau, Timor-Leste use the US dollar; of these countries, only Timor-Leste has a monetary authority.

<sup>12</sup> For further background, see for example, Cabezón and others (2015), IMF (2016), and Lombardi and Rustomjee (2022).

<sup>13</sup> See Center for Research on the Epidemiology of Disasters (2020), and World Bank (2013).



10. The overall economic performance of Asia and Pacific SDS was mixed over 2010–2019, as growth was broadly restored to pre-Global Financial Crisis (GFC) rates in a context of moderate inflation (Table 1).<sup>14</sup> The average growth rate among Asia and Pacific SDS, at 3.7 percent per year, was similar to the average growth rate among non-SDS emerging markets and developed countries (EMDCs) over 2010–2019. This performance closed the average growth differential of 2.5 percentage points in favor of EMDCs that had been observed in the previous decade. However, despite this satisfactory growth performance, aggregate domestic and external balances deteriorated over the period with a build-up of the debt burden in the absence of effective adjustment. The risks of debt distress consequently increased in five Asia and Pacific SDS since 2010, with high risks of debt distress being assessed in the latest debt sustainability assessments (DSA) of seven Asia and Pacific SDS and debt being considered unsustainable in Palau (Table 2). This aggregate performance largely reflected developments in the largest countries in the region and was driven by a general deterioration of economic developments in Bhutan, Timor-Leste, and a few key services exporters (Maldives and Fiji in the second half of the period). There was a substantial heterogeneity of situations among other Asia and Pacific SDS, with the commodity exporters of the group faring relatively well over the evaluation period.

<sup>14</sup> For further details on the growth performance of SDS, see Rustomjee, Balasubramanian, and Li (2022).

**Table 1. Asia and Pacific SDS Economic Performance, 2001–2020**(GDP weighted data, in percent unless otherwise noted;  
average over shown sub-periods)

	2001–2008	2009	2010–2014	2015–2019	2020
Growth	4.5	0.1	4.8	4.2	-12.6
Inflation	4.3	4.9	5.5	2.4	0.3
Current Account Balance <sup>1</sup>	-2.1	8.8	8.0	-13.3	-15.1
Fiscal Balance <sup>1</sup>	-2.9	-5.8	-4.7	-6.3	-11.5
Gross Debt <sup>1</sup>	41.7	45.0	48.4	57.6	85.0

Sources: IMF, October 2021 WEO; IEO calculations.

<sup>1</sup> In percent of GDP.**Table 2. Risk of External Debt Distress, Debt Sustainability Analysis for Fiji, FSM, Samoa, Solomon Islands, and Tuvalu, 2010–2020**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Fiji <sup>1</sup>	Low	Low	Low	Low	Low		Low		Low	Moderate	Moderate
FSM <sup>2</sup>						High		High		High	
Samoa	Low		Moderate	High		Moderate <sup>3</sup>		High	High	High	High
Solomon Islands		Moderate	Moderate		Moderate		Moderate	Moderate	Moderate	Moderate	Moderate
Tuvalu			High		High		High		High		

Sources: IMF; IEO calculations.

<sup>1</sup> MAC DSA applies for Fiji. Assessments of debt sustainability is for public debt.<sup>2</sup> First DSA for FSM was done in 2015.<sup>3</sup> Upgrading from high to moderate risk of debt distress reflects change of discount rate to 5 percent and GDP rebasing.

11. The COVID-19 pandemic exacerbated the macroeconomic challenges of the region, as it triggered a severe recession with aggregate GDP declining by an estimated 13.5 percent in 2020. Asia and Pacific SDS took swift measures in early 2020 to protect their population and support their economies. As a result of these measures and the remoteness of Asia and Pacific SDS, the human toll of the pandemic was minimal in 2020 and concentrated in the Maldives, which accounted for 95 percent of the 14,543 cases of COVID-19 and the related 50 deaths reported at end-2020 by Asia and Pacific SDS (Table 3). However, the 2020 world recession and the economic disruptions engendered by the pandemic resulted in major setbacks to the resilience building efforts and progress towards the SDGs for these countries. Policy buffers were used to address the pandemic, with a likely deterioration of the debt sustainability in several states. The timeline for the recovery is yet unclear and shrouded with uncertainty. While most Asia and Pacific SDS have been able to continue preventing COVID-19 outbreaks, Fiji and Timor-Leste joined the Maldives as epicentres of the pandemic in mid-2021, with the number of cases and deaths rising to 140,574 and 713, respectively on August 23, 2021. The policies to support the recovery will have to address the potential scarring from the pandemic and to charter a path to renewed stability and resilience in a difficult environment.

	New Cases		Deaths	
	Cumulative	Per 100,000	Cumulative	Per 100,000
December 31, 2020				
Total	14,543	286	50	1
Maldives	13,757	2,591	48	9
Fiji	49	6	2	0
Timor-Leste	44	3	0	0
Bhutan	670	88	0	0
Others	23	1	0	0
August 23, 2021				
Total	140,574	2,765	713	14
Maldives	79,959	15,060	223	42
Fiji	43,597	4,899	438	49
Timor-Leste	14,403	1,111	49	4
Bhutan	2,585	339	3	0
Others	30	2	0	0

Sources: WHO (COVID-19 Dashboard); IEO calculations.

### III. CASE STUDIES

#### A. Fiji

##### Country Profile

12. Fiji is a south-west Pacific SDS with a population of just over 883,000 (6th most populated among IMF SDS), a land area of 18,274 km<sup>2</sup> spread over 332 islands, and an exclusive economic zone<sup>15</sup> of 1.29 million km<sup>2</sup>. Classified by the World Bank in 2021 as an upper-middle income country,<sup>16</sup> Fiji's GDP is \$5.5 billion. Around 30 percent of the population lives under the national poverty line, although extreme poverty is rare, and the infant mortality rate is 25.7.<sup>17</sup>

13. After independence from British rule in 1970, Fiji went through a period of political instability from a 1987 coup to parliamentary elections in September 2014, won by the FijiFirst

<sup>15</sup> <http://www.searoundus.org/data/#/eez>.

<sup>16</sup> <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups>.

<sup>17</sup> <https://www.adb.org/countries/fiji/poverty> and World Bank: [https://databank.worldbank.org/views/reports/reportwidget.aspx?Report\\_Name=CountryProfile&Id=b450fd57&tab=y&dd=y&inf=n&zm=n&country=FJI](https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tab=y&dd=y&inf=n&zm=n&country=FJI), <https://databank.worldbank.org/source/world-development-indicators/Type/TABLE/preview/on>.

party.<sup>18</sup> Today, Fiji is a multiparty democracy with Voreqe Bainimarama as prime minister since 2014 (he was re-elected in November 2018).

14. Fiji is the second largest and most advanced economy in the region, serving as regional hub for Pacific Island states and as host for development partners and pan-Pacific institutions. With a narrow economic base, the Fijian economy is increasingly dominated by the service sector, which accounted for more than 70 percent of GDP in 2018, with tourism (directly or indirectly) contributing around 40 percent of GDP. The country's major exports are bottled water, fish, sugar, and garments.<sup>19</sup> Fiji is highly vulnerable to climate change and natural disasters, ranking 19 out of the 34 SDS (IMF, 2016). Climate change and natural disasters have, according to the World Bank, constituted a major obstacle to the country's development and their economic cost is likely to increase over time. For example, in 2016, Tropical Cyclone Winston caused damages of around one-third of GDP.

15. As a member of the IMF since 1971, Fiji's quota is SDR 98.4 million, which conveys voting power of 0.05 percent. Since 1993, Fiji has hosted the Fund's PFTAC, the first (out of 10) of such centers established by the IMF. Since 2010, Suva also hosts the Fund's Resident Representative Office for Pacific Islands, which covers Fiji and 10 other member countries including 9 SDS.<sup>20</sup> Over the last 50 years, Fiji had only one IMF-supported program: a 12-month Stand-By Arrangement (SBA) approved in November 1974, which was never drawn upon. Fiji did not draw on emergency financing during the pandemic (Table 4). IMF spending on Fiji has been increasingly devoted to CD support, especially in the second half of the evaluation period (Figure 2).

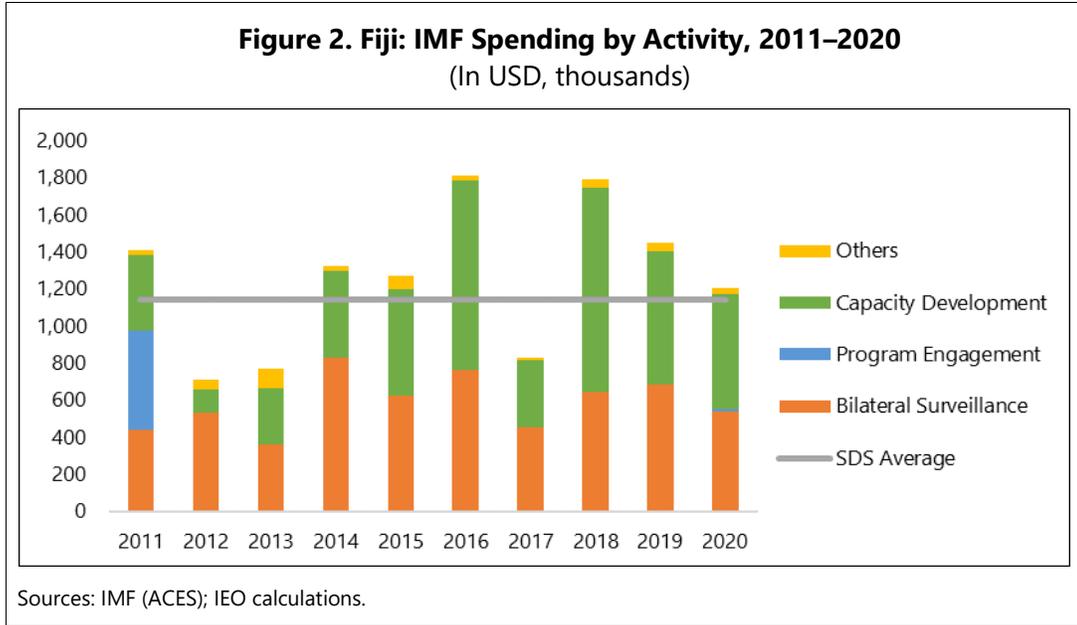
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Article IV	■			■				■			
Programs											
Emergency financing											
Other									■ FSSR		

Sources: IMF; IEO calculations.  
Note: FSSR=Financial Sector Stability Review.

<sup>18</sup> <https://www.britannica.com/place/Fiji-republic-Pacific-Ocean/Government-and-society>.

<sup>19</sup> ADB-Fiji Country Program Strategy 2019.

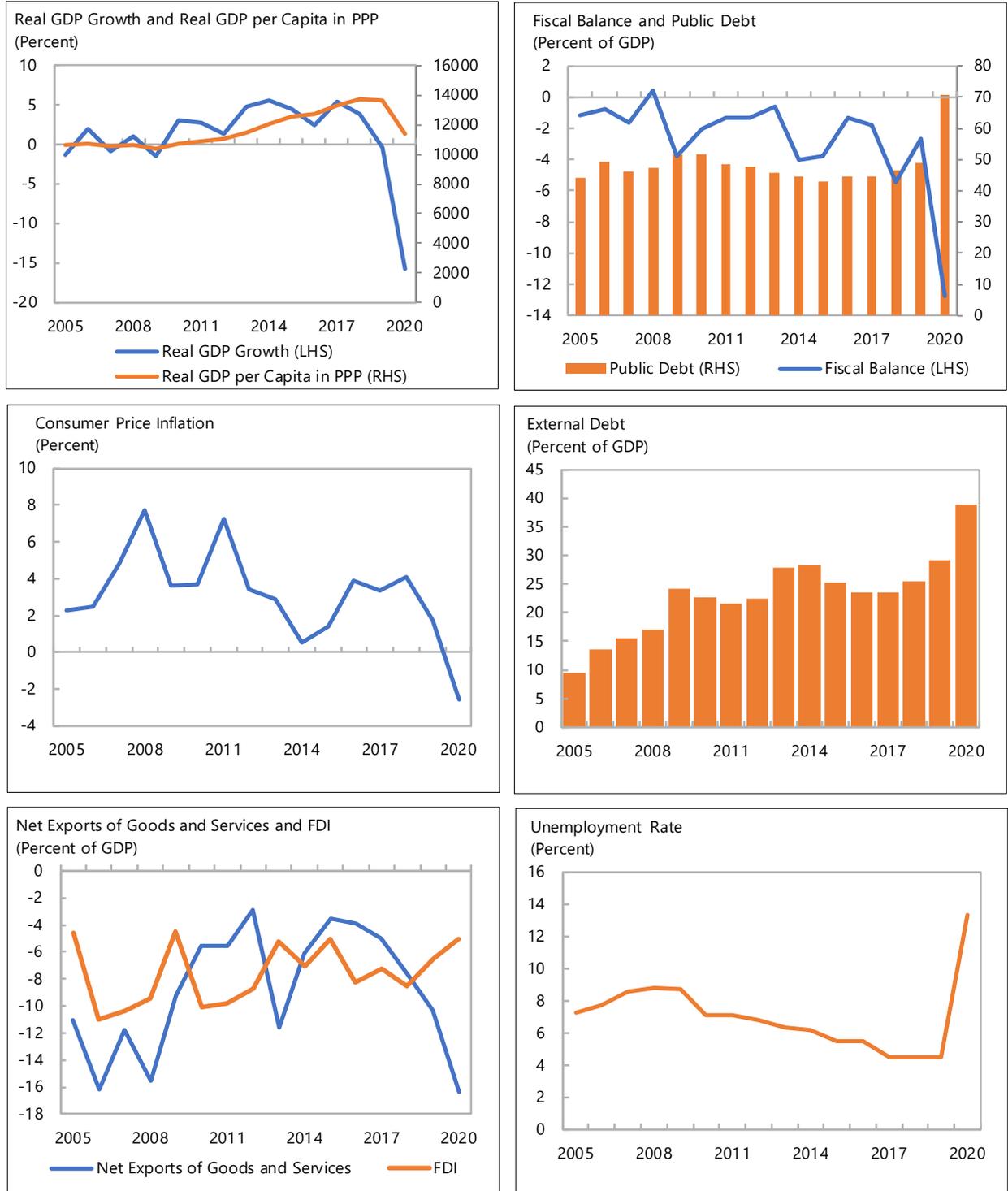
<sup>20</sup> Kiribati, Marshall Islands, FSM, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.



16. Over the decade and through 2019, Fiji enjoyed sustained economic stability and growth (Figure 3), despite the effect of several natural disasters, most importantly Cyclone Evan in 2012 and Cyclone Winston in 2016. Between 2010 and 2018 real GDP growth averaged 3.7 percent, although in 2019 the economy contracted by 0.4 percent amid lower government spending, tighter domestic financial conditions, and global deceleration. Over this period, the fiscal deficit averaged 2.4 percent of GDP, rising to 5.5 percent in 2018 and 4.4 percent in 2019. Public debt levels stayed between 43 and 51 percent of GDP, inflation was generally low despite a spike in 2011, and unemployment declined continuously, from 7.1 percent in 2010 to 4.5 percent in 2019.

17. The economic impact of the COVID-19 pandemic in Fiji has been devastating. Thanks to its geographic isolation and the swift measures adopted by authorities, Fiji was able to avoid widespread contagion until early 2021. Since then, the country has suffered three major outbreaks raising the toll to date to 63,687 cases and 827 deaths. However, economic damage was unprecedented. In 2020, real GDP contracted by 15.2 percent, public and external debt soared to 70 percent and 20 percent of GDP respectively, and the fiscal deficit reached almost 14 percent of GDP. Unemployment jumped to 14 and inflation dropped to -2.8 percent. The economic downturn over 2020 reflected a combination of several factors, but first and foremost, the tourism industry came to a halt. Other business with weaker links to tourism were also affected. While fighting the pandemic, Fiji was also hit by two tropical cyclones; Harold, in April 2020, which caused damage of about 3.3 percent of GDP and Yasa, in December of the same year, which left a toll of 4.5 percent of GDP.

**Figure 3. Fiji: Macroeconomic Developments, 2005–2020**



Sources: IMF, October 2021 WEO; IEO calculations.

## Main Elements of Fund Engagement

### *Surveillance*

18. Fiji is on a 12-month Article IV consultation cycle, notwithstanding three gaps (including in 2020) over the evaluation period. During the early years of the evaluation period, still in the wake of the GFC, surveillance focused mainly on spurring Fiji's anaemic growth in a way compatible with fiscal and external sustainability. In order to achieve these goals, staff laid out the core elements of what would constitute the Fund's advice throughout the period. These included: first, implementing or accelerating a series of structural reforms, including: (i) public enterprises, mainly the Fiji Sugar Corporation (FSC); (ii) civil service; (iii) land tenure; (iv) central bank independence and supervision functions; (v) the removal of price controls; (vi) and the improvement of the business climate. Second, adopting a more flexible exchange rate regime and removing exchange restrictions. And third, ensuring fiscal sustainability while nurturing growth. Little attention was paid to the financial sector in these early years and, in the realm of climate change and natural disasters, reports did not go deeper than mentioning they posed a significant risk for Fiji and, therefore, adequate buffers were needed.

19. Following Cyclone Evan and massive floods in 2012, surveillance turned more to SDS-specific issues, such as diversification, volatility, regional integration, resilience to shocks, transportation costs, and size-related problems. This process was helped by growing internal research at the Fund (see, for example, Sheridan and others, 2012) and the issuance of staff guidelines for engagement with SDS in mid-2014.<sup>21</sup> There was also a strong push for data quality improvement (supported by technical assistance (TA) provision) and heftier coverage of socio-political issues, including poverty, unemployment, emigration, and the incipient transition to democracy. Risk assessment matrices were introduced in 2013 and there was increased attention to financial sector issues.<sup>22</sup> Eventually, the successful elections of 2014 allowed, among other things, for a rapid improvement of the business climate, the re-engagement with traditional development partners and donors, and a vigorous growth momentum.

20. The impact of Cyclone Winston in February 2016 (with losses amounting to 30 percent of GDP), floods in December of the same year, and Cyclones Josie and Keni in April 2018, brought vulnerability to natural disasters and its implications for growth and fiscal sustainability to the center of the surveillance analysis during the later part of the evaluation period. This analysis was supported, again, by research on the topic by the country team (Lee and others, 2018), the Fund (IMF, 2019; Alwazir and others, 2017), and others (Mansur and others, 2017; Government of Fiji, 2017). Policy advice tried to strike a balance between, on the one hand, supporting needed

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<sup>21</sup> The issuance of the 2014 Staff Guidance Note on the Fund's Engagement with Small Developing States (IMF, 2014) marks the adoption of the GROWth framework for engagement with SDS.

<sup>22</sup> For example, the 2013 Article IV report included a box on "Financial Inclusion and Access," and the 2014 Report incorporated a box on "Re-engagement with Traditional Development Partners" and an annex detailing the implementation process of recommendations from the 2006 FSAP.

reconstruction efforts and structural reforms and, on the other, undertaking adequate fiscal consolidation to rebuild buffers and preserve external and debt stability.

21. Surveillance also highlighted Fiji's shared characteristics with other Pacific Island Countries (PICs), including the risk posed by the withdrawal of correspondent banking relationships (CBR). Governance and corruption were presented as an area with much room for improvement, linked to the enhancement of data provision through the subscription to Generalized Data Dissemination Standard (e-GDDS) in 2018. Following the 2018 Financial Sector Stability Review (FSSR),<sup>23</sup> renewed attention was also devoted to the financial sector, including through the elaboration of a CD program spanning 2–3 years. In general, later Article IV reports benefited from a more streamlined, pointed,<sup>24</sup> pragmatic, and prioritized approach to recommendations and took into account IMF guidance on SDS.

22. Overall, surveillance and policy advice during the evaluation period did focus on the most pressing issues affecting Fiji. All the elements of the GROWth framework were present in Article IV reports (before and after the approval of the framework itself), although with varying depth.<sup>25</sup> Most notably, the attention to natural disasters and financial sector issues grew rapidly after 2014, particularly towards the end of the period. Similarly, all reports seemed to benefit from an adequate level of knowledge of the Fijian economy, with specificity and the sense of prioritization of recommendations rising over time, maybe helped by lengthening mission chief (MC) tenures.

23. In interviews, Fijian authorities were very appreciative of surveillance advice and pointed out that the IMF has been a strong facilitator of needed reforms. They were satisfied with the specificity of the IMF's recommendations and staff's familiarity with the economy. In this respect, they highlighted the importance of on-the-ground presence, as the only way to adequately understand local economic developments and circumstances. They praised highly the role of the resident representative based in Fiji, although the position is shared with many islands in the region, as well as the contribution of long-term experts (see CD section below). In general, they attached high value added to surveillance exercises, especially the Debt Sustainability Assessment (DSA), which they considered "well done and respected," and critical to access financing from the World Bank and other institutions. Authorities also praised the quality and usefulness of the FSSR, which they saw as better adapted to the needs of Fiji than the Financial Sector Assessment Program (FSAP). Specifically, they applauded the practical approach of the exercise and that it was linked to a TA follow-up program. On the climate change and natural

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<sup>23</sup> FSAPs and FSSRs are complementary with the FSSR (set up in 2017) being a TA instrument that combines a financial sector diagnostic review and capacity building as well as a review of financial statistics, while the FSAP is primarily a surveillance instrument. FSAPs include an assessment of the resilience of the sector to severe but plausible shocks and AML/CFT issues. They are usually conducted jointly with the World Bank (except for advanced economies), but not the FSSRs.

<sup>24</sup> The reports included targeted boxes and annexes on specific issues, e.g., on pension savings withdrawal after Winston (2017), fiscal space assessment (2018), and natural disasters risk management (2019).

<sup>25</sup> GROWth stands for Growth and job creation, Resilience to shocks, Overall competitiveness, Workable fiscal and debt sustainability options, and Thin financial sectors.

disasters front, authorities expressed their interest in the Fund's dedicated vehicles, the Climate Change Policy Assessment (CCPA) and the Disaster Resilience Strategy (DRS).

24. Staff interviewed for the evaluation agreed with the authorities on the productive character of surveillance. They emphasized the need to listen to the authorities' concerns and adapt recommendations to the needs and capacity of the country in order to produce realistic and useful policy advice. This was seen as a precondition for the satisfactory levels of traction achieved. On surveillance instruments, staff also agreed with authorities on the usefulness of the MAC DSA, which provided a good anchor for the country teams' analysis, serving to illustrate the importance of adequate fiscal policies. Staff also stressed the importance for SDS of the incorporation of the template for adaptation to climate change in the DSA. They were more negative, however, regarding the external balance assessment (EBA), which they thought can be meaningless for less sophisticated SDS.

25. Officials' assessment of the interactions with surveillance teams was also positive. They emphasized a marked improvement over time, starting before the evaluation period. In early years, staff's attitude was, in their view, that of a "lecturer," telling authorities what to do. By contrast, in latter part of the evaluation period, country teams had in their view become much more collaborative and open, willing to listen, and ready to learn about Fiji's specific circumstances. They noted that teams were responsive, as well as willing to elaborate on issues especially important to authorities and offer live guidance on pressing problems. Authorities also reported an increase in the frequency of interactions with staff in recent years, which began before the pandemic but had recently intensified.

### ***Program Work and Emergency Financing***

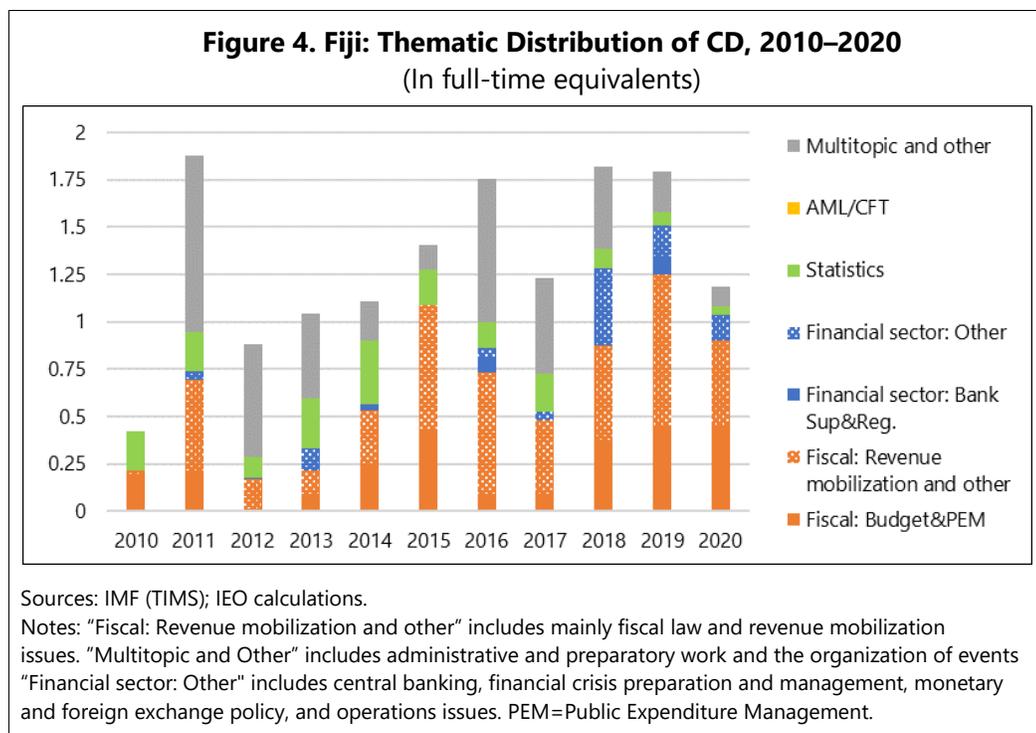
26. Despite the absence of an IMF-supported program in the last decade, Fiji's experience may help to understand factors that may influence SDS authorities' decision to make a program request. At the beginning of the evaluation period in 2011, Fijian authorities requested an arrangement with the Fund in support of their reform program. During negotiations, staff proposed a 27-month SBA, with access up to 300 percent of quota. However, eventually Fiji authorities withdrew their interest. Several reasons underpinned that decision. First and foremost, at the time, the stigma associated with an IMF-supported program still loomed large in the region (a view shared by several countries in the Pacific), outweighing the financial benefits offered by the Fund's involvement. Secondly, the conditions demanded by the Fund, such as the removal of exchange controls, were perceived as too tough. Thirdly, financing was available from other sources, including the sovereign bond market. In the end, the authorities decided that it was better to take the Fund's policy advice and implement it on their own, without the financing and the conditionality attached to a program.

27. More recently, authorities also considered the possibility of requesting emergency financing during the emergency response phase to COVID-19, but again agreement was not reached. While fiscal financing needs were large, given the spending surge and revenue drop

associated with the pandemic, the balance of payments (BOP) needs were less. The rise in the fiscal deficit could be financed domestically and external needs met from financing flows from the World Bank, the Asian Development Bank (ADB), and other development partners, including bilateral donors, and use of the IMF-World Bank Debt Service Suspension Initiative (DSSI) without drawing down reserves. Some country officials considered that, for a one in a century shock, IMF terms were too demanding and unattractive in comparison with more concessional loans provided by other development partners. Nevertheless, in general terms, authorities opined that the stigma issue had diminished substantially, although it had not disappeared. In their view, however, the Fund did play a useful catalytic role by providing an assessment letter that helped authorities benefit from the DSSI and secure funding from development partners.

### **Capacity Development**

28. Fiji has been a relatively heavy user of IMF CD and PFTAC's largest CD user during the evaluation period, absorbing between 10 percent and 15 percent of the center's total annual mission days.<sup>26</sup> To a lesser extent Fiji also received CD support from the Fund's Singapore Training Institute (STI) and through visits organized directly from HQ, and benefited from an FSSR in 2018. The thematic focus of the TA received was on the fiscal front (up to 70 percent of the total), mainly in the areas of Public Financial Management (PFM) and revenue administration. Other areas concomitantly supported by PFTAC during the last ten years were financial sector regulation and supervision, macroeconomic modelling and analytical capacity, and statistics (Figure 4).



<sup>26</sup> Pacific Financial Technical Assistance Centre—Annual Reports, 2010–2020.

29. Integration of the TA and surveillance functions seems to have improved over time. During interviews, staff insisted on the need and the effort made to align country needs, policy advice, and TA provision, where possible including that from other providers. Excellent examples were the pairing of Article IV surveillance or FSSR diagnostics with follow-up TA activities.<sup>27</sup> Staff also praised highly the work done by PFTAC, although recognizing its final impact may have been affected by many factors, such as institutional capacity and varying commitments of the recipient country. In the early years of the evaluation period, coverage of PFTAC TA in Article IV reports was essentially pro-forma and reflected slow progress in TA delivery and follow-up, with identical objectives repeated year after year. Later, however, coverage improved substantially. While in the first half of the evaluation period there was limited analysis in Article IV reports of the implementation of previous Fund recommendations and reform progress (especially in the financial sector), this analysis became more systematic and integrated with TA provision in the second half, a process that was also encouraged by the elaboration of Regional Strategy Notes.<sup>28</sup>

30. Authorities greatly valued the TA received from the Fund, especially from PFTAC. In interviews, they emphasized provider's commitment, dedication, and specific knowledge of the country and the region. They recognized that as host of PFTAC, proximity had favored enormously the transfer of knowledge, allowing for informal discussions, and even help with research activities. Officials were satisfied both with the thematic coverage and amount of the TA received and found the Fund always responsive to their requests, although sometimes with some delay, and accommodative on their priorities. Authorities also appreciated the strong integration of surveillance and CD activities and supported the participation of PFTAC experts in surveillance missions, which in their view contributed to tailoring the diagnosis and recommendations. While having a strong preference for PFTAC and long-term experts, authorities appreciated receiving TA via a mix of delivery methods, which included the organization of high-level conferences that, in their view, allow for the exchange of country experiences and send a strong message on the relevance and needs of SDS in the region.

### ***Collaboration with Partners***

31. The IMF maintained well-functioning working relationships with development partners and bilateral donors in Fiji, especially in the second half of the evaluation period and on the ground. After the coup in 2006 Fiji's relations with traditional development partners were

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<sup>27</sup> An interesting exercise, which deserves credit and may be considered an example going forward, is Box 1 in the 2018 Article IV report, which presented links between detailed surveillance recommendations and associated CD actions by the Fund and other providers.

<sup>28</sup> APD's 2017 Regional Strategy Notes on Capacity Development aimed at (i) further integrating CD activities with policy advice in country work, (ii) emphasizing country ownership and results; (iii) strengthening interaction between APD country teams, functional departments, and TA and training centers; and (iv) ensuring support from current and prospective external partners for CD.

reduced,<sup>29</sup> and it was not until after the elections in 2014 that these relationships started to normalize. Nevertheless, IMF-World Bank collaboration—with Bank staff participating in each Article IV consultation during the evaluation period—and was mainly focused on the implementation of structural reforms. In most recent years collaboration intensified further with enhanced information sharing and coordinated TA delivery, policy advice provision, and disaster response (e.g., after Cyclone Winston in 2017). Staff emphasized that coordination of the efforts by the Fund and other development partners is a sine qua non condition to maximize impact. They also commented on the Fund’s capacity to “set the narrative” among development partners by providing the macroeconomic framework and sharing IMF assessments. Although the coordination effort with partners was substantial, most of the time reporting of such in Article IV reports was either pro-forma or absent during the decade.

32. Authorities confirmed that IMF country teams were sufficiently coordinated with the main multilateral development partners, including the ADB, World Bank, and bilateral donors such as the Japan International Cooperation Agency (JICA) operating in the country. They also confirmed that the division of labor among them was clear. In this respect, authorities emphasized the importance of the DSA carried out by the Fund, as other stakeholders depended on it for their own operations.

### ***Staffing of Country Teams and Engagement of Senior IMF Officials***

33. During the evaluation period Fiji had five MCs, three of whom completed just one surveillance cycle, and the other two completed two and three cycles each. Authorities were generally satisfied with the composition of country teams. Staff were perceived as possessing the necessary technical expertise and specific country knowledge and able to engage in meaningful dialogue at both the technical and political levels. Officials did not see lack of continuity or excessive turnover as major issues, although they lamented that there was a reshuffle of the country team in the midst of the pandemic.

34. Despite reportedly meeting authorities’ expectations, staff interviewees were unhappy with the staffing resources available. Typically, the team was formed by the MC and two economists, all of whom had other assignments absorbing at least 50 percent of their time. Staff interviewees also emphasized the need to listen, learn, and adapt to the peculiar circumstances of the economy, which requires time. In a context of hard resource constraints, some staff noted that one option would be to increase flexibility and focus on a few critical issues (which would also be in line with the limited absorptive capacity of some SDS), rather than ticking all the boxes in the standard surveillance template. Moreover, due to the need to fully absorb the specifics of the economy, some staff members considered that the tenure of country assignments should be at least two surveillance cycles.

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<sup>29</sup> For example, the relationship with ADB was put on hold, and with the World Bank the interaction was limited. In response, Fijian authorities developed ties with EXIM banks in China and Malaysia as sources of external financing.

## B. Federated States of Micronesia

### Country Profile

35. The Federated States of Micronesia (hereafter FSM) is a remote microstate comprising 607 islands in the wider region of Micronesia in the Western Pacific. It has a population of about 104,000 inhabitants, a combined land area of 702 km<sup>2</sup>, and an EEZ of more than 2.6 million km<sup>2</sup> of the Pacific Ocean, the 14th largest in the world. It gained independence in 1979 and consists of four states under a federal structure governed by the Constitution adopted at that time.<sup>30</sup> The FSM was previously part of the United Nations Trust Territory of the Pacific Islands, which included the Marshall Islands and Palau and was administered by the U.S. from 1947 to 1978. With a gross national income (GNI) per capita of \$3,930 in 2019, the FSM is classified as a lower-middle income country. Its high institutional and social fragility is reflected in a World Bank's Country Policy and Institutional Assessment (CPIA) score of 2.73, and it is included on the IMF list of FCS. This fragility is also reported in Fund assessments of the FSM's data provision to the Fund for surveillance purposes as having serious shortcomings that significantly hamper surveillance.<sup>31</sup>

36. The FSM has received substantial external support from the U.S. It entered a COFA with the U.S. in 1986 to formalize closer ties between the two countries.<sup>32</sup> Under the Compact, amended in 2004 and set to expire in 2023, the U.S. provides over \$110 million (25 percent of GDP) in annual financial assistance to the FSM, as well as a variety of federal grants and services. A Joint Economic Management Committee was set up with representatives of both countries to ensure effective focus and good governance in the use of the funds.<sup>33</sup> The assistance is provided in the form of contributions to a jointly managed Compact Trust Fund (CTF) and sector grants to support seven specific areas of public services (health, education, infrastructure, public sector capacity building, private sector development, environment, and accountability). The CTF was set up in 2004 to build up financial assets whose income would replace the sector grants at the expiration of the Compact in 2023. From the creation of the Compact Trust Fund in 2003 to end-2019, the FSM contributed \$30 million and the U.S. contributed \$406 million, with the valuation of Trust Fund assets reported at \$784 million at end-September 2020.<sup>34</sup> Additional

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<sup>30</sup> Authority is highly decentralized, with state governments significantly larger than the national government. See FSM (2004), "Strategic Development Plan (2004-23), The Next 20 Years: Achieving Economic Growth and Self-Resilience."

<sup>31</sup> During the evaluation period, the Graduate School USA (GSUSA) assisted the FSM with annual updates of finance and economic statistics. GSUSA also produced comprehensive annual Economic Reviews and Economic Briefs.

<sup>32</sup> The U.S. dollar is the official currency and legal tender in the FSM.

<sup>33</sup> The second financial package adopted in 2003 included a strengthened governance framework that proved difficult to implement by the national and state governments. Subsequent delays in the disbursement of assistance (34 percent of GDP at end 2008) and a challenging international environment weakened economic performance substantially in the late 2000s.

<sup>34</sup> Trust Fund for the People of the FSM, March 18, 2021, "Fiscal Year 2020, Annual Report."

assistance from the U.S. includes support for special education, post-disaster relief and reconstruction from the Federal Emergency Management Agency (FEMA) and United States Agency for International Development (USAID), deposit insurance and supervisory oversight for the Bank of FSM by the Federal Deposit Insurance Corporation (FDIC), postal services, civil aviation safety, and weather monitoring.<sup>35</sup> The U.S. is also responsible for the security and defense of the FSM, and eligible FSM citizens can enter, study and work in the U.S. without visas. Negotiations on the future of the Compact and U.S. assistance are ongoing as of December 2021.

37. The FSM is highly vulnerable to natural disasters and climate change; ranked 20 out of 34 SDS by the IMF (IMF, 2016). It is affected not only by tropical storms but also by flood and drought episodes linked to El Niño oscillations. The FSM is not in the highest risk zone of the Pacific but still has a 24 percent probability of being hit by at least one disaster in any given year, and 8 percent of its population live within five meters of sea level.<sup>36</sup> Four tropical cyclones were reported in the early 2000s with minor damage, and the country was hit by two cyclones, one flood episode, and one drought spell over the 2010–2020 period. Typhoon Maysak affected 35,000 people and resulted in estimated damages of \$11 million in 2015, just after the Article IV Consultation mission. Authorities expressed interest in Fund assistance in a subsequent staff visit at the end of the year, but support from the U.S. under the COFA and from other partners provided sufficient assistance to prevent further discussions on use of Fund resources.<sup>37</sup>

38. The FSM is a small open economy with imports and exports of goods and services equivalent to 66 percent and 31 percent of GDP, respectively, in 2019.<sup>38</sup> The economic structure remains simple, with a private sector dominated by production of non-traded goods, limited exports, and a small tourism sector. Fishing and agriculture account for one quarter of economic activity, the largest share among Asia and Pacific SDS; otherwise, the economy is dominated by the government and tertiary sectors, while the manufacturing and mining sectors are insignificant. Public employment accounts for half of total employment, and the average annual public sector wage is about twice as high as the private sector wage. Fishing accounts for about 70 percent of merchandise exports, which amounted to \$47 million in 2018 and go predominantly to Asian markets. Imports of food and fuel account for half of total imports, and the U.S. is the largest partner. Foreign investment has been limited by prohibitions of foreign ownership of land and businesses, a corporate registration process requiring approval from the state and national

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<sup>35</sup> See Box 1 of 2019 Article IV Consultation report (IMF, 2019a), and Box 2 of 2010 Article IV Consultation report (IMF, 2011).

<sup>36</sup> Lee and others, 2018, "The Economic Impact of Natural Disasters in Pacific Island Countries: Adaptation and Preparedness," IMF Working Paper WP/18/108. FSM Government, 2015, "Second National Communication to the UN Framework Convention on Climate Change," Chapter 3. Pacific Catastrophe Risk Assessment and Financing Initiative, 2011, Country Risk Profile: The FSM." Out of 181 countries, the FSM ranks 70<sup>th</sup> and 73<sup>rd</sup> on the exposure and overall risk scores of the 2020 World Risk Index.

<sup>37</sup> For more details, see IMF (2019b), Annex II.

<sup>38</sup> Excluding exports of other services which reflects predominantly the services of the Micronesia Registration Advisors (MRA), a private company that manages the domiciliation of foreign corporations in the FSM.

government, and weaknesses in the legal regime and the judicial system. The banking sector is shallow, with two commercial banks, a government-owned FSM Development Bank, and credit unions. Banks are co-supervised by the Banking Board and the FDIC and they have been able to avoid the loss of correspondent banking relationships. The FSM has a social security system, but it is not self-sufficient, and the long-run viability of the system would require reforms.

39. Economic growth over the period 2001–2014 was variable but negative on average, reflecting difficulties in meeting conditions for the disbursement of Compact grants, stop-and-go investment patterns, and external shocks, particularly the GFC and commodity prices boom over 2007–2013. Current account deficits remained large despite efforts at fiscal adjustment; inflation eroded competitiveness; and government debt crept up (Figure 5).

40. Positive growth resumed at an average rate of 1.9 percent from 2015 to 2019, while annual inflation was contained to 0.5 percent. Government debt continued to decline to 18.7 percent of GDP in 2019 and the FSM continued to have a positive net international position. Nevertheless, the emergence of current account balance (CAB) surpluses averaging 11.6 percent of GDP over 2015–2019 reflects a supportive international environment, large but volatile services revenue of the company managing offshore tax domiciliation, (Micronesia Registration Advisors (MRA)), large increases in fishing license revenue, and episodic tax revenue on offshore corporate income and capital gains.<sup>39</sup> The turnaround of the CAB was accompanied by a strengthening of fiscal surpluses driven by higher revenue. In light of the positive outturns, the national government earmarked some fishing license revenue and offshore corporate income tax revenue to the FMS Trust Fund to foster fiscal sustainability and benefit future generations.<sup>40</sup> The improvement of the overall budget surplus is not projected to be sustainable in light of the projected loss of Compact sectoral grants, the volatility of the offshore corporate income tax revenue and current expenditure policies.<sup>41</sup> The overall fiscal balance is projected to turn from a

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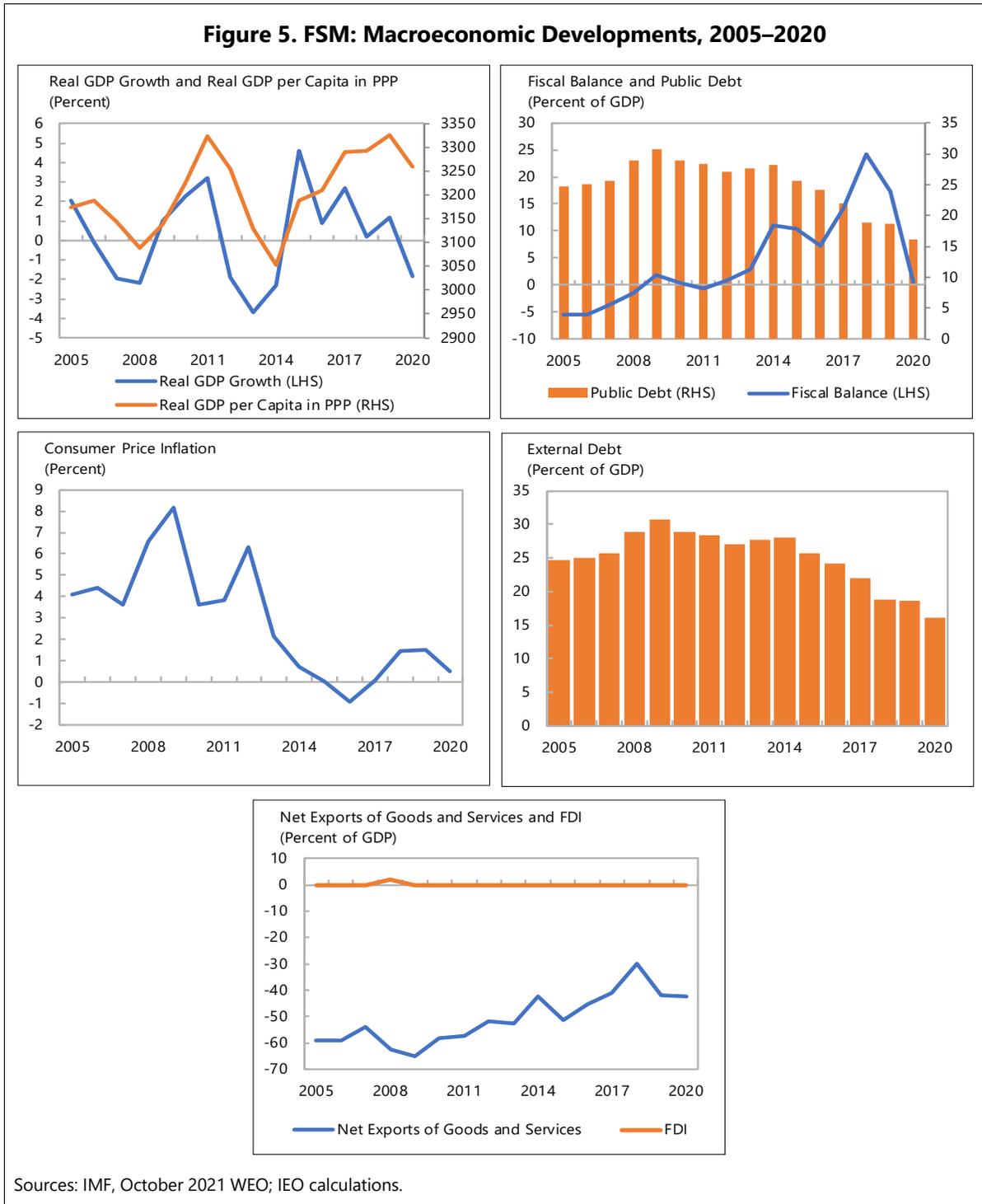
<sup>39</sup> The FSM passed legislation in 2005 enabling the creation of an overseas domicile targeted at Japanese companies and offering a corporate income tax of 21 percent. The legislation has been successful in attracting companies and resulted in a growing annual stream of corporate tax revenue to the government and large occasional tax revenue on capital gains varying from \$28 million in 2014 to \$77 million in 2017). The Global Forum on Transparency and Exchange of information for Tax Purposes has assessed the FSM as largely compliant after the FSM passed legislation on exchange of tax information and transparency.

<sup>40</sup> The FSM created its own sovereign Trust Fund (FSMTF) in 2001 on the lines of the Compact Trust Fund to ensure long-term fiscal sustainability and provide for future generations. At end-September 2020, cumulative assets of the FSMTF (\$307 million) and the Compact Trust Fund (\$780 million) were equivalent to 266 percent of GDP. New legislation earmarks 20 percent of fishing license fees and 50 percent of corporate income tax to the FSMTF.

<sup>41</sup> The FY2020 Annual Report of the Compact Trust Fund finds that the distributions of the Trust Fund would be in a range of \$44–54 million under various scenarios of rates of returns over the period 2020–2023, which is well short of the target to replace annual grant assistance after FY2023 (estimated at \$80.6 million, about 20 percent of GDP).

surplus to a deficit of around 4–5 percent of GDP in FY2024. This is a key underlying reason for the recent IMF DSAs to assess FSM to be at a high risk of debt distress.<sup>42</sup>

**Figure 5. FSM: Macroeconomic Developments, 2005–2020**



<sup>42</sup> The FSM has remained, however, at a high risk of debt distress under current policies and taking account of the impending lapse of the COFA. The DSA thresholds on the present value of external debt to GDP and public debt to GDP ratios are projected to be breached within a 20-year period.

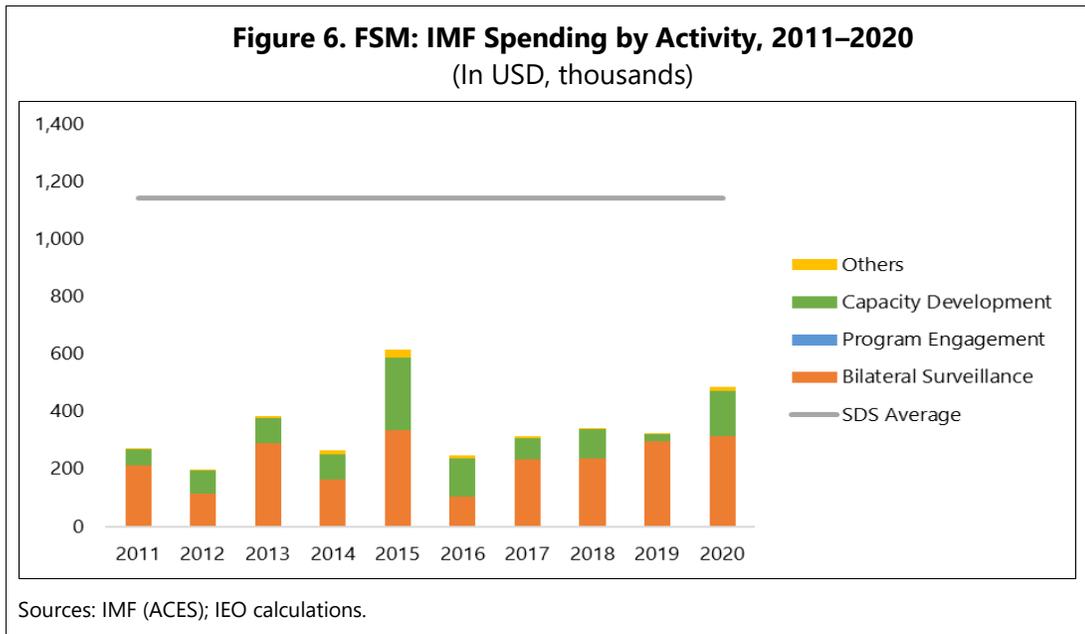
41. The government took early measures to limit the outbreak of the COVID-19 pandemic in the FSM and benefited from United States assistance to alleviate the economic and social impacts of the crisis. While no COVID-19 cases to date have been reported by the FSM, the economic toll has been significant with output dropping 1.8 percent in 2020 largely due to a shutdown of export activities, international border closure, and lower internal demand. Positive growth is not projected to resume before 2022, with the economic and social challenges of the pandemic recovery compounded by the uncertainty of the future of the Compact.

42. IMF engagement with the FSM has exclusively been for surveillance and capacity development purposes since the country joined the Fund in 1993 (Table 5 and Figure 6). The FSM has never made recourse to the Fund for a financial arrangement or emergency assistance. The FSM has a quota of SDR 7.2 million (0.002 quota share), with a voting share of 0.03, and is eligible for Fund concessional financing under the PRGT through the small country exception.

**Table 5. FSM: IMF Engagement, 2010–2020**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Article IV	■		■			■		■		■	
Programs											
Emergency financing											
Other										■ (CCPA)	

Sources: IMF; IEO calculations.  
 Note: CCPA=Climate Change Policy Assessment.



## **Main Elements of Fund Engagement**

### ***Surveillance***

43. The FSM is in a 24-month surveillance cycle and six Article IV consultations were considered by the IMF Executive Board over 2009–2020.<sup>43</sup> Four staff visits took place between the Article IV missions to provide continuity in surveillance, but these visits were relatively short.

44. The surveillance activities were broadly in line with the various Guidance Notes issued over the review period for IMF engagement in SDS (IMF, 2014; revised 2017) and for Surveillance under Article IV Consultations (IMF, 2015a), as well as the operational priorities of the 2014 Triennial Surveillance Review.<sup>44</sup> In interviews, most mission chiefs reported that the guidance notes were very useful, particularly at the beginning of their assignments, to assist with relevant issues. There were no Selected Issues Paper (SIP) on the FSM over the period, but the staff reports included various boxes on the implications of the GFC and the challenges of commodity price volatility, the Compact Trust Fund, the use of Compact Trust grants, the fisheries sector, private sector development, financial inclusion, the efficiency of public service, and resilience to natural disasters.

45. Surveillance in the FSM was tailored to address the key issues of the FSM and focused on the consequences of the expiration of the Compact. The topic of how to address the projected fiscal cliff after 2023 has been debated as far back as the 2006 Article IV consultation with staff recommending at various times medium-term fiscal adjustment to be achieved in the order of 4 percent to 6 percent of GDP.<sup>45</sup> Staff also urged a comprehensive tax reform, including the introduction of a value added tax (VAT), and streamlining of expenditure focusing on the wage bill, along with improved public financial management, and tax administration reinforcement. The need to foster growth and private sector development has been the second topic of focus in Article IV consultation discussions, with particular attention to reducing the cost of doing business. Financial inclusion, private sector financing, and the strengthening of banking supervision were a third area of focus. The possible loss of banking sector oversight by the FDIC after 2023 highlighted the need of updating banking laws, developing prudential regulations,

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<sup>43</sup> In principle, Article IV consultations take place annually. The Fund can place a member on an “extended cycle” after consulting with the Executive Director for the member and obtaining the member’s consent, only if the member (a) is not of systemic or regional importance; (b) is not perceived to be at some risk of policy imbalances or particular threats from exogenous developments, or the member is facing pressing policy issues of broad interest to the Fund membership; or (c) has outstanding credit to the Fund under all facilities above 200 percent of quota (Decision 14747-(10/96)).

<sup>44</sup> For guidance note on engagement with small developing states, see IMF (2014); IMF (2017a). For guidance note on surveillance, see IMF, 2015). The 2015 Guidance Note for Surveillance has a specific box on surveillance for SDS.

<sup>45</sup> The FSM government published a Strategic Development Plan 2004–2023 when the initial Compact was amended. A new 2023 Action Plan was launched in February 2015 to address the post-2023 challenges focusing on growth through structural reforms, revenue mobilization (tax reforms generating 4 percent of GDP), and expenditure control.

and expanding bank supervision to the FSM Development Bank and credit unions in the country. Finally, formal discussions on strengthening resilience to natural disasters and climate change grew in the wake of the 2015 Typhoon Maysak. The 2017 Article IV consultation reflected the cost of natural disasters in the macroeconomic framework,<sup>46</sup> and the 2019 Article IV discussions discussed the findings and recommendations of the joint CCPA.

46. FSM's CCPA, the fifth of its kind, was conducted in collaboration with the World Bank and integrated in the 2019 Article IV consultation, given the macro-structural relevance of climate change for the country. It reviewed the FSM's plans for mitigating and adapting to climate change, in line with its Nationally Determined Contribution (NDC) under the Paris Agreement. The CCPA found that FSM had made significant strides to counter climate change, such as through the expansion of renewable power generation and the execution of various adaptation investment projects. It also assessed FSM's ability to address the risk of natural disasters as partly supported by the current Compact with the U.S. The CCPA nevertheless identified significant gaps regarding a National Adaptation Plan and a comprehensive disaster resilience strategy, as well as capacity constraints that hindered an acceleration of adaptation investments, particularly at the state level. A financing gap of \$400–500 million was estimated over the next 15 years between the FSM's ambitious investment plans and currently projected financing. The authorities welcomed the CCPA which provided a comprehensive review of their mitigation and adaptation plans, and supported the recommendations for the way forward, but it is too early to assess implementation.

47. The engagement of the Fund and the policy discussions during Article IV consultations were highly valued in the FSM. The importance of surveillance was highlighted during interviews with authorities who believed that it pushed governments to reflect on recent economic and financial developments, and to act, as well as to collect appropriate information. Fund documents report general agreement of the authorities with staff's analyses and recommendations, a point confirmed in interviews with officials. Interviewees indicated that a key contribution of Article IV consultations in the FSM has been to provide a candid evaluation of where the country was and discuss the way forward. In this context, the DSA was viewed as an important tool and the CCPA as a very good contribution that encompassed previous work on climate change resilience. There have been rare occasions of divergence of views, such as in the recent discussions on the use of the FSM Trust Fund resources to finance projected fiscal deficits, but this has intensified the dialogue instead of shutting it down. Some country representatives stressed interest in receiving more practical and tailored advice, which could be met through greater use of SIPs and cross-country analysis, while acknowledging that this would require more work and analysis in terms of macro-relevant areas to cover (such as the fisheries sector and the Nauru agreement).

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<sup>46</sup> In line with the recommendations in IMF (2016), Annex IV.

48. Traction of Fund recommendations was limited in the crucial fiscal sector. A review of the implementation of past Article IV recommendations in staff reports points to a mixed track record, particularly regarding the passing of legislation and fiscal policy.<sup>47</sup> While there was general agreement on the size of the fiscal cliff at the expiration of the Compact and on the adjustment measures to address it, the pace of reform was slow, partly due to federal structure of government and capacity limitations. Most of the fiscal improvement observed since 2015 can be linked to external factors. Plans for the comprehensive tax reform, developed with IMF support, including the establishment of Unified Revenue Authority (URA) and the introduction of a VAT, met resistance in two states preventing the full adoption and implementation of the related legislation. The streamlining of expenditure, including the wage bill, did not have significant results. Yet, there were many efforts to improve tax administration and public financial management with the support of Fund TA; a PFM reform road map was approved for 2017–2020, and a Public Expenditure and Financial Accountability (PEFA) assessment and a Public Investment Management Assessment (PIMA) were conducted during the review period.

49. Several factors could explain this relative lack of traction.

- First, the burden sharing of the proposed adjustment among the states and national governments was not well defined. Given the fiscal federalism structure of the FSM and the large autonomy of states, the issue may not be so much the size of the consolidated fiscal adjustment but its modalities and operationalization across the various levels of government. Greater specificity of the recommended adjustment measures and their implementation at the state and federal levels could have provided for a deeper discussion of the needed adjustment and allow for a more effective consensus building on the recommendations or some alternatives.<sup>48</sup> While Fund missions met with various representatives of the states, the discussions were mainly with the national government and there was no report of joint sessions with all stakeholders in the adjustment process.
- Second, the limited involvement of the Fiscal Affairs Department (FAD) on fiscal and macro-fiscal issues focused on tax administration and PFM, and not the broader fiscal policy strategy, for example, how to develop a fiscal responsibility law. Moreover, FAD did not comment on Policy Notes and Staff Reports during the period under review.
- Third, the 24-month cycle for Article IV consultation in the FSM and the high turnover of staff prevented continuity in the engagement of the Fund and limited its role as a trusted advisor. The value-added of very short staff visits was also questionable in this context. The lack of continuity in staffing prevented the buildup of a stronger research program as most topics require data and information collection that cannot be achieved without

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<sup>47</sup> Review of implementation of staff policy advice started to be reported in the 2015 Article IV Consultation staff report.

<sup>48</sup> The 2009 Article IV Consultation report sketched a baseline and alternative scenario that had a breakdown across states, but this approach was not reproduced later on.

longer term planning.<sup>49</sup> The macroeconomic challenges of a post-Compact era and the period leading to it could justify a change of the consultation cycle to the regular 12-month, a question that the Legal Department raised on several occasions in its review process of Article IV documents on the FSM.

50. Surveillance recommendations in other sectors were of good quality, useful, relatively comprehensive, and forward-looking, but remained fairly conventional. The 2017 Article IV Consultation report was a good example, providing a comprehensive review of the issues facing the FSM and suggestions for policy measures and initiatives. Recommendations on private sector development were mainly directed at improvements of the regulatory framework and reduction of the cost of business, but they paid less attention to issues of diversification (tourism) and intensification (fisheries), where coverage was largely generic. Financial sector supervision and Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) issues also lacked granularity, while recommendations to extend supervision to the FSM Development Bank and the Credit Unions were broad. The external sector assessment was challenged by the full dollarization of the economy and the relative inadequacy of the EBA-lite framework for FSM's particular circumstances. As discussed with the Surveillance, Policy and Review (SPR) department, only the current account approach seemed appropriate to FSM circumstances. Topics of fiscal federalism, full-dollarization, market structure and monopoly regulations (telecom, energy, transportation), credit unions, and domestic fisheries could have been discussed in depth in SIPs.

### ***Program Work and Emergency Financing***

51. The FSM has never made recourse to the Fund for financial support, including during the COVID-19 pandemic outbreak in 2020. This reflected, according to interviewees, the lack of effective BOP needs given that the COFA has provided reliable external financial assistance to the country. The FSM also received substantial support from other development partners, including the ADB, the EU, and bilateral partners, mostly in the form of grants given the debt sustainability rating of the FSM. Sometimes financing by other institutions was facilitated by an IMF assessment letter, such as support during the COVID-19 pandemic from the ADB.

52. Staff interviews suggest that the large autonomy of the states, and issues of timeliness of data, could complicate any potential IMF-supported program as the upper credit tranche (UCT) support depends on assurances that the authorities have the commitment and capacity to implement a set of policies that is adequate to correct external imbalances and enable repayment of the Fund within the specified maturity period. Any potential program engagement with the Fund, including under the Policy Support Instrument (PSI), would require early preparation to ensure the conditions of a broad political consensus on fiscal policy and measures across the national state and the four states. Concerns regarding the political stigma associated with a Fund program also emerged in interviews and staff thought that emergency financing

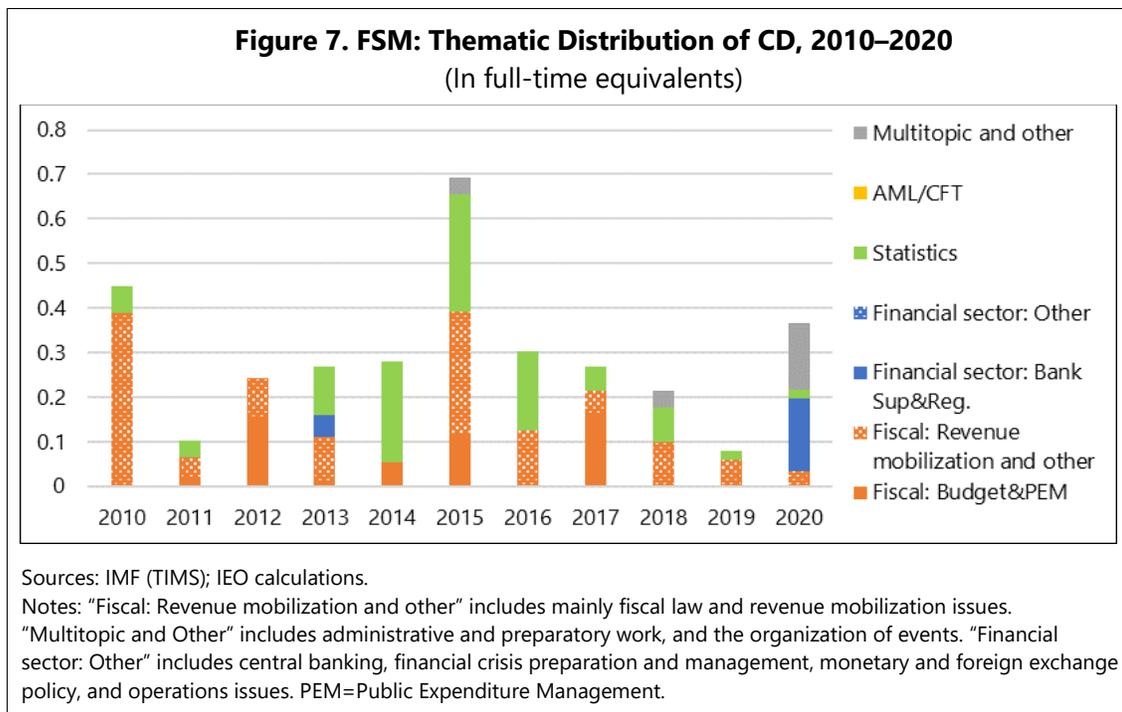
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<sup>49</sup> This applies not only to fiscal federalism issues but also to the financial sector (monitoring of credit unions).

under the Rapid Credit Facility (RCF) would be easier for the Fund to support the FSM, particularly in the context of natural disasters, as it does not require ex post conditionality.

### **Capacity Development**

53. Relative to other countries in the region, the FSM was a moderate user of Fund TA/CD, with an average use of about 0.3 full-time equivalent (FTE) per year over the period (Figure 7), mainly from PFTAC. CD activities were broadly supportive of surveillance activities with a special focus on revenue mobilization, statistics, PFM issues (PEFA and PIMA), and bank supervision. These activities were complemented by PFTAC’s organization of many training seminars and workshops across the region and support of various regional institutions. The 2019 CCPA was also an important steppingstone for boosting CD on addressing the challenges of climate change and natural disasters. Officials from the Ministry of Finance highlighted the high quality of PFTAC’s TA while noting its limited visiting capacity, which detracted from effectiveness. They viewed virtual engagement as a possible solution, as well as greater reliance to South-South collaboration with involvement of more advanced SDS in the region.



54. The FSM accounted for only 3 percent of the CD missions and days of PFTAC over the period FY2017–2020. Although tax administration accounted nearly half of the missions to the FSM over the period, the number of mission days was nearly equally split between tax administration, PFM, bank supervision, and statistics, while macroeconomic analysis CD accounted for only 2 percent of CD days. The COVID-19 pandemic has reduced considerably the delivery of PFTAC CD in the FSM with only one mission being reported in FY2021 (a Government Finance Statistics mission).

**Table 6. PFTAC Activities in FSM**

	PFM		Tax Admin.		Macro		Fin Sector		Real Sect Stat		GFS Stat		Total	
	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days
2021	--	--	--	--	--	--	--	--	--	--	1	7	1	7
2020	--	--	--	--	--	--	1	22	--	--	1	7	2	29
2019	--	--	1	16	--	--	1	37	--	--	--	2	2	55
2018	--	--	2	24	1	6	--	--	2	26	--	5	5	61
2017	1	56	3	24	--	--	--	--	1	10	--	--	5	90
Total	1	56	6	64	1	6	2	59	3	36	1	14	14	235

Source: PFTAC Annual Reports, FY 2017–2021.

55. While the CD program was broadly in line with the country's priorities and needs, it did not include any CD on how to address the end of the COFA (such as further tax reforms and issues of fiscal federalism). The delivery of the CD activities in the FSM was not a continuous and sustained process across sectors over 2010–2020, which may reflect capacity constraints on both the authorities' and PFTAC's sides or the presence of other CD providers for which no information was reported in Fund documents. The pattern of distant and lumpy CD activities raises the issue of effective progress towards the targeted CD milestones and objectives and the durability of the realized achievements. For example, the completion of the second PEFA led to the adoption of a PFM reform roadmap in 2017, for which there was no follow up from the Fund. The reporting of CD activities in the Informational Annex of Article IV Consultation reports lacked specificity and granularity, which prevented a comprehensive picture of progress. The 2020 PFTAC Annual Report pointed to results broadly achieved towards well-functioning macroeconomic policy and institutions, strengthened compilation and dissemination of Government Finance Statistics (GFS) data, and improved core tax administration functions, while the objectives in strengthening banking regulations and prudential norms were only partially achieved and the targets in dissemination of real sector data did not materialize.<sup>50</sup> Given the FSC status of FSM, there appears to be room for a scaling up of CD activities in the country keeping the focus on a few selected priorities with effective monitoring and follow up. A mission chief viewed the process of vetting CD missions by the area department as a positive move and had high expectations on CDMaP's ability to facilitate a more tailored and demand-driven CD, recommending more agility and flexibility to support Article IV consultations.

### ***Collaboration with Partners***

56. The World Bank and the ADB had very strong links with FSM and there was good coordination on policy advice among development partners, including the Fund. Collaboration between the Fund and other partners was exemplified by the routine participation of World Bank and ADB staff in Article IV consultation missions over 2009–2019. This allowed for greater exchange of information and greater coherence and coordination of policy advice, as well as

<sup>50</sup> Chart 3 of 2020 PFTAC Report.

specific contributions to staff reports. Fund staff also benefited from the sectoral knowledge and work of World Bank and ADB staff on mission with them.

57. Staff of the Ministry of Finance stressed that the Fund was a key and highly valued leader on macroeconomic policy advice, while other partners were more involved in other sectors, such as private sector development. The dialogue between the authorities and other development partners was also reported as good.

### ***Staffing of Country Teams and Engagement of Senior IMF Officials***

58. Staffing was a key issue for the six consultations with the FSM over the period 2009–2020. The 24-month consultation cycle and a perceived stigma of working on SDS led to high turnover of staff. APD provided staff at the A-14 level the opportunity to lead Article IV consultation missions to the FSM and, while the experience of having worked on SDS is reported by staff as a rich and fulfilling one, it is not clear that this impacted the tenure of mission chiefs and it created additional challenges to train and prepare senior economists to lead missions. Based on the reports of the six Article IV consultations that took place between 2009 and 2019, mission length was on average 11 days and the mission chief was different in five of the six missions. While 21 Fund staff participated across the six missions, 18 participated in only one mission and the other three participated in two missions. The regional resident representative and World Bank staff participated in two and three missions, respectively, while all missions had participation from the ADB.<sup>51</sup>

59. High turnover prevented greater analysis of selected issues, which was exacerbated by lack of readily available data and the 24-month surveillance cycle. The issue was compounded further by the fact that assignments to SDS in APD were usually not a full-time position, but a shared one with other responsibilities on a larger country. Staff on these dual assignments faced greater timing and workload challenges, which had a perverse effect as rewards were perceived by staff to be higher on larger countries. The turnover also affected the teams' institutional memory, forcing the authorities to "start again" the dialogue and "educate" new teams, which also complicated the capacity of staff to dig deeper into some issues because of time constraints. The authorities, Executive Directors, and even staff voiced frustration with these challenges and urged longer tenure and a stronger relationship of staff with the authorities.

## **C. Samoa**

### **Country Profile**

60. Samoa is a small developing state consisting of two main islands and eight small islets of volcanic origin in the Polynesian region of the Pacific Ocean. It has a population of 200,000 and is classified as a microstate. The two main islands account for 99 percent of the total land area of

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<sup>51</sup> The World Bank also participated in three missions (2012, 2014, and 2019).

2,842 km<sup>2</sup> and the country benefits from an EEZ of 127,950 km<sup>2</sup>, which is the second smallest EEZ among Pacific islands, just above Timor-Leste. Samoa is an upper-middle income country with a GNI per capita of \$6,500 in 2019 but it is still eligible for concessional financing from the PRGT under the small country exception. It gained independence from New Zealand in 1961 and adopted a parliamentary democracy model.

61. Samoa is classified as a services exporter whose economy relies heavily on tourism, remittances and foreign aid. The services sector accounted for nearly three-quarters of economic activity in 2019. The steady growth of services reflects mostly the expansion of the tourism sector through the completion of new hotels and the organization of major regional and international events since 2010, including the 2014 international conference on Small Islands Developing States. The industrial sector declined from 18 percent to 16 percent of GDP over the evaluation period, while the primary sector remained constant at 10 percent of GDP.<sup>52</sup> Industry was impacted by the shrinkage and eventual closure of the Yazaki corporation, the largest private-sector employer, in August 2017.<sup>53</sup> The closing of the Yazaki corporation was a major setback in the diversification of economic activities of the country. It had a substantial negative impact on Samoan merchandise exports and increased the dependency of the country on services and remittances.

62. Samoa has been ranked as the most vulnerable SDS to natural disasters (IMF, 2016), but, unlike other Pacific Island states, its vulnerability to climate change has been assessed as low.<sup>54, 55</sup> Since 1983, Samoa has reported 13 natural disaster events, of which 4 took place over the period 2010–2019: Cyclone Evan in 2012 resulted in damages and losses estimated at 30 percent of GDP or \$210 million; Cyclone Gita in 2018 caused limited damages as well as a drought in 2015; and a measles epidemic in late 2019 had negative economic repercussions, including a sharp decline in tourism and the interruption of the economic momentum derived from the hosting of the Pacific Games in July 2019.

63. Samoa has been hard hit by the COVID-19 pandemic. The government took early actions to successfully protect the population (e.g., quarantine, travel restrictions, and social distancing measures), strengthen the health care system, and provide assistance to the private sector. The measures proved effective with only one COVID-19 case and no deaths reported at end-2020.

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<sup>52</sup> Fisheries accounts for a large part of the primary sector (5.4 percent of GDP and 55 percent of exports in 2007). See Gillett (2009).

<sup>53</sup> The Yazaki corporation closed its harness assembly operation following the exit of Toyota from auto production in Australia in the wake of the GFC. It had more than one thousand employees in Samoa and had scaled down its activities gradually. Its formal closing is estimated to have reduced growth by about 0.9 percentage points in 2017–2018.

<sup>54</sup> Only 1.4 percent of the total population of Samoa is estimated to live within 5 meters above the sea level.

<sup>55</sup> While not differentiating between natural disasters and climate change, other vulnerability indicators provide a more nuanced assessment with the UN index of victims of natural disasters over 2000–2020 ranking Samoa 91<sup>st</sup> out of 143 countries. The World Risk Index ranks Samoa 107<sup>th</sup> and 73<sup>rd</sup> out of 181 countries in terms of exposure and overall vulnerability, respectively.

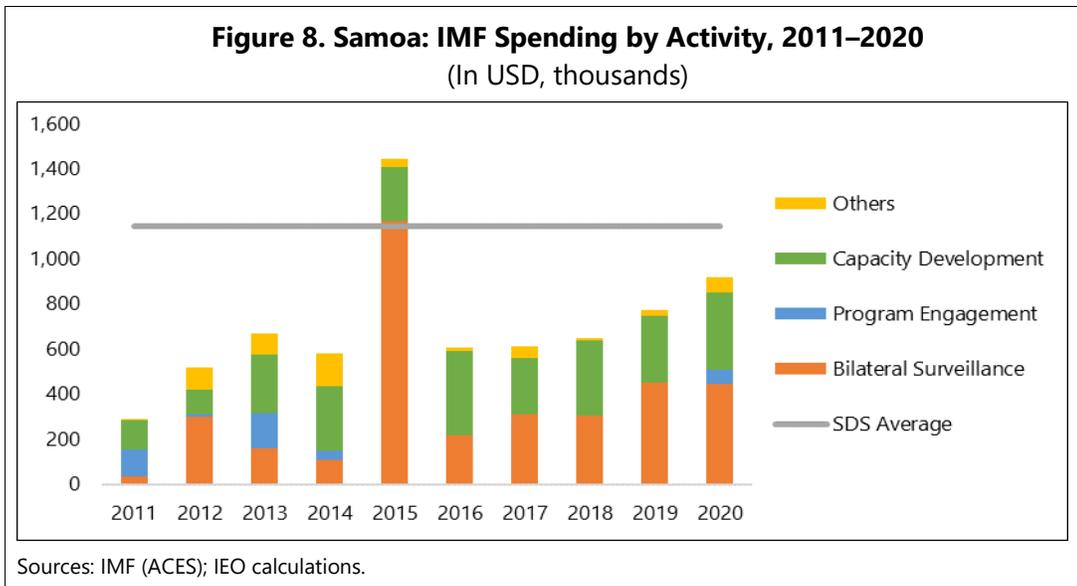
The pandemic nevertheless pounded the tourist sector. The Samoan economy contracted by 8 percent in 2020 and experienced a sharp widening in the current account deficit.<sup>56</sup>

64. Samoa joined the Fund in December 1971. Its current quota amounts to SDR 16.2 million (0.003 percent quota share) and it is eligible to use PRGT resources under the small country exception. Samoa has benefited from Fund emergency assistance on three occasions: first, in the wake of the 2009 tsunami under a Rapid Access Component of the Exogenous Shocks Facility (RAC-ESF) in the amount of SDR 5.8 million, equivalent to 50 percent of quota and 1.5 percent of GDP, compared with estimated damages of 15 percent of GDP; second, in the aftermath of the 2012 Tropical Cyclone Evan under an RCF in the amount of SDR 5.8 million equivalent to 50 percent of quota and 1.2 percent of GDP; and third, in the context of the 2020 COVID-19 pandemic (an RCF in the amount of SDR 16.2 million, equivalent to 100 percent of quota) (Table 7). In all cases, the Fund assistance had strong catalytic impacts in encouraging external financing from partners that helped to address the fiscal and BOP needs of the country. Data on IMF spending on Samoa shows substantial amounts devoted to CD support for the most part of the evaluation period (Figure 8).

**Table 7. Samoa: IMF Engagement, 2010–2020**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Article IV Programs	■		■				■	■	■	■	■
Emergency financing				■ RCF							■ RCF
Other						■ FSAP					

Sources: IMF; IEO calculations.  
Note: FSAP=Financial Sector Assessment Program.



<sup>56</sup> Real GDP in the third quarter of 2020 was estimated to have reverted to its 2014 level.

65. Samoa's exchange rate arrangement is a conventional peg to a basket of four currencies (US dollar, Australian dollar, New Zealand dollar, and Euro), which is reviewed annually to ensure that the tālā's value reflects Samoa's international payments and trade structure. Most capital account transactions require approval from the Central Bank of Samoa (CBS). The country's financial sector is dominated by four commercial banks providing about 60 percent of credit to the economy and public financial institutions (PFIs) providing another 30 percent. The offshore financial sector is limited in scope and size.<sup>57</sup>

66. Samoa has the highest institutional capacity among PRGT-eligible Asia and Pacific SDS, ranking first on all CPIA cluster and overall indices.<sup>58</sup> Globally, it ranked second on the overall CPIA score among all International Development Association (IDA) countries, just behind Rwanda. This achievement is attributable to the efforts made by the authorities to strengthen institutions, legislative and regulatory frameworks, policy making, and the business environment, including with regards to the culturally sensitive issue of communal land. Similarly, Samoa's data provision for surveillance purposes is broadly adequate for surveillance, despite some shortcomings and weaknesses in national accounts, monetary, and external sector statistics. Samoa has participated in the e-GDDS since 2012 and disseminates key macroeconomic and financial data through a web-based National Data Summary Page. It ranks second among Pacific islands on the statistical capacity score calculated by the World Bank.

67. Samoa achieved a strong economic performance over the 2000s, reflecting sound and prudent policies as well as the benefits of strong structural reforms, including on communal land use.<sup>59</sup> Fiscal policies were anchored in Samoa's public debt management strategy that aimed at limiting budget deficits to 3.5 percent of GDP and keeping public debt below 40 percent of GDP. The ratio of debt to GDP was halved from 57 percent to 28 percent over the period 2000–2008. Inflation and current account deficits remained relatively high, reflecting the surge of international commodity prices, and the real exchange rate appreciated over the period.

68. This strong economic performance was interrupted by the global financial crisis and the impact of a destructive tsunami in 2009. The recovery effort was hampered by further natural disasters in 2012 and 2018 (tropical storms Evan and Gita) and the gradual winding down of the Yazaki plant until its formal closing in 2017. The period 2010–2014 was marked by low growth and reconstruction efforts widening the fiscal and external deficits in the wake of the global recession and two significant natural disasters. The period 2015–2019 faced less significant external shocks, which allowed for resumption of higher growth and improvements in the fiscal and external balances that extended into 2020.<sup>60</sup> The reconstruction programs in the aftermath

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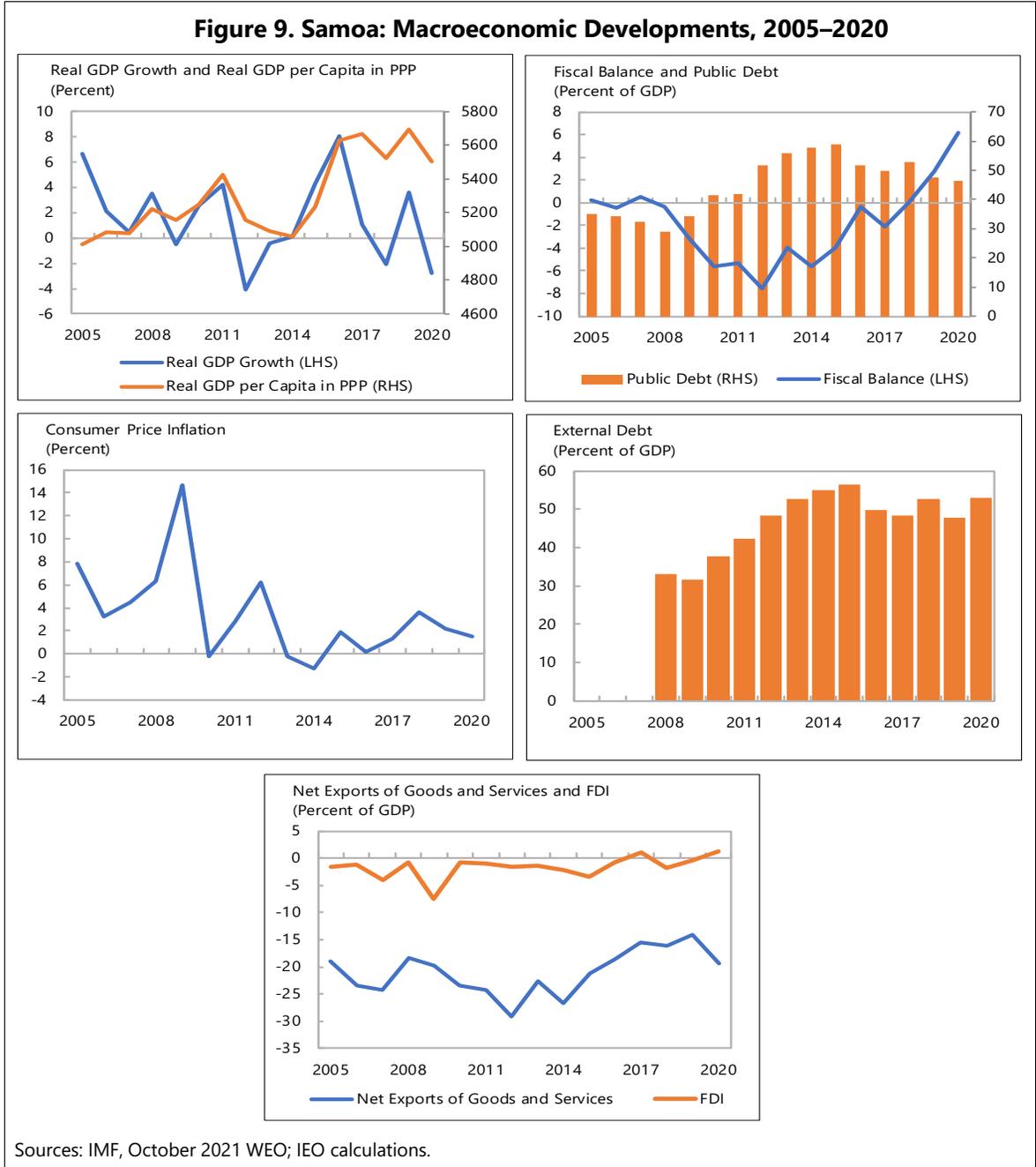
<sup>57</sup> IMF (2015b).

<sup>58</sup> The World Bank does not publish CPIA scores for non-IDA members.

<sup>59</sup> An electronic land-registry was set up in August 2009 and work proceeded on the establishing a credit information bureau.

<sup>60</sup> Fiscal year starts on July 1. FY2020 ends on June 30, 2020.

of the tropical storms, an expansion of the tourism sector, and the organization of regional events provided support for renewed growth, but the stop-and-go pattern of growth over the 2010s was accompanied by an increase in the debt burden and a high risk of debt distress. Economic activity has been further challenged by the additional threat of CBR losses. The impact of the 2020 COVID-19 pandemic was projected to worsen in 2021 with further economic recession, sharp deteriorations of fiscal and external balances, and higher debt levels (Figure 9).



## **Main Elements of Fund Engagement**

### ***Surveillance***

69. Six Article IV consultations with Samoa were concluded over the period 2010–2020. The country’s surveillance cycle switched from 24-month to a 12-month at the conclusion of the 2017 consultation. The change was made at the authorities’ request, given the usefulness of the consultations to the country. Staff indicated that the inclusion of Samoa in the CBR pilot also played a role in supporting the switch. Two interim staff visits occurred between 24-month cycle of consultations. With the additional Board consideration of three emergency assistance requests over the period, there has been close Fund engagement in all but one of the 11 years under review.

70. Surveillance focused on the key challenges that Samoa had to address over the evaluation period, mainly severe external shocks and natural disasters, as well as issues of loss of correspondent banking relationships. Article IV consultations also benefited from the 2015 FSAP and contributed to the monitoring and implementation of its recommendations. A SIP on the impact of the 2009 tsunami on tourism, impediments to bank intermediation and monetary transmission, and state-owned enterprise reform was prepared in the context of the 2010 Article IV consultation, but no SIP has been issued since. Overall, surveillance activities were in line with surveillance and small states guidance notes and reflected the five priority areas of the GROWTh framework, with a special focus on resilience.

71. The Article IV policy discussions in the first part of the 2010s centered on: (i) the role of fiscal policy to support the rebuilding efforts while maintaining debt sustainability; (ii) prudent monetary and exchange rate policies to foster macroeconomic stability; and (iii) reforms for private sector development. They mostly focused on the authorities’ policy commitments under the RAC-ESF support and the 2012 RCF.<sup>61</sup> The relatively low levels of debt provided a policy buffer for fiscal stimulus. Given Samoa’s generally favorable economic performance and progress, Fund policy recommendations were mostly limited to managing a conjunctural budgetary expansion during the recovery through emergency assistance with no ex post conditionality. This empathetic approach contributed to the authorities’ strong ownership of the policies and facilitated additional financing by the donor community to support the reconstruction efforts.

72. In the second half of the 2010s, surveillance continued to highlight the strengthening of the fiscal framework to foster debt sustainability. Discussions gradually expanded to cover the threat of CBR losses, for which Samoa was a Fund pilot, and to monitor the implementation of the 2015 FSAP recommendations, which was instrumental in addressing weakness of the financial sector, such as the PFIs. The discussions on growth examined the impact and implications of the

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<sup>61</sup> The 2009 Article IV consultation had been postponed giving the authorities more time in managing disaster relief and implementing a recovery framework.

Yazaki plant closing and various new developments, such as hosting regional events and the construction of new hotels and a fish treatment plant, but they eschewed elaboration of a strategic vision for growth in Samoa with an appropriate combination of diversification and intensification.

73. The fiscal policy discussions over the period consistently focused on achieving the medium-term debt strategy objectives of limiting the budget deficits and debt. Ceilings for the fiscal deficit and debt ceilings were initially set to 3.5 percent and 40 percent of GDP, respectively. The debt ceiling was increased later to 50 percent by the authorities while staff maintained an objective of 40 percent with a deficit ceiling of 2 percent in its recommendations. Staff policy recommendations were generally broad in nature but gained some specificity toward the end of the period.

- In the context of 2009 tsunami, fiscal policy accommodated the full cost of the recovery while maintaining a scaling up of development expenditure by more than 6 percentage points of GDP. This approach contributed to high deficits in the early 2010s and the increase of the debt-to-GDP ratio from 30 percent to 53 percent over the period 2008–2012, with a related deterioration of the risk of debt distress from low to moderate in 2012 and high in 2013.<sup>62</sup> While the authorities noted in 2012 that the fiscal and monetary stimuli did not boost the Samoan economy as anticipated, surveillance reports of the period did not offer more hindsight on these developments. It is likely that the quality of data, the lack of continuous engagement, and the absence of a fiscal economist in the team prevented a more granular analysis, to the detriment of the surveillance activities.
- In the context of the 2013 Tropical Cyclone Evan, a multi-year fiscal strategy was discussed to address the recovery and reconstruction costs, including expenditure reprioritization involving the redeployment of one-fifth of the pre-cyclone projects to create fiscal space equivalent to 7½ percent of GDP over three years. The subsequent Article IV consultation in 2015 did not report on the implementation of this measure and its impact on the development program, preventing a fuller discussion on how the natural disaster was effectively addressed.

74. The debt sustainability and external sector assessment tools used by staff proved useful in conducting surveillance activities. As a PRGT-eligible member, Samoa was assessed using the LIC-DSA. Early 2016 guidance on incorporating the risk of natural disasters in the analysis was strengthened further and formalized in the new LIC-DSA to provide more robust conclusions. The authorities welcomed the reform of the LIC-DSA and its integration of natural disasters, which are an unfortunate reality for them. Staff found that the tools for the EBA were more

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<sup>62</sup> Staff estimated in 2015 that the two natural disasters added about 15 percent of GDP to Samoa's external debt.

difficult to implement in the context of a small state such as Samoa because of data limitations and the impact of natural disasters on past data and projections.<sup>63</sup>

75. Samoa's 2015 FSAP proved invaluable in Article IV discussions and the strengthening of the financial sector. The in-depth review of Samoa's financial sector and the identification of its strengths and weaknesses were very well received and appreciated by the authorities. It helped focus attention on the need for reform of PFIs and the strengthening of the regulatory and legal framework, as well as the need to reinforce banking supervision. The FSAP found that some PFIs were vulnerable to shocks due to low asset quality and weak loan portfolios and that a subsidized lending program through the PFIs represented contingent liabilities for the public debt. It made a series of recommendations to contain risks, enhance the role of PFIs, and improve supervision of commercial banks to reduce the risks of non-performing loans. The authorities endorsed the recommendations and implemented them gradually since 2015, with the help of TA and monitoring during surveillance missions.

76. CBRs came under increasing pressure in the mid-2010s, threatening the inflows of remittances in Samoa, where they are equivalent to about 18 percent of GDP. About 80 percent of these remittances are channelled through Money Transfers Operators (MTOs), which faced closure of bank accounts and difficulties in accessing financial services.<sup>64</sup> The factors underlying the withdrawal of correspondent banks from CBRs include issues of profitability and relationship risks as well as stricter regulatory and enforcement frameworks related to prudential requirements and AML/CFT in the recipient country.<sup>65</sup> Samoa was included in a Fund pilot project to address the threat of CBR losses and mitigate effective losses through a comprehensive and coordinated set of measures. The main priorities of the pilot project were to upgrade the effectiveness of Samoa's AML/CFT regime, establish a database for customer identification and monitoring, and address risks from the offshore sector. The authorities welcomed the support provided by the Fund, including through TA, and were committed to take necessary reforms to mitigate risks from CBR losses. They nevertheless expressed concern about the proposed centralized database to facilitate Know-Your-Client requirements and argued successfully for the implementation of a regional solution which had been successful in context of the Eastern Caribbean Currency Union. Authorities also worked on the implementation of the

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<sup>63</sup> All exchange rate assessments include a disclaimer that caution should be exercised in interpreting the results.

<sup>64</sup> The 2018 Article IV consultation reported that 9 of the 12 MTOs operating in Samoa lost at least one CBR since 2013.

<sup>65</sup> At the request of its membership, the Fund decided in 2016 to examine this issue and provide policy advice and capacity development to its members. See Erbenova and others (2016); IMF (2017); Alwazir and others (2017); and IMF (2018), Box 2.

recommendations outlined in the 2015 Mutual Evaluation Report by the Asia/Pacific Group on Money Laundering.<sup>66</sup>

77. Other policy advice made in the context of Article IV consultations was relevant and tailored to the country situation, such as on monetary policy, resilience to natural disasters, financial inclusion, and state-owned enterprise governance, as well as the business environment and the development of the private sector. Comprehensiveness could have been strengthened by tax and expenditure policy discussions to complement the tax administration and expenditure management measures mentioned. Overall, policy advice was extensive and well-focused.

78. Traction appears to have been good, with staff listening to the authorities' concerns and seeking appropriate consensus. Staff's review of implementation of past Fund recommendations was generally positive but quite cryptic in Article IV reports. Linkages to capacity development were also not clearly spelled out reports and could have received more attention to show the integration of CD with surveillance.

79. The statistical tables in Article IV consultation reports improved over the 2010–2020 period, reflecting progress in quality and availability of data with the help of TA, but there were still weaknesses in coverage. Tables on monetary developments started to be published in 2017 but did not include any projections. Linkages between the sectoral tables were not transparent. While not questioning the consistency of the tables, this lack of transparency and silo approach to statistics were not conducive to good reporting and better understanding of economic developments.

80. During interviews, the authorities were very appreciative of the quality and extent of Fund engagement with Samoa. They highlighted the importance of Article IV consultations in providing independent, transparent, and accountable reviews of economies policies and developments that were useful for their policy making. Interviewees also noted that Article IV consultations were valuable contributions to Samoa's engagement with other donors, by providing macroeconomic reviews of the country. They were satisfied with the timely conduct of surveillance ahead of Samoa's budget discussions and commended Fund staff for accommodating special requests, such as preparing non-technical summaries of the consultations for local outreach purposes. The Fund's review of the authorities' data and projections was also highly valued for its contributions to a constructive dialogue and reaching common views. The authorities did not perceive any gap in the coverage of surveillance activities and found the surveillance tools (DSA and EBA) to be valuable for Samoa. They singled out the contributions of the FSAP and the CBR pilot, which benefited from close integration with CD. On the downside, they expressed concern about the high turnover of Fund staff working on Samoa,

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<sup>66</sup> Recent Article IV consultations, including the 2021 consultation, have reported on the progress achieved and made additional recommendations to address this issue. Samoa was put on the EU blacklist of non-cooperative tax jurisdictions in December 2017. Subsequently, the authorities cooperated actively with the EU to remove Samoa from the list. These issues were discussed with staff in Article IV consultations.

as it hampered institutional knowledge of country conditions. In this respect, they noted the value of SIPs as a way to provide greater tailoring of analysis and recommendations to local conditions.

### ***Program Work and Emergency Financing***

81. IMF lending activities in Samoa were limited to three emergency assistance operations over the period 2009–2020. These operations all aimed at addressing short term BOP needs in the wake of two natural disasters and the COVID-19 pandemic. They required quick interventions of the Fund to support the country and had a catalytic effect for external support by other donors in the immediate aftermath of these shocks. Samoa had been a relatively strong economic performer throughout the 2000s; it had built some policy buffers and faced no protracted BOP needs at the end of that decade.

82. The substantial impacts of the 2009 and 2012 natural disasters were setbacks in the development of Samoa, but the challenges were met in part by using the policy buffers that had been previously accumulated. IMF financing under the RAC-ESF and the RCF in the wake of the 2009 tsunami and the 2012 Tropical Cyclone Evan supported the swift policy reactions of the authorities to address the recovery efforts. These operations involved no prior actions; assurances to close the financing gap were not required; and, in the absence of ex post conditionality, the monitoring of the implementation of the policy commitments was left to surveillance. Besides addressing the financial cost of the external shocks in the BOP and fiscal sectors, these commitments included a series of structural measures to enhance the resilience of the economy in line with Article IV consultations policy advice. Subsequent monitoring in surveillance was, however, hindered by the 24-month surveillance cycle which prevented continuity of a close dialogue and more granular analysis, such as on the implementation of specific policy commitments or the links between the BOP and the fiscal financing gaps.

83. In the aftermath of the 2009 and 2012 disasters, Samoa was left more vulnerable to external shocks in the second half of the 2010s. Staff appraisal of the 2013 RCF request included the suggestion that the RCF support “would give Samoa a breathing space to consider a multi-year reform program that could be potentially supported by the Fund to tackle the country’s medium-term challenges” (IMF, 2013). However, there was no follow up on this proposal by the authorities, most likely because the macroeconomic outlook improved and large BOP needs did not materialize,<sup>67</sup> limiting Fund engagement to surveillance until the 2020 pandemic.

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<sup>67</sup> The risk of debt distress was also changed for high to moderate in the 2015 Article IV consultation, reflecting an increase in the discount rate to 5 percent and a rebasing of GDP.

84. The COVID-19 pandemic provided a major challenge to the resilience of Samoa. The Fund was quick to approve the authorities' request for assistance, benefiting from the mission that conducted the Article IV consultation in March 2020.<sup>68</sup> Samoa was the first Pacific Island to receive assistance from the Fund on April 24, 2020, and the second in APD, just two days after Maldives. The RCF in an amount of 100 percent of quota was justified by the urgent BOP need generated by the sudden exogenous shock of the COVID-19 pandemic, which followed on the heels of the December 2019 measles outbreak. The Fund provided for around one-half of the projected financing gap for 2020.<sup>69</sup> The assistance was not made conditional on prior actions, but the authorities made strong commitments on improved governance and transparency on the use of emergency funds. Although the report discussed the drivers of the BOP gap (collapse of the tourist sector) and the budgetary pressures to address the pandemic, the links between the fiscal and BOP gaps and their financing could have been clarified more explicitly and monetary sector projections included in the program documents.

85. During interviews, the authorities valued the support of the Fund through emergency lending when the country had to address the challenges of natural disasters and the COVID-19 pandemic. They appreciated the timely approval of the assistance and its catalytic role. There was no reluctance to go to the Fund for support and the authorities seemed to have good knowledge of the facilities framework.

86. More broadly, the authorities emphasized that they sought grants and highly concessional financing as part of their medium-term debt management strategy to preserve debt sustainability while providing sufficient financing for the development needs of the country. In this context, the authorities reported that the terms of Fund assistance were less favorable than available elsewhere. Moreover, they suggested that access to Fund financial assistance should be higher when a country is hit by multiple disasters and may reach the lending limits of the Fund. They would also welcome a facility that would provide financing for spending needed to build resilience to climate change.

### ***Capacity Development***

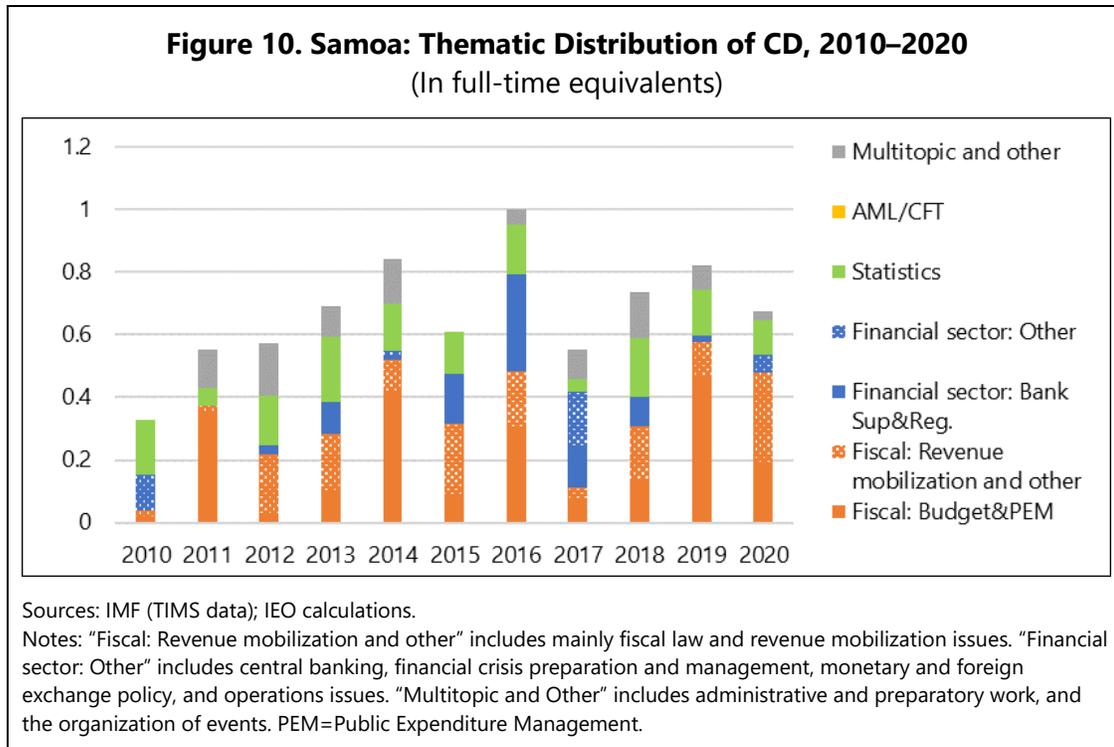
87. Samoa benefited from sizable capacity development support over the period 2010–2020, mostly from PFTAC. There was a steady increase in CD activity to reach one FTE by 2016, followed by a more stable level around 0.7 FTE on average for 2017–2020 (Figure 10). CD activities were focused on PFM, revenue administration, banking supervision, and statistics. Surveillance benefited from the CD activities, although the integration of CD into surveillance was not well documented in Article IV reports. In addition to PFTAC, Samoa received TA from HQ in the context of the FSAP and CBR pilot in the second half of the period (LEG and MCM, including

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<sup>68</sup> The Article IV mission in early 2020 did not publish a report because of the COVID-19 outbreak and switched to preparing the documents for the RCF request that were considered by the Board in April 2020.

<sup>69</sup> For details on how financing gaps associated with the pandemic were closed in the 16 SDS that had emergency financing during the pandemic, including Samoa, see Maret (2022).

AML/CFT issues) and for the implementation of the e-GDDS (STA). A safeguard assessment was conducted in 2010, leading the Central Bank to address concerns on CBS autonomy and independence, audit quality, and staff capacity.<sup>70</sup>



88. A review of the PFM Reform Strategy for PICs over 2010–2020 reported that political will, ownership, and institutional capacity played an important role in the successful implementation of key PFM reforms in Samoa (IMF and others, 2010; and IMF, 2020b). The PFM roadmap and IMF-World Bank Joint Management Implementation Plan were integrated in the Ministry of Finance's Finance Action and Sector Plans and monitored on an annual basis.

89. In interviews, the authorities commended Fund capacity development support for Samoa and praised the extensive support of PFTAC (Table 8). They reported that their CD requests have been met satisfactorily and that the dialogue on CD priorities with Fund staff has been positive. They particularly appreciated the special assistance provided to the Monetary Authority to address CBR issues and the AML blacklisting of Samoa by the EU. They noted their preference for on-site rather than virtual CD missions and encouraged longer missions by advisors to foster absorption. While training and CD have reinforced the capacity of local staff, the authorities raised concerns about sustainability and critical mass as they face turnover of their limited staff.

<sup>70</sup> An update safeguard assessment was programmed for the first half of 2021.

**Table 8. PFTAC Activities in Samoa**

	PFM		Tax Admin.		Macro		Fin Sector		Real Sect Stat		GFS Stat		Total	
	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days
2021	5	88	8	139	1	15	1	10	2	21	1	5	18	278
2020	4	54	4	72	1	5	--	--	1	32	--	5	10	168
2019	7	129	2	32	--	--	1	20	1	12	1	16	12	209
2018	3	37	4	55	2	11	--	--	2	23	1	12	12	138
2017	3	13	3	18	1	7	1	12	1	20	--	--	9	70
Total	22	321	21	316	5	38	3	42	7	108	3	38	61	863

Source: PFTAC Annual Reports, FY 2017–2021.

### ***Collaboration with Partners***

90. Interviewees reported good collaboration between the Fund, the World Bank and the ADB. The Fund benefited from the local presence of other international organizations in the country. ADB and World Bank staff participated formally in Article IV missions over the period 2010–2015, but this participation did not extend after 2015, although close collaboration between institutions was maintained. The authorities concurred on the good collaboration among international organizations and highlighted that advice was usually consistent across them. Fund staff has also expressed satisfaction of the collaboration with ADB and the World Bank, while noting that the process of validating DSA work and reports by the World Bank should be further streamlined for faster clearance. The authorities reported the complementarity of donors with the Fund’s comparative advantage on surveillance and macro-financial capacity building, while ADB focuses on infrastructure and the World Bank on sectoral projects and financial management.

### ***Staffing of Country Teams and Engagement of Senior IMF Officials***

91. Fund staffing on Samoa face similar challenges to the ones observed in other Asia and Pacific SDS. Eight surveillance and three program missions took place over the period 2009–2021.<sup>71</sup> APD faced problems to fully staff these missions with its own personnel and there were on average only three APD staffers on each mission. The regional resident representative office participated in the last seven missions of the period under review. APD typically borrowed staff from other departments (SEC, STA, FIN, ICD, KMU to fill missions on a one-off basis, with additional assistance from MCM and LEG on specific issues (CBR, FSAP, AML/CFT), which increased mission staffing to an average of four staff members, still a small mission team size. The 2021 Article IV mission, conducted virtually in the second half of January 2021, was an outlier with 13 staff members as the virtual format allowed for participation by more IMF specialists. While turnover of APD staff on Samoa was moderate over the period, as Samoa benefited from Fund engagement in 10 of the 13 years covered by the period, partly reflecting the switch from a

<sup>71</sup> The virtual 2021 Article IV mission was led by the same mission chief than the 2020 RCF and concluded by the Board on a lapse of time basis.

24-month to a 12-month consultation cycle, the turnover of staff from other departments was very high. Excluding staff visits, a majority of APD MCs and economists participated in two or more Article IV missions; only two MCs and four APD economists participated in one mission.

92. The authorities voiced concerns about Fund staff turnover, while emphasizing that they had no issue with the quality and size of mission teams. During interviews they reiterated concerns expressed during previous Board discussions, regretting their experience of high frequency of MC turnover, particularly given that the particular risks, vulnerabilities, and operating context they grappled with took time to manage. The recent change in APD's staffing policy, extending the length of country assignments on SDS from two to three years, has yet to have an impact.

## **D. Solomon Islands**

### **Country Profile**

93. The Solomon Islands consists of six major islands and over 900 smaller islands spread longitudinally over 1,500 km in Oceania. The country's land area is about 28,900 km<sup>2</sup>, mostly covered by forests, and the population of nearly 670,000 in 2019 is 95 percent of Melanesian origin. The Solomon Islands has the fourth largest EEZ among all Asia and Pacific SDS with 1,589,000 km<sup>2</sup> and participates in the Nauru Fishing Agreement. The climate is very humid throughout the year with more than 3,000 mm of annual rainfall.

94. The country gained independence from the United Kingdom in July 1978. It is a constitutional monarchy with a parliamentary system of government. The post-independence period has seen turbulent politics, a protracted conflict with Papua New Guinea over 1988–98, issues of governance and corruption over logging activities, and rising internal tensions that culminated in violent ethnic conflict, "the Tensions," over 1998–2003. The conflict brought the economy to a halt and the government faced substantial liquidity and solvency issues. The situation improved in 2003 with the arrival of a large international contingent to restore law and order, the Regional Assistance Mission to Solomon Islands (RAMSI) led by Australia and New Zealand. A Truth and Reconciliation Commission was created in 2008 to heal the country after the conflict, and RAMSI withdrew in 2017.

95. The Solomon Islands is heavily exposed to natural disasters and climate change, ranking fifth on the overall World Risk Index and ninth in terms of exposure. It was ranked by IMF staff the fourth most vulnerable country to natural disasters among the Pacific Islands with a 13.5 percent probability of the occurrence of a severe natural disaster (IMF, 2016). It was estimated that, on average, losses/damages from natural disasters equivalent to 1 percentage point of GDP reduce GDP by 0.3 percentage points in the year of the disaster (Cabezon and others, 2015, and 2016 Article IV Consultation Report). The frequency of natural disasters was higher in the 2010s than in the 2000s, with 15 events reported compared with five in the preceding decade. Yet, the 2014 flood was the only disaster singled out in the context of the

third review under the 2012–2016 extended credit facility (ECF) for the loss of life and its impact on growth, due to the widespread damage to key infrastructure, water and sanitation systems, housing and agricultural output, as well as the closing of a major gold mine, the Gold Ridge.

96. Because of its weak institutional capacity, the Solomon Islands has continued to be classified as an FCS after the departure of RAMSI, but it has slightly improved its overall CPIA score over the period 2010–2019. It is a low middle-income country with the second smallest GNI per capita among all Asia and Pacific SDS, at \$2,781 in 2019, and a GDP of about \$1.3 billion. Data provision to the Fund was assessed as broadly adequate for surveillance during the period under review, despite some shortcomings. The Solomon Islands participates in the e-GDDS initiative and has improved its supply of statistics data with the statistical capacity score (overall average) increasing from 30 in 2007 to 47 in 2019.

97. The Solomon Islands joined the Fund in September 1978 just after independence. Its current quota amounts to SDR 20.8 million (providing for 0.03 of voting share) and it can access Fund resources under a blend of PRGT and GRA resources. The Solomon Islands also receives external financing on IDA terms from the World Bank. The Solomon Islands has its own currency, the Solomon Islands dollar, that is under a conventional peg arrangement against a composite basket of trade-weighted currencies.

98. The primary sector accounted for 35 percent of GDP in the early 2000s and remains a main driver of the economy. The Solomon Islands is an open economy with exports and imports of goods and services equivalent to 37 percent and 47 percent of GDP in 2019, respectively. Forestry and other crude materials accounted for 84 percent of merchandise exports in 2018, while food represented 13 percent, with the main export partners being China, the EU, and India. Fisheries accounted for about 75 percent of food exports as they benefit from the second largest on-shore processing capacity in the Pacific Islands after Fiji—they also employ 3,000 people and licenses fees provide 10 percent of government revenue. Travel and transportation accounted for 82 percent of services exports in 2018, reflecting the emerging tourism market, while personal remittances have remained very low at less than 2 percent of GDP. The SI has an undeveloped potential in mineral resources; the Gold Ridge mine, that reopened in 2011 after eight years of closure because of the conflict, had its operation shut again indefinitely as a result of the 2014 floods.<sup>72</sup>

99. The Solomon Islands embarked on a strong recovery at end of the conflict in 2003. However, the recovery was accompanied by high inflation and the CAB deteriorated sharply up to 2010, as a surge of imports was only partially compensated by buoyant exports of over-exploited logging and higher remittances. The budget deficit was kept limited despite the fiscal stimulus and a more-than doubling of expenditure between 2003 and 2009, thanks to a strong recovery of revenue. The debt burden was reduced as the SI benefited from debt rescheduling and relief by major creditors under the Horiara Club Agreement, in 2007, on the commitment to

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<sup>72</sup> The Gold Ridge mine accounted for 20 percent of net exports and 6 percent of government revenue in 2013.

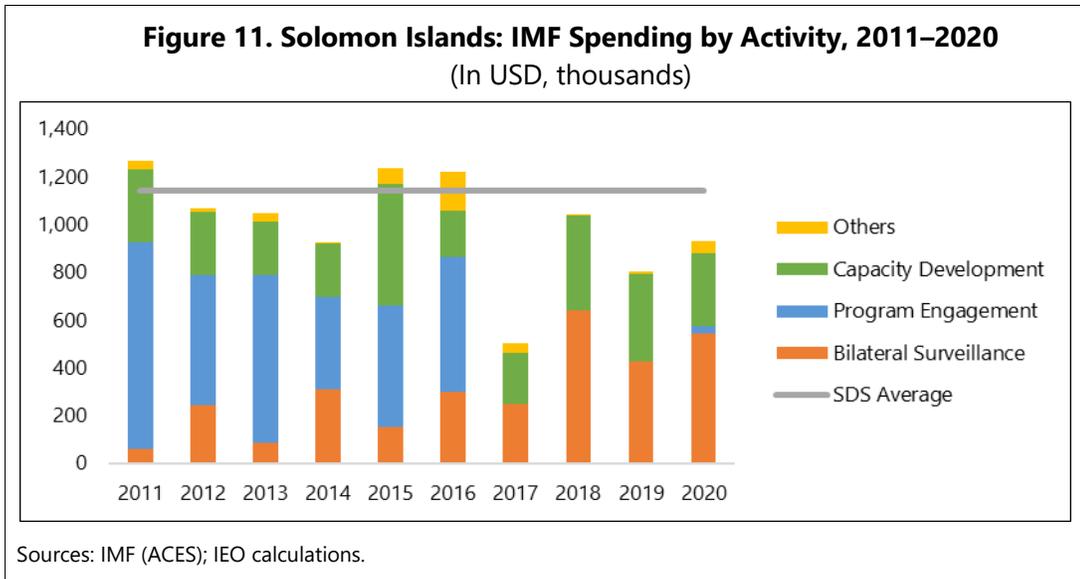
accessing external financing on Official Development Assistance-only terms until the SI achieved “green light status” under IDA’s debt distress ratings system.

100. The IMF supported programs under the Standby Credit Facility (SCF) in 2010–2011 and the ECF in 2012–2016 aimed at addressing these challenges and, in particular, restoring budget and cash management on a sounder basis (Table 9 and Figure 11). The programs were successful in achieving their objectives and growth performance continued in a strengthened macroeconomic framework, with a further decline of the debt-to-GDP ratio. This positive environment extended to the period 2015–2019 with buoyant growth and further reductions of inflation, the current account deficits, and the debt burden (Figure 12). A decline of government revenue in a context of expenditure pressures led, however, to renewed budget deficits and a weakening of the fiscal position, with renewed concerns about governance towards the end of the period. Emergence of CBR issues also started to threaten the stability of the financial sector.

**Table 9. Solomon Islands: IMF Engagement, 2010–2020**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Article IV											
Programs		SCF	SCF	ECF	ECF	ECF	ECF				
Emergency financing											RCF/RFI

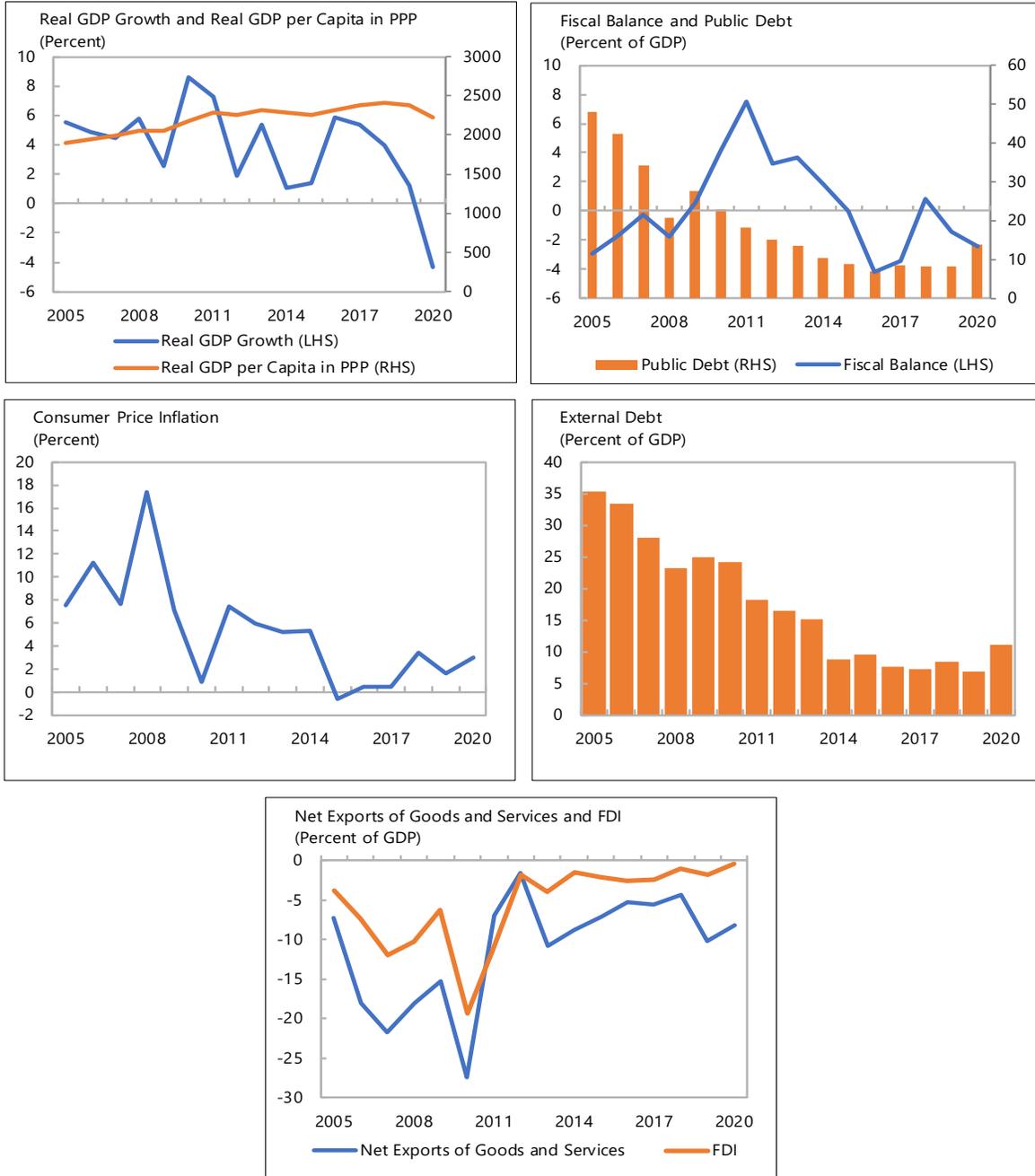
Sources: IMF; IEO calculations.



101. The COVID-19 pandemic had a severe impact on the economy of the Solomon Islands. The global recession reduced demand for Solomon Islands commodity exports, which was exacerbated by transportation disruptions for the exports of fresh fish; tourism came to a stop; and investment was sharply reduced. The timely prevention measures taken by the authorities to avoid a local outbreak were successful, with only 17 cases and no death reported at end-2020,

but they also hampered domestic activities and exerted budgetary pressures. The CAB deficit remained contained by a fall in imports; the budget deficit and debt levels increased; and real GDP declined by 4.3 percent. The Fund provided emergency financing covering about one-fifth of the financing gap of 10 percent of GDP in 2020.

**Figure 12. Solomon Islands: Macroeconomic Developments, 2005–2020**



Sources: IMF, October 2021 WEO; IEO calculations.

## **Main Elements of Fund Engagement**

### ***Surveillance***

102. The Solomon Islands remained on a 24-month consultation cycle, until the cycle was reduced to 12-month at the end of its IMF-supported ECF program in 2016. Seven Article IV consultations were conducted over the 2009–2020 period, with three of these being concurrent with program reviews. Short staff visits took place in 2009, 2018, and 2019, so Fund missions took place in the Solomon Islands in every year of the period 2009–2019, while the negotiations of the 2020 Rapid Credit Facility/Rapid Financing Instrument (RCF/RFI) were held virtually. Surveillance activities were tailored to the situation of the country in line with the various SDS guidance notes. Two sets of SIPs were issued in 2011 and 2018 on managing mineral resources, monetary transmission mechanisms and inflation dynamics, fiscal anchors, and public investment in the face of natural disasters.

103. The 2009 Article IV consultation was instrumental in setting the stage for upcoming Fund program support. Policy discussions focused on the need to strengthen the fiscal and external positions in a context of declining logging activities and to foster a positive growth environment while ensuring financial sector soundness. While there was broad agreement on the outlook, the authorities' "views differed on the pace and scope of fiscal and exchange rate adjustment," but the constructive analysis and open dialogue allowed for the authorities to reconsider their position when the cash position of the government became critical and needed assistance, which paved the way for the 2010 IMF-supported SCF program.

104. The consultations during the program period complemented the program reviews, offering dialogue on a broader agenda focused on resilience to external shocks and structural reforms to achieve sustainable and inclusive growth, while the program targeted short-term rebuilding policy buffers and improving institutional capacity and governance. The 2016 consultation introduced a comprehensive policy framework to address natural disasters and climate change and focused on policies that could support the Sustainable Development Goals (SDGs), including financial inclusion. In this context, it discussed the 2016–2035 National Development Strategy and the related 2016–2020 medium-term development plan of the authorities for 2016–2035. Post-program Article IV consultations faced a loosening of fiscal policy and deterioration of the fiscal situation, with the emergence of expenditure arrears and a lack of transparency in government spending, such as in the Constituency Development Funds (CDFs),<sup>73</sup> and the policy discussions refocused on restoring internal stability and addressing the governance challenges that had been growing over time, stemming from weaknesses in the oversight of the resource sectors and public financial management. The 2018 consultation also included an extensive review and discussions of financial inclusion, as well as addressing the loss of a CBR of a local bank and the broader risk that losses of CBR could imply for the financial sector.

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<sup>73</sup> CDFs are budget transfers to Members of Parliament for rural development in their districts.

105. During interviews, the authorities reported strong appreciation for Article IV consultations, which they found to be effective in covering the macro-critical issues faced by the country. Some challenges were nevertheless deemed to deserve more attention such as the understanding of monetary policy transmission channels and the loss of CBRs for which the Central Bank had requested TA. The authorities stressed the importance of Article IV consultations in giving confidence to the donor community and having a catalytic effect on donors' support. The integration of CD into surveillance was deemed important, as it can provide support for the implementation of policy advice. The proactive role of Fund staff in surveillance was appreciated and the authorities supported the 12-month consultation cycle which fosters greater discipline and more continuous attention. As for the surveillance tools, their usefulness was noted with a request for greater sharing of knowledge and tutoring in using these tools. Finally, the authorities expressed interest in participating in the CCPA and DRS initiatives and requested more support regarding climate change financing and financial inclusion.

106. A member of civil society voiced appreciation for the candid dialogue and advice provided by the Fund on transparency and governance issues, particularly on the management of the CDFs and the logging sector. In this context, the Fund was encouraged to pay more attention to public sector management, local governments, and decentralization issues, while keeping an active outreach and public information program.

### ***Program Work and Emergency Lending***

107. The Solomon Islands and the Maldives are the only two Asia and Pacific SDS that had UCT IMF-supported programs over the period 2010–2020. The Solomon Islands faced a challenging external environment in the wake of the 2009 GFC with a decline in logging exports and a weak cash position. To address these problems and a protracted BOP need, it requested an 18-month SCF with access of 120 percent of quota (SDR 12.5 million) that was approved by the Board in June 2010. The arrangement was followed by a one-year precautionary SCF arrangement, in an amount of SDR 5.2 million, that led to a 3-year low-access ECF arrangement, equivalent to 10 percent of quota (SDR 1.04 million), in July 2012. All program reviews were completed and the ECF program was successful in achieving macroeconomic stability and rebuilding policy buffers while having an effective catalytic effect on donor financing despite the low access to Fund resources.

108. The IMF-supported programs focused on addressing cash management issues arising from an expansionary fiscal policy supporting the recovery effort after the Tensions and a projected decline of logging exports. Restoring the cash position of the government to ensure a smoother budgetary execution was accompanied by structural reforms to strengthen PFM and monetary policy and to boost resilience. Technical assistance and capacity development activities were integrated in the programs to assist in their implementation. The programs benefited from greater stability in the staffing of the Fund teams that covered the period 2009–2016.

109. A key challenge in the design of an IMF-supported program for Solomon Islands was the exposure to external shocks. The 2012 ECF emphasized the need for further progress in restoring domestic and external resilience through larger fiscal and external buffers. However, given the volatile and uncertain environment linked to the logging sector, the vulnerability to external shocks and natural disasters in particular, and the dependency on external aid, the program included a downside scenario and contingent monetary and exchange rate policies. The materialization of multiple risks, including some that had not been envisaged (such as the renewed closing of the Gold Ridge mine because of flooding), led to lower than projected growth outcomes and the adoption of a more conservative program, but the integration of contingent policies and alternative scenarios was useful in maintaining a constructive policy framework and fostering preparedness to deal with external and unexpected shocks.

110. Performance under the programs over 2010–2016 was generally satisfactory. About 90 percent of the quantitative performance criteria were met, in part by loosening the cash balance targets to reflect the impact of the unexpected floods. However, despite CD support, capacity constraints affected the implementation of the structural reforms program and only about half of the structural benchmarks were met (or implemented with delay), with the other half still outstanding at the end of the program.<sup>74</sup>

111. The 2020 RCF/RFI to address the COVID-19 pandemic's severe impact on the Solomon Islands economy was based on an estimated BOP gap of around \$38.8 million, equivalent to 2.5 percent of GDP, after taking into account a projected decline of gross official reserves of \$7.1 million. The staff report indicated that the Fund's disbursement of \$28.8 million would cover "a fifth of the external financing needs in 2020 (with the rest covered by a significant drawdown of international reserves and financing from development partners)" including the World Bank and the ADB (IMF, 2020). The government committed to setup a committee to oversee the fiscal stimulus spending and ensure good governance in the use of the emergency assistance, including through publication of audits of the COVID-19 related expenditures and related procurement information.

112. The authorities expressed satisfaction with the Fund's financial support and its catalytic impact on external financing over the period 2010–2020. They recognized that stigma used to be associated with Fund programs as conditionality was excessively rigid. The government has, however, come to realize how the Fund programs work and can benefit the SI. The authorities noted that the Fund had also changed and been less dogmatic over time in its relationship and engagement with the Solomon Islands. Positive experience with the Fund programs fostered the trusted advisor role of the Fund and helped the authorities in their dialogue with the Fund. The authorities appreciated the timely consideration of the RCF/RFI to address the COVID-19 pandemic. The interviewed civil society representative was more critical of the lack of transparency of some spending and concerns about corruption and governance.

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<sup>74</sup> IMF (2019c).

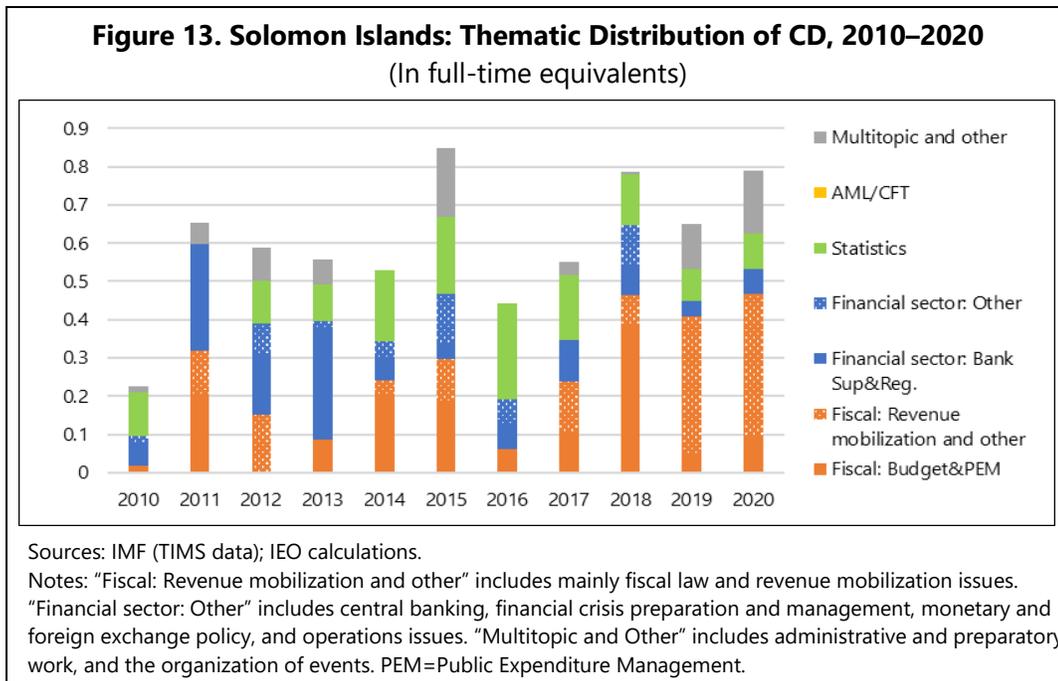
**Capacity Development**

113. As RAMSI fulfilled most of the TA needs of the Solomon Islands until its departure in 2017, the country was until then a moderate user of Fund CD, which focused on specific technical contributions during that period, such as bank financial supervision, the fiscal regime for natural resources, and statistics. A donor-funded resident advisor contributed to improvements in the National Accounts statistics and rebasing of GDP from 2004 to 2012. Since 2017, CD has increased, largely reflecting TA on revenue mobilization, while TA on statistics continued at a high level. Since then, Solomon Islands was the second largest recipient of PFTAC TA (Table 10), slightly behind Fiji (Figure 13). Macro-fiscal work centered on a macroeconomic programming framework and debt sustainability analysis. The country also benefited from the substantial training and workshop activities organized by PFTAC. CD activities also aimed at ensuring, in a context of limited absorption capacity, the implementation of the structural reforms encapsulated in the IMF-supported programs over 2010–2016.

**Table 10. PFTAC Activities in Solomon Islands**

	PFM		Tax Admin.		Macro		Fin. Sector		Real Sect Stat		GFS Stat		Total	
	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days
2021	1	5	3	36	1	15	2	18	3	23	1	12	11	109
2020	2	28	7	113	3	35	--	24	--	--	--	5	12	205
2019	2	15	7	120	3	26	2	32	1	18	1	16	16	227
2018	8	68	1	13	--	--	1	19	2	31	1	12	13	143
2017	3	32	2	16	1	7	2	31	2	45	--	--	10	130
<b>Total</b>	<b>16</b>	<b>147</b>	<b>20</b>	<b>298</b>	<b>8</b>	<b>83</b>	<b>7</b>	<b>124</b>	<b>8</b>	<b>117</b>	<b>3</b>	<b>45</b>	<b>62</b>	<b>814</b>

Source: PFTAC Annual Reports FY2017–2021.



114. The Fund CD work on the Solomon Islands has been guided by APD's Regional Strategy Notes, which gave priority to fragile, small, and island economies. The CD for Solomon Islands over 2013–2017 focused on strengthening fiscal management, such as TA on the Public Finance and Audit Act and the 2013 PFM Act and solidifying the financial sector with the Financial Institutions Act, where the IMF/PFTAC had a comparative advantage. A 2012 PEFA was complemented by a PFM Roadmap, which had an emphasis on strengthening cash management but also included non-PEFA dimensions such as governance and anti-corruption. The PFM roadmap has been integrated in the Joint Policy Action Matrix of the Solomon Islands that inform the dialogue between the country and donors in the context of budget support. The 2020 review of PFM reform strategy in the PICs reported, however, that capacity constraints hampered full use of the roadmap. On revenue, Fund TA progressively substituted for the New Zealand TA that was phased out in parallel with RAMSI and started with a government tax review completed over three years. MCM, STA, and LEG provided TA on central bank management and financial sector supervision, monetary and BOP statistics, and various pieces of legislation, respectively.

115. The authorities voiced strong appreciation of Fund CD activities and praised PFTAC for its hands-on approach and quality TA. While noting that their own staff turnover did not facilitate retention and progress, officials advocated for ways to improve assimilation and integration, such as greater use of templates and better documentation. They were satisfied that most of their requests had been fulfilled and commended the Fund for its responsiveness to the needs of the country with an effort to prioritize.

### ***Collaboration with Partners***

116. Good coordination and collaboration among donors were exemplified during the RAMSI period, particularly in the context of capacity development. This situation broadly continued after the withdrawal of RAMSI and interviewees reported that the IMF maintained very good working relations with all other donors in the Solomon Islands. As in many other Pacific Islands, World Bank and ADB staff were invited to participate in Article IV consultation missions.<sup>75</sup> Country teams met regularly with relevant stakeholders and donors, who benefited and relied on the Fund surveillance work for input in their budget and project support of the country.

117. The authorities did not raise any issue of lack of coordination among donors during interviews and reported that they pay attention to avoid overlap, with the Fund focusing on its mandate of macroeconomic supervision. A Civil Society representative pressed for greater outreach and more candidness from the whole donors group.

### ***Staffing of Country Teams and Engagement of IMF Senior Officials***

118. Staffing on missions to the Solomon Islands increased substantially as a result of the IMF-supported programs. Mission team size increased from three staff members for the 2009

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<sup>75</sup> ADB and World Bank staffers participated in the 2009 and 2011 Article IV consultations, respectively.

Article IV consultation to an average of close to five members for the 14 missions that followed over 2010–2019 (the RCF/RFI negotiations in 2020 were virtual). APD provided on average three staff members, and the team was complemented by an SPR economist in seven missions between 2011 and 2020, a FAD economist in two missions, and an ICD economist and an economist from the Risk Management Unit in two other missions. The regional resident representative office also participated in six missions over 2010–2019, including the last five missions.

119. Ample staffing of mission teams over the period under review was also supported by limited turnover, partly reflecting the semi-annual program review process. One mission chief led six missions over the period, and two other mission chiefs led three missions each. The average tenure of economists was, nevertheless, only slightly more than two missions, which contributed to a lack of economist overlap and team continuity at the economist level.

120. The authorities noted high turnover, participation by staff with limited experience, and a consequent need to improve institutional memory transmission during rotations. While appreciating the overall quality of policy advice, the authorities confirmed the need for greater team continuity and overlap.

## **E. Tuvalu**

### **Country Profile**

121. Tuvalu is a small developing state situated halfway between Australia and Hawaii in the Polynesian region of Oceania. It is composed of three reef islands and six atolls with a combined surface area of 26 square km<sup>2</sup> and an EEZ close to 750,000 km<sup>2</sup>. The population is estimated at 11,646 in 2019, the lowest of any IMF member, all of it living within five meters above the sea level. Tuvalu is a former British colony that became fully independent as a sovereign state within the Commonwealth in October 1978.

122. Tuvalu is a microstate and FCS with a GNI per capita of \$5,620 in 2019. It is classified as an upper-middle income country and has the smallest GDP of any sovereign nation in the world. Its CPIA scores rank among the lowest in the Asia and Pacific SDS. The public sector is the largest employer, accounting for 65 percent of employment.

123. Tuvalu is an open economy that has few exports and depends heavily on imports, as there are limited economic activities besides subsistence agriculture and fisheries. Tuvalu participates in the Nauru fishing agreement and other fishing treaties that provide a large part of government revenue together with additional income from its Trust Funds and the lease of the “.tv” internet domain. Remittances are an important source of revenue in Tuvalu, originating from Tuvaluan seamen working on foreign ships and participants in the seasonal workers programs of New Zealand and Australia. The banking sector is very shallow, with banking services provided by the National Bank of Tuvalu and one development bank; non-performing loans are high and accounted for about 40 percent of total loans. The country has two government-owned trust

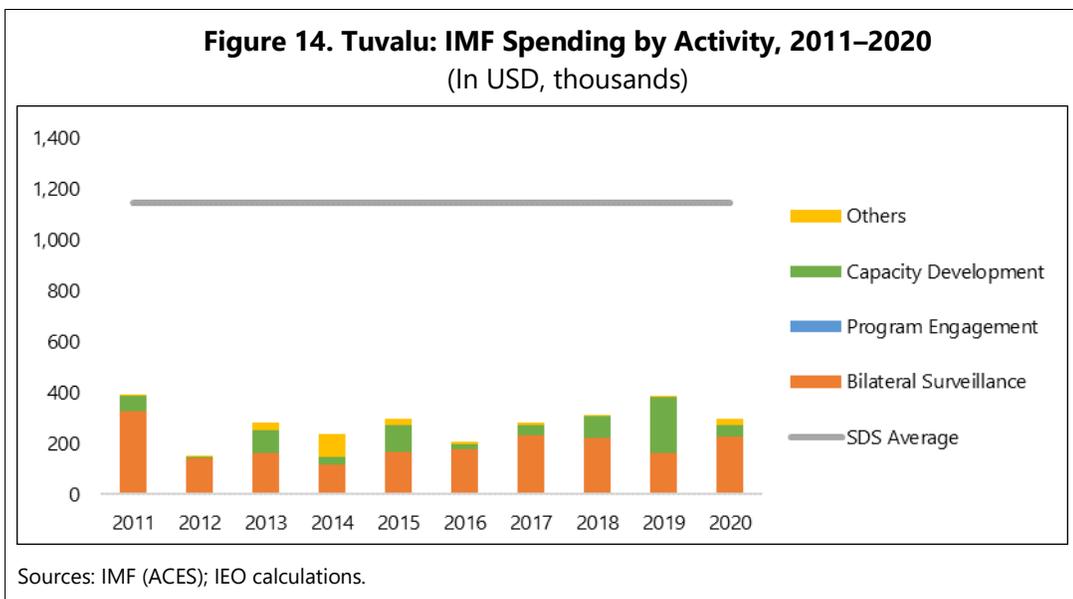
funds to provide for the future and financing for natural disasters. The first one is the Tuvalu Trust Fund that was established by the UK, New Zealand, and Australia in 1987 and has current assets of about 300 percent of GDP. Its structure is similar to the Compact Trust Fund in FSM, with the surplus revenue of the Trust being distributed to a Consolidated Investment Fund (CIF). The second Trust Fund is the Tuvalu Survivor Fund, which was created in 2016 and can provide for recovery financing after natural disasters without approval of stakeholders.

124. Tuvalu joined the IMF in June 2010 and has a quota of SDR 2.5 million and a voting power of 0.03 percent. It is eligible for PRGT resources. Its economy uses the Australian dollar as legal tender and there is no central monetary institution. On top of bilateral surveillance, Tuvalu benefits from PFTAC CD, TA, and training (Table 11 and Figure 14). Availability, timeliness, and quality of data have always been an issue: data provision to the Fund is assessed to have serious shortcomings that significantly hamper surveillance, and TA has been instrumental in preparing data for the BOP and GDP. Staff reported that the lack of macro-critical data made it difficult to provide policy advice. Tuvalu participates in the e-GDDS but has not yet published its data through a National Summary Data Page.

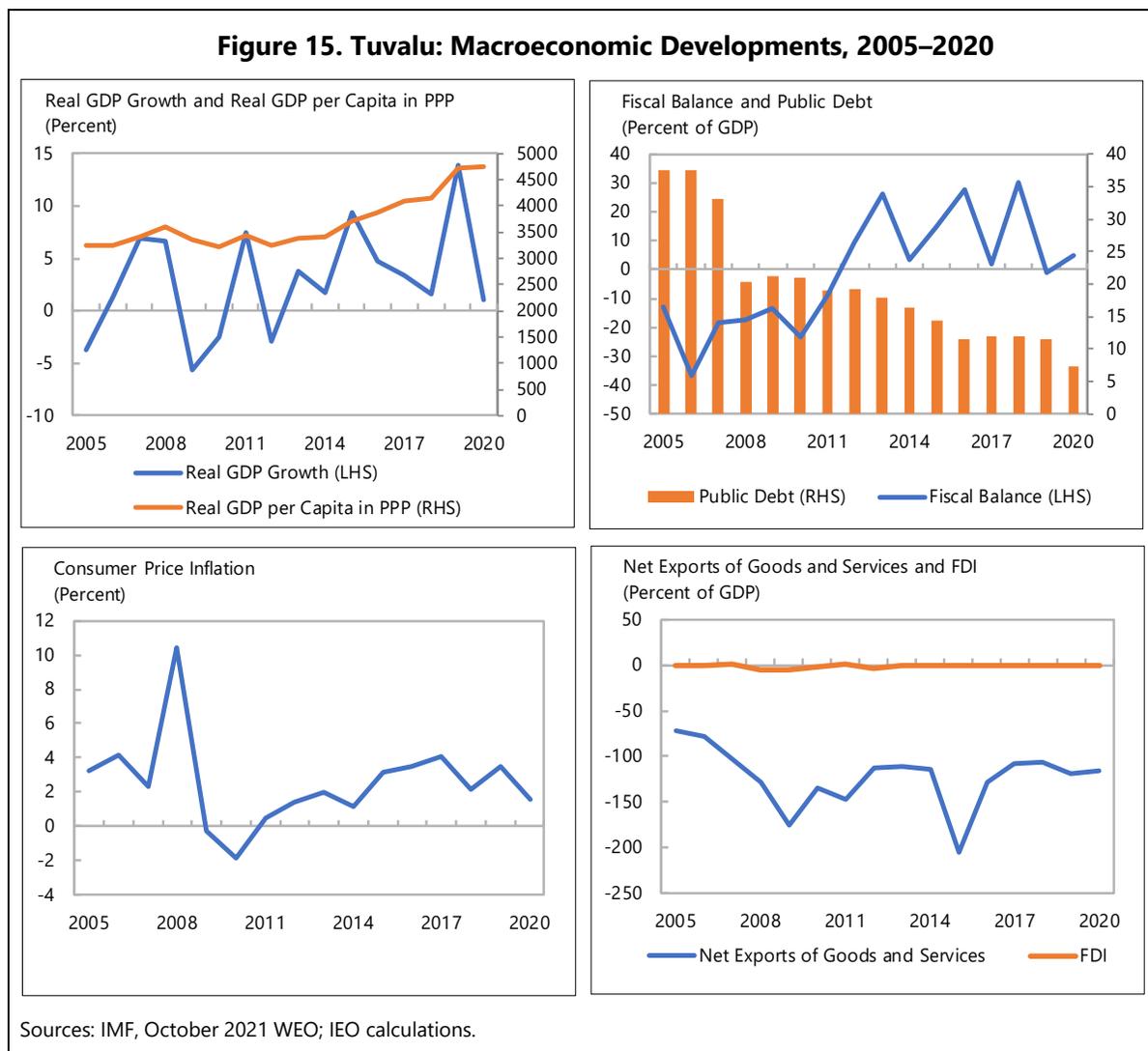
**Table 11. Tuvalu: IMF Engagement, 2010–2020**

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Article IV											
Programs											
Emergency financing											
Other											

Sources: IMF; IEO calculations.



125. Because of its low elevation, Tuvalu is highly vulnerable to natural disasters and climate change. It is also subject to the effects of El Niño, which is linked to higher risks of tropical storms, and La Niña, which increases the risk of drought. Tuvalu ranks third on the United Nations Environmental Vulnerability Index, behind Kiribati and the Marshall Islands.<sup>76</sup> The 2011 drought exacerbated the problems of access to drinkable water and led to a freshwater crisis that required donors' assistance to provide a desalinization plant and storage tanks (Figure 15). The waves and storm surge created by Cyclone Pam in 2015 caused major damage to infrastructure, housing, and crops evaluated at \$15.0 million; the recovery was assisted by many donors. Due to the swift adoption of measures by Tuvaluan authorities, the country remained COVID-free as of February 2022 according to the WHO. Staff remained engaged virtually with Tuvalu during the pandemic, but the country did not request emergency assistance from the IMF.



<sup>76</sup> The WorldRiskIndex does not include Tuvalu because of insufficient data.

## **Main Elements of Fund Engagement**

### ***Surveillance***

126. Tuvalu has been on a 24-month consultation cycle since joining the Fund. Five Article IV consultations were concluded by the Executive Board over 2009–2020. Three staff visits of moderate length took place between formal consultations, but none since the 2018 Article IV consultation. Contact has continued on a virtual basis.

127. Despite its remoteness, Tuvalu was not immune to the effects of the 2009 GFC that resulted in a hard budget constraint with the depletion of the CIF that had financed an expansionary fiscal policy since 2005. Surveillance activities focused in the early 2010s on the fiscal adjustment program to redress the fiscal situation and restore fiscal sustainability. A comprehensive public enterprise reform program was launched with ADB assistance. A Banking Act was passed, and while no progress was made in putting in place the supervisory and prudential requirements recommended by the Fund, thorough on-site examinations were completed for banks. Various tax revenue measures were taken (including the introduction of a VAT). The first DSA was also conducted in the context of the 2012 Article IV consultation with an assessment of high risk of debt distress.

128. The 2014 Article IV consultation report noted a new budgetary expansion that was made possible by a more than doubling of licenses fees, and policy discussions focused on fiscal sustainability and reforms for sustained and inclusive growth. Staff reiterated the urgent need to establish a framework for banking supervision and resolution. The 2016 Article IV consultation discussed the recovery effort after Cyclone Pam (which incurred damages of around 33 percent of GDP), the authorities' new National Strategy for Sustainable Development (2016–2020), and the Policy Reform Matrix (2012–2015). The 2018 Article IV Consultation focused on policies to promote resilience to external shocks, welcoming the financing of the Green Climate Fund to fight coastal erosion. Staff recognized that the recommendation, sustained since 2010, of creating a bank supervisor position had to be reviewed and modified with the Ministry of Finance taking that responsibility.

129. Staff interviewed reported that conducting consultation missions in Tuvalu was challenging because of data issues but well appreciated by various stakeholders. They emphasized that greater integration of CD and surveillance should be actively supported, particularly in the area of statistics. Staff, however, did not favor changing the 24-month consultation cycle to 12-month arguing that the largest risks in Tuvalu are mainly of a longer-term nature and that near term risks are significantly mitigated by Tuvalu's assets in its buffer funds.

130. Official interviewees affirmed that Tuvalu has benefited from IMF surveillance and CD initiatives, particularly from PFTAC. They found the scope of consultations to be relevant and useful, with good coverage in the reports. They compared the process with the similar one in place for the Tuvaluan Trust Funds. The authorities highlighted, however, the need for greater

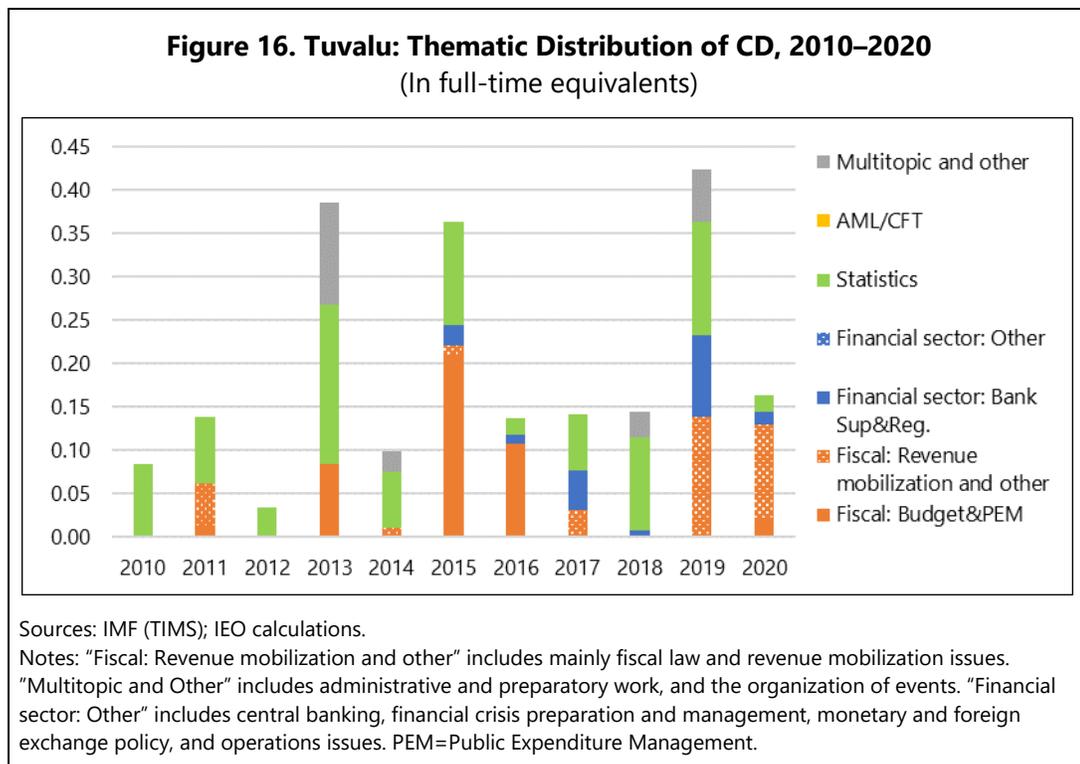
engagement between Article IV consultations. The surveillance tools such as the DSA were assessed as valuable and useful, and the authorities pressed for further emphasis on an action-oriented strategy to address climate change. They expressed interest in receiving assistance for developing a Disaster Resilience Strategy that would help mobilizing climate change financing.

### ***Program Work and Emergency Lending***

131. Tuvalu has never had an IMF-supported program or emergency financing. The authorities' strategy was to favor grants and highly concessional financing, which the Fund does not provide but is available from bilateral donors such as Australia, New Zealand, Japan, South Korea, as well as other international organizations. The authorities stated that they did not request Fund assistance in the context of Cyclone Pam or the COVID-19 pandemic because assistance from other donors provided sufficient grant support for the recovery, while the financing conditions of the Fund were not as concessional.

### ***Capacity Development***

132. Tuvalu received regular CD on statistics over 2010–2020. There were other periods of more intense CD in PFM in 2015–2016, banking supervision in 2019, and revenue mobilization in 2019–2020 (Figure 16). Most of the CD was provided through PFTAC, which provided moderate levels of TA to Tuvalu that were commensurate with the limited absorption capacity of the country (Table 12).



**Table 12. PFTAC Activities in Tuvalu**

	PFM		Tax Admin.		Macro		Fin Sector		Real Sect Stat		GFS Stat		Total	
	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days	Missions	Days
2021	--	--	3	36	--	--	--	--	2	24	--	--	5	60
2020	1	5	2	28	1	10	1	3	1	17	--	--	6	63
2019	--	--	2	19	2	18	1	24	--	--	--	2	5	63
2018	--	--	--	--	1	8	1	3	1	20	1	8	4	39
2017	--	--	1	6	--	--	1	25	1	20	--	--	3	51
Total	1	5	8	89	4	36	4	55	5	81	1	10	23	276

Source: PFTAC Annual Reports, FY 2017–2021.

### ***Collaboration with Partners***

133. Interviewees reported good collaboration between the Fund and other international organizations. World Bank and ADB staff participated regularly in Fund’s Article IV missions when they occurred during the evaluation period. The authorities reported nevertheless that coordination could be strengthened further to provide more consistent advice. They noted recent divergence of advice on economic diversification with the Fund recommending emphasis on tourism and the World Bank focus on the fisheries sector. The authorities did not feel that the Fund’s focus on the tourism sector was the proper strategy.

### ***Staffing of Country Teams and Engagement of Senior IMF Officials***

134. Staffing of the five Article IV missions to Tuvalu over 2010–2020 was challenging. Excluding the regional resident representative who participated in two missions in 2012 and 2014, no Fund mission member participated in more than one Article IV mission during the evaluation period.<sup>77</sup> The participation of APD staff on missions to Tuvalu declined from three to one over time, compensated by the participation of the resident representative office in four consultations and staff from other departments on an ad hoc basis (SPR, SEC, STA, LEG, and KMU), which contributed to an average mission team size of four persons over the period. World Bank and ADB staff joined four of the five missions in equal or greater numbers than HQ Fund staff. The rapid turnover of staff on Tuvalu, which is exacerbated by the 24-month surveillance cycle, engendered loss of institutional memory and prevented effective continuity of engagement and dialogue.

135. The authorities regretted the high turnover of staff, highlighting that they were faced with new staff for each successive Article IV consultation. They reported a need for greater engagement between missions, as this interim period was important for implementation of policy advice and as the momentum of policy dialogue needed to be maintained. They

<sup>77</sup> Staffing of the three staff visits that took place over the period 2010–2020 have not been available.

suggested that more continuous engagement and inclusion of more specialist advice from functional departments could be achieved through remote discussions or virtual follow up. It would also be useful to include a policy recommendation matrix/monitoring table in each Article IV report to facilitate monitoring, and follow-up. Such a matrix approach is used in reviews and discussion of Tuvalu's two trust funds.

#### **IV. CROSS-COUNTRY FINDINGS**

##### **A. Surveillance Activities**

###### **Key Contributions**

136. The most valued contributions of surveillance activities in Asia and Pacific SDS case study countries during the evaluation period were the regular production of an independent and authoritative review of recent economic and financial developments and the provision of policy advice to preserve or strengthen internal and external stability. The authorities in all the Asia and Pacific case studies expressed strong appreciation for the Article IV consultation process and its value added, noting the efforts of the Fund to be a better listener and trusted advisor over the past decade as compared to prior. They reported that the substance of the consultations was sufficiently tailored to their unique country circumstances, and they praised the consultation process for its promotion of a constructive engagement and policy dialogue on their development strategy and the maintenance, strengthening, or restoration of macroeconomic stability. They highlighted the contributions to their policy decision-making through the elaboration and discussion of a comprehensive macroeconomic framework that took into account international developments, reflected the specificity of their country, and incorporated projections of the impact of domestic policies. They appreciated the policy recommendations made in that context and highly valued the CD activities of the Fund, particularly of PFTAC, which enhanced their institutional capacity. They noted that IMF engagement had a signalling effect that helped their relationship with other donors and appreciated the Fund's assessment letters. The good collaboration of the Fund with other development partners, including the World Bank and ADB, also contributed to greater coordination of activities and integration of respective advice.

137. Surveillance activities were tailored to the priority needs of country cases, aligned with the guidance on SDS and surveillance, and fairly conventional. Because of the pegged exchange rate arrangements, surveillance focused appropriately on fiscal policy measures to address economic developments that threatened internal and external balances, most of them external shocks, particularly natural disasters. Fiji had to address Cyclone Evans and floods in 2012 and Cyclone Winston in 2016; the FSM was pounded by Typhoon Maysak in 2015 and faces the lapsing of its COFA with the USA in 2023; Samoa struggled through a Tsunami, three cyclones, and a measles outbreak; the Solomon Islands was affected by the GFC and a loss of logging exports in the early 2010s, as well as various natural disasters thereafter; and Tuvalu was struck by Cyclone PAM in 2015. These events highlight the significant vulnerability of Asia and Pacific SDS to external shocks, reflecting not only the volatility of their environment and their intrinsic

lack of shock absorbers due to smallness, but also weaknesses in their institutional capacity. Surveillance activities were thus mostly reactive but usually well-tailored to the needs of the member countries. The experience with external shocks also fostered the discussion of ex ante resilience building measures toward the end of the period under review, supported by intensive research within the small states group in the Fund and the formal advent of the CCPA and DRS.

138. Notwithstanding this positive overall assessment, most case study country authorities were concerned about the turnover of Fund staff working on SDS and some expressed the need for a more continuous engagement and dialogue than provided under the 24-month consultation cycle. Most appreciated the surveillance tools but requested greater tutoring on their use, as well as greater analysis of financial sector issues. There was a common interest in specific CD and TA activities, such as the FSAP, FSSR, AML/CFT, mitigation of CBR losses, CCPA, and the DRS. On climate change and natural disasters, authorities appreciated the efforts of Fund staff to analyse their impact on SDS and discuss mitigation and adaptation strategies, but they noted issues of financing and developing financial strategies.

### **Gaps in Surveillance Activities**

139. There is room to enhance surveillance and traction through more granularity and tailoring of economic analysis and policy advice. Members were usually pleased with the coverage and relevance of surveillance activities and policy advice, but the analysis and the recommendations should have taken greater account of the institutional capacity of the countries and reflect more the specific environment of SDS, such as the culturally sensitive issue of communal land and the various fiscal federalism structures in place. There should also be more focus on the practical implementation of the policy advice and recommendations, and the ways to achieve it, including with the provision of specific TA. This enhanced tailoring could be supported by greater use of SIPs on topics jointly identified with the authorities, such as the Blue Economy, and prepared in advance of the consultation, building on APD regional research program on SDS.

140. The focus of surveillance during the evaluation period was on fiscal policy as a means to maintain macro-economic stability and preserve debt sustainability. This approach was justified given fiscal issues faced by these countries and the pegged exchange rate arrangements of Asia and Pacific SDS (including full dollarization for some of them). States with better data quality, under a 12-month consultation cycle, or having received specific policy TA on policies in the form of FSAPs, FSSRs, AML/CFT advice, or CBR recommendations benefited the most from surveillance activities. In general, however, prioritization of fiscal policy on surveillance was somewhat to the detriment of other key thematic areas identified in the 2017 GROWTH framework, although resilience to shocks received increasing attention in the second half of the 2010s. There were limited discussions of growth potential and prospects, labor markets and employment, private sector development and financing, and development issues through diversification/intensification of economic activities. The coverage of financial sector developments was insufficient although it contains critical information on the external sector. Staff has nevertheless to be commended on exchange rate and external sector assessments that are a challenge in SDS as the EBA-lite

framework is difficult to implement in the circumstances of SDS (volatility, vulnerability to shocks, smallness, pegged exchange rate arrangements including full dollarization for some, and data issues).

141. The substance of surveillance could be strengthened in the financial sector area and enhanced in the discussion on growth and private sector development. The effective oversight and reporting of financial sector developments is uneven across Asia and Pacific SDS and should be improved across the board to enhance the value-added of this sector in the promotion of economic developments and understanding of external sector evolutions. On the one hand, members having benefited from FSAPs and FSSRs had better coverage and follow-up in monitoring, and most SDS have had TA to strengthen banking sector supervision. On the other hand, the TA credit unions and nonbanking financial institutions remains weak, as well as the monetary policy transmission mechanisms. The frequency of FSSRs and FSAPs could be intensified in the region to alleviate some of these weaknesses and foster a resilience-focused surveillance.

142. Regarding issues of growth and private sector developments, SDS offer unique opportunities to discuss microeconomic issues of macroeconomic relevance, which could fall under Fund's surveillance mandate. Surveillance activities should cover these issues in greater depth while remaining in line with the operational priorities of the 2014 Triennial Surveillance Review. Asia and Pacific SDS are particularly vulnerable to external shocks and do not have the safety nets and shock absorbers that larger economies may have when confronted with such shocks. Thus, the greater need for risk management and resilience building in these countries, as well as the necessity of a deep knowledge of market structures and market participants in the local economy by country teams. The greater economic uncertainty and risks faced by SDS should be reflected in contingency and resilience policies. Collaboration with other development partners could be strengthened further on these less traditional issues, such as market structures and regulations, diversification and intensification, labor markets, parastatals, private sector financing, and issues in transportation, energy, and telecommunication sectors. Fund recommendations should usefully go beyond improving business environment and discuss in greater details sectoral policies, including blue economy issues. Consistency of advice with recommendations from other international financial institutions should be reinforced. Macroeconomic evaluations of the authorities' development plans and strategies should be included in Article IV consultations. Cross-regional studies and South-South knowledge sharing could be useful in that context

143. While resilience is one of the thematic areas of the 2017 GROWTh approach and often mentioned in reports and discussions, its meaning and operationalization in Fund activities were not defined comprehensively until 2019 (IMF, 2019d) and the introduction of the concept of Disaster Resilience Strategy (DRS) and its three pillars of structural resilience, financial resilience and post-disaster and social resilience.<sup>78</sup> The DRS provides a particularly useful and pro-active framework for Fund activities in SDS and should be extended to more SDS and refined further in the context of surveillance and CD activities (Annex I Figure AI.1). The design and implementation

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<sup>78</sup> See also Khor and others (2016) for an earlier discussion of resilience in the Pacific islands.

of resilience-based macroeconomic policies could be further refined and incorporate the specificity of SDS. The two DRS pilots so far (prepared by the government of Dominica and Grenada with support from the Fund) offer good examples of the value-added of DRS, including natural disaster risk financing strategies, risk management frameworks (such as the creation of a Vulnerability and Resilience Fund in Dominica), and comprehensive macroeconomic frameworks incorporating the implementation of the DRS. There is ample scope to leverage the early gains from DRS: for example, well-designed DRS could improve the catalytic effect on financing and could be supported by the Fund under low-access or precautionary programs. SDS could also benefit from the new Fund strategy to help members address climate change challenges through expansion of coverage of Article IV consultation and financial assessment reports and a significant increase in climate related CD.<sup>79</sup> Area departments in charge of SDS could lead the efforts in refining further the DRS approach to the circumstances of SDS, particularly microstates and FCS, and ensuring synergies with the new Fund strategy to help members address climate change. Support of fragile SDS will also have to be consistent with the new FCS strategy of the Fund under development, including the rolling out of Country Engagement Strategies (CES), enhancement of CD provision impact, and possible enhancements of program design, conditionality, and the lending toolkit.

144. Policy recommendations also faced some traction issues, particularly in the fiscal sector, which can be traced to insufficient recognition of the specific circumstances of SDS, such as limited institutional capacity and other characteristics, a lack of specificity of advice (such as incorporating the fiscal federalism structure in FSM), the high turnover of Fund staff on missions, discontinuities in the Fund engagement and policy dialogue because of the 24-month cycle consultation cycle, and weaknesses in the integration of CD to support the recommendations.<sup>80</sup> Thus, while there was broad agreement on the advice, progress in the implementation of the policy advice was slow and their transformational impact limited. Traction was higher in areas with greater TA support, e.g., in the context of implementing FSAP recommendations and prevention/mitigation measures for CBR losses in Samoa. In the fiscal area, while the analysis and policy recommendations were fairly conventional and appropriate, more attention should have been given to fostering traction and supporting the implementation of policy advice.

145. Traction in the context of surveillance activities could be enhanced by preparing for the authorities, and including in Article IV reports, a detailed summary or dashboard of the Fund's-policy recommendations, akin to the quantitative indicators and structural benchmarks of IMF-supported programs, which could also include indications of TA support and a relevant timeline. During the evaluation period, a brief outline of policy advice was provided in the executive

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<sup>79</sup> The strategy includes the development of a Climate Macroeconomic Assessment Program (CMAP), a diagnostic tool building on the CCPA with stronger macroeconomic and financial focus to analyze climate change policies and preparedness for climate-vulnerable countries.

<sup>80</sup> With the exception of SPR and LEG, many functional departments have also limited their review activities of internal country documents, including mission policy notes, which has reduced broader internal discussion of policy issues faced by SDS.

summary of the most recent Article IV reports. The review of the implementation of Fund recommendations was only provided in the context of the subsequent consultation documents, often after 24-months, through a table maybe not vetted by the authorities. This approach hindered authorities' ownership and traction, as well as potentially preventing timely adoption of corrective measures.

146. The Fund's surveillance tools have proven useful in the conduct of surveillance activities but difficult to use in some cases, due to the specificity of the SDS environment. They would benefit from greater guidance and possible refinements when used in SDS.

- DSAs and external sector assessments are difficult to make in SDS that are dollarized or highly vulnerable to natural disasters and external shocks and whose baseline projections are subject to considerable uncertainty. The revised LIC and MAC DSA frameworks offer substantial improvement in this regard, and the specific consideration of a natural disaster scenario in the LIC-DSA should provide more robust assessments of risks of debt distress in the context of SDS. However, the revenue from fishing licenses in the external primary income accounts can create a large wedge between GDP and GNI (as in FSM, Tuvalu, Timor-Leste, Kiribati). Defining the LIC-DSA thresholds in terms of ratio to GNI could be analysed in a complementary discussion of debt sustainability in the DSA reports. Alternatively, in the same way as remittances are factored in the assessment of a country's debt carrying capacity when they exceed a given threshold, regular primary income from fishing licenses could also be factored in through a recalibration of the composite indicator in the debt sustainability framework.
- The external sector and exchange rate assessments remain a challenge to implement in some SDS because of factors such as volatility of BOP outcomes and dollarization, and greater guidance should be provided for their application in the context of SDS. They will continue to require close attention considering existing data limitations and the heightened vulnerability of SDS. Staff should be encouraged to do more sensitivity analysis and document better the underlying factors leading to any change in these assessments.<sup>81</sup>

147. Some of the surveillance gaps mentioned above stem from internal limitations and external constraints that would need to be addressed to strengthen the value added of surveillance activities.

- The 24-month consultation cycle and staffing issues tended to hinder in-depth engagement and continuity of the trusted advisor relationship with the authorities. They sometimes resulted in a stop-and-go pattern of surveillance that was detrimental to traction and to the effective implementation of the policy advice. The 24-month cycle

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<sup>81</sup> For example, such documentation was missing in the context of Samoa for which the 2015 Article IV consultation no longer reported a significant misalignment of the exchange rate while previous assessments in the early 2010s reported an overvaluation with a need for realignment.

contributed to high Fund staff turnover on missions and loss of institutional memory. It was also detrimental to research programs that require longer on-site presence for data collection and investigation. These issues were at times compounded by the authorities' own staff turnover.

- The conventional surveillance approach adopted in most SDS hinders greater specificity/tailoring and thinking outside the box. While the tailoring of surveillance to priority issues is real and policy advice appropriate, more emphasis should be given to the effective implementation of the policy advice with greater integration of CD activities to overcome weaknesses in institutional capacity. Despite an active research program on cross-regional issues, the absence of SIPs has limited the consideration of specific surveillance issues. These problems are linked in part to staffing constraints on SDS.
- The internal review process is usually limited to SPR and LEG, which prevents greater integration of CD and specialist expertise through participation of other functional departments.
- Data quality and timely availability are important issues in SDS surveillance. While fiscal data are usually satisfactory, monetary and external sector data present greater challenges that impede the production of reliable macroeconomic frameworks and could affect the design and approval of an IMF-supported program should the need arise.

148. APD was active in strengthening its coverage of the Asia and Pacific SDS and fostering better surveillance of member countries within the Fund's budget constraints over the evaluation period. While SDS are not systemic, they featured prominently in the accountability framework of the department. The creation of the Pacific Island Division provided for a better internal organizational structure that championed the cause of SDS, promoted cross-country work, and enhanced the sharing of institutional knowledge on SDS, including through an active research program and organization of various outreach activities. APD's support of PFTAC and the presence of a regional resident representative were also instrumental in enhancing surveillance activities and well appreciated by the authorities. However, coverage of the 14 Asia and Pacific SDS could justify greater local presence of the Fund.

149. Staffing issues remain a challenge despite efforts to address members' and staff concerns. To palliate the situation, APD has taken several measures to reduce turnover and enhance institutional memory: for example, APD's 2020 Accountability Framework included an objective to extend mission chief tenure for small states from 2 to 3 years; the transition between MCs has been strengthened through greater mentoring from the front office, as well as participation of the previous MC in the internal review process of his or her successor's policy consultation note. Progress on staffing is likely to remain slow due to limited staff resources and budget constraints, as well as lingering perceptions regarding work on SDS. The recent Fund policy change requiring work on FCS or LICs for promotion, as currently designed, could also have an adverse effect on incentives to work on SDS.

150. Fund staff interviewees expressed concern about the lack of resources available to work on SDS, given the high potential impact of the Fund's work on these economies, much greater than in larger ones. In their view, teams were spread too thin and unable to conduct further research and analytical work that would be greatly appreciated by authorities. Under APD's staffing model, relatively junior economists assigned to desk positions in advanced and large emerging economies are offered MC positions in SDS as secondary assignments. While this offers an incentive in the form of career opportunities, it also often means that SDS work is done in the margins of "primary" assignments. It also poses a heavy burden on staff and makes the quality of engagement dependent on their willingness and interest to devote extra time to non-primary, less-visible assignments.

## **B. Program Activities and Emergency Assistance**

### **Key Contributions**

151. Program activities in case study Asia and Pacific SDS were very limited over the evaluation period with only the Maldives and Solomon Islands having active IMF-supported programs early in the period. This reflected the fact that most of these SDS did not face medium term or protracted BOP problems. This situation reduced potential interest in IMF-supported programs and limited Fund interventions to emergency financial assistance with five operations approved under the RCF or RFI in the context of natural disasters and the COVID-19 pandemic. But the IMF was not always approached after major natural disasters. For example, FSM and Tuvalu did not request Fund emergency assistance when they were hit in 2015 by Typhoon Maysak and Cyclone Pam, respectively. Both events occurred between Article IV consultations (24-month cycle), and interviewed authorities noted that both countries benefited from sufficient donor support to address the shocks without assistance from the Fund.

152. While the Maldives program went off-track after the first review and expired in late 2012, the SCF- and ECF-supported programs in Solomon Islands over 2010–2015 were completed successfully with restoration of macroeconomic stability and strong structural reforms. The success of the Solomon Island programs reflected their catalytic effect on external financing, close engagement by the country team, and good CD integration, as well as strong ownership by the authorities. These programs also provided 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.

153. Most officials interviewed reported good knowledge of Fund facilities, crediting Fund staff for conducting specific outreach, but a few admitted having only limited knowledge, in particular of the non-financial support instruments and the availability of precautionary programs. Some acknowledged the lingering stigma associated with Fund programs, mainly used for political purposes, and suggested outreach as a remedy. Most interviewees stressed their policy of focusing on grants and highly concessional loans in line with their medium-term debt strategies and highlighted the fact that such financing is not available from the Fund, which limits

SDS interest in IMF-supported programs. They noted that they were able to find appropriate financing for their development objectives in the 2010s, at times supported by Fund assessment letters, and avoided recourse to IMF-supported programs with attached conditionality.

### **Gaps in Program Activities and Emergency Assistance**

154. The limited recourse to the non-emergency financial instruments of the Fund can be traced in part to the absence of significant structural or protracted BOP problems in Asia and Pacific SDS in the past, the capacity of the authorities in mobilizing sufficient external financing, and their consequent lack of interest in IMF-supported programs or engagement beyond surveillance activities and emergency financing. For most of the authorities interviewed, stigma was a concern of the past and could be handled through greater political outreach and transparency.

155. The most frequent explanation for lack of recourse to Fund assistance relates to the terms of Fund financing (short maturity, not enough concessionality). Authorities' knowledge of Fund facilities was not an issue in many Asia and Pacific SDS, but more outreach should be done to highlight the potential benefits of the nonfinancial assistance programs of the Fund, such as the Staff Monitored Program (SMP), the Policy Support Instrument (PSI) and the Policy Consultation Instrument (PCI), as well as the possibility of precautionary programs, which could prove useful in navigating the aftermath of the COVID-19 pandemic, such as heightened risks of debt distress. The use of nonfinancial assistance programs and precautionary programs could be attractive in addressing fragility and vulnerability issues in Asia and Pacific SDS while addressing the authorities' concern with concessionality of Fund support. There could also be interest in a facility focused on building economic resilience to external shocks that would be supported by strengthened capacity development programs and could be used to shore up the implementation of the DRS.

## **C. Capacity Development**

### **Key Contributions**

156. Fund CD activities in Asia and Pacific SDS have been increasingly demand-driven and the authorities have expressed satisfaction with the Fund's responsiveness to their CD requests. PFTAC is the key provider of Fund CD in the region and a much-appreciated partner for CD, with significant contributions in revenue mobilization, PFM, financial sector supervision, and statistics. Diagnostic and policy-oriented TA is led by HQ staff in specific areas, such as the FSAP/FSSR, CBR loss mitigation measures, AML/CFT, and more recently the CCPA (Tonga and FSM) and has also been highly valued.

157. PFTAC provides CD in 16 countries, including 13 Asia and Pacific SDS. It has seven resident advisors that deliver and manage five CD programs. The programs on PFM and Revenue Policy Administration accounted for about half of PFTAC activities for most of the period under

review before increasing to two thirds of the 2,300 days of CD missions in FY2020. In the same year, the programs on statistics (national accounts and government financial statistics), financial sector supervision, and macroeconomic analysis and programming accounted for 16 percent, 10 percent, and 5 percent of the PFTAC activities, respectively. Fiji, Samoa, the Solomon Islands, Tonga and regional activities each accounted for about 210 mission days of CD (or 11 percent of all activities), while the other eight Pacific islands had on average 52 days of CD (or 3 percent of all activities). The six Asia and Pacific SDS that are listed as FCS accounted for about one-quarter of PFTAC field activities in FY2020.

158. Despite PFTAC limited resources and staffing, it has reported good progress in achieving milestones of its programs. The midterm review of PFTAC in 2016 found it to be highly relevant to the needs of its members and recommended a program approach to its CD activities to improve sustainability of its results, while noting that for some countries missions in some areas had been too infrequent.

### **Gaps in Capacity Development Activities**

159. Although the authorities and staff interviewed expressed overall satisfaction with the benefits of CD,<sup>82</sup> the monitoring and evaluation of CD achievements remain a difficult endeavor. Not only does the substance of TA evolve over time (such as with the emergence of new standards and new best practices), but also the assessment of a transformative CD requires time. The sustainability of outcomes remains subject to the constraints of the institutional capacity of most SDS.

160. Overall, clear progress in addressing encompassing issues of economic, environmental, social and institutional fragilities is not well established. The continued listing of six Asia and Pacific SDS as FCS, the limited improvement of CPIA scores, the Fund's continuing assessment of data adequacy issues in the region, and the mixed macroeconomic performance of Asia and Pacific SDS in the 2010s raise some concerns on the joint effectiveness and achievements of surveillance, program and CD activities.

161. The integration of CD with surveillance could be strengthened with a greater focus on policy implementation to foster traction (e.g., on fiscal rules and policy buffers). Most of the CD delivered over the period was involved in nuts-and-bolts aspects of the various sectors, such as statistical standards, PFM systems, revenue administration, and financial regulations, while macro-fiscal policy CD was limited. In addition, limited local institutional capacity to implement reforms led in some cases to delays which were not well appreciated at the time of the recommendations. APD prepared a discussion note in April 2019 that outlined the broad contours of a strategy around four pillars to strengthen the integration of CD and surveillance activities, including training, in the department. The strategy has been integrated in the 2021–

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<sup>82</sup> See also PFTAC Annual Reports 2010–2020, as well as PFTAC's 2010 and 2016 Program Documents.

2023 regional strategy note and should be supported by the completion of the Fund-wide transition to a full-fledged CD framework inclusive of results-based management (RBM).

162. The 2020 review of PFM strategies in PICs recommends that a more granular and targeted approach be taken to PEFAs over the next five years. PICs should focus on basic PFM reforms and more transparent public finances, as well as better management of climate change considerations, public infrastructure, gender inequalities, and state-owned enterprises (IMF and others, 2010).

163. PFTAC's five CD programs and allocation of activities across its members is the result of a complex process that involves members, APD, and the Fund's functional departments and aims at fulfilling the needs of its members under the umbrella of PFTAC's program documents that set the strategy and financing resources of PFTAC. Thus, while the work program execution can be justified by many factors, it can also be examined in terms of its effective and equitable contributions to the CD of all its individual members, with a view to improving the level and allocation of its resources over time. The work program involving seven resident advisors providing CD in five sectoral programs to 16 countries could be reconsidered to provide greater weight to emerging needs (such as resilience building to external shocks, including natural disasters, and macro-fiscal policy) and providing more resources to individual members with particular needs specifically CD for the 10 Asia and Pacific SDS that are microstates or FCS countries and have consequently limited institutional capacity would benefit from greater hands-on interventions and closer monitoring of implementation, which would require more PFTAC resources, financial and human.

164. While transformational change takes time to be effective, the lack of CPIA progress for Asia and Pacific SDS since 2010 is a matter of some concern for several reasons.<sup>83</sup> First, it questions the effectiveness of capacity development, surveillance, and program activities in which the Fund and other development partners have been engaged with SDS. Second, various evaluations of the CPIA have confirmed its relevance for growth and poverty reduction, and lack of improvement does not bode well for growth and equity prospects. Third, the CPIA has policy implications since it guides the allocation of IDA lending resources (higher scores are linked to less grants), the assessment of debt sustainability under the Debt Sustainability framework, and the setting of debt limits under Fund programs (higher scores are linked to higher debt thresholds). It is possible that the same CPIA score may have slightly different meaning across time, but there would still be room for scores to improve by using country comparison at any given time and drawing lessons from countries with higher scores. Thus, while not unique, the CPIA can provide a useful summary indicator on the quality of the institutional and policy frameworks across countries at a given time and can help guide CD and policy advice to focus on key structural and institutional reforms.

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<sup>83</sup> The average CPIA for all IDA countries has similarly not improved much over time.

## D. Conclusion and Lessons

165. While the Fund's engagement with the five Asia and Pacific under study has been satisfactory and appreciated over the period 2010–2020, there is room to improve the substance of surveillance, program, and CD activities, as well as the conditions under which they are conducted. In addition, several improvements could be achieved cross-sectionally by enhancing the internal review process and ensuring a greater and more regular coverage of SDS documents in the review process. APD should also emphasise a greater commitment to SDS in its accountability framework and keep an active research program on cross-cutting issues of interest to Asia and Pacific SDS.<sup>84</sup>

### ***Surveillance Activities***

166. In the area of surveillance, eight actions could be considered to maximize the value-added provided to Asia and Pacific SDS and achieve better traction:

- Adopt an overarching focus of surveillance activities on resilience to shocks and accelerate the development of IMF-supported DRS across SDS. The DRS addresses to some extent the surveillance and CD weaknesses observed in this review, but the design and implementation of resilience-based macroeconomic policies could be further refined and incorporate greater SDS specificity.
- Ensure greater continuity of engagement by eliminating the 24-month consultation cycle or by introducing interim consultations with country update reports to be issued to the Board for information.
- Reduce staff turnover. This would contribute to greater continuity of engagement and better institutional memory. APD could make further progress in this regard and continue to improve staffing of its Pacific Island Division and missions to SDS, through enforcing three-year assignment periods, achieving greater staggering of staff on SDS, and ensuring assignment of at least one full-time economist to each SDS. The policy of offering mission leadership to selected A14 economists has also proven useful but appropriate mentoring and supervision of new mission chiefs should be reinforced. The new HR policy requiring experience in an LIC or FCS country for promotion could be extended to include experience in SDS.
- Reinforce the regional resident representative office with more local staff to provide better oversight of the 15 member countries covered by the office. Consideration might even be given to the opening of one or two new resident representative positions to provide stronger and more equitable regional coverage of SDS throughout the region.

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<sup>84</sup> APD's Pacific Islands Monitor reports on various strands of existing and upcoming research, such as management of fiscal risks from national airlines in PICs (Issue of April 2021).

- Strengthen surveillance of financial sector and enhance discussions on growth and private sector development, possibly through greater collaboration with other multilateral agencies.
- Strengthen the specificity, comprehensiveness, and tailoring of the policy advice made in the context of surveillance activities, with greater integration of macro-fiscal TA, to enhance traction and implementation of the Fund's recommendations. Analysis would also benefit from the regular production of comprehensive SIPs and background papers.
- Take greater consideration of the institutional capacity of members to implement policies in the design of policy advice, integrate further CD in surveillance, and increase focus on implementation.
- Include in Article IV reports a detailed summary of policy recommendations to help authorities with implementation. It would be important to ensure that advice is specific, measurable, achievable, relevant, and time-bound (SMART) to facilitate traction and commitments against which the next consultation will make a review. The proposed reinforcement of monitoring of past recommendations through an ex ante and comprehensive table, that will also benefit the authorities in monitoring progress between consultations, could take the form of quantitative indicators and structural objectives-akin to conditionality tables in program cases-and incorporate close integration of TA/CD activities.

### ***Program Activities and Emergency Financing***

167. In the context of program and emergency assistance, the Fund could increase the usefulness of IMF-supported programs for SDS by:

- Supporting the capacity of member countries to undertake UCT programs through CD and follow up support.
- Explaining the benefits of non-financial, low-access, and precautionary programs to address resilience building issues in SDS. To alleviate the authorities' concern about non-sufficiently concessional financing while building up on the good reputation of the Fund as a trusted advisor for its surveillance advice, the use of non-financial, low access, or precautionary arrangements with catalytic effect on financing by other partners could be explained and promoted. The tailoring of such arrangements to the Asia and Pacific SDS environment should, however, be prepared in advance, and the authorities engaged early, to elaborate realistic macro-frameworks and offer effective program design and conditionality in light of the data availability and varying institutional capacity across member countries, many of whom are FCS and microstates. Specific TA could be envisaged to accompany the launch of such programs and facilitate their implementation and monitoring.

- Adapting further the existing lending toolkit to the specific needs of SDS. Although the facilities and financial instruments toolkit is sufficiently flexible to address the needs of the membership, consideration could be given to relaxing constraints on the access ceiling in the context of repeated recourse to emergency financing, such as when a country is hit by successive natural disasters. A more specific resilience-building facility with a strong CD component could also be studied to facilitate the implementation of sound policies to address SDS vulnerabilities to external shocks and climate change.

### ***Capacity Development Activities***

168. Capacity development activities in Asia and Pacific SDS are highly appreciated by the authorities and have been relatively well integrated in surveillance activities in the sectors they covered (particularly PFM, statistics, revenue mobilization, and banking supervision). The advent of RBM and adoption of a programmatic approach to CD are on-going improvements in CD that should enhance the effectiveness and efficiency of CD activities, but sustainability of outcomes and emergence of new needs require continuous attention to ensure the effectiveness and efficiency of CD operations. To this effect, the IMF could consider:

- Further developing CD activities on resilience building (e.g., DRS, risk and debt management, fiscal rules and resilience financing strategies) and macroeconomic analysis with a view to foster traction and improve policy design and implementation.
- Reviewing the level and allocation of PFTAC resources to finance new areas of CD on resilience building and macro-fiscal issues, as well as strengthen CD programs in microstates and FCS.
- Adapting further CD to the needs of SDS in fragile situations and ensuring appropriate implementation of Fund FCS policies in these countries. With six Asia and Pacific SDS being FCS, as a result of weak capacity and institutions, greater efforts to address the roots of fragility should be undertaken. This may require more selective CD activities and closer regional collaboration among donors and members.
- Strengthening statistical support to SDS, as data quality remains an important issue. More comprehensive, better quality, and timely statistics would facilitate both surveillance and program activities. A more analytic presentation of macroeconomic statistics highlighting the links between the BOP, fiscal and monetary sectors is also warranted to enhance the engagement of the Fund and its preparedness to support adjustment programs in some SDS.

## ANNEX I. ASIA AND PACIFIC SMALL DEVELOPING STATES: BASIC DATA ON CASE STUDIES

**Table AI.1. Profile of Asia and Pacific Case Studies<sup>1</sup>**

Country	Population 2019 Est.	Population Density/km <sup>2</sup>	Population below altitude of 5 meters (Percent of total pop.)	GDP PPP US\$ 2019 (US\$ billions)	GDP per Capita PPP US\$ 2019	Income Group <sup>2</sup>	Disaster Risk Assessment Ranking <sup>3</sup> 2020	Exclusive Economic Zone <sup>4</sup> (km <sup>2</sup> )	Total Internal Area (km <sup>2</sup> )	Date of IMF Membership	IMF Quota (SDR millions)	IMF financing	World Bank financing
Fiji	889,953	48.7	4.9	12.69	14,290	UMIC	15	1,282,978	18,272	5/28/71	98.4	GRA	Blend
FSM	113,815	162.1	8.4	0.36	3,548	LMIC	73	2,996,419	702	6/24/93	7.2	PRGT	IDA
Samoa	197,097	69.6	1.4	1.17	6,796	UMIC	98	127,950	2,831	12/28/71	16.2	PRGT	IDA
Solomon Islands	669,823	23.2	2.9	1.66	2,781	LMIC	5	1,589,477	28,896	9/28/78	20.8	Blend	IDA
Tuvalu	11,646	447.9	47.5	0.05	4,471	UMIC	--	749,790	26	6/24/10	2.5	PRGT	IDA

Country	Exchange Rate Arrangement		Article VIII	Gross Debt 2019		Debt Distress Risk Assessment			Country Policy and Institutional Assessment		Enhanced General Data Dissemination Standard		Data Adequacy <sup>6</sup> 2020
	Type (2019)	Anchor		Percent of GDP	In millions of US\$	Level	Date	Deterioration since 2010	2010	2019	Metadata first posted	NSDP <sup>5</sup> first posted	
Fiji	Convent. Peg	basket peg	✓	48.9	2,687.9	Moderate	Feb-19	Yes	NA	NA	May-00	Sep-18	B
FSM	Hard Peg	US dollar	✓	17.1	70.0	High	Jun-19	Same	2.71	2.73	Nov-14	Jul-17	C
Samoa	Convent. Peg	basket peg	✓	47.4	404.4	High	Mar-21	Yes	4.10	3.98	Sep-12	Apr-17	B
Solomon Islands	Convent. Peg	basket peg	✓	8.3	131.3	Moderate	May-21	Same	2.78	2.93	Jun-11	--	B
Tuvalu	Hard Peg	Australian \$	✓	16.3	7.6	High	Jun-18	Same	2.77	2.88	Apr-13	--	C

Country	Island State	Micro State	Fragile State <sup>7</sup>	Service exporter	Commodity exporter	Diversified exporter	Positive Net external Position	Compact of Free Association with USA	Nauru Fishing Agreement	Remittances Receipts 2016–2018 (In percent of GDP)	Tourism Receipts 2016–2018 (In percent of exports)	Openness 2013–2015 (In percent of GDP)	Agriculture & Fishing 2013–2015 (In percent of GDP)
Fiji	✓			✓						5.2	50.5	112.8	8.7
FSM	✓	✓	✓			✓	✓	✓	✓	6.4	--	108.1	25.8
Samoa	✓	✓		✓						16.8	61.0	81.1	9.3
Solomon Islands	✓		✓		✓				✓	1.3	13.2	95.6	--
Tuvalu	✓	✓	✓		✓				✓	10.9	--	--	18.3

Sources: IMF and World Bank, unless specified.

<sup>1</sup> Small Developing States are defined as Fund members that have a population below 1.5 million and are neither advanced market economies nor high-income oil exporting countries. Microstates are defined as small developing states with a population below 200,000.

<sup>2</sup> Based on World Bank 2020 classification using GNI per capita (Atlas method) in current USD; high-income countries (HIC) have per capital annual incomes.

<sup>3</sup> WorldRiskIndex 2020. Incomplete data prevented the ranking of Marshall Islands, Nauru, Palau, and Tuvalu.

<sup>4</sup> Exclusive Economic Zone extend 200 nautical miles from the coast of a state and provide special rights to that state for exploration and use of maritime resources, including energy production from water and wind (1982 United Nations Convention of the Law of the Sea).

<sup>5</sup> National Statistics Dissemination Portal (NSDP).

<sup>6</sup> As defined in IMF, 2013, "Data Provision to the Fund for Surveillance Purposes – Operational Guidance Note," (Washington).

<sup>7</sup> Based on July 2020 list of the World Bank for Fiscal Year 2021.

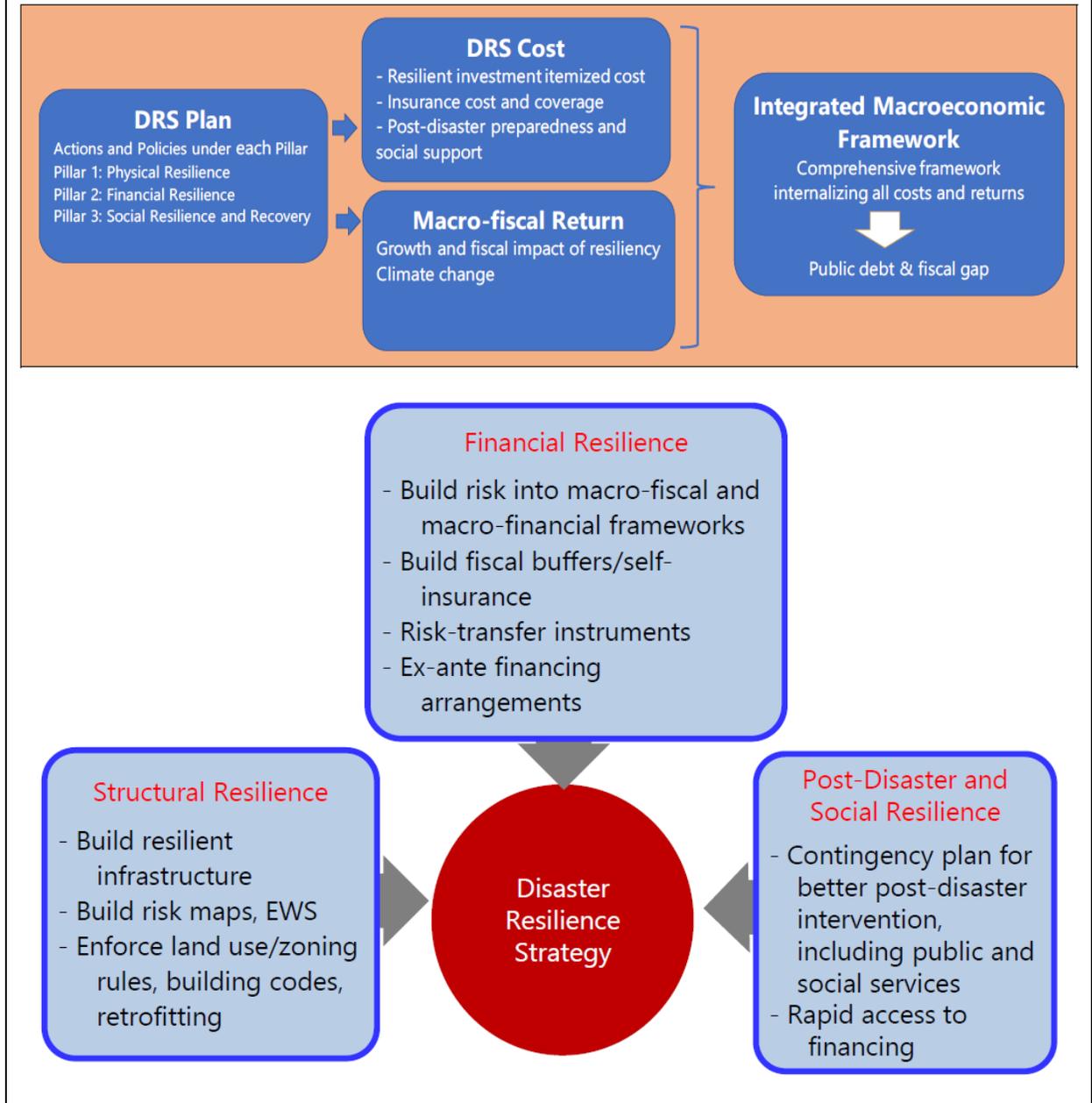
**Table AI.2. Economic Developments in Asia and Pacific Case Studies<sup>1</sup>**

	2001–2008	2009	2010–2014	2015–2019	2020	2021
	(In percent GDP, unless otherwise specified)					
<b>Fiji</b>						
Growth (In percent)	1.5	-1.4	3.5	3.1	-15.7	-4.0
Inflation (In percent)	3.7	3.7	3.5	2.9	-2.6	1.1
Current Account Balance	-8.4	-3.8	-5.0	-7.0	-13.4	-15.7
Government Balance	-1.9	-3.8	-1.8	-3.0	-12.8	-15.8
Government debt	45.1	51.5	47.7	45.5	70.8	86.8
<b>FSM</b>						
Growth (In percent)	-0.1	1.0	-0.5	1.9	-1.8	-3.2
Inflation (In percent)	2.6	8.2	3.3	0.4	0.5	2.6
Current Account Balance	-13.4	-21.1	-10.8	12.0	3.0	1.2
Government Balance	-1.9	1.9	3.0	14.7	0.6	1.3
Government debt	25.2	30.7	28.0	21.9	16.1	15.1
<b>Samoa</b>						
Growth (In percent)	4.2	-0.5	0.4	2.9	-2.7	-7.2
Inflation (In percent)	5.4	14.6	1.4	1.8	1.5	-3.0
Current Account Balance	-6.8	-4.7	-6.6	-1.0	1.0	-13.0
Government Balance	-0.6	-3.1	-5.6	-0.7	6.2	-0.7
Government debt	40.3	34.1	49.8	52.1	46.5	47.6
<b>Solomon Islands</b>						
Growth (In percent)	2.8	2.6	4.8	3.5	-4.3	1.2
Inflation (In percent)	9.7	7.2	4.9	1.1	3.0	2.4
Current Account Balance	-4.0	-17.7	-7.8	-4.7	-1.6	-5.8
Government Balance	-0.1	0.6	4.1	-1.6	-2.4	-2.8
Government debt	43.6	27.5	16.1	8.2	14.0	20.4
<b>Tuvalu</b>						
Growth (In percent)	1.6	-5.6	1.5	6.5	1.0	2.5
Inflation (In percent)	4.0	-0.3	0.6	3.3	1.6	2.5
Current Account Balance	-3.1	-69.6	-37.7	-1.6	3.8	-4.5
Government Balance	-17.8	-13.5	1.3	14.7	5.0	-7.2
Government debt	32.0	21.1	18.7	12.3	7.3	6.0

Source: WEO, October 2021.

<sup>1</sup> Geometric mean over the period of growth and inflation, annual average for other variables.

**Figure AI.1. Disaster Resilience Strategy: Description**



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