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IMF Engagement with Small Developing States on Growth Issues

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Prepared by Cyrus Rustomjee,* Sriram Balasubramanian,† and Jiakun Li‡

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ABBREVIATIONS

AFR	African Department (IMF)
AIV	Article IV
APD	Asia and Pacific Department (IMF)
CD	Capacity Development
EUR	European Department (IMF)
FCS	Fragile and Conflict-Affected State
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GRA	General Resources Account
ICT	Information and Communications Technology
LIC	Low-income Country
MCD	Middle East and Central Asia Department (IMF)
ND&CC	Natural Disaster and Climate Change
PIC	Pacific Island country
PRGT	Poverty Reduction and Growth Trust
REO	Regional Economic Outlook
SC	Structural Condition
SDS	Small Developing State
SGN	Staff Guidance Note
SIP	Selected Issues Paper
UCT	Upper Credit Tranche
WEO	World Economic Outlook
WHD	Western Hemisphere Department (IMF)

EXECUTIVE SUMMARY

This paper reviews Fund engagement with Small Developing States (SDS) on growth policy issues. It draws on an extensive review of the literature since 2000 on the challenges to growth in SDS (Briguglio, 2022), which found that SDS experience vulnerabilities due to small population and economic size, proneness to natural disasters and challenges in developing well-diversified, resilient economies, all of which pose challenges for achieving sustained economic growth. Reflecting these challenges, growth rates in SDS have persistently lagged those of other emerging markets and developing countries over the past four decades, including during the evaluation period. Moreover, both the GFC and the COVID-19 pandemic shocks had a much greater adverse impact on SDS than on LICs and fragile, non-SDS members. SDS in all regions were in fact much worse affected by the COVID-19 pandemic than the GFC, especially Caribbean SDS and tourism-dependent SDS. Recovery for SDS after the COVID-19 pandemic is expected to take far longer than for LICs and for non-SDS fragile states, particularly for Caribbean SDS.

Overall, IMF research publications and policy papers contributed important value-added to the broader literature on growth challenges and policy options in SDS. The Fund's contribution increased during the evaluation period, particularly on the role of fiscal policy in creating room for SDS to respond to adverse external shocks. Areas receiving less attention included: (i) how growth strategies could encourage more inclusive growth over the longer term; (ii) how growth challenges due to lack of diversity and reliance on a single sector can be overcome; and (iii) on growth-related aspects of financial sector policies.

Country authorities were broadly satisfied with Fund surveillance on growth policy issues but saw opportunities to increase value added. They called for more granular policy guidance and advice; more attention to drawing on experience of other SDS, including through regionally-oriented policy guidance; and more granular advice on diversification policies. Selected Issues Papers were generally informative and focused on relevant growth-related challenges, although relatively few chapters were prepared for Pacific SDS, where particular concerns about growth have been identified in Fund and external literature.

Area Departments used differing methods to prepare and communicate research, policy analysis and information related to growth. Lessons can be drawn from each approach, particularly from APD's use of a dedicated Small States Monitor. Coverage of diversification issues in Fund surveillance expanded, with references to horizontal and vertical diversification policies in Article IV reports growing considerably. There is ample scope for staff to extend treatment of vertical policies in bilateral surveillance. An update of the 2017 Staff Guidance Notes would present an opportunity to encourage this.

Growth outcomes of SDS programs were mixed, with limited overall improvement in growth rates, and a tendency toward growth optimism in program projections. Compared to other General Resource Account and Poverty Reduction and Growth Trust programs, structural conditions (SCs) in SDS programs exhibited a somewhat higher share of growth and efficiency-related SCs; and a relatively high share of both fiscal and other structural SCs, but a low share of SCs related to vulnerability management.

I. INTRODUCTION

1. This paper assesses the IMF's engagement with its 34 Small Developing States (SDS) members support efforts to achieve sustainable economic growth. SDS comprise a heterogeneous group but share many similar characteristics and vulnerabilities which pose particular challenges for macroeconomic stability and sustained growth. Due to their small population and economic size, they have narrow production and export bases. Many experience high youth unemployment while outward migration by the highly educated limits skills needed to drive sustained economic growth. In addition, their narrow economic bases mean that they are relatively open, making them more susceptible to macroeconomic volatility, commodity price fluctuations and disruptions in world markets, and are highly exposed to terms-of-trade shocks and volatile trade tax revenues. In addition, many SDS also suffer from remoteness and insularity, raising trade transportation costs. All these factors challenge policymaker's efforts to achieve well diversified resilient economies and sustained economic growth.

2. SDS are also among the most vulnerable countries to natural disasters and climate change (ND&CC). Eighteen out of the 20 most exposed countries in the world are on the Fund´s list of SDS.[1] Especially in the Caribbean and Pacific regions, they suffer much greater economic consequences from natural disasters, and more frequently, than other economies (Lombardi and Rustomjee, 2022a). Many SDS are located in regions prone to hurricanes, cyclones, and tsunamis and those in the Pacific region are also highly vulnerable to sea-level rise. These factors have adversely impacted growth in SDS and have had several macro-critical effects, including immediate economic disruption from disasters, sizeable contractions in output and exports, disaster-related expenditures for social needs and rebuilding, abrupt declines in fiscal revenues, and increased imports. At the same time, increased vulnerability translates into a need for ample buffers to provide resilience against disaster risks, including adequate official reserves, low debt levels, strong fiscal and external positions, effective insurance mechanisms, and reliable access to financing.

3. The vulnerabilities and particular characteristics of SDS pose challenges, both for authorities in grappling with these constraints and for staff, in calibrating Fund support to help SDS address these challenges. This paper considers the extent to which these vulnerabilities and characteristics have impacted growth in SDS; and assesses the value provided by Fund's engagement with SDS on growth-related issues, in IMF surveillance and policy advice, program support, and capacity development (CD) activities during the evaluation period of 2010–2020.

4. The ongoing COVID-19 pandemic commenced in the final year of the evaluation period, imposing a heavy toll on most small states, with the initial health-related shock quickly transforming into a sustained macroeconomic shock. Many of the most severely impacted SDS were largely tourism-dependent and saw their tourism sectors coming to an abrupt halt from

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[1] Based on the United Nations 2020 Exposure Index.

mid-March 2020. The rapid curtailment of commercial activity and additional direct health and social expenditure and balance of payments pressures brought growth to a halt, and reversed years of developmental gains.

5. Key evaluation questions include: (i) How effectively did the IMF absorb, adapt and integrate the extensive body of external literature and analytical work on growth in SDS in its engagement with these countries? (ii) Was IMF research dealing with challenges to growth in SDS useful, relevant, timely, and of good quality? (iii) Was the Fund's policy advice on growth issues appropriately tailored to country circumstances? (iv) Given that SDS face many common challenges in fostering sustained economic growth and are regionally concentrated, how well was the Fund's Regional Economic Outlook, used to identify and discuss growth-related challenges facing groups of SDS members? (v) How effectively did bilateral surveillance cover diversification issues? (vi) Did Fund-supported SDS programs include attention, through the presence of relevant structural conditionalities, to supporting policies that can help improve growth in SDS?

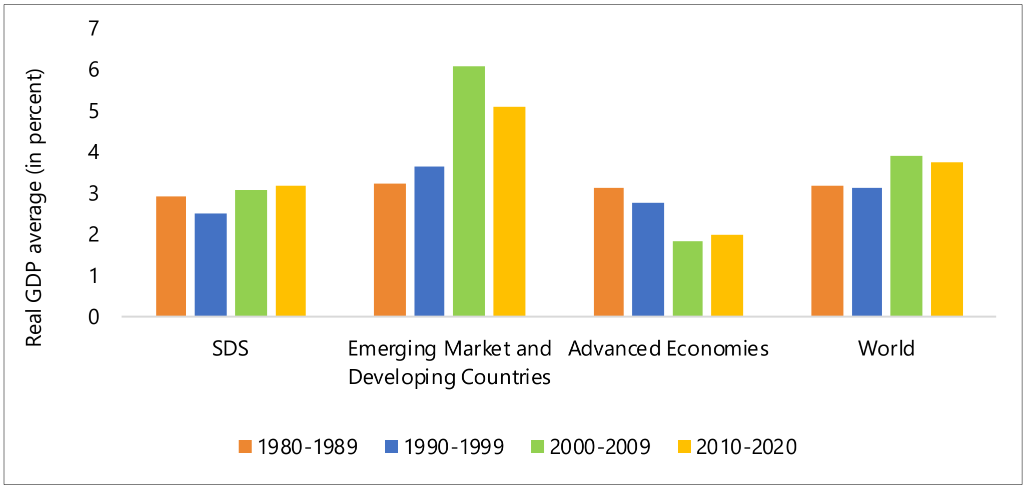
6. The paper is structured as follows. Section II traces SDS' growth performance since 2010; compares the impact on growth in SDS arising from the Global Financial Crisis (GFC), which closely preceded the start of the evaluation period, and the COVID-19 pandemic shock, and assesses the time period likely to be needed for SDS to return to their pre-pandemic growth path. Section III reviews external literature as well as IMF research and policy papers related to the Fund's engagement on growth-related policy issues in SDS. Section IV evaluates coverage of growth-related issues in surveillance activities, including in Selected Issues Papers (SIPs) for Article IV (AIV) consultations; in regional surveillance, through an assessment of the flagship Regional Economic Outlooks; and specific policy analysis and advice on issues related to diversification. Section V draws on the methodologies used in the IEO's recent evaluation of *Growth and Adjustment in IMF-Supported Programs* (IEO, 2021), to review the composition of growth-related and other program objectives in 18 Fund-supported programs in 11 SDS members; and considers the growth impact of structural conditionalities used in a smaller sample of these programs. Section VI concludes.

II. Growth Experience

A. Growth Performance

7. SDS growth performance has persistently lagged that of other emerging markets and developing countries, registering lower average real GDP growth rates in each of the past four decades, including during the evaluation period. Growth rates have also consistently fallen short of the global average (Figure 1).

Figure 1. Real GDP Growth—SDS, EMDCs, AEs, and Global, 1980–2020[1]



Sources: WEO; IEO calculations.
[1] Real GDP growth in simple average.

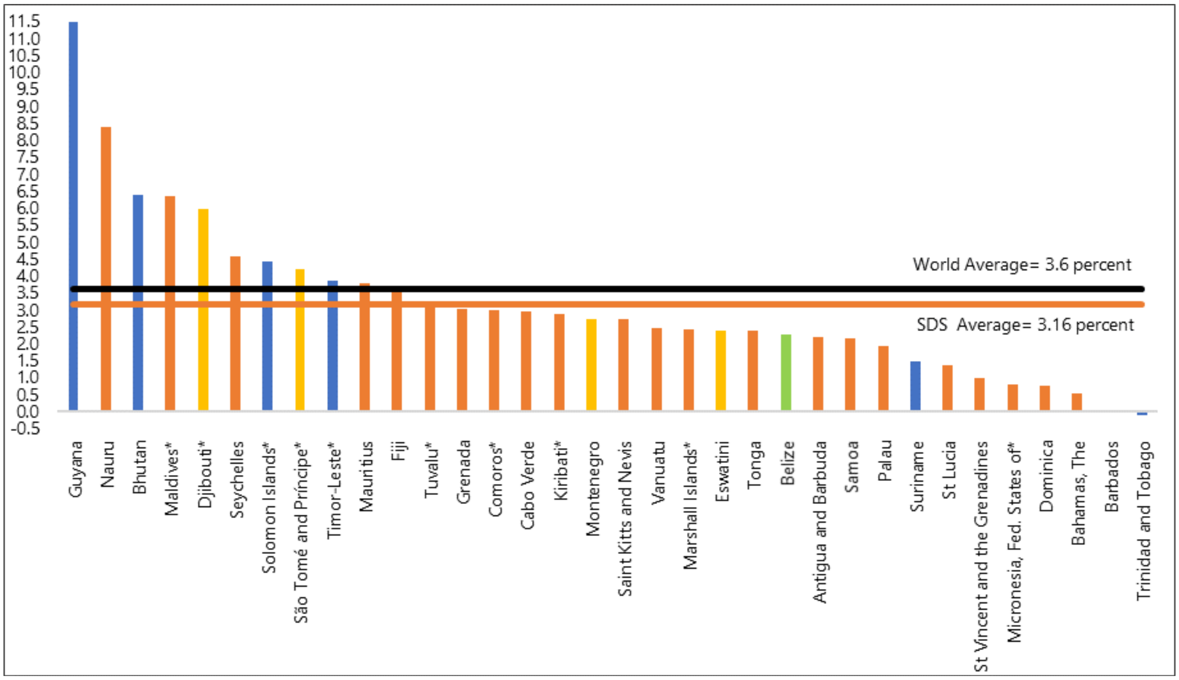
8. Growth experience has varied widely across SDS (Figure 2). Over the evaluation period, less than a third of SDS attained average growth rates higher than the global average. Four of seven commodity-exporting SDS were among the top ten fastest growing SDS, including two (Solomon Islands and Timor-Leste) that are also FCS. Among tourism-dependent SDS—which comprise almost a half of SDS members—only four achieved growth rates higher than the global average. Of 15 microstates, only 5 (Grenada, Kiribati, Nauru, Seychelles, and Tuvalu) achieved average growth rates above the SDS average, while 10 others experienced much lower growth rates. Among SDS regional groupings, growth rates were particularly low among Caribbean SDS over the evaluation period. Growth exceeded the SDS average in only one Caribbean SDS, while Caribbean members comprised 7 of 10 SDS with the lowest growth outturns. The Caribbean region has experienced stagnant growth for an extended period, a challenge identified in several studies.[2]

B. Proneness to Shocks

9. A key aspect of SDS growth dynamics is that growth performance has been particularly compromised by their proneness to exogenous shocks. This characteristic is well demonstrated by looking at the impact of both the GFC and the COVID-19 pandemic on: (i) the real GDP growth path of SDS and other country groups, SDS regions, and intra-SDS groups (including microstates and tourism-dependent SDS); and (ii) by assessing the period of time required for SDS and other country groups to restore their pre-crisis real GDP growth path.

[2] For example, see IMF (2013d) and Ruprah, Melgarejo, and Sierra (2014).

Figure 2. Real GDP Growth Across SDS, 2010–2020



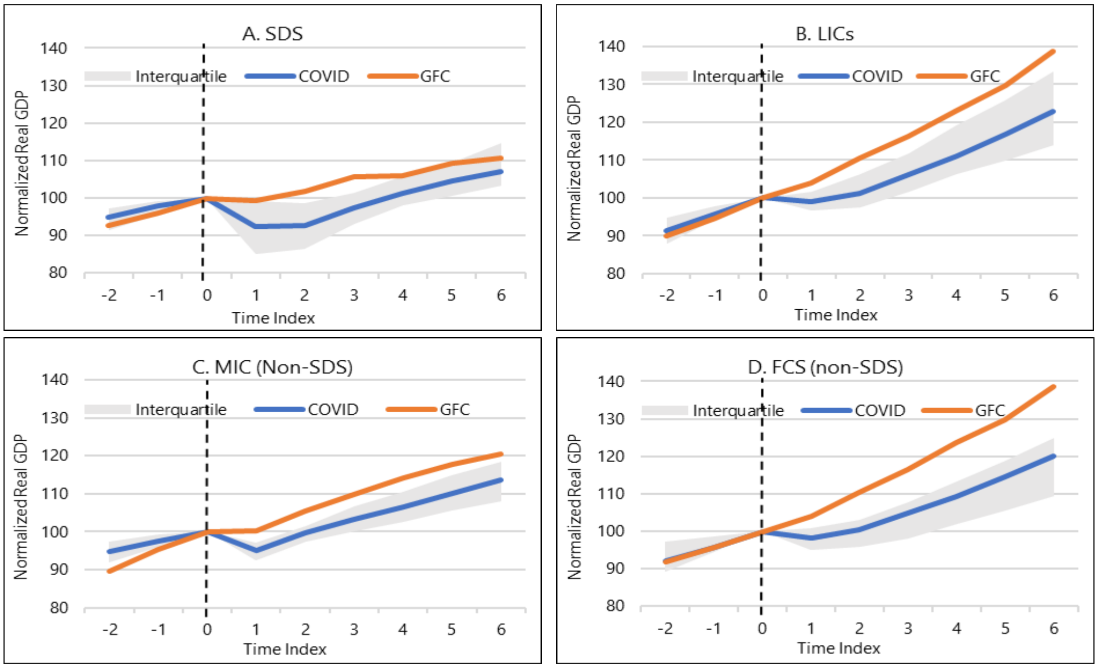
Sources: WEO; IEO calculations.
Note: *denotes FCS. Orange=tourism dependent SDS; Blue=commodity exporting SDS; Green=tourism dependent and commodity exporting SDS; Yellow=others.

10. Figure 3 compares experience of SDS, LICs and non-SDS fragile states, in terms of the real GDP path following the GFC and the COVID-19 pandemic, respectively, with t=1 representing the year in which each crisis occurred.[3] The figures present the median of the real GDP path post-GFC and post-COVID, as well as the interquartile range for the COVID GDP growth path, with WEO projections for 2021–2026.

11. Three key findings emerge: First, both the GFC and the COVID-19 pandemic had a much greater adverse impact on SDS than on LICs and fragile, non-SDS members. Specifically focusing on the COVID-19 pandemic, SDS activity contracted more sharply in the 2020, and is expected to recover much more slowly. Secondly, the COVID-19 pandemic had a much greater economic impact than the GFC, for all groups. Third, all country groups will need more time to recover from the pandemic than from the GFC.

[3] Data is based on the October 2021 WEO. Data from 2021–2026 are projections. To facilitate comparison of impact of the two crises, for GFC, year 2008 is time index 0 and the first year of crisis impact (2009) is therefore measured as t=1. For COVID, year 2019, is time index 0, marking the year in which the crisis hit and the first year of measured impact, 2020, is measured as t=1. For each crisis (GFC or COVID), a timeline is constructed that goes from 3 years prior to the crisis to 5 years after the crisis hit. All real GDP is normalized, respectively for each crisis, so that real GDP at index 0 is 100. Real GDP is calculated as the sample median to rule out the influence of outliers. Due to the absence of complete data for the full period, which is necessary to allow for country comparisons, observations for four countries (Lebanon, Somalia, South Sudan, and Syria) were not included.

Figure 3. GFC and COVID-19 Impacts on Path of Real GDP by Country Categories



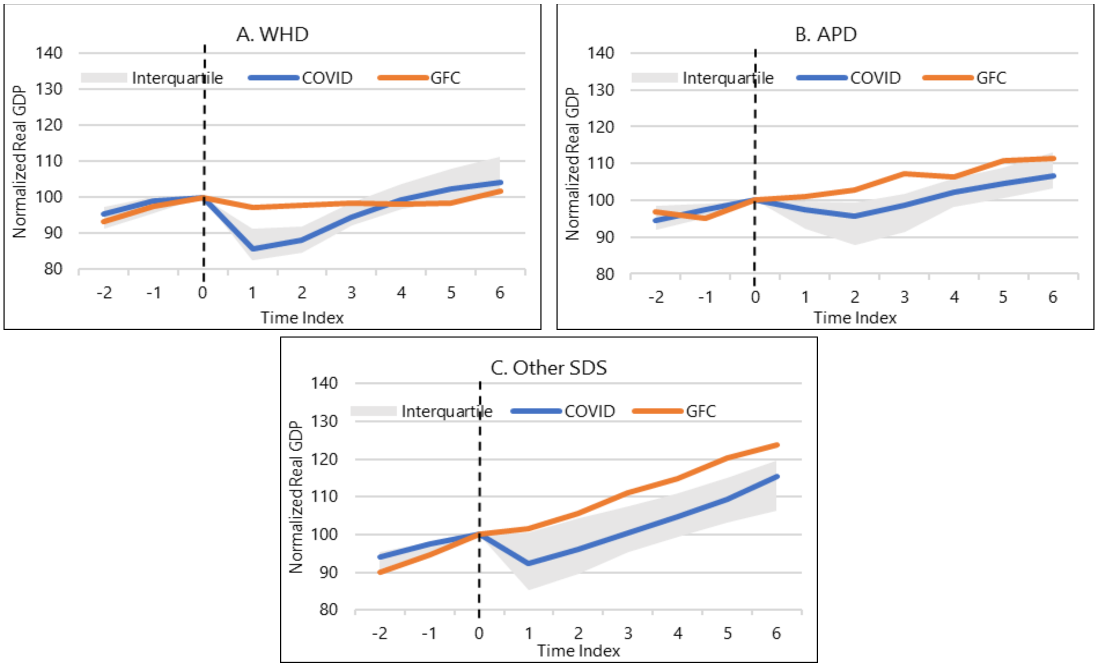
Sources: IMF (October 2021 WEO); IEO calculations.
Notes: For GFC, year 2008 is time index 0. For the COVID-19 pandemic, year 2019 is time index 0. Real GDP is normalized so that it equals to 100 at time 0.

12. Figure 4 shows the comparative impacts of the GFC and the COVID-19 pandemic on Caribbean, Asia-Pacific and other SDS. It highlights that SDS in all regions have been much worse affected by the COVID-19 pandemic than the GFC. Furthermore, the impact of the COVID-19 pandemic has been far greater for Caribbean SDS, most notably severe deterioration of the real GDP path in 2020 following the outbreak of the pandemic. Caribbean SDS are also projected, based on median, to take much longer to recover from the pandemic than Asia and Pacific, as well as Other SDS[4]—five years to return to the pre-pandemic income level—compared to four years in Asia and Pacific SDS and three years in the other SDS.

13. Using the same methodology, Figures 5 compares experience among microstates and other SDS with a population greater than 200,000, as well as the experience of tourism-dependent and non-tourism dependent SDS. The results show that both microstates and non-micro SDS were much more substantially affected by the COVID-19 pandemic than the GFC. While microstates suffered a comparatively milder deterioration in the path of real GDP, these members are expected to take four years to recover just as their larger SDS counterparts. Tourism-dependent SDS suffered a much greater hit to real GDP following the pandemic, compared to non-tourism dependent SDS; and based on the median real GDP path, are projected to take about four years to recover pre-pandemic income levels.

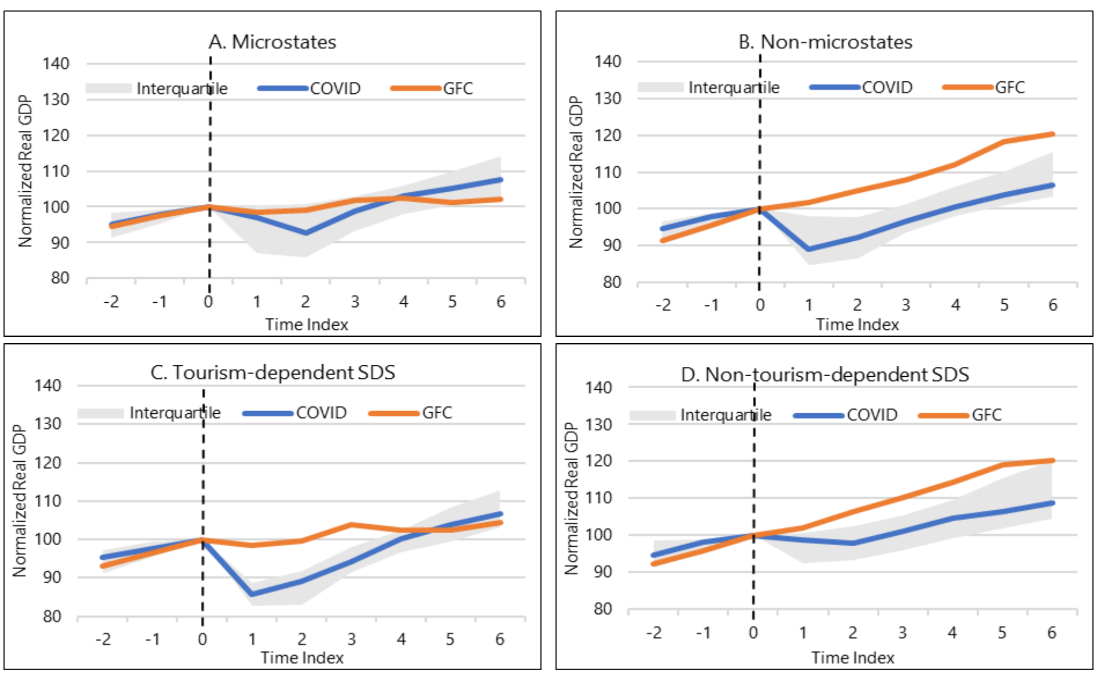
[4] Other SDS comprise all African SDS, Djibouti and Montenegro.

Figure 4. GFC and COVID-19 Impacts on Path of Real GDP by Region



Sources: IMF (Oct 2021 WEO); IEO calculations.
Notes: For GFC, year 2008 is time index 0. For the COVID-19 pandemic, year 2019 is time index 0. Real GDP is normalized so that it equals to 100 at time 0.

Figure 5. GFC and COVID-19 Impacts on Path of Real GDP by Country Characteristics

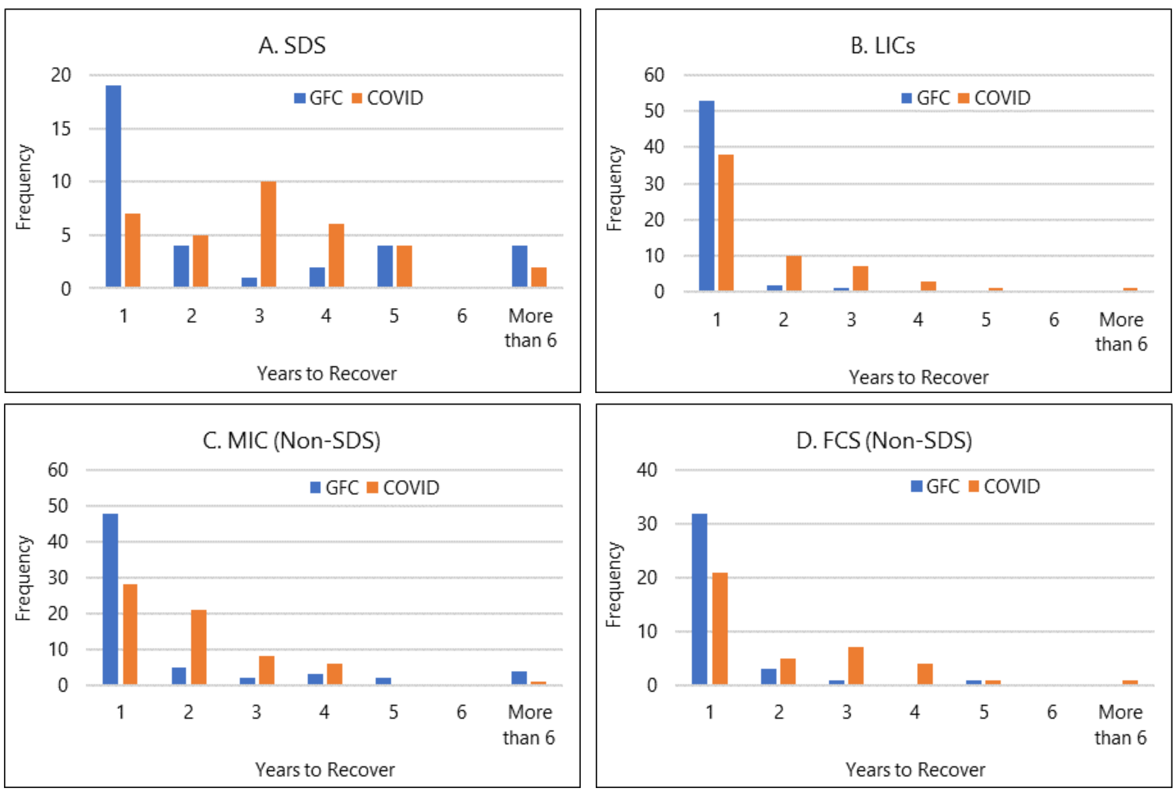


Sources: IMF (October 2021 WEO); IEO calculations.
Notes: For GFC, year 2008 is time index 0. For the COVID-19 pandemic, year 2019 is time index 0. Real GDP is normalized so that it equals to 100 at time 0.

14. Figures 6 and 7 provide an alternative metric showing the prolonged impact of exogenous shocks on activity in SDS: the recovery period, measured as the estimated number of years required to return to the pre-crisis real GDP level following the COVID-19 shock, for SDS, LICs and non-SDS fragile states. The results illustrate that the recovery period for SDS members after the COVID-19 pandemic is expected to be far longer than that for LICs and non-SDS Fragile States. Caribbean SDS are expected to take about five years, based on the median level for this group, to recover from the pandemic. And recovery is expected to be prolonged for a much larger proportion of SDS, compared to SDS' experience during the GFC. While all but 2 SDS recovered to their real GDP level, within the first two years following the crisis, 22 SDS, or two-thirds of SDS members, will need at least three years to recover. Among SDS, half of Caribbean SDS are currently expected to take at least four years to recover, while a half of all Asia and Pacific SDS will take three or more years to do so.

Figure 6. Years to Recover from GFC and COVID-19 Pandemic by Country Categories

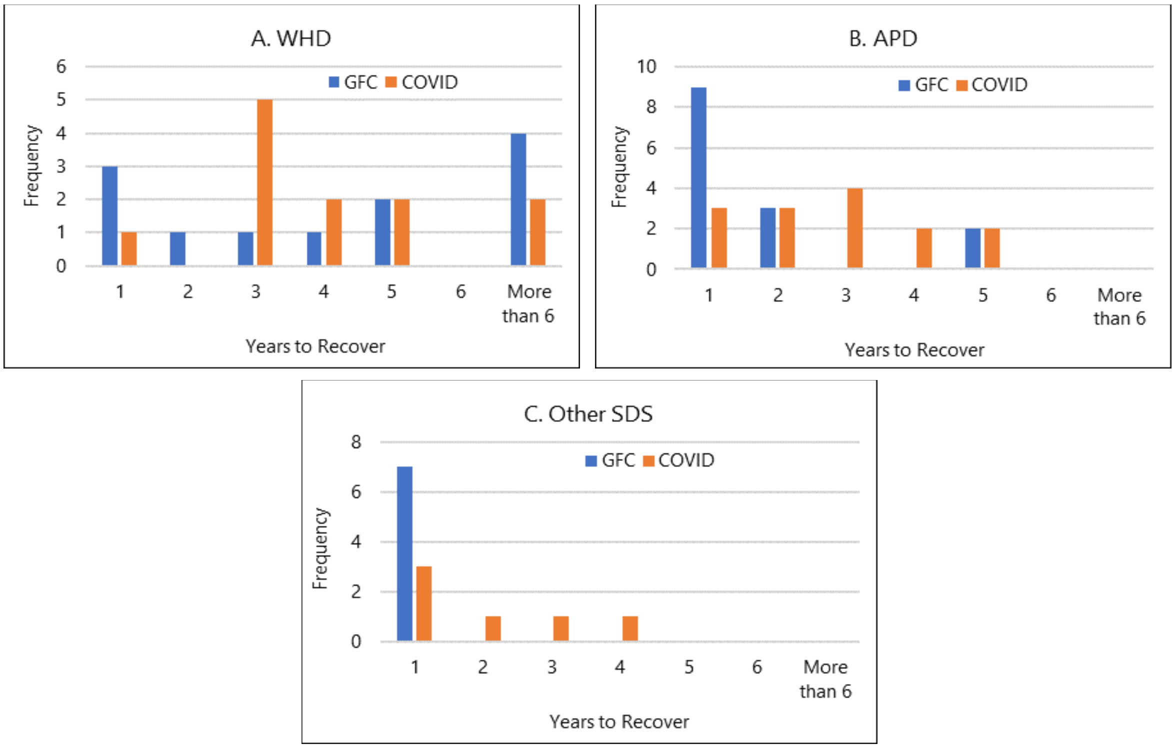
(Frequency)



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

Note: Recovery is defined as a return to the pre-crisis Real GDP level.

Figure 7. Years to Recover from GFC and COVID-19 Pandemic by Region
(Frequency)



Sources: IMF (October 2021 WEO); IEO calculations.
Note: Recovery is defined as a return to the pre-crisis Real GDP level.

III. Review of Research and IMF Policy Analysis[5]

A. External Literature

15. An extensive literature on the challenges to growth in SDS has developed over the past two decades. Some early studies considered whether, in matters relating to economic growth, SDS were different from larger countries. Easterly and Kraay (2000) found that keeping other relevant factors constant, small states tended to have higher per capita GDP than other states. Armstrong and Read (2002a, 2003), drawing on empirical research on the growth implications of size, found evidence to be inconclusive, irrespective of definitions of size, the sample data sets and the stratification of data, concluding that size is not a systematic barrier to economic growth and, in addition, that the economic performance of some small states outstripped that of many larger states. Similarly, Aiyar (2008), found no specific evidence that smallness is a disadvantage to economic growth, that small states in general had a higher GDP per capita when compared to other developing states, and that while small states may have some special disadvantages, they also had some advantages as well.

[5] This section is drawn from findings of a Policy Note prepared for the SDS Evaluation, prepared by Professor Briguglio (Policy Note on Economic Growth of Small Developing States and the Role of the IMF (Briguglio, 2021a).

16. More recently, Briguglio (2009; 2016) found that small size poses disadvantages to growth, mostly due to limited possibilities in reaping the benefits of economies of scale and due to high exposure to external shocks, though they also concluded that growth in a particular small state benefits from policy-induced changes. The authors constructed and juxtaposed vulnerability and resilience indices and classified countries according to their vulnerability and resilience scores, deriving a Vulnerability and Resilience Framework. Their index of economic resilience, includes policies that lead to macroeconomic stability, as well as market flexibility, among components of the index.[6] They found that achieving internal balance, through a sustainable fiscal position, low price inflation and an unemployment rate close to the natural rate, as well as external balance, reflected in the international current account position or by the level of external debt, provided economies with room to manoeuvre when hit by external shocks. Moreover, the presence of market flexibility, allowing the economy to adjust rapidly following an external shock, reduced the risk of being negatively affected by shocks. Building on their findings, the authors found that small states, even if highly vulnerable economically, can nurture growth and competitiveness by adopting economic policies aimed at enabling the country to withstand, adjust to or recover from adverse shocks.

17. Several studies also identified high costs as a particular constraint facing small states. For example, Briguglio (1998) found that that country size affects cost per unit of manufactured products, with large states benefitting from economies of scale in manufacturing, as expected. Similarly, Winters and Martins (2004) found that small states experience high costs, even in areas where they can enjoy comparative advantage, such as tourism. By contrast, Spolare (2004) observed that for highly integrated small states in close proximity to large international markets, factors other than size, including close proximity to large international markets, lack of remoteness, rather that size, may benefit competitiveness even though costs may be high.

18. Trade openness is also cited as a factor that can positively affect growth in small states, although most studies acknowledge that trade openness can also lead to GDP and terms of trade volatility (Easterly and Kraay, 2000; Armstrong and Read, 2002a and 2003; Alesina, 2005). Briguglio (1995) and Briguglio and Vella (2016) note that trade openness makes small states highly exposed to external shocks, leading to volatility in terms of trade and GDP growth. Openness can therefore have undesirable negative effects by generating volatility (Briguglio and Vella, 2018). Volatility itself has been considered undesirable, including in generating a welfare loss through the negative effect of economic, political and policy-related uncertainty, (Loayza and others, 2007) and in prompting a higher risk of policy failure (Gavin and Hausmann, 1996; Fatás and Mihov, 2013); and may also lead to lower growth, ceteris paribus (Ramey and Ramey, 1995; Hnatkovska and Loayza, 2005).

19. Geographical location and distance to main commercial centres are found to be important determinants of growth in small states. Remoteness and distance can result in higher

[6] The resilience index, as constructed in Briguglio (2016) includes: (i) macroeconomic stability; (ii) prudent market flexibility; and (iii) political, social and environmental governance.

foreign trade costs, reducing export competitiveness and attractiveness of foreign direct investment (FDI) (Armstrong and Read, 2006). At the same time, changing trade patterns and investment in ICT may reduce the disadvantage brought about by remoteness (Gibson, 2019).

20. Tourism is widely identified as having a positive benefit for economic growth in small states, providing an important source of income and employment. See, for example, Narayan and others (2010) and Everett and others (2018), for Pacific small states; and Cannonier and Galloway Burke (2019) and Apergis and Payne (2012), for Caribbean small states. However, there can also be disadvantages to heavy reliance on tourism, given small states' high degree of trade openness and limited range of merchandise exports, which make these countries highly vulnerable to terms of trade shocks. Goodwin (2017) and Martin and others (2018) highlighted risks of overdependence on tourism. In addition, high levels of tourism in small states can also lead to environmental degradation and social discomfort (Archer and others, 2005).

21. For several reasons, levels of human capital, quality of institutions and governance-related factors also have a strong influence on growth in small states. Human capital—including education, training and "learning-by doing"—is considered to be key determinant of the underlying comparative advantage of some small states (Armstrong and Read, 2004) and a "conditioning variable" for small state development. Yet, small states face acute challenges in retaining human capital, as a result of loss of skills and brain drain through large outward migration, leading to a loss of a larger proportion of their skilled labor force than larger states. Several constraints also adversely affect small states' institutional development, including higher per capita cost of public administration compared to larger economies and the limited pool of skills in the public sector (Brown, 2010).

22. Many authors study the economic consequences of the environmental vulnerability of SDS. Both the Commonwealth Secretariat (Atkins and others, 2000; and Briguglio, 2016) developed vulnerability indices that include proneness to natural disasters as one of the index components. Due to the fact that many small states are prone to natural disasters, some authors emphasized the need to strengthen disaster management in such states. Jayaraman (2006) pointed out that the economies of small states in the Caribbean and the Pacific regions are frequently affected by natural disasters, and such occurrences lead to the contraction of output, pressures on the balance of payments and on government budgets. The author suggested that measures conducive to reducing the adverse consequences of natural disasters include improving preparedness, better management of the environment, improved land use planning, and provision of relief measures involving non-government organizations. Natural disasters in small states and policies conducive to reducing their harmful effects are also discussed in Marto and others (2018), Roberts and Bonne (2019), and Zhang and Managi (2020).

23. Several studies focused on the relationship between natural disasters and growth in SDS, finding that natural disasters have negative effects on public finances and on growth (Mitchell and others, 2017; Rasmussen, 2006). Several earlier studies considered the relative impacts of natural disasters on short-term and longer-term growth. Raddatz (2007) examined the short-

term impacts of external and exogenous shocks, finding that natural disasters have adverse short-run effects on output. A similar study by Noy (2009) identified structural and institutional factors that exacerbate impacts on output. Raddatz (2009) found that smaller and poorer states are more vulnerable to natural disasters and climatic events, with most of the impact on output occurring in the year in which disaster event takes place. Findings from research on the longer-term impacts of natural disasters have been more ambiguous. Noy and Nualsri (2008), Raddatz (2009), and Jaramillo (2009) found long-term adverse impacts on growth, while Skidmore and Hideki (2002) found natural disasters to have a positive long-term impact on growth, as, in the aftermath of disasters, capital stock is updated and new technologies are adopted, leading to enhanced growth performance.

B. IMF Research

24. Prior to 2009, and with few exceptions, the literature on SDS growth and associated economic policy and development challenges originated and proliferated largely outside the IMF. Subsequently, the IMF joined the discussion on small states economic policy issues more actively, particularly on issues related to growth in SDS, building on the extensive literature on small states that emerged during the 1990s and 2000s. Initially appearing as IMF working papers, this work evolved over time to include several books and compilations of regionally-oriented studies focusing particularly on Caribbean and Pacific SDS. There has also been substantial work at the country level, discussed in Section IV, although relatively little looking across SDS as a group.

25. Fund research on the factors affecting economic growth initially focused on the role of fiscal policy, but quickly expanded to consider many other factors identified in the external literature as influencing growth in SDS, including geographic isolation from major economic centres, trade openness, the role of structural reform in supporting growth, factors influencing growth surges, impacts of natural disasters on per capita GDP and debt, the influence of location and social stability on growth, and the role of export diversification in strengthening growth. Consequently, over the evaluation period there has been a steady acceleration in the number and range of IMF research products on SDS-related issues, including those focusing on determinants of growth in SDS. Collectively these papers have provided critical empirical findings on the factors influencing growth in SDS and helped inform a growing body of SDS-related policy papers and guidance notes, as discussed further below.

26. Among this material, an early paper on small states focused on the fiscal characteristics of small states which can influence the implementation of sound economic policies (Ota and Medina Cas, 2009). The authors highlighted economies of scale constraints, relatively large public sector, and high degree of trade openness, which could lead to high exposure to external shocks; emphasized the erosion of trade preferences and natural disasters which contributed to rising debt in some SDS, particularly those located in the Caribbean; and drew policy recommendations for small states. It argued that fiscal tightening could reduce the dangers stemming from high public debt and economic volatility, by boosting flexibility and creating space to respond to shocks. It also presented evidence linking better and more effective governance policies to lower

public and external debt. A second study highlighted the influence of remoteness (geographical isolation from main business centers) as a constraint on development and growth (Becker, 2012). A third paper (Papageorgiou and others, 2013) considered a variety of structural reforms and their impacts on growth in SDS. The paper examined the institutional environment in which reforms are implemented and the influence of this environment on prospects for growth.

27. From 2013, a proliferation of research helped advanced knowledge of various aspects of the growth challenges facing SDS. Most studies took a regional approach, focusing on the challenges faced by SDS in the Caribbean and in Pacific island SDS respectively. For Caribbean SDS, Acevedo and others (IMF, 2013c) discussed the fiscal and growth-related challenges facing Caribbean SDS, particularly when faced by natural disasters and found that these SDS, while sharing many features of other small states, have specific characteristics which negatively affect growth and fiscal balances, including the instability associated with the aftermath of the 2008/09 GFC and the high and increasing costs of frequent natural disasters. While many cost disadvantages were structural, some, such as high labor and utility costs, were policy-driven, eroding competitiveness and giving rise to high current account deficits, high debt ratios and slow growth. Fiscal adjustment could help correct for domestic and external imbalances, but the authors noted that the smallness and vulnerabilities of these countries made adjustment exceptionally difficult. The study urged a Caribbean-wide regional surveillance exercise, building on the success of the Caribbean Regional Technical Assistance Center for delivering technical assistance in a regional framework, observing that a region-wide approach would take the spotlight off any individual country's failure to succeed and could foster peer support.

28. More recently, a detailed volume by Srinivasan and others (2018) provided several chapters dealing with challenges facing Caribbean policymakers. The book discussed policy options for promoting a sustained and inclusive economic growth, arguing that the Caribbean economies need to improve their fiscal positions, their thin financial market and their monopolistic structures for this purpose. The authors also referred to the prevalence of violent crime in some Caribbean small states, which, the authors argued, tends to negatively affect investment and growth. The book also emphasized the need for regional collaboration and deeper integration with Latin American countries in dealing with these challenges, and for reducing economies of scale constraints, all of which could also be conducive to improving Caribbean SDS ability to withstand their economic vulnerabilities.

29. Several Fund staff papers and books have examined challenges to growth in Pacific SDS. Yang and others (2013) considered the determinants of growth among Pacific SDS. Tumbarello and others, 2013 assessed whether and how SDS in the region differed in their characteristics from SDS elsewhere and examined structural reforms that could contribute to raising growth rates in Pacific SDS. In 2016, Khor, Kronenberg, and Tumbarello (2016a) discussed the factors that affected economic growth in Pacific SDS, provided an overview of the policy issues and challenges faced by these countries and sought to identify policies that could help raise growth performance in a way that is both inclusive and sustainable. This collection of papers argued that

the slow rate of growth of Pacific SDS could be partly explained by the region's unique characteristics, including small populations and small internal markets, remoteness, vulnerability to ND&CC, narrow production bases due to smallness and therefore economies of scale constraints. While these were inherent features, economic policies also mattered. These included weak macroeconomic policy frameworks, which led at times to unsustainable exploitation of natural resources, weak policy implementation capacity, limited financial depth, laws and customs that limited the flexibility of product and factor markets, for example, land tenure, high levels of public debt in some countries, and high dependence on foreign aid and remittances. Political instability also hampered investment and the development of sound institutions. Improving growth required putting in place policies that promoted macroeconomic stability and debt sustainability, attracting FDI and strengthening institutions. The authors considered regional collaboration as very useful to mitigate the economies of scale constraints, enhance competition, protect and promote regional interests, and allow greater specialization in areas of comparative advantage.

30. More recently, Cabezon and others (2019) dealt with ND&CC in the Pacific SDS, arguing that these events worsen countries' fiscal positions and damage growth prospects. The authors calculated that in the region, for damage and losses equivalent to 1 per cent of GDP, growth drops by 0.7 percentage points in the year of the disaster. The paper also discussed a multi-pillar framework to enhance resilience to natural disasters at the national, regional, and multilateral levels and the importance of enhancing countries' risk management capacities. McIntyre and others (2018) assessed the economic performance of different groups of SDS between 1990-2015 and found those that were more diversified experienced lower output volatility and higher average growth than most other SDS, though also that export diversification has a more significant impact on reducing output volatility than improving long run growth in SDS, with diversification requiring fundamental changes and should be contemplated in the context of a cohesive development strategy. Similarly, Lee and Zhang (2019) considered whether country size and income levels matter when LICs and SDS pursue export diversification, finding that export structure to be less diversified in SDS that face resource constraints and small economic size; and that export diversification may promote economic growth and reduce economic volatility in these countries, although benefits tend to be greater for relatively larger and poorer countries within the group of LICs and small states. In addition, Al Hassan and others (2020) analyzed how Caribbean integration has evolved, discussed obstacles to progress, and considered potential benefits from greater integration. The authors found that further liberalization of trade and greater labor mobility across the Caribbean can generate significant economic benefits, with improved factors and skills allocation providing opportunities to increase labor productivity and create long-term growth benefits for the region, including by helping to limit loss of skills through outward migration.

31. Beyond regionally-focused research, staff have produced only limited in-depth pan-SDS analysis. One example is a paper, developed mid-way through the evaluation period, by Cabezon and others (2015) which shows how the unique characteristics of SDS make fiscal management

more challenging than elsewhere. It found that the indivisibility of expenditure in the provision of public goods and public sectors, which are the main employers, introduce rigidities into budgets, tilting the composition of spending toward recurrent outlays. The authors argued that this led to limited fiscal resources and high recurrent spending, possibly crowding out private investment in growth-enhancing areas. They further contended that SDS generally—and particularly fragile SDS and commodity exporters—faced greater revenue volatility than other country groups owing to their exposure to exogenous shocks and narrow production bases; and also often lacked the capacity to dampen revenue volatility because of difficulties relating to shallow domestic banking systems, with limited access to international capital markets. A negative consequence was often resort to procyclical fiscal policy. In this regard, the authors referred to fiscal anchors, such as debt and deficit targets, to help smooth spending and isolate budgets from revenue volatility; and recommended fiscal buffers to create possibilities for spending on infrastructure and human capital, including education and health. Mobilizing revenues by bolstering administrative capacity and reforming the domestic tax system were also needed to increase fiscal space to meet critical development spending needs while improving the business environment, with reforms tailored according to the particular country circumstances.

C. IMF Policy Papers and Guidance Notes

32. Building on the IMF's collection of Working Papers and regional analytical work as well as the external literature, the IMF also prepared three policy papers addressing macroeconomic policy challenges in SDS during the evaluation period. The first, in 2013, focused on macroeconomic issues in small states and implications for Fund engagement (IMF, 2013a). It provided a framework for examining the growth-related and other challenges of small states, including limitations on their ability to reap the benefit of economies of scale leading to higher costs per capita, limited diversification possibilities and exposure to natural disasters. The paper referred to the small domestic market of SDS, often compelling them to rely heavily on exports and therefore rendering them highly exposed to external shocks. It found that their limited capacity often constrains SDS' ability to diversify tax revenue, leading these members to rely heavily on trade taxes. A common problem stemmed from high levels of public debt resulting from fiscal imbalances. The paper emphasized the need for sustained fiscal consolidation and exchange rate flexibility; highlighted challenges to the development of SDS' financial sectors, which were often underdeveloped in many SDS and therefore could not play their full role in alleviating volatility and fostering growth; and emphasized that SDS' commercial banks often provide a captive market for government financing, causing the financial sector soundness to become closely linked to fiscal sustainability.

33. The paper also argued that small states experienced substantially higher costs of natural disasters relative to the size of their economies—roughly triple that in larger middle-income countries. It suggested ways for SDS to strengthen their disaster risk mitigation and responsiveness by, inter alia, identifying and integrating natural disaster risks into macro

frameworks, ensuring sufficient fiscal space and flexibility within their fiscal frameworks to help redeploy spending rapidly, and exploring how to promote insurance coverage.

34. The paper concluded that IMF engagement with SDS on growth should be extended and deepened. It proposed that the Fund build on a continuing analytical work program to better understand issues such as growth under-performance and how policy advice and program design could help these countries to reinvigorate their growth strategies. It asserted that the growth challenges facing SDS be given particular emphasis in policy advice for small states, given limited diversification of SDS economies; and signaled that the enhanced focus on growth could include a sectoral focus, informed by continuing analytical work and with Fund staff building greater familiarity with the growth challenges facing individual production sectors, for example, tourism and resource extraction than might be typical for larger, more diversified states. The paper also proposed that Fund programs should also reflect the particular needs of SDS, given their growth challenges. With sectoral and targeted business climate reforms likely to be more critical than for larger economies, it encouraged greater emphasis on growth-related conditionality in Fund-supported programs.

35. A second paper, (IMF, 2015a) updated and built further on the 2013 paper. It dealt with macroeconomic developments and selected issues in SDS and described the economic outlook for these states referring to economic vulnerability and slow growth. Three in-depth studies were included, together with policy recommendations related to fiscal management, exchange rate devaluation and financial inclusion. The paper contended that expenditure rigidity and revenue volatility in the face of limited fiscal buffers often resulted in procyclical fiscal policy, requiring efforts to streamline and prioritize recurrent spending to create fiscal space for capital spending; and found that the quality of expenditure could be improved through fiscal anchors and public financial management reforms. As regards financial services, it acknowledged that in many SDS the banking sector was typically small and highly concentrated, and that lack of competition constrained the effective delivery of financial services. For lower-income SDS in particular, weak financial inclusion limited access to credit, with consequences for investment and growth. The paper recommended that where possible, SDS should foster competition as a way to develop financial inclusion.

36. A third policy paper (IMF, 2016) focused on the role of the IMF with regard to resilience to ND&CC in SDS. It argued that these countries are disproportionately vulnerable to such calamities and observed that on average, the annual cost of disasters for these states was nearly 2 percent of GDP—more than four times that for larger countries. It found that that disaster proneness had major macroeconomic repercussions, including debt problems; and proposed a range of macroeconomic pro-active policy approaches, including disaster response, risk reduction and preparedness, integrated into core investment and debt management frameworks.

37. The evolution of IMF research and policy work on growth and macroeconomic policies in SDS was embedded in staff guidance documents on the Fund's engagement with SDS. An initial version (IMF, 2014a) was later updated (IMF, 2018). These documents drew together the

analytical and policy threads from earlier research and policy papers on SDS. They emphasised that the main areas of concern of the IMF with regard to SDS focused on improved growth performance, through the improvement in economic governance relating mainly to fiscal policy, exchange rate management, promotion of competitiveness, and public sector efficiency.

38. The guidance notes also reflected several strands of SDS policy issues identified in the external literature. They referred to the unique economic characteristics and constraints faced by SDS and provided operational guidance on policy advice offered by the IMF to SDS members, together with information on the manner in which these states may make use of Fund facilities and instruments, program design, capacity building activities, and collaboration with other institutions and donors. Both SGNs identified the special characteristics and vulnerabilities of SDS, suggesting that the Fund considered small country size as an element meriting special analysis and advice. At the same time, the Fund acknowledged that SDS are heterogeneous in terms of economic development and therefore that a one-size-fits-all policy advice may not be appropriate.

39. Both documents also identified themes emphasised in the external literature as crucial challenges and underlying vulnerabilities for SDS. These included: first, SDS' volatility due to inherent factors that render these states highly exposed to shocks, including external economic changes, ND&CC; and second, challenges in strengthening economic resilience, building on an insight in an earlier IMF paper that resilience is not only associated with economic solutions but also with public institutions and good governance in general, calling for a balance between setting fiscal anchors and allocating sufficient budget resources this purpose, while promoting social consensus on the appropriate sequencing of development projects. The 2017 SGN in particular singled out resilience as one of the main pillars of policies conducive to stability and growth, noting that SDS experiencing higher macroeconomic volatility due to shocks including frequent natural disasters, and macroeconomic policies should aim at enhancing the ability of SDS to recover from such shocks; and emphasizing the importance of resilience building of SDS in fragile situations.

40. Both SGNs also highlighted the role of the public sector and called for public sector reform, given that in many SDS the public sector is relatively large with extensive economic intervention and owning key economic assets. This, in turn, affects the fiscal sustainability of many SDS and potential for new public sector investment and growth. IMF guidance for teams working in SDS related to a large extent to rebalancing of public and private sector roles, with a closer working relationship between the two sectors, including levelling the playing field for new private sector entrants. There was also considerable emphasis on fiscal sustainability and the creation of room for manoeuvre in order to enable SDS to withstand and recover from adverse economic shocks, including ND&CC.

41. The guidance documents included information as to how the characteristics of SDS should shape Fund surveillance and financial support, program design, capacity building activities, and collaboration with other institutions and donors. The documents used the acronym

GROWTh to refer to five key thematic areas as central to the policy dialogue. These are: (i) **G**rowth and job creation; (ii) **R**esilience to shocks; (iii) **O**verall competitiveness; (iv) **W**orkable fiscal and debt sustainability options; and (v) **Th**in financial sectors. These documents cautioned that in applying this guidance, staff should continue to tailor their engagement to specific country circumstances. They also emphasized that given limited policy analysis capacity in SDS, the emphasis of staff analytical work should be on immediate policy-relevant issues rather than on basic research. This exercise should be supported by improved information systems and data, and policy prescriptions that require analytical toolkits, which should be provided by Fund staff to SDS authorities for policy analysis.

42. Reflecting similar analysis in the external literature, the SGNs noted the importance of social matters, such as inclusiveness, equity, poverty reduction, social safety nets and income distribution. The 2017 SGN made several references to the need that the Fund considers social matters. However, considerations relating to social matters were given marginal importance, and are generally inserted as a caution to reduce the possible social damage of economic reforms.

Assessment

43. Over the evaluation period, Fund staff made important contributions to the overall body of research and policy analysis on SDS growth issues, particularly in identifying policy solutions intended to solve problems associated with economic instability and growth of SDS.

44. The external literature can be grouped under three main headings, namely, (i) those that emphasise structural SDS' weaknesses and adopt a quasi-fatalistic stance as if these handicaps cannot be overcome; (ii) those that argue that SDS can mitigate their disadvantages and handicaps by appropriate policies; and (iii) those that conclude that SDS are no different from larger states in so far as economic policy is concerned. IMF work fell largely into the second of these groups, looking for policy solutions to address the growth-related constraints facing SDS associated mostly with small population size, a high degree of trade openness and proneness to natural disasters, while also recognizing heterogeneity and lessons to be learned from other countries facing similar issues.

45. While the external literature on growth in SDS was heterogeneous, IMF work on growth issues was more focused, particularly on the roles of fiscal policy and, more recently, governance, in addressing challenges to growth. IMF papers consistently proposed policies for fiscal adjustments aimed at creating room for manoeuvre for SDS to respond to adverse external shocks and suggested that weak governance, or low government effectiveness, is associated with higher total public and external debt. These documents also highlighted that fiscal adjustment can be growth-supportive in SDS, especially if implemented through cuts in current primary spending rather than revenue increases; and recognized that given the limitations on monetary policy in SDS, fiscal policy is crucial since it is one of the few policy options SDS have to respond counter-cyclically to economic downturns and shocks. Furthermore, these documents emphasized that fiscal policy underpins the credibility of the fixed exchange rate regime of many

SDS. IMF work also highlighted that a variety of other factors play a role in affecting growth and competitiveness in SDS, including exchange rate regimes and dependency of many SDS on exports, commodities and the tourism sector, reinforcing the need to have a deeper understanding growth and competitiveness dynamics in the context of SDS countries.

46. Four areas of relatively less attention can be highlighted. First, less attention was paid to distributional dimensions of economic growth than in the external literature. Although inclusiveness, equity, poverty reduction, social safety nets and income distribution were mentioned in Fund work on SDS, the impression left is that these were postscripts as if to acknowledge that social hardship could possibly ensue in the short run as a result of remedial action, such as fiscal tightening. There was relatively little work on how growth strategies could encourage more inclusive growth over the longer term.

47. Second, while there were some useful examples of research on the group of SDS as a whole, there was generally less attention to research looking across the whole group of SDS, looking for cross-cutting lessons. This gap partly reflected that most of the research and analytical work on SDS was done within two separate departments responsible for the Western Hemisphere and Asia Pacific. To a degree, the challenges facing growth in SDS in the Caribbean and the Pacific are somewhat distinct, but there should still be benefits reaped from a more holistic research agenda, as shown in the external literature. More recent initiatives, such as cross-departmental research work highlighting the impact of tourism in the aftermath of the pandemic across Western Hemisphere and Asia Pacific countries (IMF, 2021) are therefore encouraging.

48. Third, there was relatively little research and analytical work on overcoming the growth challenges from lack of diversity and heavy reliance on a single sector or even a single very large firm. While such work would have required more attention to micro-economic and supply side issues that do not fall squarely within IMF economists' core competencies, such issues are clearly macro-relevant in the context of SDS.

49. Fourth, there was relatively little research and analytical work on growth-related aspects of financial sector policies, a point also made in the separate background paper on financial sector issues in SDS (Marston, 2022). Most financial sector analysis has been directed at stability issues—which are certainly important—but much less on how financial sector development can contribute to growth, for example, by providing credit needed for diversification and extending access to financial services to foster inclusion. Overall, IMF publications as well as policy papers on macroeconomic challenges and vulnerability to natural disasters contributed important value-added to the broader literature on SDS, principally in terms of rigor in assessing the effects of fiscal policy on growth and competitiveness. The IMF contributions also emphasised the role of good economic governance in SDS, underscoring the fact that such governance is of major importance for SDS in particular, in view of the inherent constraints that are faced by these countries. But there were also significant gaps related to social issues and inclusion, cross-regional research and attention to supply side issues.

IV. SURVEILLANCE

50. The 2014 SGN, updated in 2017, provided an explicit focus for staff engagement with SDS on growth challenges. Guidance includes the need for particular emphasis on the effects of fiscal, monetary and exchange rate developments on growth and employment; the need to build resilience to support growth; the need to ensure country specificity; and a focus on competitiveness.

51. Interviews with country authorities highlighted that while authorities were broadly satisfied with the content of the Fund surveillance on growth-related issues, they flagged areas where the Fund could improve the quality and depth of engagement in policy guidance and advice. They typically noted three specific contexts: first, the value of granular growth-related analysis in country's SIPs; second, the opportunity to learn from experiences of other SDS, including through regionally-oriented policy guidance; and, third, as corroborated by the IEO desk analysis, granular policy guidance and advice on opportunities and options for SDS to diversify their economies, to help broaden currently narrow economic base. The next section reviews Fund engagement in each of these three areas during the evaluation period.

A. Selected Issues Papers

52. Staff research and analysis of growth-related issues at the country level is typically presented in chapters for SIPs prepared as part of AIV consultations. To assess the coverage of staff analytical work on SDS's growth agenda, the evaluation reviewed country-specific analytical work in staff SIPs. During the evaluation period 2010–2020, 53 SDS SIPS were prepared, with a total of 91 separate chapters. SIP contents varied widely, including chapters related to: (i) growth, job creation and structural challenges; (ii) ND&CCand other exogenous shocks; (iii) monetary and exchange rate policy; (iv) financial sector issues; and (v) fiscal policy and debt sustainability options. Among SIPS prepared during the evaluation period, 22 SIPS included at least one chapter on a growth-related topic. These SIPS were prepared for 19 SDS, or just over a half of all SDS members; and contained a total of 29 separate chapters related to growth, job creation and structural challenges.[7]

53. Growth-related chapters focused in most instances exclusively on the challenges faced by the country itself. However, on a few occasions, chapters included informative comparative information, on growth experience in other SDS. Examples include a chapter in the 2018 SIP for Belize, which provided comparative information on energy consumption and rates in several other Caribbean SDS for benchmarking purposes; a chapter on growth constraints in the 2018 SIP for São Tomé and Principe, which includes a comparative analysis of economic performance

[7] Among these 19 SDS, 8 were prepared for Caribbean (Bahamas, Barbados, Belize, Domenica, Grenada, Guyana, Suriname, Trinidad and Tobago), 4 for African SDS (Comoros, Eswatini, São Tomé and Principe, Seychelles), 2 for Pacific Island SDS (Marshall Islands, Solomon Islands), 2 for other Asian members (Bhutan, Maldives), and 1 for MCD (Djibouti).

in São Tomé and Príncipe with three other SDS (Cabo Verde, Mauritius, and Seychelles), highlighting factors that have caused growth to lag behind other small island-states in Africa. In one instance, in 2012, a single SIP covered three countries simultaneously, providing comparative analysis of various challenges in two SDS (Cabo Verde, Eswatini) as well as Namibia. The SIP focused on these three countries in the context of their status as small middle-income countries in AFR. A chapter on enhancing inclusive growth and employment in small middle-income countries noted that notwithstanding their positive growth record over the previous decades, the benefits of strong growth had not been evenly shared across the population in each country. Trend growth in many small middle-income countries in Sub-Saharan Africa had also generally declined in recent years, while unemployment remained high. The chapter compared growth experience among several small and other middle-income countries; identified structural impediments to productivity that could be addressed, including the quantity of high quality human capital, reducing skill mismatches in the labor market through efficient investments in education and healthcare, increasing access to finance to help overcome low levels of intermediation and reducing the relatively large size of governments. It highlighted key policy lessons for all three countries, including that reducing income inequalities had the potential to lead to significant gains in terms of increasing the duration of growth spells in small middle-income countries; and that policies that led to a more sustained reduction in structural unemployment would also help to enhance more inclusive growth.

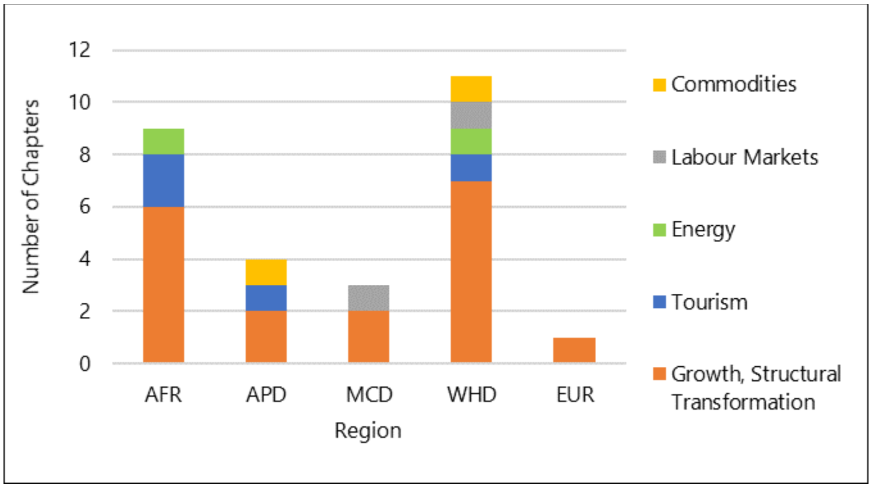
54. Topics for country-specific growth challenges varied widely, including: (i) ten chapters related to sectoral policies, including tourism (5 chapters), commodities (2 chapters) and energy (1 chapters);[8] (ii) labour markets and labour-market institutions (2 chapters); and (iii) a wide range of other topics closely associated with growth (18 chapters).[9]

55. Between 2010–2019, most growth-related SIP chapters were prepared by WHD (12) and AFR (9) (Figure 8). About two-thirds of all chapters in AFR, MCD and WHD focused on broader growth policy and structural issues, while the remaining chapters in these regions discussed sectoral issues, including tourism, commodities and energy policy (AFR, WHD) or labour markets (MCD). Most growth-related SIP chapters in APD dealt with sectoral challenges to growth.

[8] Sector-focused chapters were prepared for The Bahamas, Barbados, Belize, Bhutan, Comoros, Eswatini, Guyana, Marshall Islands, São Tomé and Principe, and Solomon Islands.

[9] Chapter topics included: competitiveness, diversification, productivity, structural reforms and economic transformation, modelling countries' demand response, trade, impacts of inward spillovers on growth, export sector performance, improvements in the business environment, the impact of demand and price volatility on growth, gender inequality and the impact of corruption on growth.

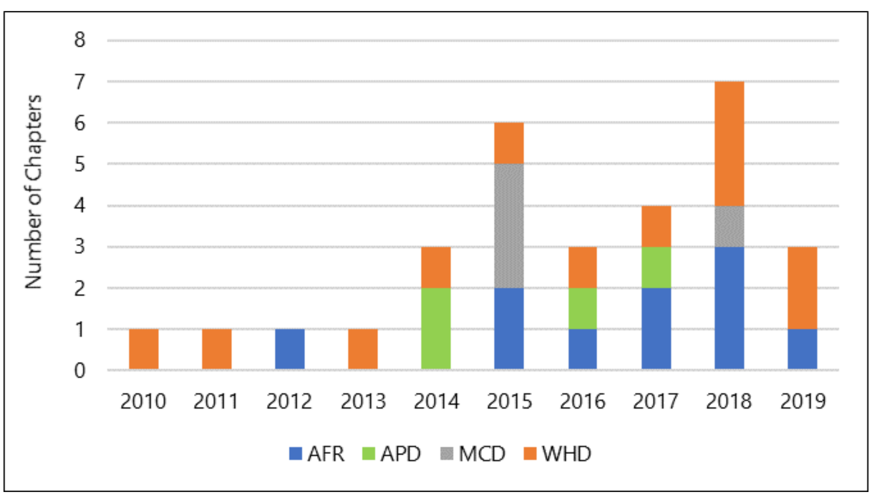
Figure 8. SDS Growth-Related SIP Chapters by Topic and Region, 2010–2019



Sources: SDS SIPs 2010–2019; IEO calculations.

56. Staff attention to growth-related challenges in SIPs stepped up significantly over the evaluation period. Between 2010–2014, staff prepared 7 growth-focused SDS SIP chapters, while in the subsequent five-year period 2015–2019, staff prepared 23 SIP chapters (Figure 9). The number of chapters prepared rose considerably in 2015, following publication of the 2013 paper on Macroeconomic Issues in Small States (IMF, 2013) and issuance of the 2014 SGN. From 2016–2019, the average number of SIP chapters on growth-related issues has averaged just over four per year, with the largest number (7) in a single year, in 2018. With the exception of 2012, WHD produced prepared at least one growth-related SIP per year consistently through the evaluation period, while AFR has prepared at least one SIP per year since 2015.

Figure 9. SDS Growth-Related SIP Chapters by Region, 2010–2019



Sources: SDS SIPs 2010–2019; IEO calculations.

57. Staff's country-specific analytical focus on growth also increased in comparison with the previous decade: while 13 chapters on growth or a related structural agenda were prepared in the period 2000–2009,[10] the number of SIP chapters on growth almost trebled, to 30 chapters, from 2010–2020. The increase in coverage of sectoral issues has been particularly marked. All 11 SIP chapters on growth that assessed sector-specific policies were prepared during the evaluation period.

58. SIP growth chapters utilized a variety of approaches and analytical tools. For example, a chapter on growth in the 2018 SIP for Sao Tome and Principe assessed growth challenges, considered the characteristics and challenges facing the tourism sector and provided comparisons with other African SDS. A 2017 SIP for Solomon Islands also included a chapter on growth-related issues, examining the country's infrastructure gap applying the Fund's Debt-Investment-Growth (DIGNAR) model to help illustrate the outcomes of different profiles of public investment and evaluate macroeconomic and financial implications of alternative investment programs, financing strategies and institutional capacity in managing public investment. The analysis also incorporated shocks arising from high vulnerability to natural disasters, with findings illustrating the benefits of climate and natural disaster resilient infrastructure on fiscal indicators, investment and growth. A growth-focused chapter in the 2019 SIP for Dominica reviewed potential to diversify exports, beyond tourism, to other non-commodity exports. It provided a detailed assessment of the country's tourism potential, described challenges in boosting growth from tourism, and provided an assessment of potential for diversification including lessons from other SDS that had successfully diversified exports. A 2019 SIP for Belize also included a growth-related chapter tracing the evolution the tourist sector, identified comparative advantages and identified reforms to help strengthen tourism and its contribution to growth; and analyzed the impact of structural and institutional reforms on tourist arrivals, as well as the impacts on arrivals due to crime and damage from natural disasters. The assessment included comparative analysis based on a sample of 12 Caribbean countries.

Assessment

59. Interviews with country authorities and Executive Directors drew attention to the value attached by SDS authorities to more granular analytical work on growth-related issues, going beyond the Fund's traditional areas of expertise related to the effects of fiscal, monetary and exchange rate developments on growth and employment. They appreciated the increased attention to these issues over the evaluation period, notably on the tourism sector. Nonetheless, they considered that the Fund could provide more granular growth-related policy analysis which would help to provide a wider menu of potential policy choices for strengthening growth

[10] These included SIP chapters for The Bahamas (3 Chapters on growth-related issues), Barbados, Belize (two chapters on growth-related topics), Cabo Verde, Eswatini, Fiji, Kiribati, Timor-Leste, Tonga, and Trinidad and Tobago.

performance. There has also been relatively limited attention to sectoral issues related to diversification beyond the tourism sector.

60. A particularly relevant contribution from many growth-focused SIP chapters has been staff's presentation and analysis of comparative data across several SDS with common structural constraints to growth. Examples of SIP chapters for Cabo Verde, Eswatini and Namibia (2012), Belize (2018), Dominica (2019), Sao Tome and Principe (2018, 2019), for example, illustrate that SIP findings can offer amplified insights, for other SDS beyond the country for which the chapter was prepared.

61. An important lacuna has been the relative dearth of growth-related SIP chapters, generally across area departments, limiting opportunities for staff to developed more detailed and granular assessments of growth challenges in SDS and to leverage the opportunity to present cross-country comparative analysis of SDS challenges, particularly where challenges are common to groups of SDS, either with the same region or on a pan-SDS basis.

B. Regional Surveillance

62. Over the evaluation period, bi-annual Regional Economic Outlook (REO) documents for both the APD and WHD regions have provided assessments of growth-related challenges and growth performance of SDS members in each region. REOs for AFR, EUR, and MCD have also periodically reflected on growth performance and related challenges in SDS in these regions, though with lower frequency.

63. APD REOs have covered a variety of growth-related topics for SDS in Asia and the Pacific, including: a detailed Box assessing the impact of the global crisis on Pacific Island Countries (PICs) and a dedicated Box on restoring macroeconomic sustainability in the Maldives (April 2010); fiscal challenge for the Marshall Islands, Micronesia, and Palau, as members of the Compact of Free Association treaty with the United States (October 2010); challenges to growth recovery in PICs, with the REO highlighting that most PICs seemed to be stuck on low-growth path, with recovery from the GFC slower than that of Asian LICs and emerging economies; a discussion of links between PICs to regional economies, highlighting their growth, consequences for inward spillovers and impacts on PIC growth from adverse oil shocks (April 2012 and April 2014); limited potential growth in PICs due to structural impediments to growth, including small size, dispersion, sparse population geographic distance from major markets and higher per capita government costs due to small size and diseconomies of scale in the provision of public services (April, 2013). From 2015, drawing on staff analyses in Working Papers, APD REOs began to reflect on the impact of natural disasters in PICs and the severe macro-critical challenges these events pose for SDS, including humanitarian cost, damage to infrastructure and their effects in increase macroeconomic volatility (April 2015; April 2016). In 2020, the REO focused on the impacts of the pandemic across the region. While noting that most Pacific Islands had been largely free of COVID-19, the REO drew attention to falling remittances in PICs, highlighted that scarring effects of the crisis were likely to be larger in countries that were highly dependent on

tourism and other services that required in-person contact, affecting small states in South Asia and PICs.

64. Approximately midway through the evaluation period, APD also began issuing a Small States Monitor. These short bulletins have provided a blend of information, including summaries of topical regional surveillance issues, together with updates on recent analytical work, conferences, events and useful resources for staff working on SDS. The inaugural bulletin in April 2014 covered regional developments, focused on a special topic (implications for fiscal policy of leveraging fishery resources and provided short country notes on two PICs, highlighted recent media developments including details of DMDs' recent speeches in the region and forthcoming cross-country SDS-related research, and offered useful links to other institutions dealing with SDS and information on upcoming events. Eleven subsequent bulletins, generally issued bi-annually, have followed a similar template and have included a range of policy themes, many related to growth. These include tourism, ND&CC, fiscal multipliers and trade integration (2014); the impact of Cyclone Pam, one of the most destructive natural disasters to have hit a Pacific SDS (Vanuatu), boosting resilience to natural disasters, infrastructure and public investment (2015); the macroeconomic and other impacts of natural disasters (2017); virtual currencies, governance and corruption, and tourism (2018); lessons from Micronesia's recently-concluded Climate Change Policy Assessment, fishing revenues, the impacts of Fintech and fibre-optic under-sea cables in increasing connectivity and promoting financial inclusion, and developments with Correspondent Banking Relationships and pressure on remittances in PICs (2019). With the onset of the COVID-19 pandemic, issues covered in the 2020 bulletin covered macroeconomic and other developments in PICs.

65. Throughout the evaluation period, WHD has provided region-wide coverage of key policy issues and challenges in Caribbean SDS, in a subsection of Chapter 2 of its biannual WHD REO. From the beginning of the evaluation period and consistently thereafter, REOs drew attention to the persistence of weak growth performance in most Caribbean SDS, while frequently distinguishing challenges faced by tourism-dependent SDS (for example Belize, Grenada and St. Vincent and the Grenadines) and commodity exporters (including for example Trinidad and Tobago and Suriname).

66. The October 2010 WHD REO included a specific chapter on growth performance, tourism and debt in the region. Subsequently, REOs from 2010–2014 gave particular attention to the protracted challenges Caribbean SDS faced in recovering from the GFC. These included recovery in growth, tourism and efforts to boost competitiveness, high public debt burdens and efforts to strengthen the financial sector, which had been slow to recover from the crisis due to weak credit demand and in some cases damaged bank balance sheets. Policy advice included reducing high public debt levels, improving medium-term fiscal policy frameworks, reducing financial vulnerabilities and pursuing reforms focused on address key structural weaknesses, including high production, labor and energy costs. Over the evaluation period, REOs also provided brief but focused attention on specific challenges, including challenges faced by tourism-intensive

Caribbean economies (2010), fiscal consolidation challenges (October 2011), constraints to competitiveness in tourism (April 2012) and broader competitiveness challenges in the region (May 2013). REOs in the second half of the evaluation period continued to draw attention to these constraints to growth, while also pointing to other structural constraints to growth, including overdependence on fossil fuels (October 2015), incidence and effects of natural disasters (October 2016) and resilience to ND&CC (April 2018); Correspondent Banking Relationships (October 2016); crime and growth in the Caribbean and several other countries in the region (April 2018). The 2020 REO focused on the impact of the COVID-19 pandemic across the region, including Caribbean SDS, noting that the collapse in tourism had affected Caribbean SDS particularly severely and that tourism-dependent Caribbean would experience more severe recessions following the pandemic, because of the sharp and long-lasting decline in tourism.

67. Six of the IMF's 34 SDS members are located in the African region. While the growth and related challenges of these members have been addressed in as part of the REO surveillance exercise, when assessing the economic challenges of these and other members, regional surveillance has not differentiated or assessed members according to population size. In selected instances, SDS members have been the subject of particular attention, for example Mauritius (April 2015), though not by virtue of the country's status as an SDS.

Assessment

68. Area departments used differing methods to assemble and communicate research, policy analysis and information related to growth and related policy challenges in SDS. WHD developed a standardized approach, including a regular sub-chapter in biannual REOs, focusing on recent macroeconomic developments in Caribbean SDS. These analyses, although relatively short, nevertheless provided a useful regular snapshot of key macroeconomic and growth-related policy challenges facing Caribbean SDS.

69. By comparison, in APD, coverage of SDS' growth-related challenges was much more sparse, although when provided, included detailed analytical assessments of the identified challenge. APD's regional coverage of SDS was significantly supplemented by the APD Small States Monitor, which substantially augmented APD REO coverage of SDS-related growth policy and related macroeconomic and structural policy developments in Pacific SDS, provided a continuous, condensed update on macroeconomic developments; and offered a mechanism to appraise staff working on SDS policy issues in the region about recent management engagement on SDS issues, and information gleaned from regional SDS-related seminars and CD.

C. Diversification Issues

70. For many SDS members, diversification of the economy is a major development challenge given their narrow economic base and small population size. In interviews, some authorities and Board members highlighted a particular interest for bilateral surveillance to

provide more detailed insights into the challenges faced by SDS in diversifying their economies; and to offer a wider range of policy options to do so.

71. Staff recognized at an early stage in the evaluation period that challenges to diversification in SDS can be acute, with a 2012 IMF survey of SDS mission chiefs highlighting that diversification was particularly difficult to achieve in SDS. Subsequently, a 2014 Board paper[11] for a broader group of LICs showed that diversification and structural transformation play important roles in influencing the macroeconomic performance, with increases in income per capita at early stages of development typically accompanied by a transformation in a country's production and export structure, including through diversification into new products and trading partners as well as increases in the quality of existing products. It found that diversification in exports and in domestic production had been conducive to faster economic growth in LICs. Increased diversification was also found to be associated with lower output volatility and greater macroeconomic stability. For SDS specifically, the paper concluded that these economies lacked the capacity to diversify because of their small size, with narrow and undiversified production and export bases often making them more vulnerable to external shocks. The two SDS SGNs reiterated findings from the external literature and staff research, that narrow economic bases presented an important challenge to growth and that greater attention was needed to improving competitiveness and the business climate in SDS, but did not provide specific discussion on how to encourage diversification.

72. Building on the 2014 Board paper, in 2018 an internal Fund Diversification Working Group (DWG) examined how best to promote diversification to boost growth, resilience, and job creation in LICs. It distinguished between "horizontal policies;" and "vertical policies" to achieve diversification.[12] Results of a stock-taking exercise by the DWG, across Fund teams working on LICs, which was presented in an informal Board seminar in May 2021, found that the Fund's bilateral policy advice had focused on horizontal policies, drawing substantially on IMF Export Diversification and Export Quality data toolkits, and Fund research. Staff had occasionally advised on sector-specific policies in an ad hoc fashion, but notwithstanding that many countries were moving ahead with vertical, or sector-specific policies, the absence of structured guidance for country teams limited their ability to engage meaningfully with country authorities on these issues. Staff concluded that requests for policy advice from authorities on vertical policies warranted engagement by staff in so far as they were macro-critical and WTO-compliant.

[11] "Sustaining Long-Run Growth and Macroeconomic Stability in Low-Income Countries – The Role of Structural Transformation and Diversification" (IMF, 2014).

[12] "Horizontal policies" include policies that target all sectors by improving their business environment, through measures such as strengthening human capital, institutions, physical infrastructure, access to finance, reducing barriers to trade. "Vertical policies" include policies that targeted specific sectors, through measures including Special Economic Zones, public investment in research and development banks, development banks, and promotion of FDI.

73. To assess the extent to which staff offered guidance or policy advice to authorities in the context of diversification, the evaluation reviewed the extent and focus of coverage of diversification policy issues in SDS Article IV consultations using a text analysis approach. The analysis quantified the number of times specified search words were identified in SDS AIV Reports during the evaluation period. In this period, a total of 234 AIV reports were produced for all 34 SDS. Coverage was assessed first by thematic area; and second according to discussion of horizontal and vertical diversification policies. The analysis distinguished between three thematic strands in staff engagement on diversification: (i) coverage in AIV reports of issues related to the general impact of diversification on economic development and growth; (ii) coverage of export diversification; and (iii) staff discussion of more granular issues related to sectoral and product diversification. A description of the key search words and the methodology used is included in Annex I.

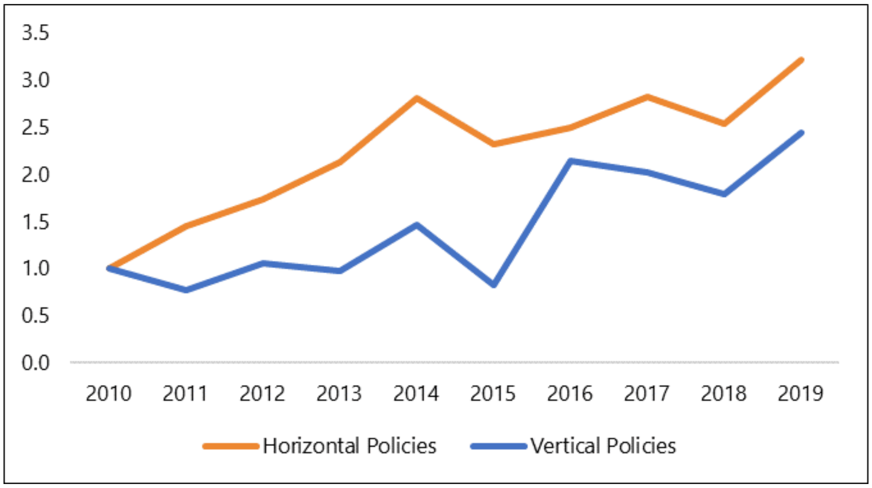
74. Results of this exercise show that policy advice and guidance in AIV reports paid greatest attention to export diversification, with 43 percent of all references related to diversification discussing opportunities, challenges and constraints to export diversification. A further 37 percent of references considered broader issues related to members' development and growth potential, while the remaining one fifth of references mentioned sectoral or product-specific diversification issues.

75. A similar analysis identified references to horizontal and vertical policies in SDS AIV reports over the evaluation period. Among these, 85 percent discussed horizontal policies and 15 percent vertical policies. Horizontal policy references covered a wide range of topics related to diversification. When horizontal policy references were included, they discussed labor market policies (39 percent of the time), the overall business environment (27 percent), human capital (13 percent), small and medium enterprise development (7 percent), monopolies (5 percent) and other policies related to infrastructure, strengthening institutions, promoting FDI and reducing red tape (9 percent).

76. When vertical policies were discussed, in 75 percent of these cases, staff referred to trade policy issues. In just over 3 percent of the total sample of horizontal and vertical policy references were vertical policies relating to issues such as Special Economic Zones, sectoral FDI, sectoral reallocation or value-added, targeted lending or investment, industry development plans or industrial policy, mentioned in staff reports.

77. Staff attention to both horizontal and vertical diversification policy issues in bilateral surveillance stepped up considerably over the evaluation period. Over the evaluation period, the average number of references to both horizontal and vertical diversification policy issues, per AIV report, increased steadily, with the number of references to horizontal policies per report trebling and the number of references to vertical policies more than doubling (Figure 10). Staff generally paid more attention to horizontal policies, particularly between 2012–2016, although this gap has narrowed considerably in the later stages of the evaluation period.

Figure 10. Horizontal and Vertical Diversification Policies in SDS AIV Reports: References Per AIV Report, 2010–2019



Sources: SDS AIV Reports (2010–2019); IEO calculations.
Note: Number of references indexed to 2010 (2010=1).

Assessment

78. Country authorities and some board members have highlighted that SDS can benefit from Fund policy guidance and advice on diversification policies. Evidence from a text analysis review of AIV reports over the evaluation period shows that rising attention has been given to diversification policies over the evaluation period. Attention has concentrated on horizontal policies, rather than vertical policy issues, including sectoral policy issues of particular interest to policy makers.

79. While AIV reports have regularly commented on issues related to horizontal diversification, there is ample scope for staff to extend treatment and coverage of vertical policies when addressing diversification issues in bilateral surveillance. An update of the 2017 SGN would present an opportunity to introducing more granular guidance to staff, on scope, parameters and possible limitations to staff engagement with authorities when discussing and providing policy guidance and advice on vertical integration issues in bilateral surveillance.

V. Programs and Conditionality

80. This section uses methodology from the recent IEO evaluation of *Growth and Adjustment in IMF-Supported Programs* (IEO, 2021) to look at growth-related issues in programs with SDS during the evaluation period.

81. During the evaluation period, 11 SDS either had ongoing upper-credit tranche (UCT) programs, or entered into new programs, for a total of 18 programs in all. Of these, 6 SDS used a

total of 7 GRA programs: and 5 SDS used a total of 12 PRGT programs.[13] In all cases, programs included structural conditionalities pertaining to macroeconomic policies designed to support SDS members efforts to strengthen economic growth (Table 1).

82. Compared to other country groups, a greater proportion of SDS programs (72 percent or almost three-quarters of all programs) were successfully completed, suggesting adequate Fund support for implementation in the SDS context.

Table 1. Program Performance over the Evaluation Period

	SDS	FCS[2]	LICs	EM
Number of countries	11	25	42	30
Number of programs	18	42	74	55
Completed programs	13	20	49	30
As percent of total	72	48	66	55
Off-track programs[1]	1	10	11	14
Quickly off-track programs[1]	4	12	14	11
Precautionary programs	1	3	8	10
Exceptional access programs	1	0	0	20
As percent of total	6	0	0	36

Sources: WEO; IEO calculations.
Notes: FCS=Fragile and conflict-affected states; LIC=Low-income countries; EM=Emerging markets.
[1] Following the definition used by the 2018 Review of Conditionality, "off-track programs" refer to programs where at least two reviews were completed and at least two reviews were not completed at the end of the program and "quickly off-track programs" refer to programs where at most one review was completed and at least two reviews were not completed at the end of the program.
[2] Excluding SDS that are classified as FCS.

83. The approach used in IEO (2021) was utilized to identify the extent to which the 18 SDS programs over the evaluation period included structural conditions conducive to fostering growth and to compare the overall balance of structural conditions whose primary goal was to help achieve adjustment-, vulnerability- or growth-related program objectives (Table 2).[14] Compared to other UCT programs, programs in SDS exhibited a somewhat higher proportion of

[13] SDS using GRA programs included Antigua & Barbuda, Barbados, Maldives, the Seychelles (2), St. Kitts and Nevis, and Suriname. SDS using PRGT arrangements included Comoros, Djibouti, Grenada (3), Sao Tome and Principe (4), and the Solomon Islands (3).

[14] The evaluation utilized the MONA database, which classifies structural conditions in IMF programs according to their content, or growth orientation, differentiating each structural condition according to whether it is intended primarily for: (a) facilitating adjustments in aggregate demand and underpinning stabilization efforts by enhancing the functioning of fiscal, monetary, and exchange rate policies; (b) enhancing growth and economic efficiency that would help the economy adapt better to changes in economic conditions, for example, structural conditions related to trade reforms or pricing policies in factor markets; and (c) managing vulnerabilities and addressing actual and potential balance sheet risks, for example, measures for strengthening prudential regulations and financial sector supervisory capabilities.

structural conditionalities related to growth/efficiency, considerably higher than the share of growth/efficiency structural conditions (SCs) in PRGT programs, but a correspondingly low share of SCs on vulnerability management. SDS programs devoted particular attention to SC's related to fiscal policy. Compared to other GRA and PRGT programs, programs in SDS included a much smaller share of SCs related to monetary, financial and exchange rate policies.

Table 2. Structural Conditions by Depth, Content, and Sector
(In percent of total)

	Number of SCs per Program	Depth			Content			Sector		
		High	Medium	Low	Demand Control	Growth/ Efficiency	Vulnerability Management	Fiscal	Monetary/ Financial/ Exchange Rate	Other Structural
Total	23.9	12.4	36.9	50.6	67.1	10.3	22.7	57.0	28.1	15.2
GRA	25.2	15.9	36.3	47.8	60.6	12.0	27.5	48.3	33.4	18.2
PRGT	23.0	9.3	37.5	53.1	72.8	8.8	18.4	63.9	23.5	12.5
SDS	16.8	11.0	40.4	48.6	70.2	18.3	11.5	60.1	21.6	18.3
GRA	19.4	10.3	43.3	46.4	66.0	23.7	10.3	52.6	25.8	21.6
PRGT	15.1	11.6	38.0	50.4	73.6	14.0	12.4	66.1	18.2	15.7

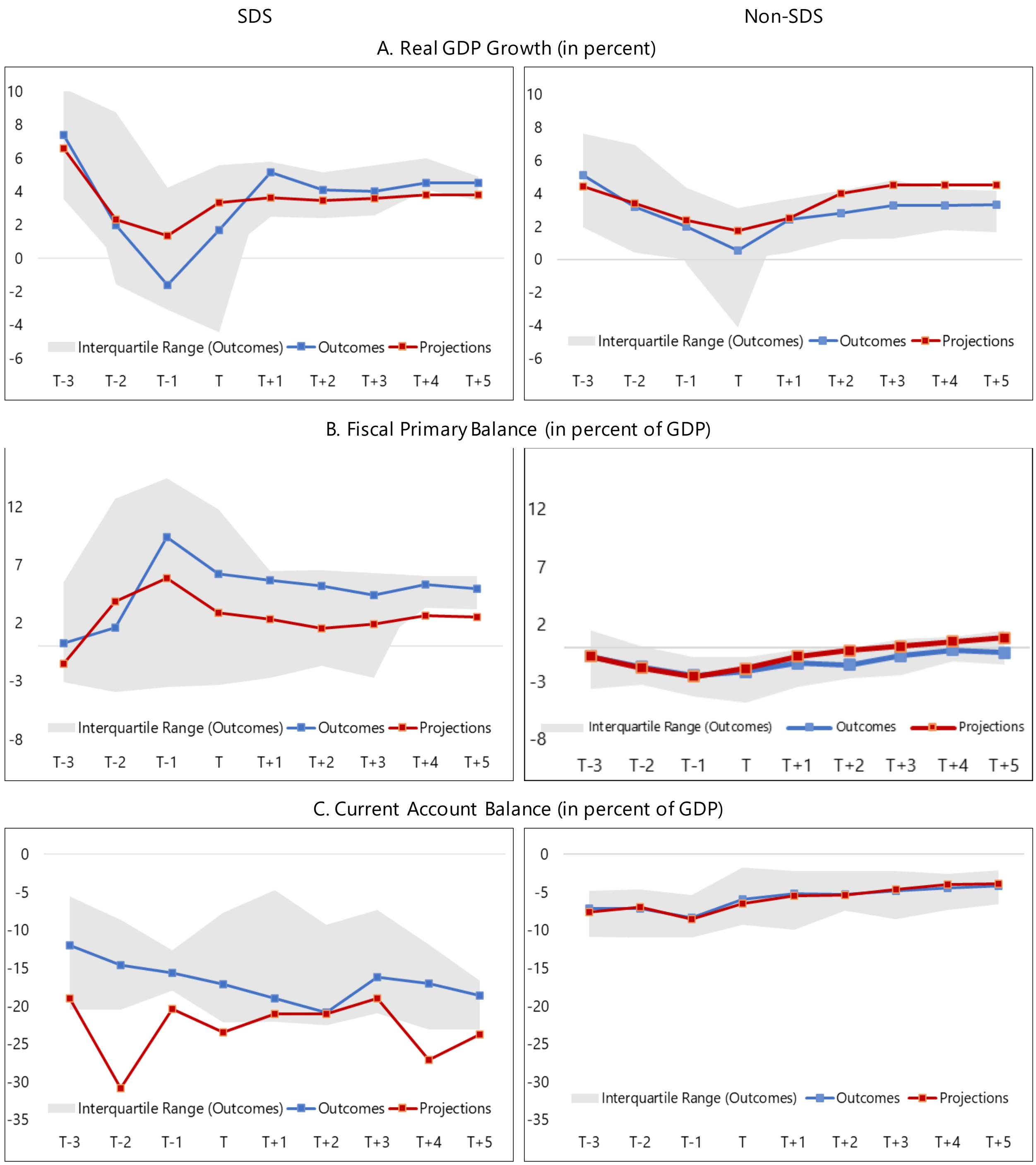
Sources: MONA; 2018 ROC; IEO staff calculations.
Notes: Covers all UCT programs during 2010 to 2019, using approach followed in IEO (2021).

84. The evaluation reviewed trajectories for growth projections and outcomes among SDS programs and compared results with those for non-SDS programs. Figure 11 compares SDS GRA programs with non-SDS GRA programs; and Figure 12 makes a similar comparison for PRGT programs. Results show that GRA programs in SDS performed reasonably well, with growth outcomes modestly but consistently exceeding projections, while for SDS with PRGT programs, post program growth performance fell short of projections in SDS, in part due to limited attention to growth enhancing reforms, as highlighted earlier in this paper.

85. Overall, taking into account of both GRA and PRGT programs in SDS, there was some limited overall improvement in growth rates after these programs, as average post-program two-year real GDP growth was 3.5 percent compared to 2.3 percent of average pre-program two-year real GDP growth (Figure 13). Among SDS with GRA programs, there was a marked improvement between pre- and post-program growth performance, in part reflecting factors including careful structuring of program engagement to support growth-enhancing outcomes, the contribution of CD and support of long-term resident experts and a continuity of Mission Chiefs and country teams.

Figure 11. Growth and Adjustment Trajectories: GRA

(Cross-country medians)



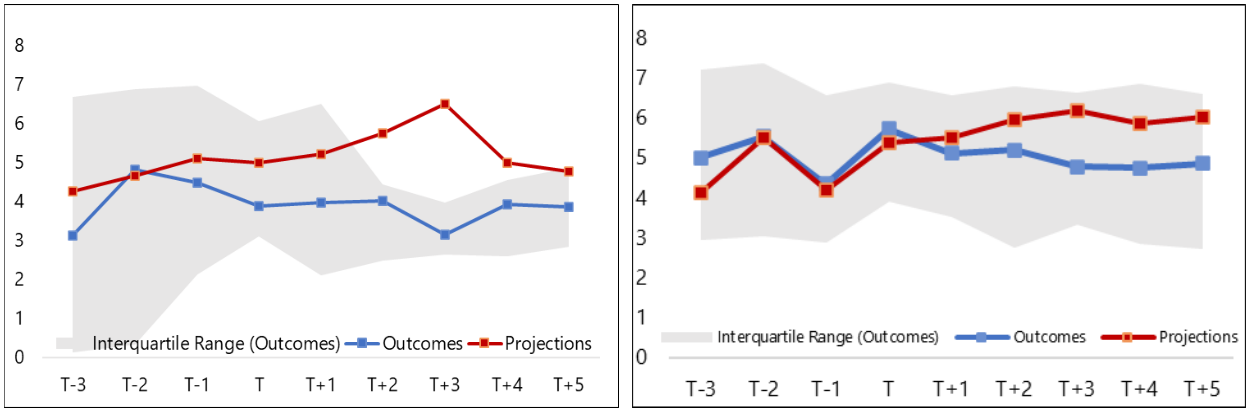
Sources: WEO; IEO calculations based on IEO (2021).

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

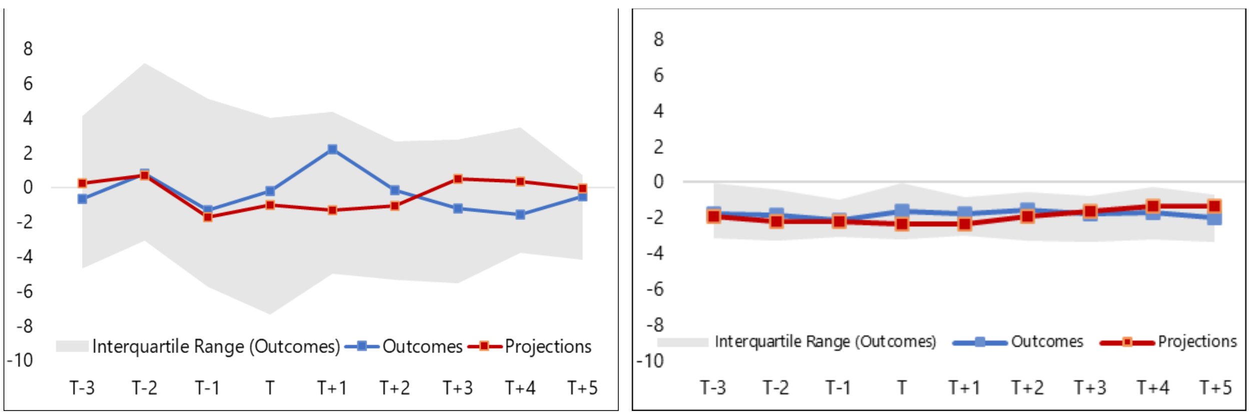
Figure 12. Growth and Adjustment Trajectories: PRGT
(Cross-country medians)

SDS | Non-SDS

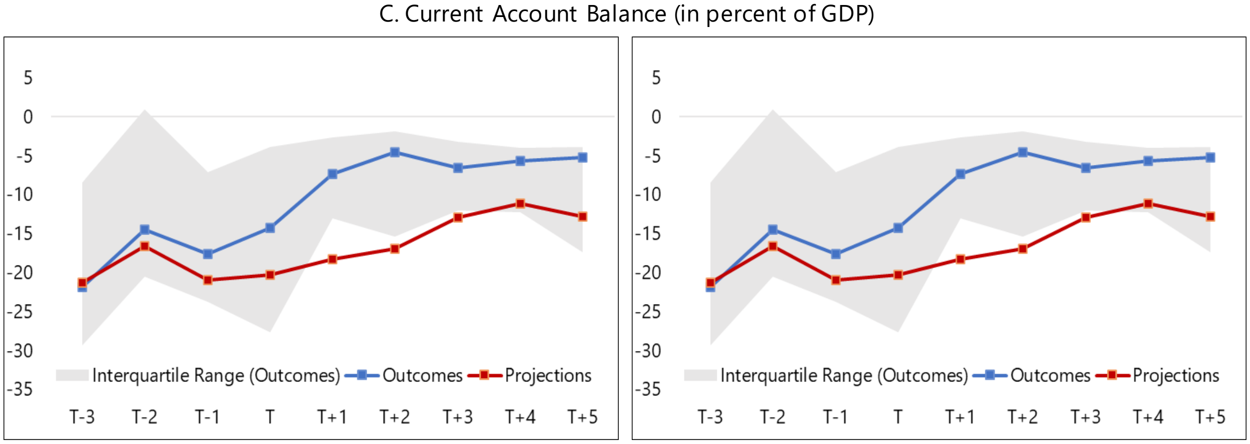
A. Real GDP Growth (in percent)



B. Fiscal Primary Balance (in percent of GDP)



C. Current Account Balance (in percent of GDP)

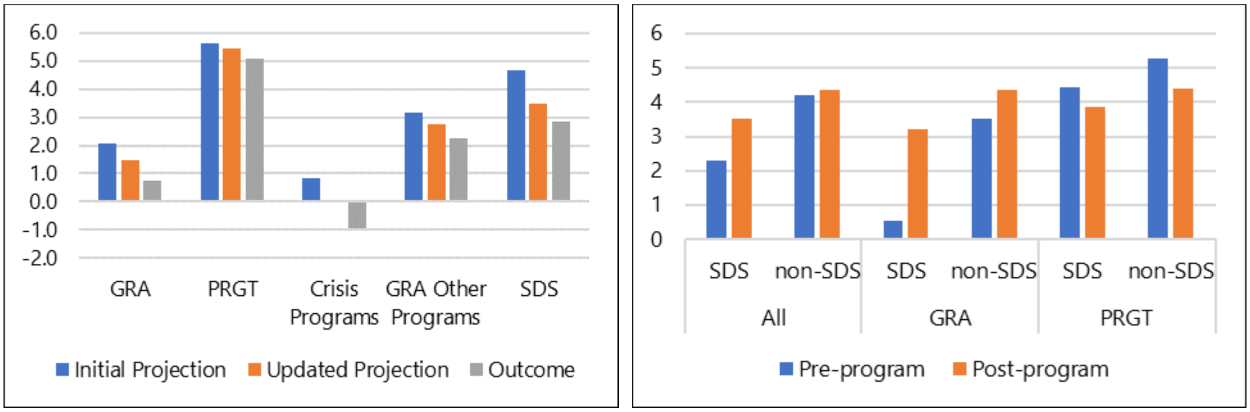


Sources: WEO; IEO calculations, based on IEO (2021).
Note: All projections refer to initial program projections made at program approval (T). Outcomes and projections represent cross-country medians. Data availability is not uniform across periods mainly because post-program outcome data are not yet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

Figure 13. Growth in IMF-Supported Programs

A. Program Projections and Outcomes
(In percent; cross-country averages)

B. Growth Improvement
(In percent; 2-year average)



Sources: IMF; IEO calculations. Based on IEO (2021).
Notes: For growth improvement, whenever a country had 2 consecutive programs with less than 2 years of non-program years in between, those programs are treated as one program.

Assessment

86. There is greater room to pay more attention to growth in the context of SDS programs. While a large proportion of SDS programs were successfully completed, conditionality in these programs tended to focus on adjustment rather than vulnerability; and programs reflected very high growth optimism in initial projections. Growth outcomes in SDS programs were mixed. Growth in GRA programs performed reasonably well, with growth outcomes modestly but consistently exceeding projections during and after programs, and considerably exceeding pre-program growth. However, for SDS with PRGT programs, growth performance was little changed during and after programs and fell well short of projections, which may in part reflect limited attention to growth enhancing reforms.

87. In regard to GRA programs, relatively strong performance is consistent with findings elsewhere in this evaluation (DaCosta and Rustomjee, 2022) that when GRA programs are accompanied by strong Fund appreciation and adaptation to local contexts to foster ownership, support from Fund CD, deployment of long-term residential advisors to support programs, and continuity of MCs and country teams, these factors can contribute to program success.

88. In respect of PRGT programs, these findings are consistent with conclusions from IEO (2021). The importance of addressing them is highlighted by the findings of the 2018 Review of Program Design and Conditionality (ROC), which emphasized that growth shortfalls implied less progress in reducing stock imbalances or ensuring debt sustainability than intended, while disappointed growth expectations could adversely affect domestic support for program implementation.

VI. CONCLUSIONS

89. SDS' characteristics and vulnerabilities, including their narrow production and export bases due to their small population and economic size, and their vulnerability to ND&CC had adverse impacts on growth and other macro-critical effects and challenged policymakers' efforts to achieve macroeconomic stability, well diversified resilient economies and sustained growth. Reflecting these challenges, growth rates in SDS, particularly tourism-dependent SDS, microstates and Caribbean SDS persistently lagged those of other emerging markets and developing countries and fell short of the global average growth rate in each of the past four decades, including during the evaluation period. Both the GFC and COVID-19 shocks also had a much greater adverse impact on SDS than on LICs and fragile, non-SDS members, while SDS in all regions were also much worse affected by the COVID-19 pandemic than the GFC.

90. The 2014 SGN, updated in 2017, provided an explicit focus for staff engagement with SDS on countries' growth challenges, emphasizing particular attention to the effects of fiscal, monetary and exchange rate developments on growth and employment. further attention in three areas could improve the quality and depth of engagement: (i) more granular policy guidance and advice, through chapters prepared in SIPs; (ii) more opportunities to learn from experiences of other SDS, including through regionally-oriented policy guidance; and (iii) more granular advice and guidance on diversification policies.

91. Growth outcomes of SDS programs have been mixed, with limited overall improvement in growth rates and there is ample room to pay more attention to growth particularly in the context of PRGT programs. A large proportion of SDS programs were successfully completed. However, conditionality in these programs tended to focus on adjustment rather than vulnerability; and programs reflected growth optimism in initial projections, both findings consistent with conclusions from IEO (2021).

92. The Fund's contribution to research on challenges to growth in SDS escalated and deepened considerably over the evaluation period. Emphasizing that disadvantages and handicaps to growth in SDS can be mitigated by appropriate policies, Fund research focused particularly on macroeconomic challenges, the role of fiscal policy in creating room for SDS to respond to adverse external shocks and on the role of governance in addressing challenges to growth. Looing forward, further attention could be given to work on how growth strategies can encourage more inclusive growth over the longer term; research across the whole group of SDS, to identify cross-cutting lessons and to overcome growth challenges due to lack of diversity and reliance on a single sector; and research on growth-related aspects of financial sector policies, including on how financial sector development can contribute to growth.

ANNEX I. TREATMENT OF DIVERSIFICATION ISSUES IN SDS ARTICLE IV REPORTS—TEXT ANALYSIS

The paper utilised text analysis to determine the extent to which SDS AIV reports included coverage of diversification issues. Two-hundred-thirty-four AIV reports were reviewed, for the period 2010–2020. The following key words were used to denote thematic issues, as well as specific policy approaches, identified in AIV reports.

1. Key Thematic Issues in Diversification

- **Diversification, growth and transformation:** diversified, undiversified, diversification and growth, diversification policy, diversification policies, diversification process, structural transformation, industrialization, long-run growth, patterns of diversification, output diversification, market diversification, higher value-added, diversification and volatility, barriers to entry, development paths, geographic diversification.

- **Sectoral and product diversification:** sectoral policy, sectoral policies, sectoral strategy, sectoral strategies, sectoral productivity, sectoral value-added, sectoral shift, production structure, narrow production base, horizontal diversification, sophisticated products, product quality, quality upgrading, quality ladder, sectoral diversification, product diversification.

- **Export diversification:** export base, export structure, export concentration, export diversification, export product diversification, export quality, quality convergence, small export markets, diversification in export partners, global value chains, GVC, extensive margin, intensive margin.

2. Specific Policy Approaches

- **Horizontal policies:** business environment, physical infrastructure, red tape, SMEs, promoting FDI, monopolies, human capital, strengthen institutions, strengthen infrastructure, property rights, labor market, labor policy.

- **Vertical policies:** special economic zones, SEZ, R&D, sectoral FDI, sectoral reallocation, sectoral value-added, sectoral assessment, targeted lending, targeted investment, industry development plans, industrial policy, industrial support, market access rules, picking winners.

3. Methodology

- A desk-top study was devised to examine the extent of coverage for five growth-related topics in AIV consultation Summings Up for a group of sample countries during the evaluation period (2010–2020). The sample included eight countries or approximately 25 percent of all SDS members, chosen for geographic representation in keeping with the share of SDS members from various regions (two from consultations covered by the

African, Asia and Pacific, and Western Hemisphere departments, respectively, and one each from consultations covered by the European and Middle East and Central Asia Department, respectively) as well as varying income levels. The countries were Barbados, Bhutan, Comoros, Djibouti, Montenegro, Samoa, Seychelles, and St. Kitts and Nevis. Of the eight countries, three were microstates, or one each from the three most predominant regions where SDS members are located.

- The desk-top study sought to compare the extent of coverage relative to three points in time over the evaluation period, that being the consultation preceding the 2013 Board discussion on Macroeconomic Developments in Small State and the subsequent release of the 2014 SDS Guidance Note, the consultation following the issuance of the 2014 Guidance Note, and the end of the period yet while excluding 2020 by which time the COVID-19 pandemic came into play. Given that some SDS Article IV consultations are on a 24-month cycle, the data point in time is a range of years rather than one constant year.

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