Independent Evaluation Office
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BACKGROUND PAPER

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IMF Engagement with Small Developing States—AFR+2 Case Studies

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IMF Engagement with Small Developing States—AFR+2 Case Studies

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Contents

ABBREVIATIONS

AfDB	African Development Bank
AFR	African Department (IMF)
AFRITAC	Africa Technical Assistance Center
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
ATI	Africa Training Institute
BOP	Balance of Payments
CCPA	Climate Change Policy Assessment
CCRT	Catastrophe Containment and Resilience Trust
CD	Capacity Development
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
EBA	External Balance Assessment
ECF	Extended Credit Facility
EFF	Extended Fund Facility
EU	European Union
EUR	European Department (IMF)
FAD	Fiscal Affairs Department (IMF)
FSAP	Financial Sector Assessment Program
FSSR	Financial Sector Stability Review
GDP	Gross Domestic Product
GNI	Gross National Income
IFI	International Financial Institution
MCD	Middle East and Central Asia Department (IMF)
MCM	Monetary and Capital Markets Department (IMF)
OBP	Office of Budget and Planning
PCI	Policy Coordination Instrument
PRGT	Poverty Reduction and Growth Trust
PSI	Policy Support Instrument
RCDC	Regional Capacity Development Center
RCF	Rapid Credit Facility
REO	Regional Economic Outlook
RFI	Rapid Financing Instrument
SACU	Southern Africa Customs Union
SBA	Stand-By Arrangement
SDR	Special Drawing Right
SDS	Small Developing State
SIP	Selected Issues Paper
SMP	Staff Monitored Program
SOE	State-Owned Enterprise
SPR	Strategy, Policy and Review Department (IMF)
TA	Technical Assistance

EXECUTIVE SUMMARY

The five country cases selected for this study share, beyond their small populations, high volatility arising from: (i) a lack of economic diversification, notably dependence on tourism receipts (Seychelles, Cabo Verde and Montenegro); (ii) natural disasters (drought in Eswatini); or (iii) vulnerability to climate change (Mauritius and Montenegro). Nonetheless, while economic performance (growth and inflation) has varied across the case studies it has not lagged significantly behind non-SDS on average, as the latter face many of the same challenges, particularly the lack of economic diversification.

Fund surveillance has been of significant value to SDS country authorities, with teams viewed as well organized, capable, and professional. More developed SDS, with stronger institutional and policy frameworks, have better absorbed policy advice. In less developed SDS, surveillance had less traction either because it was not viewed as well targeted at domestic policy priorities (growth and investment strategies) or because of implementation constraints.

Although fairly limited in the country case studies, program engagement generated a high level of satisfaction; Stand-By Arrangement/Extended Fund Facility engagement in Seychelles and Policy Coordination Instrument/Policy Support Instrument engagement in Cabo Verde and Seychelles. Emergency financing in the context of COVID-19, provided to four of the five case studies, was widely seen as timely and adequate, except in the case of exceptionally large shocks, and had a clear catalytic impact.

Country authorities were highly appreciative of the quality and availability of capacity development (CD) in the range of topics at the core of the Fund's expertise. They reflected positively on the main delivery modalities according to their respective circumstances. More advanced SDS were better able to absorb and act upon CD activities, including specialized tools such as the Financial Sector Assessment Program (FSAP), Anti-Money Laundering/Countering the Financing of Terrorism activities, and the Climate Change Policy Assessment.

Despite continued interest in considering a differential treatment of SDS, particularly from country authorities, it is not clear whether a distinctive mode of SDS engagement is either needed or feasible for this group of countries, given budget constraints. The AFR+2 case studies and other SDS in the region display some common challenges—although to varying degrees—but, in many regards, these challenges are like those faced by non-SDS countries in the region and, for that reason, a distinct model for Fund engagement with them has not been implemented.

The main lessons for improvement or adaptation identified are:

- Simplifying the use of surveillance tools and streamlining requirements to reduce the burden on country teams would free up time for needed research and strategic analysis and it would facilitate tailoring.

- While the facilities toolkit appears to have been well suited for this group of SDS members, especially during COVID-19, questions remain on how to calibrate appropriate access limits when shocks are very large relative to GDP. The increase of access limits for emergency facilities at the onset of the pandemic was useful. It may be appropriate to retain these higher limits for SDS (and countries in similar circumstances) facing exceptionally large shocks.

- Capacity development could gain traction with more resident advisors. Addressing this perceived gap in CD provision within the existing CD budgets would require reallocating funding from other activities.

- The value added of surveillance in SDS could be augmented by improving staffing: reducing the rate of staff turnover, i.e., meeting the targeted mission chief tenure; and reconsidering the general rule of not having a resident representative or local office in SDS with program engagement. Experimentation with dual or multiple country resident representatives and locally staffed offices could help in this respect.

- Better knowledge management tools could contribute to better understanding of SDS and improving cross-country comparisons.

I. INTRODUCTION

1. This paper focuses on Fund engagement in five IMF small developing state (SDS) member countries during 2010–2020 in the AFR+2 grouping[1]: Cabo Verde, Eswatini, Mauritius, Montenegro, and Seychelles. This paper has been prepared in support of the IEO Evaluation on the IMF and Small Developing States, although the issues and findings emerging from the case studies may also apply to other IMF member small states with common challenges.

2. The selection of country case studies aims to reflect IMF engagement across the diverse situations and common challenges of the AFR+2 SDS. The range of surveillance versus program engagement is reflected in the choice of Eswatini and Mauritius (largely surveillance-only) and Seychelles (longer-term program engagement) and Cape Verde (PSI). The choice of Mauritius also reflects the hosting of training and regional capacity development centers (RCDCs) that benefit several SDS. Seychelles is also of interest as it is the only microstate in AFR+2 and it was a pilot country for the Climate Change Policy Assessment (CCPA) diagnostic tool. The choice of Montenegro is guided by interest in broader geographic coverage for the paper and the country's engagement in the Financial Sector Assessment Program (FSAP). While the case studies do not include a fragile or conflict-affected state (FCS), IMF engagement in FCS was comprehensively evaluated in 2018 (IEO, 2018).

3. The main objective of the paper is to assess the effectiveness of Fund engagement in helping countries achieve macroeconomic stability while addressing challenges such as weak competitiveness, limited institutional capacity, and exposure to volatility arising from lack of diversification and, as relevant, climate change and natural disasters. This assessment covers IMF surveillance, program engagement, and capacity development (CD) activities during 2010–2020, taking into account collaboration with other organizations (e.g., World Bank, other development partners) and the adequacy of human and other resources assigned within the IMF to support SDS members.

4. The paper draws on a desk review of surveillance and program documents, including briefing papers, staff reports, and back-to-office reports; information on CD provision; other IMF reports and research on SDS; and semi-structured interviews with IMF mission chiefs and senior staff; Executive Directors; country authorities; and in-country stakeholders.

5. The structure of the paper is as follows: Section II presents the regional background. Section III presents each of the five country cases. Section IV highlights key issues and lessons drawing on the country cases. Section V concludes.

[1] For the purpose of this paper, the AFR+2 grouping includes all six SDS covered by the IMF African Department (AFR) (Cabo Verde, Comoros, Eswatini, Mauritius, Sao Tome and Principe, and Seychelles); and each of the SDS members in the European Department (EUR) (Montenegro) and the Middle East and Central Asia Department (MCD) (Djibouti).

II. Regional Background

6. Apart from sharing small populations, each of the eight SDS in AFR+2 is exposed to high or extreme volatility arising from either a lack of economic diversification, notably from heavy dependence on tourism receipts (Seychelles, Cabo Verde and Montenegro), and susceptibility to natural disasters (drought in Eswatini, cyclones in Sao Tome and Principe and Comoros), or forward-looking vulnerabilities to climate change (Mauritius, Montenegro and Djibouti) (Table 1). In 2020, all of the AFR+2 SDS were middle-income countries except for Seychelles (high income) and Mauritius (added to the high-income group in 2020). All bar Comoros were assessed as having adequate statistical capacity for IMF surveillance. There is significant heterogeneity across AFR+2 SDS as regards geographical location, official language, and institutional fragility (see Annex I for additional information).

Table 1. Vulnerability Indicators for Tourism, Climate Change, and Natural Disasters

	International tourism receipts dependence[1]	Vulnerability to natural disasters[2]	Vulnerability to climate change[3]
Cabo Verde	Extreme	Medium	Low
Comoros	Medium	High	Low
Eswatini	Low	High	Medium
Mauritius	Medium	Medium	Extreme
Seychelles	Extreme	Medium	NA
Sao Tome & Principe	Low	High	Low
Montenegro	High	Low	Extreme
Djibouti	Low	Medium	High

Sources: WTO; IMF (2016).
[1] International tourism receipts-to-GDP ratio 2019: Extreme – >0.25, High – 0.15–0.25, Medium – 0.05–0.15, Low – <0.05.
[2] Combination of frequency and impact of disasters in small states during 1950–2014.
[3] Maplethorpe Climate Change exposure index 2016.

7. Across AFR+2 countries, economic performance varied during the evaluation period but did not lag significantly behind non-SDS on average. For 2010–2020, average GDP growth ranged from 1.2 percent (Cabo Verde and Montenegro) to 5.7 percent (Djibouti). Double-digit GDP declines in tourism dependent countries in 2020 halved average growth over the decade in Cabo Verde, Mauritius, and Montenegro. Average growth for AFR+2 SDS for the evaluation period was broadly similar to non-SDS AFR+2 growth (2.2 percent vs. 1.9 percent)[2] and Asia Pacific SDS (2.7 percent), and well ahead of Western Hemisphere SDS (0.5 percent). Inflation

[2] AFR+2 SDS average growth is slightly lower than non-SDS growth in AFR and MCD, i.e., excluding EUR non-SDS from the comparator group.

remained well anchored and well below 10 percent in all AFR+2 countries and was somewhat lower than in non-SDS AFR+2. At least in part, low inflation is supported by conventional exchange rate pegs in five countries and no separate legal tender in one country (Montenegro), while two countries have floating exchange rate regimes (Seychelles and Mauritius). Most of AFR+2 SDS have high or elevated public debt levels and a significant share have high current account deficits. The four countries with the highest current account deficits are also tourism dependent with high import content foreign direct investment (see also Annex I).

8. Article IV surveillance in AFR+2 was on the regular 12-month cycle in all AFR+2 countries except during program engagement in which case it was on a 24-month cycle,[3] although delays occurred during COVID-19, and on occasion in light of domestic constraints, e.g., elections. Two countries had FSAPs during the evaluation period (Montenegro and Mauritius) and one undertook a Climate Change Policy Assessment (Seychelles). Financial and non-financial program engagement was more frequent in the AFR+2 SDS grouping than in Asia-Pacific or Caribbean SDS and was stepped up very sharply in 2020 during the COVID-19 pandemic (Figure 1a).

9. All countries bar Mauritius drew on Fund financial support during the evaluation period with a spike in disbursements in 2020 (Figure 1a). Four countries had programs under the extended credit facility (ECF) or extended fund facility (EFF) (Comoros, Djibouti, Sao Tome & Principe, Seychelles), of which two (Seychelles and Sao Tome & Principe) were longer-term program engagement (Annex I).[4] Seven of the eight countries drew on the emergency facilities in 2020 for support in dealing with the COVID-19 pandemic. Total disbursements in 2020 to AFR+2 reached nearly SDR 240 million, compared to cumulative disbursements of SDR 85 million during 2010–2019 (Figures 1a and 1b). Two countries (Comoros and Eswatini) had a Staff Monitored Program (SMP) during the evaluation period although in neither case was the SMP followed by an upper credit tranche arrangement.[5] In addition, two countries had non-financial engagement through signaling instruments (the PSI and PCI) on three occasions (Cabo Verde and Seychelles). Despite significant program engagement across AFR+2, only Comoros hosted a resident representative office (locally staffed since 2015) at the end of the evaluation period. Djibouti's representative office closed in 2018 six years after the end of program engagement.

10. AFR+2 also benefitted from IMF and G-20 debt relief during COVID-19. Three of the four PRGT-eligible countries received grants for debt relief in 2020–2021 under the Catastrophe Containment and Relief Trust (CCRT) to alleviate COVID-19 financial pressure (Comoros, Djibouti, Sao Tome) benefitting from a higher income eligibility threshold for SDS than non-SDS. These

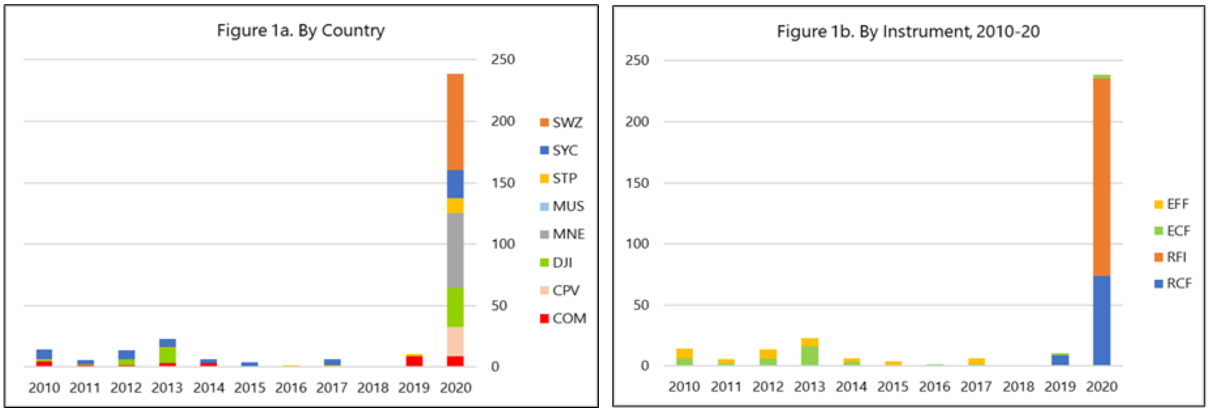
[3] The expected frequency of Article IV consultations is set out in Board Decision No. 14747 (10/96) and is less frequent in a program context because of the extensive staff engagement associated with program design and monitoring.

[4] Longer-term program engagement is defined as occurring when a member has spent at least 7 of the prior 10 years under IMF-supported arrangements, excluding precautionary arrangements for which there was no drawing.

[5] All five SMPs in SDS through March 2017 were among the AFR+2.

countries and Cabo Verde also received debt relief under the G-20 Debt Service Suspension Initiative (DSSI) (see Annex I).[6]

Figure 1. IMF Disbursements to AFR+2, 2010–2020
(In millions of SDR)



Sources: IMF; IEO calculations.

11. SDS in AFR+2 receive significant quantities of CD support.[7] Annual CD delivery doubled during the evaluation period (compared to a 30 percent increase for all SDS) with CD delivered by FAD contributing to most of the increase. Towards the end of the evaluation period, CD was boosted by resident advisers in Eswatini and Montenegro, with the latter financed by a regional CD trust fund. In addition, Mauritius hosts a training institute (Africa Training Institute, ATI) and one of the IMF's RCDCs in Africa (AFRITAC South). All the other SDS also participated in RCDCs, except Montenegro.

12. The most significant contribution to regional surveillance during the evaluation period was a Selected Issues Paper (SIP) issued in parallel with the 2013 Article IV staff reports for Cabo Verde, Namibia, and Eswatini focused on small middle-income countries in AFR (also including Botswana, Lesotho, and Namibia), which was subsequently developed into a book (Leigh and Mansoor, 2016). In 2016, the AFR *REO* chapter on natural disasters highlighted drought risks for small states which were found to be more vulnerable to GDP per capita declines than non-small states (IMF, 2016b). The 2020 AFR *REO* chapter on climate change adaptation also highlighted Sub-Saharan vulnerability to drought, including in the case of Eswatini (IMF, 2020).

13. The African Department has generally followed a similar approach to SDS staffing as it applies to larger countries. Accordingly, IMF Article IV surveillance teams working on AFR+2 SDS countries typically followed Office of Budget and Planning (OBP) guidelines and comprised a mission chief (who generally has in addition a policy assignment), two desk economists (at least

[6] For details on the CCRT, DSSI, and SDS, see Abrams (2022).

[7] For details on CD provision to SDS see de Las Casas and Balasubramanian (2022).

one dedicated to the country)[8], supplemented by another staff member on mission (usually a research assistant or an economist from the same department). By contrast, in EUR and MCD, SDS mission chiefs may have a second non-SDS country assignment. In a program context, teams may also have a functional department economist (Strategy Policy and Review Department (SPR), FAD or Monetary and Capital Markets Department (MCM)). In addition to the Article IV consultation, staff visits occur once a year, involving one less area department economist than the Article IV consultation. Country work is reviewed by an area department Deputy Director, an SPR senior reviewer (typically B1-B3 grade), the Legal Department (LEG), and the Finance Department (FIN). Other functional departments will only review if the SDS is on the departmental review list: in mid-2021 FAD reviewed four AFR+2 case study countries (Eswatini, Montenegro, Mauritius, and Seychelles) and MCM reviewed two (Mauritius and Seychelles).

14. In interviews, AFR staff noted that SDS and non-SDS have similar challenges and the surveillance product is not differentiated for SDS versus non-SDS. Accordingly, AFR does not differentiate distinguish between SDS and non-SDS countries (except systemically important countries) for country team staffing with at least an A15 mission chief, same-sized mission teams, and surveillance on a 12-month cycle outside of programs. The exception to this treatment is that SDS do not have Resident Representatives during periods of program engagement. The absence of SPR and FAD economists on SDS teams places an additional burden on the two desk economists and may discourage staff applying for SDS vacancies.

III. COUNTRY CASES

A. Cabo Verde

Country Profile

15. Cabo Verde is a lower-middle-income[9] island economy with improving economic and social indicators during the evaluation period. GNI per capita was $3400 at the beginning of evaluation period and for much of the subsequent decade and in 2018 was $1.85 billion.[10] It comprises 10 islands with a combined land area of 4,000 km^2, about 1.5 times the size of Luxembourg, and a 2019 population of 600,000. In 2018, 35 percent of the population lived below the national poverty line (down from 46 percent in 2010) and 3.4 percent lived in extreme

[8] Area department staffing of country case study desks as of June 2021: Cabo Verde - 2 economists; Eswatini - 1.5 economists and 0.5 EP; Mauritius - 2 economists and 0.5 EP; Montenegro - 1 economist; Mauritius - 2 economists and 0.5 EP.

[9] World Bank country and lending groups FY2021: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

[10] World Bank Country Profile (GNI, GDP, area, poverty headcount, child mortality): https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=CPV.

poverty below $1.90 per day (8.4 percent in 2010). The 2018 under-5 mortality rate was 16 per 1,000 births (26 in 2010).

16. Cabo Verde achieved independence from Portugal in 1975. It is a representative democracy with the first multi-party elections held in 1991 and it is one of the most politically stable countries in Africa. After 15 years in opposition, the reformist center-right party *Movimento para Democracia (CpD)* won Parliamentary elections in 2016 and 2021 and Presidential elections in 2016 replacing the former ruling party the *Partido Africano da Independência de Cabo Verde (PAICV)*. Elections in October 2021 returned the *PAICV* to the presidency.[11]

17. The tourism sector is an important income generator. Together, travel and tourism contribute 37 percent of GDP and 39 percent of employment.[12] Remittances are also significant, as the overseas population is larger than the resident population. Both these factors are sources of economic vulnerability. Agriculture and industry are also significant sources of employment. Although Cabo Verde is classified as having a medium vulnerability to natural disasters, there were no natural disasters with significant macroeconomic effects during the evaluation period.

18. Cabo Verde joined the IMF in 1978, it has a quota of SDR 23.7 million, and a voting share of 0.03 percent.[13] During the evaluation period, Cabo Verde was eligible for support under the PRGT by way of the IMF small country exception. Prior to the evaluation period, Cabo Verde program engagement included a Stand-By Arrangement (SBA) in 1998–2000 and an arrangement under the Poverty Reduction and Growth Facility (PRGF, now Extended Credit Facility) (ECF) during 2002–2005. IMF program engagement during the evaluation period was through signaling instruments, including a PSI (2010–2012) and a PCI (2019–2021) (Table 2). In 2020, a Rapid Credit Facility (RCF) disbursement was approved in response to COVID-19. Cabo Verde has also benefited from substantial CD support, particularly since 2013 (Figure 2).

Table 2. Cabo Verde: IMF Engagement, 2010–2020

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

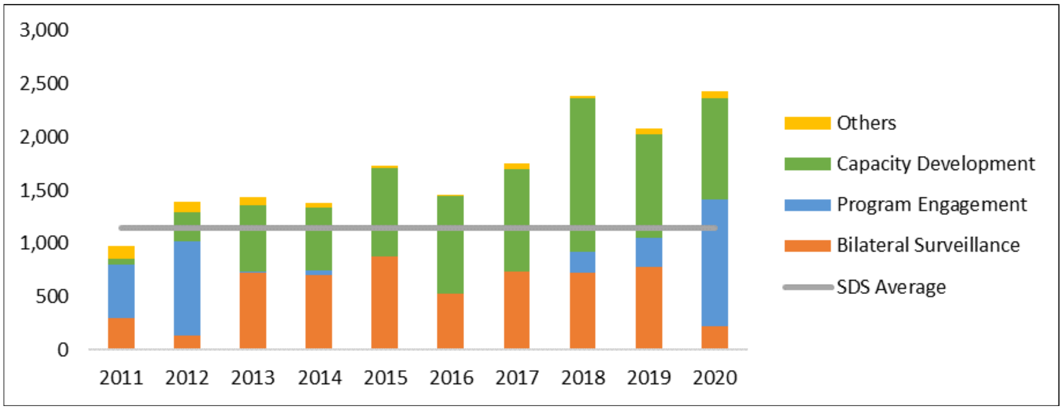
Sources: IMF; IEO calculations.

[11] See: https://www.britannica.com/place/Cabo-Verde.

[12] World Travel and Tourism Council 2019 data, https://wttc.org/Research/Economic-Impact.

[13] Quota and voting shares for all case studies as of April 2, 2021 from: https://www.imf.org/external/np/sec/memdir/members.aspx.

Figure 2. Cabo Verde: IMF Spending by Activity, 2011–2020
(In thousands of USD)



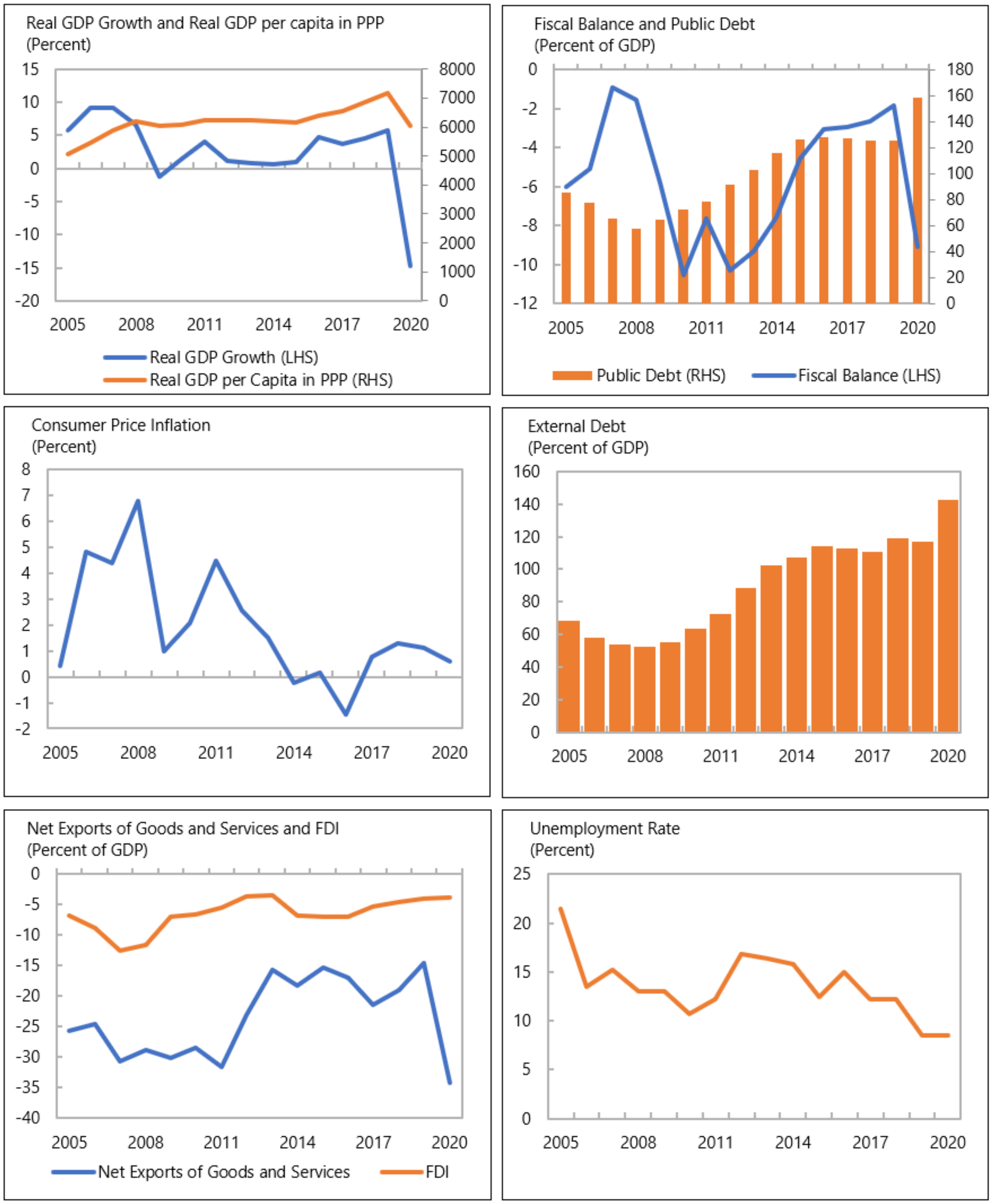
Sources: IMF (ACES); IEO calculations.

19. Cabo Verde has maintained a fixed peg to the euro since 1999, reflecting close ties with Portugal, the former colonial power. It followed expansionary fiscal policies in the early part of the evaluation period to offset spillovers from the euro zone crisis, focused on an expansion of public investment (Figure 3). However, growth remained stagnant despite the counter-cyclical stimulus. Fiscal expansion, slow growth, and effective exchange rate depreciation as the euro weakened relative to third currencies combined to create rising debt levels, with public debt above 100 percent of GDP throughout most of the evaluation period. GDP growth picked up in the second half of the evaluation period to around 5 percent while inflation remained on par with eurozone inflation. The current account deficit, which narrowed from over 10 percent of GDP to under 5 percent during the evaluation period, is financed mainly by FDI and official financing.

20. Following the COVID-19 shock, Cabo Verde was under a state of emergency during March–May 2020 and experienced an almost complete shutdown of tourism arrivals as well as air and maritime transportation through end-2020. 2020 GDP declined by 14.8 percent. The fiscal deficit rose from 1.8 percent of GDP in 2019 to 9.1 percent of GDP in 2020, bringing public debt to a new record high of 156.3 percent of GDP (doubling the level at the start of the evaluation period), while the current account deteriorated from close to balance in 2019 to an estimated deficit of 15.9 percent of GDP in 2020. Gross international reserves declined from 9.1 months to 7.2 months of prospective import coverage in 2020. A revised 2020 budget provided fiscal support to the economy through loan guarantees for enterprises, tax deferrals, and a reallocation of spending for personnel, training and medical equipment and 1.2 percent of GDP of support for vulnerable groups, while net external financing of the budget rose from 3.6 percent to 6.3 percent of GDP in 2020.[14] The central bank loosened monetary policy, temporarily eased prudential requirements, and introduced loan and insurance payments moratoria.

[14] For more detail, see IMF (2021).

Figure 3. Cabo Verde: Macroeconomic Developments, 2005–2020



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

Main Elements of Fund Engagement

Surveillance

21. The main policy priorities and challenges for Cabo Verde during the evaluation period were: (a) medium-term fiscal consolidation to contain initially rapidly rising debt levels and subsequently to lower elevated debt risks; (b) maintaining a prudent monetary policy and adequate reserve holdings to protect the euro peg; (c) strengthening financial sector policies to address elevated NPLs and encourage financial sector development; and (d) structural reforms to underpin accelerated growth including improvements to the business environment and reform of state-owned enterprises (SOEs).

22. Surveillance priorities did not change significantly during the evaluation period with a continuing focus on ensuring public debt sustainability, especially by curbing investment spending, protecting the peg through reserve accumulation, building financial resilience, and structural reforms to raise potential growth through improving the business climate. In 2018 and 2019, measures to address the loss of correspondent banking relationships entered the surveillance agenda including analysis in a SIP drawing on IMF research. These priorities were broadly in line with the 2014 and 2017 SDS staff guidance notes.

23. In interviews conducted for this paper, country authorities generally viewed IMF surveillance as appropriate and effective, particularly in helping to evaluate and manage macroeconomic risks, while room for improvement remained. It was noted that the combination of surveillance and program engagement had not prevented a deterioration of the debt risk rating to high during the evaluation period. A tougher IMF position on the public investment program, launched during the PSI, to identify high return projects, and more realistic growth projections could have helped flag rising debt vulnerabilities earlier. Officials saw a need for surveillance to be more tailored to take account of special needs and vulnerabilities of SDS in relation to lack of scale economies, some indivisible fixed costs, and high trade openness. Also, advice to the central bank to raise interest rates to attract remittances was not an effective policy in the SDS context of a weak transmission mechanism, and there was little scope to act on advice related to liquidity management and financial sector development because of limited institutional capacity.

24. Staff noted that the limited number of counterparts made providing well-tailored advice more difficult and may have limited the scope of surveillance. Staff indicated that data problems were not a major impediment to surveillance, although dealing with data inconsistencies could be time consuming. AFR staff for Cabo Verde (and other SDS) noted that the interdepartmental review process often ignored institutional capacity constraints in SDS, recommended first-best solutions and a one-size-fits-all approach, and can be a box ticking exercise. However, improving the review process would need more time and resources.

25. Staff interviewees noted that surveillance tools had advanced a lot during the evaluation period, including with adjustments for SDS circumstances, but that they have become too

sophisticated for the authorities to fully understand and for staff to explain the outputs in an intuitive way. Staff and authorities saw greater value in the debt sustainability analysis (DSA) and DSA scenarios than in the external sector assessment (EBA) (based on EBA-lite methodology) which provided mixed signals, although they noted the DSA is also complex and judgment is needed in using mechanistic tools. It was also noted that the DSA is sensitive to growth projections: missions often adopted the authorities' optimistic growth projections (based on expected returns from public investment) which created problems ex post as growth fell short. The deterioration of debt risk rating to high during the evaluation period could signal a need for more vigilance on assessing debt vulnerabilities and being more realistic in growth projections.

26. Overall, the authorities were generally responsive to staff's recommendations in Article IV consultations which suggests that surveillance delivered value added for the authorities. For example, the 2019 Article IV reported action on 2018 recommendations concerning the issuance of debt guarantees, narrowing the interest rate corridor, resolving non-performing loans, and restructuring or privatizing SOEs. An additional two recommendations concerning SOE monitoring and creating a collateral registry were incorporated as reform targets in the PCI.

Program Work and Emergency Financing

27. IMF program engagement has been through a PSI at the beginning of the evaluation period (2010–2012) and a PCI at the end of the period (2019–2021).[15] The gap between those two arrangements reflects, according to staff interviewees, a change in the composition of the authorities' economic team and their views on Fund support. RCF emergency financing was approved in April 2020.

28. The authorities expressed satisfaction with PSI and PCI engagement which gave helpful support to their domestic policy agenda, the National Sustainable Development Plan, and served as a valuable way to signal IMF approval of economic policies to development partners. Program engagement had also helped to reorientate priorities and reduce financial risks and, as a result, the authorities were better placed to deal with the onset of COVID-19. The authorities opted for use of signaling instruments involving no financial engagement as debt sustainability is a continual issue and for this reason the authorities prefer to avoid IMF borrowing outside of emergency financing. They noted that the 2019 PCI was flexible enough for targets to be modified considering the COVID-19 pandemic and to allow for an 18-month duration to avoid overlapping with national elections. However, some country officials thought the PCI was not particularly well designed, as fiscal policies were pro-cyclical and structural reforms were not substantive. They saw room for a lending instrument tailored to SDS needs to address exceptionally large shocks arising from climate change and natural disasters. The timeliness of

[15] The PCI was extended from January to March 2021 and the 3rd and final review of the PCI was completed in March 2021.

data provision was seen by staff as something of an issue for the PCI which has a fixed review schedule with three months grace.

29. In the context of COVID-19, Cabo Verde requested and was granted emergency assistance under the RCF (100 percent of quota, 1.7 percent of 2020 GDP) in April 2020 to cover balance of payments (BOP) needs generated by the impact of COVID-19. Cabo Verde also benefitted from debt relief under the DSSI. Staff projections showed a fiscal financing gap of 6.9 percent of GDP which was expected to be filled by the RCF (25 percent share), other external loans and grants (38 percent share) and additional domestic borrowing (38 percent share). The external financing gap was expected to be filled with RCF support (1.7 percent GDP), loans and grants from the World Bank, European Union, and African Development Bank (AfDB) (2.6 percent of GDP) and a drawdown of reserves (7.3 percent of GDP). The authorities indicated in their letter of intent that they remained committed to objectives set out in the PCI while noting that some quantitative targets would need to be reassessed in the next review.

30. Country authorities viewed the RCF as effective in catalyzing other official financing and helping to close the projected large fiscal financing gap in 2020. However, officials noted that while the RCF was extremely useful, it was insufficient in size to cope with the economic consequences of the pandemic necessitating a significant projected drawdown of reserves. Staff noted that the RCF played a catalytic role as the Fund was the first to disburse and others followed. Following the RCF disbursement, the second and third reviews of the PCI were completed (in October 2020 and March 2021) with staff noting a strong performance under the program despite challenging circumstances.

Capacity Development

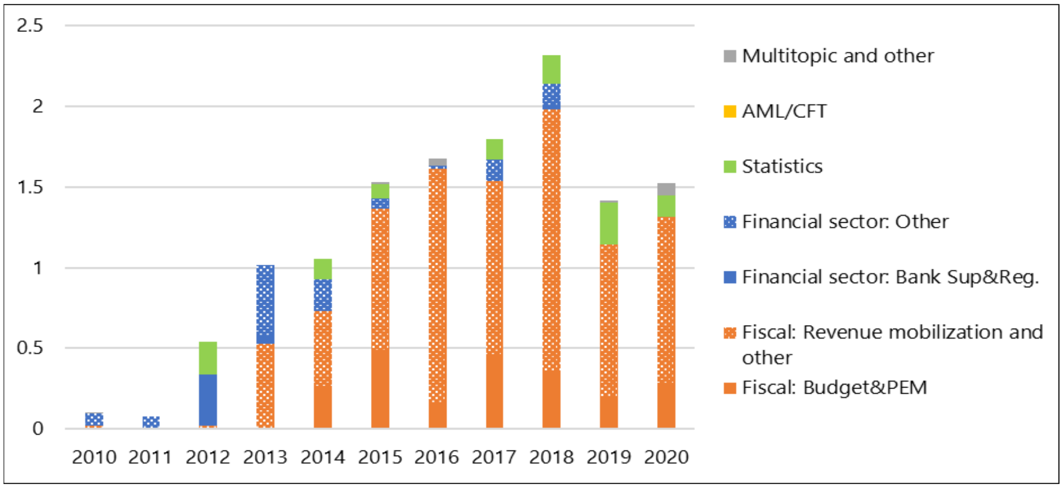
31. IMF CD support for Cabo Verde increased substantially over the evaluation period (Figure 4). Most IMF CD in Cabo Verde from 2013 onwards focused on fiscal issues in support of the policy priority of medium-term fiscal consolidation particularly revenue mobilization, tax administration, and Public Financial Management (PFM) delivered by FAD and AFRITAC West II (AW2) (Figure 4). This engagement was supported by diagnostics of revenue gaps in 2016 and tax administration (TADAT) in 2019. The 2018 IMF Country Strategy Note for Cabo Verde identified broader priorities for (i) revenue administration and tax policy reform, (ii) PFM reform, (iii) Central Bank operations, and (iv) statistical strengthening. Approximately half of the missions were fielded from AFRITAC West 2. Support from MCM and AW2 was focused on improving monetary operations, debt strategy, and foreign exchange reserves management. Statistical capacity building covered all main macroeconomic data but with an emphasis on building capacity in national accounts.

32. The authorities recognized that the Fund is an excellent partner in capacity building across its fiscal, monetary, and statistical competencies while acknowledging that SDS lack institutional resources which reduces their absorptive capacity. The 2018 CD strategy indicated that the authorities had requested more emphasis on “how, not only what” and fewer diagnostic

missions. The impact of CD could be seen in improved tax administration as well as financial programming and strengthened monetary policy. Staff noted that the main constraint on CD delivery is the authorities' capacity constraints, e.g., scheduling missions with a small number of counterparts. Country authorities flagged that AFRITAC West 2 played a key role in delivering technical assistance (TA) and training through regular visits and hands-on assistance. Staff noted that CD provision to Cabo Verde was generous in relation to its implementation capacity. They saw a difficult trade-off in meeting countries' demand for resident experts and the significant cost of this CD delivery modality.

Figure 4. Cabo Verde: Thematic Distribution of CD Provided, 2010–2020*

(In full-time equivalents)



Sources: IMF (TIMS); IEO calculations.

Notes: "Fiscal: Revenue mobilization and other" includes mainly fiscal law and revenue mobilization issues. "Financial sector: other" includes central banking, financial crisis preparation and management, monetary and foreign exchange policy and operations issues. "Multitopic and Other" includes administrative and preparatory work, e.g., scoping missions. PEM=Public Expenditure Management.

33. As regards CD integration with programs and surveillance, the authorities saw surveillance as key to identifying CD priorities. Staff noted that statistical TA has improved data quality which supports more effective surveillance and that TA recommendations were reflected in the PCI to support program implementation. Staff also noted that the CD Strategy Note has helped to better integrate CD with surveillance priorities, with Area Departments now having an important role in ensuring that CD is not supply driven.

Collaboration with Partners

34. While the IMF had no in-country presence in Cabo Verde, area department missions regularly briefed donors in the budget support group comprising of European Union (EU), Portugal, Luxembourg, the AfDB and the World Bank. Collaboration with the World Bank and the AfDB was more regular than with other partners. The authorities saw scope for more coordination between Fund staff and other development partners. In particular it was noted that

the World Bank continued to provide budget support between the 2010 PSI and 2019 PCI and tended to substitute for the IMF on macroeconomic management in this period.[16] Staff noted that collaboration with the World Bank improved during the COVID-19 emergency in terms of frequency and depth, e.g., participation in internal World Bank meetings.

Staffing of Country Teams and Engagement of Senior IMF Officials

35. From the authorities' side, rapid mission chief turnover (7 mission chiefs during the evaluation period with an average tenure of 1.75 years) resulted in lower awareness of Cabo Verde's specific circumstances. There was also a risk of having too many missions and overburdening country authorities, particularly in the case of PCI engagement with two review missions per year. They also saw the need for a resident representative (local or HQ-based) to support program monitoring. The authorities welcomed the first-ever DMD visit in 2019 prior to the PCI request as a sign of management engagement on SDS issues and staff noted good management engagement at the small states breakfast meetings during IMF-World Bank Spring and Annual Meetings.

B. Eswatini

Country Profile

36. Eswatini is a landlocked lower middle-income country[17] with moderately improving economic and social indicators during the evaluation period. GNI per capita was \$3460 at the beginning of the evaluation period and much of the subsequent decade and 2018 GNI was \$4.1 billion.[18] It has a land area of 17,400 km^2 and population of 1.14 million (2018 estimate). In 2018, 59 percent of the population lived below the national poverty line (63 percent in 2010) and 29 percent lived in extreme poverty (down from 43 percent in 2010) reflecting relatively high income and gender inequality.[19] The 2018 under-5 mortality rate was 55 per 1,000 births (down from 87 in 2010) and HIV/AIDS prevalence was high, at around 27 percent for adults 15–49, which has significantly lowered life expectancy.

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[16] World Bank budget support would nonetheless have required a positive assessment of macroeconomic policies in the Article IV or in a comfort letter in the absence of a recent Article IV. No comfort letters for Cabo Verde were published by the IMF between the PSI and PCI, as the World Bank relied on the regular Article IV assessments.

[17] World Bank Country and lending groups FY2021, https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

[18] World Bank Country Profile (GNI, GDP, area, poverty headcount, child mortality, HIV prevalence): https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=SWZ.

[19] 2014 Article IV Consultation. https://www.imf.org/external/pubs/ft/scr/2014/cr14223.pdf.

37. Eswatini (formerly Kingdom of Swaziland) gained independence from the UK in 1968. It is a monarchy where the King holds the executive authority, which may be exercised either directly or through the cabinet or a minister. Parliamentary elections are held every 5 years, following which the King appoints cabinet members, 20 out of 30 senators and 10 out of 65 members of the lower house (IMF, 2014).[20]

38. Eswatini has close linkages to South Africa and participates in the Southern Africa Customs Union (SACU) with South Africa, Botswana, Namibia, and Lesotho. Seventy percent of its total trade is with South Africa. The national currency, emalangeni, is pegged at par to the South African Rand which is also legal tender in the country. The benefits from integration with South Africa are a monetary policy anchor and good regional infrastructure, which support a relatively diversified economy (fifth most diversified SDS). Economic dependence on South Africa also can result in macroeconomic volatility, notably through large changes in SACU revenue transfers. As regards natural disasters, Eswatini has suffered from periodic droughts since the early 2000s, notably during the evaluation period in 2016–2017 and in 2019 which affected over a quarter of the population though macroeconomic impacts appear to have been somewhat mitigated by economic diversification away from agriculture.

39. Eswatini joined the IMF in 1969 and has a quota of SDR 78.5 million and a voting share of 0.04 percent. Eswatini had not had program engagement with the Fund during the three decades prior to the evaluation period. It had an SMP in 2011 and a Rapid Financing Instrument (RFI) disbursement in 2020 (Table 3). Eswatini was not eligible for IMF concessional financing from the PRGT during the evaluation period due to its per capita income level being above the applicable threshold. IMF spending on Eswatini has been largely devoted to CD support (Figure 5)

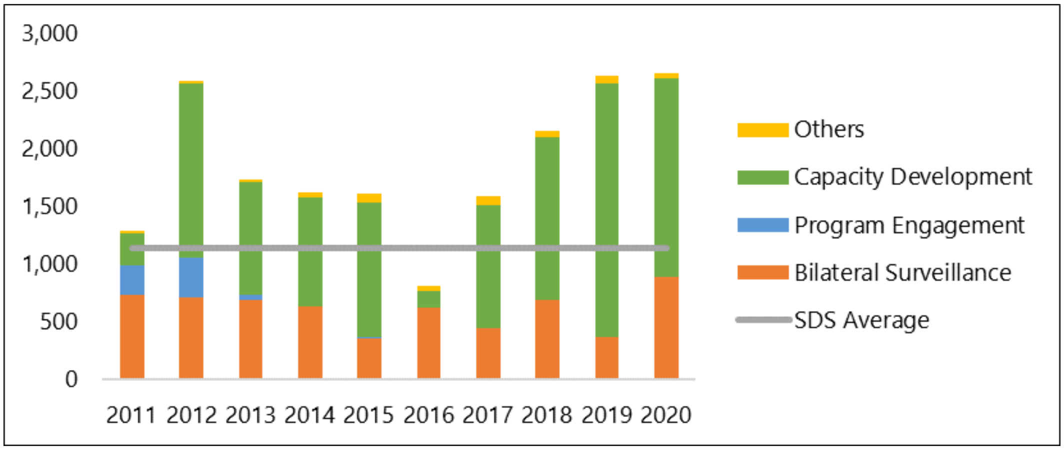
Table 3. Eswatini: IMF Engagement, 2010–2020

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

Sources: IMF; IEO calculations.

[20] See: https://www.britannica.com/place/Eswatini.

Figure 5. Eswatini: IMF Spending by Activity, 2011–2020
(In thousands of USD)

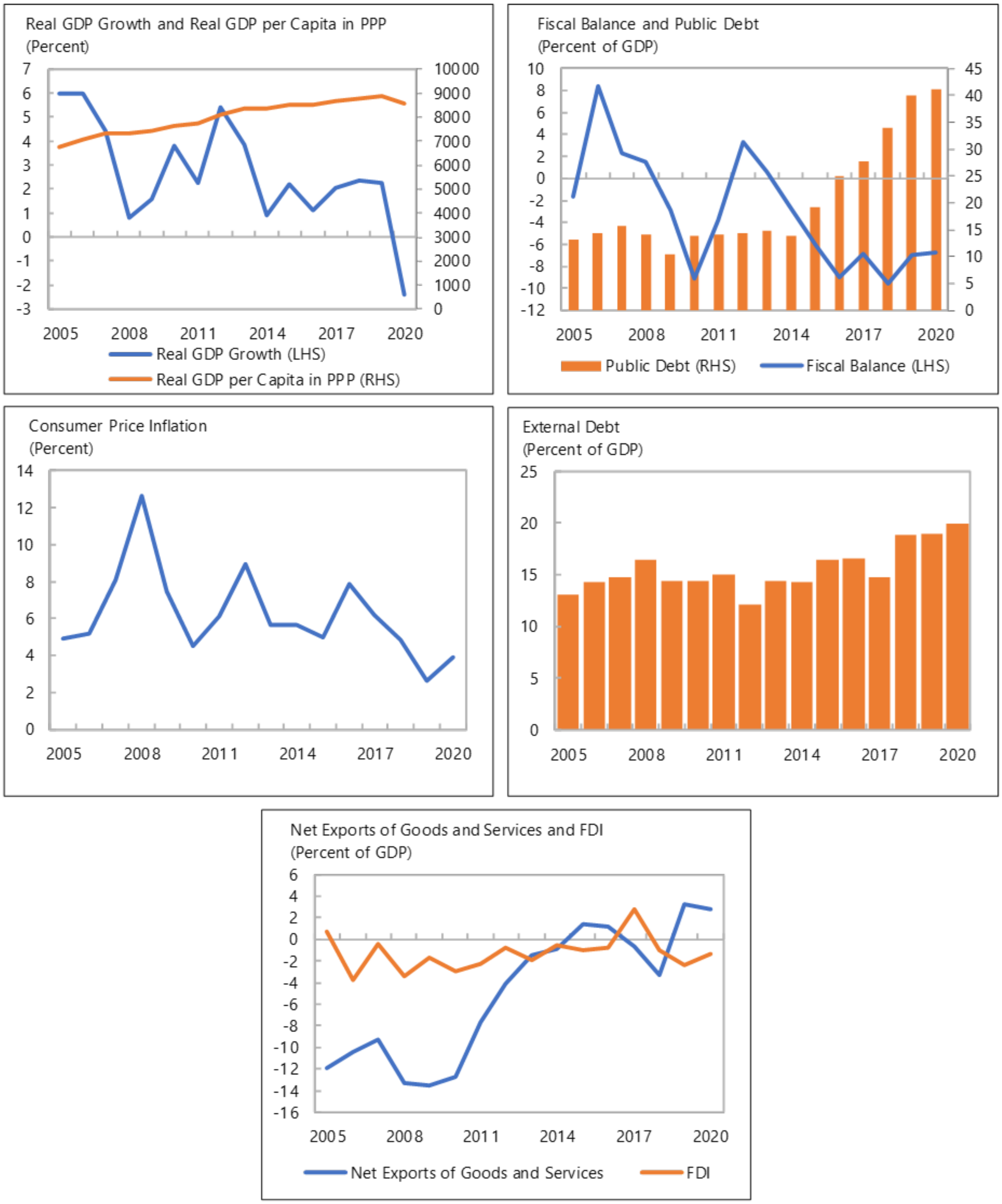


Sources: IMF (ACES); IEO calculations.

40. Eswatini has registered a sluggish growth performance in the past two decades, including in comparison to other AFR+2 SDS, due to weak private sector investment, structural and governance problems, and high HIV/AIDS. Unemployment is high—over 20 percent during the evaluation period and significantly higher for youth. The evaluation period started and ended with acute fiscal pressures resulting from sharp declines in SACU revenues and elevated public expenditures particularly on the wage bill and capital spending. During 2010–2011 and 2016–2019 the large fiscal imbalances were financed through domestic arrears accumulation, borrowing from the Central Bank of Swaziland, and domestic securities issuance. Although some fiscal adjustment took place during these episodes, gross financing needs were high, public debt rose, the external position weakened, and slumping investment resulted in stagnant growth. The intervening period of 2012–2015 was marked by greater macroeconomic stability, with improved fiscal and external positions, stronger SACU revenues, and an uptick in growth from manufacturing and construction (Figure 6).

41. In response to the COVID-19 pandemic, Eswatini imposed several lockdowns starting in March 2020, including periods with a national curfew, restrictions on business operations, and closure of borders to all but essential travel and goods. 2020 GDP declined by an estimated 1.9 percent. The fiscal deficit rose marginally to 8.1 percent of GDP percent—largely because 2020 customs receipts rose substantially reflecting lagged trade flows—bringing general government public debt to 47 percent of GDP (more than triple the level at the outset of the evaluation period). Budgetary provisions of 1.5 percent of GDP (financial year ending March 2021) were made for additional healthcare spending, food distribution, and social protection transfers alongside tax payment extensions and refunds. Fuel prices were lowered twice, and water and electricity price increases deferred. The central bank substantially lowered the discount rate and loosened prudential requirements for banks in 2020.

Figure 6. Eswatini: Macroeconomic Developments, 2005–2020



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

Main Elements of Fund Engagement

Surveillance

42. The surveillance priorities in Article IV consultations completed during the evaluation period centered on fiscal and monetary policy settings, actions to enhance financial sector stability especially as regards non-bank institutions, and structural reforms to support growth. The framing of surveillance priorities evolved from upfront fiscal adjustment and bold structural reforms (privatization and land reforms) early in the evaluation period to a more nuanced emphasis on building up resilience to shocks and a stronger focus on inclusive growth from the middle of the evaluation period in line with SDS staff guidance issued in 2014. Topics in SIPs included an analysis of export diversification and export quality upgrading (2015) drawing on earlier IMF research (Henn, Papageorgiou and Spatafora, 2013) and inclusive growth which highlighted the importance of skill mismatches (IMF, 2017) drawing on the analysis of a 2013 SIP on small middle-income countries in Sub-Saharan Africa (IMF, 2013).

43. In interviews, authorities welcomed the analytical quality of Article IV reports notably in assessing the fiscal challenges of shrinking customs revenues and more recently the impact of COVID-19. The authorities noted that Fund surveillance has improved during the evaluation period in giving more emphasis to a small states perspective although there was still room to do more in tailoring advice to provide concrete recommendations to address the instability that is associated with smallness, the lack of economies of scale, and the fiscal impact of comparatively small projects that would normally not be covered in non-SDS surveillance. The authorities believed the fiscal policy advice, while sometimes difficult to implement, had flagged policies that had helped avoid recourse to Fund financing. The authorities also noted that surveillance sometimes defaulted to a more negative assessment than warranted, especially where data gaps exist, and pointed to a lack of appreciation of the lengthy domestic consultation process that slows decision making.

44. Staff saw a benefit in increasing the frequency of remote contacts to encourage a more candid and continuing informal dialogue outside of the Article IV consultation with its published report. Staff noted that an understanding of the political economy of reform, and how to effectively frame policy advice in the SDS context, was limited in the internal review process as reviewers had limited time or weak incentives to do so, echoing sentiments expressed in other case studies on the lack of value added in the review process.

45. Surveillance tools were of mixed usefulness in Eswatini. The DSA was viewed as a very helpful tool by the authorities, although the assessment did not adequately consider vulnerabilities arising from domestic debt, in particular crowding out of the private sector. The adoption of the EBA-lite model in 2015 provided estimates of external sustainability together with flexibility to tailor the assessment to Eswatini's circumstances. However, staff noted that the analysis was not particularly useful to the authorities, due to its complexity and because external balances depended significantly on developments in the peg currency. Staff noted that the DSA and EBA outputs may suggest a level of precision that is unwarranted in SDS given data constraints.

46. The Eswatini authorities did not request an FSAP/FSSR although some country authorities thought it could be useful and interest has been stronger recently. Nonetheless, authorities noted that TA provided to the central bank was professional and of good quality in most cases particularly in supporting financial sector surveillance.

47. Staff recommendations often had limited traction, particularly for fiscal adjustment where the authorities' preference was a gradual multi-year approach rather than the upfront adjustment initially suggested by staff. This was particularly evident early in the evaluation period as the Staff-Monitored Program quickly went off track (see below). Implementation of Article IV recommendations was particularly limited due to political constraints that were mentioned by staff. Implementation picked up later in the evaluation period with progress for example in supervising and regulating the non-bank sector. In other areas, such as adoption of fiscal rules to address revenue volatility there was little traction.

Program Work and Emergency Financing

48. The 2011 SMP was approved by IMF Management in April, with a view to building a track record of policy implementation for an upper credit tranche arrangement at end-2011 and to unlock urgently needed financing from the World Bank and AfDB. However, the envisaged front-loaded fiscal adjustment, including in Q1 2011, was not implemented and the SMP went off track as March 2011 targets for the first SMP review were not met. The authorities believed that the first test date should have been set for June 2011 but went along with staff's advice for March 2011, in the hope of unlocking donor support which in the event did not materialize after the program went off-track, i.e., a negative catalytic impact. A 2011 staff assessment of the main implementation risks in a cover note to IMF Management noted that they arose from a "lack of political and social cohesion around the need for fiscal consolidation, and limited implementation capacity" and ex post staff noted in interviews with IEO that a lesson learned was that the program was too optimistic on the fiscal consolidation that could be achieved. After this negative experience, Eswatini has not requested further program engagement with country officials noting that Fund conditionality requirements would be difficult to meet. Eswatini instead has sought bilateral financing (from Kuwait Fund, India Exim Bank and Taiwan Province of China) and regional financing (from the Development Bank of Southern Africa).

49. In July 2020, a request for support under the RFI (100 percent of quota, 2.5 percent of GDP) was approved to address external financing needs in the context of the COVID-19 shock. A BOP need of 8.6 percent of GDP was expected to be filled with the RFI (29 percent share), World Bank and AfDB financing (27 percent share), and reserve drawdown (44 percent share)**.** The RFI support was viewed by authorities and staff as timely, efficient, and adequate in size. The loan created enough fiscal space to enable a breakthrough in domestic arrears clearance. In their Letter of Intent, the authorities committed to draw up a contingency plan to finance additional COVID-19 spending if needed, and to issue a supplementary budget to cover any residual financing needs. Although the RFI does not involve program conditionality, the authorities engaged with staff on detailed discussions of plans for medium-term fiscal adjustment of

6.5 percent of GDP to support debt sustainability, which were laid out in the letter of intent supporting the RFI request, and contributed to a delayed submission of the RFI request to the Executive Board compared to many other IMF members.[21] In addition the authorities committed to a multi-pronged approach to strengthen governance, transparency and accountability.

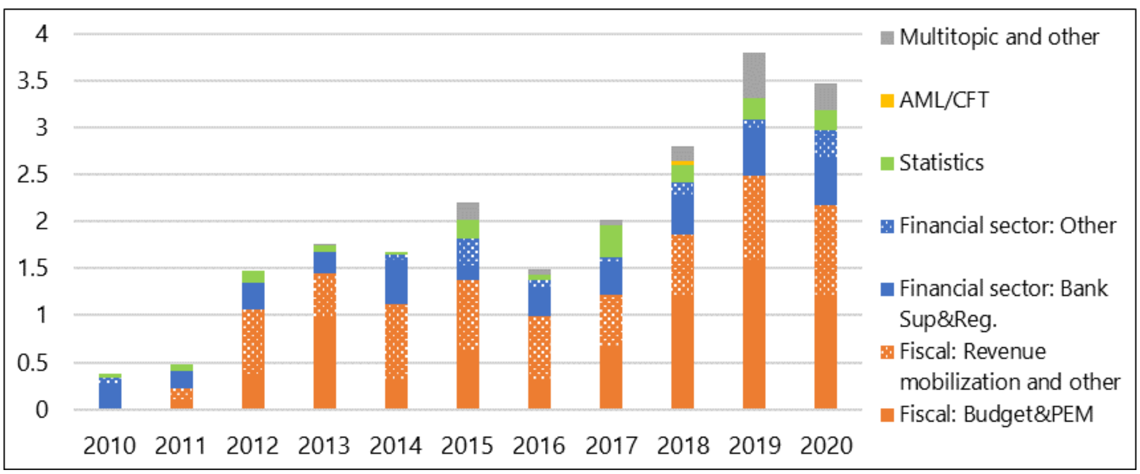
50. The authorities noted that the RFI enabled a shift in public perceptions and goodwill towards the IMF, while stigma was reduced as the RFI does not have formal ex post conditionality. In addition, although the RFI covered only a fraction of the total financing needs, it was helpful in catalyzing support from the Development Bank of Southern Africa and the World Bank although significantly later than the RFI disbursement.

Capacity Development

51. Eswatini has been the largest recipient of CD support of the five country case studies. This support, both from AFRITAC South and HQ, increased fairly steadily over the evaluation period, with assistance on fiscal policy accounting for about two-thirds of support (Figure 7). The CD strategy (presented in the 2019 Article IV report) notes that Eswatini is a high intensity technical assistance recipient with overall priorities of strengthening budget execution, domestic revenue mobilization (to reduce reliance on customs revenues), financial sector oversight, and statistical strengthening. In part, CD provision was boosted by a resident advisor to strengthen treasury functions (FAD expert) from 2017 onwards.

Figure 7. Eswatini: Thematic Distribution of CD Provided, 2010–2020*

(In full-time equivalents)



Sources: IMF (TIMS); IEO calculations.

Notes: "Fiscal: Revenue mobilization and other" includes mainly fiscal law and revenue mobilization issues. "Financial sector: other" includes central banking, financial crisis preparation and management, monetary and foreign exchange policy and operations issues. "Multitopic and Other" includes administrative and preparatory work, e.g., scoping missions. PEM=Public Expenditure Management.

[21] The urgent BOP need may also have taken longer to manifest itself than in other countries as SACU customs revenue in 2020 was robust and revenue to GDP rose in 2020 compared to 2019.

52. Overall, the authorities consider IMF TA to be of great value (as noted in the draft 2019 CD strategy). The authorities noted that TA was generally aligned with Eswatini's requests although not all TA requested is supplied. The authorities suggested that CD activities could achieve greater results by relying more on hands-on support, resident advisors, peer learning, and comparisons with international best practices to complement written recommendations from TA reports.

53. The authorities noted that flexible delivery modalities meant that CD could be tailored to the problem at hand, for example a combination of HQ and AFRITAC-S had worked well in TA on monetary policy. As regards the impact of assistance the authorities noted several recent missions had been of great assistance including a mission from HQ on options for tax base broadening, a resident advisor assisting in the rollout of an 18-month program to strengthen treasury functions, targeted support from AFRITAC on cash management including at short notice, and good advice on public financial management which enabled Eswatini to avoid making mistakes other countries had made.

54. Staff noted that recent changes giving Area Department teams a greater role in approval of TA provision allows for better prioritization of CD citing an example of a changed sequence of STA missions to maximize scope for effective impact.

Collaboration with Partners

55. Donors have a limited footprint in Eswatini which limits the number of stakeholders to engage with. The World Bank has on-the-ground representation and a World Bank economist accompanies IMF missions to Eswatini. However, AfDB and bilaterals do not have an on-the-ground presence and there is no donor roundtable to brief/debrief. Staff viewed collaboration with the World Bank and the AfDB as appropriate although the authorities believed there was scope for stronger IMF-World Bank relations. In particular, the authorities pointed to a coordination problem among the IMF, World Bank, and AfDB during COVID-19 as the World Bank and AfDB waited for IMF Board approval of the somewhat delayed RFI and then started later than desirable in drawing up their COVID-19 support financing. Moving forward in parallel would be preferable to a sequential process. Nonetheless, staff noted that IMF relations with the World Bank improved noticeably through coordinating a joint response to the COVID-19 pandemic including IMF staff attending World Bank internal meetings, as well as with the AfDB in relation to an arrears clearance loan.

Staffing of Country Teams and Engagement of Senior IMF Officials

56. Mission chief assignments were relatively stable compared to other SDS. Three mission chiefs covered most of the ten-year evaluation period (average tenure of 3 1/3 years). Managing turnover better by staggering staff transitions was mentioned by country authorities as an area for attention while mission chiefs also noted difficulties from high turnover within mission teams and the difficulty in attracting top performers. Three AFR staff on missions were occasionally

joined by other departments: FAD (2010, 2017), MCM (2019), and the Research Department (RES) (2017). One senior country official noted that mission teams are surprisingly well informed on Eswatini in contrast to comments on a lack of country-specific knowledge in other country cases, which may reflect a longer than average mission chief tenure. A senior staff member with experience in APD and AFR noted that a preference to work on larger countries in the department also did not appear to be an issue of concern in AFR. No issues of note arose concerning the engagement of senior officials and IMF management. The authorities noted that the SDS definition helped the Fund focus on small states issues which previously had a tendency to "fall between the cracks" and that the IMF SDS meetings at the Spring and Annual Meetings were evidence of progress in this regard.

C. Mauritius

Country Profile

57. Mauritius is an island SDS, located in the Indian ocean, about 500 miles east of Madagascar. Its highly heterogeneous population of 1.27 million (third largest among IMF SDS) occupies a land area of 2,030 km^2 and an exclusive economic zone[22] of 1.27 million km^2. Recently re-classified by the World Bank as high-income.[23] The country's GNI was US$13 billion and the end of the evaluation period, increasing from US$10 billion in 2010. Mortality rate under five moved from 15 in 2010 to 16 in 2020.[24]

58. Mauritius became an independent state in 1968. A governor-general representing the British monarch remained as the head of state until 1992, when Mauritius became a republic with a president as head of state. The country has been politically stable, holding free elections regularly. In 2019, the Morisien Alliance, integrated by the Militant Socialist Movement, won the elections (vs. the National Alliance, led by the Mauritian Social Democratic Party or PMSD).[25]

59. Mauritius is a success story in terms of economic development. Starting as an undeveloped, mono-crop, agricultural (22 percent of GDP) economy, with a GDP per capita of $260 at the time of independence, sound economic policies have developed and diversified the economy (World Bank and others, 2017), propelling it to high-income status in 2020. According to the AfDB, Mauritian GDP per capita is the third highest in Africa, after Equatorial Guinea and Seychelles, and the gains of development have been widely shared through jobs creation, welfare improvements, social protection, and poverty reduction programs.

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[22] http://www.seaaroundus.org/data/#/eez.

[23] https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

[24]https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=MUS.

[25] https://www.britannica.com/place/Mauritius.

60. The economy is now largely service-based (76 percent of GDP in 2019), followed by industry (21 percent) and agriculture (3 percent). Growth has been recently driven mainly by financial services, retail and wholesale trade, and information and communications technology. Moreover, Mauritian institutions have improved, with the country repeatedly being ranked by the Mo Ibrahim Foundation as the best-governed country in Sub-Saharan Africa and as high performer by the World Bank's Doing Business Report, fostering hopes of Mauritius becoming the Luxembourg or Singapore of Africa.[26] Mauritius is considered extremely vulnerable to climate, second only to Fiji, and moderately vulnerable to natural disasters (23rd out of the 34 SDS) (IMF, 2016).

61. Mauritius joined the IMF in 1968. The country's quota is SDR 142.2 million, with a voting power of 0.06 percent. The country's history of financial arrangements with the Fund is limited to a series of six SBAs between 1978 and 1986. In addition to Article IV consultations and CD, Mauritius benefitted from an FSAP in 2016 (Table 4). Deepening its relationship with the Fund, Mauritius hosts AFRITAC South and the ATI.

62. Created in 2011, AFRITAC South is one of the five RCDCs in Africa and serves 13 countries, 4 of them SDS.[27] The ATI was established in 2013 and is co-located and jointly managed with AFRITAC South. At the ATI, officials from 45 sub-Saharan African countries receive courses that are hands-on and tailored to their needs, mainly on macroeconomic policies, debt sustainability, financial sector supervision, and the management of national resources. Mauritius benefited substantially from the provision of IMF CD support, especially during the first half of the evaluation period (Figure 8).

Table 4. Mauritius: IMF Engagement, 2010–2020

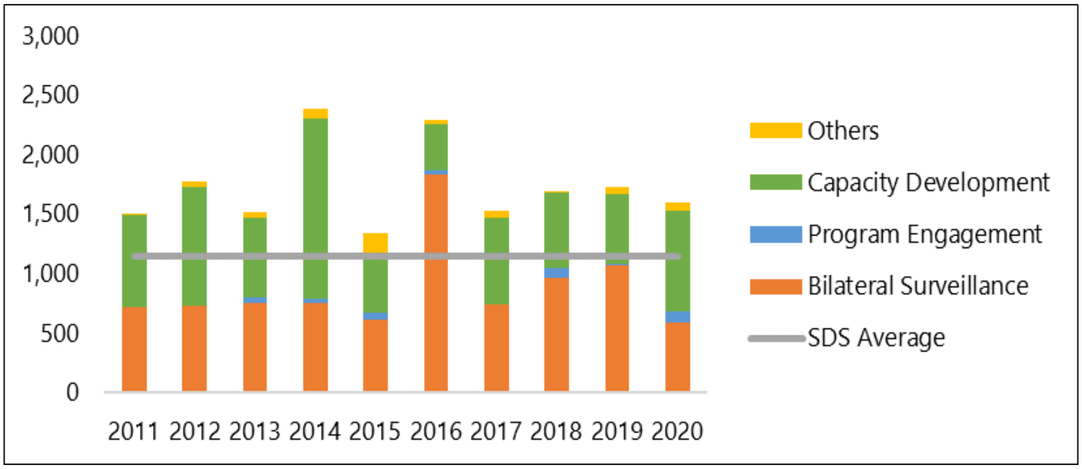
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Article IV											
Programs											
Emergency financing											
Other							FSAP				

Sources: IMF; IEO calculations.

[26] https://www.ft.com/content/b8c0f8aa-8434-11e7-94e2-c5b903247afd.

[27] Angola, Botswana, Comoros, Eswatini, Lesotho, Madagascar, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Zambia, and Zimbabwe.

Figure 8. Mauritius: IMF Spending by Activity, 2011–2020
(In thousands of USD)

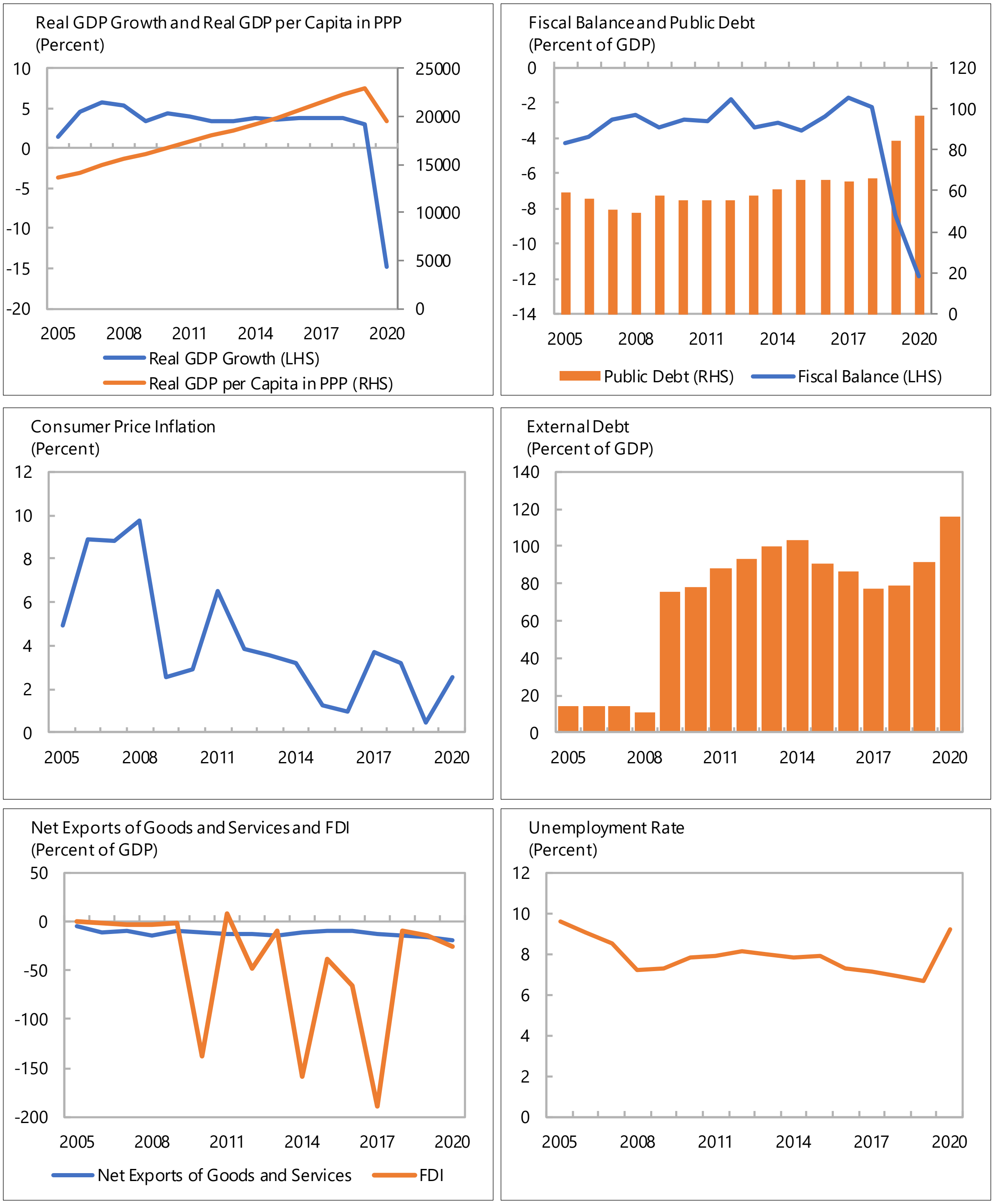


Sources: IMF (ACES); IEO calculations.

63. Mauritius rebounded quickly from the global financial crisis and the subsequent European debt crisis, thanks to a comprehensive and proactive policy package. The economy managed to sustain a real GDP growth of around 4 percent between 2010 and 2019, coupled with stable low inflation and declining unemployment rates around 7.5 percent (Figure 9). Over the same period (excluding 2019), the fiscal deficit averaged 2.7 percent of GDP and public debt grew from 55 percent to 66 percent of GDP, although the fiscal position had started to deteriorate even before the pandemic hit.

64. The economic impact of COVID-19 in Mauritius was severe. Prompt action by authorities enabled the country to elude a health crisis (according to the AfDB, the country registered 315 cases and 10 deaths from COVID-19 between January and December 2020) but the economic cost was high. Following strong shocks to the tourism industry, the financial sector, and the economy in general, the economy contracted 15 percent (compared to a previous growth projection of 3.5 percent), and unemployment jumped to 11 percent. The already troubled fiscal accounts deteriorated further due to falling revenues and rising expenditures, with the fiscal deficit over 23 percent of GDP and public debt at 99.2 percent of GDP.

Figure 9. Mauritius: Macroeconomic Developments, 2005–2020



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

Main Elements of Fund Engagement

Surveillance

65. Fund surveillance activity on Mauritius is an outlier among SDS. During the evaluation period (2010–2020), IMF surveillance treated Mauritius as a relatively well-developed, not-so-small economy, with higher institutional capacity and a good record of prudent macroeconomic management and structural reform implementation (although not free from capacity constraints). Thus, surveillance reports orbited more around its emerging market economy and financial center characteristics, than around its SDS nature. In fact, some authorities and staff members reflected upon the wide spectrum of countries covered under the SDS definition (with Mauritius at the top in terms of institutional development and income) and the possibility of using alternative or additional variables to size to map this category (e.g., vulnerability).

66. IMF short-term macroeconomic advice during the evaluation period focused on fine-tuning fiscal and monetary policy while encouraging economic reform implementation. In the absence of pronounced imbalances or major shocks (including natural disasters) and with broadly adequate fiscal and monetary policies, staff focused on calibrating policies in reaction to various adverse shocks: initially, the GFC and the subsequent debt crisis in Europe, which was transmitted to Mauritius through reduced tourism, trade, and FDI inflows; later, the fluctuation of international prices of commodities; and, towards the end of the evaluation period, the weakening of the fiscal and external positions. Throughout the period, Mauritius maintained adequate reserves levels (even when staff applied more stringent metrics that took into account the financial center character of Mauritius), the exchange rate stayed broadly in line with fundamentals, and debt was sustainable, although deteriorating in the second half.

67. Most of staff's policy advice focused on medium/long-term macroeconomic and structural policies. Recommendations addressed five main areas:

- *Raising long-term growth in support of the country's development agenda*, including not only major investment projects, but also improvements in competitiveness and diversification (e.g., creating an ocean economy), labor market reforms (with especial attention to the unemployment of women and the youth, build-up of human capital and education, and administrative enhancements aimed at reducing bottlenecks and improving the business and investment climate.

- *Implementing fiscal reforms to support growth in an inclusive way*, including green taxation, broadening of the tax base, better targeting of subsidies and social assistance programs, and reforming the public pension system.

- *Reform of SOEs*, with a recurrent emphasis on the pricing policies of water, electricity, and road networks (work often coordinated with the World Bank).

- *Statistics*, often involving the provision of TA. As a result, Mauritius subscribed to the SDDS in February 2012 and almost immediately embarked on a plan for the adoption of the SDDS Plus.

68. Financial sector policies received special attention in surveillance reports, especially during the second half of the evaluation period. Between 2010 and 2015, surveillance found the Mauritian financial sector to be well-capitalized, profitable and resilient, with advice centering on the implementation of outstanding recommendations from the 2007 FSAP (e.g., the adoption of a deposit insurance scheme or the strengthening of Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) and supervisory mechanisms). After the collapse of the financial conglomerate British American Investment Co. in 2015, attention to the offshore financial center dimension of the economy skyrocketed. An FSAP was conducted later that year (not published) and Mauritius became one of the pilot country cases in the initiative to deepen and improve macro financial surveillance.[28] Thus, the 2015 Article IV[29] report focused on the FSAP findings and recommendations (followed up upon and expanded in subsequent reports): strengthening the financial stability framework via the introduction of a macroprudential authority and improving the supervision, resolution, and crisis prevention and management frameworks.[30]

69. In general, surveillance seems to have been well anchored and focused. Reports reflected good rapport and understanding between the authorities and staff (a view confirmed by authorities), with staff making the effort to incorporate political economy considerations. Moreover, Article IV reports were well structured around the most pressing issues at each point in time and underpinned by analytical work by the team and the Fund more broadly,[31] which

[28] The IMF launched the initiative on macro-financial analysis and vulnerability assessment to mainstream macrofinancial analysis in bilateral surveillance, providing specific guidance for fully integrated analysis of macrofinancial linkages and systemic risk in both the baseline and risk scenarios in Article IV reports. The initiative started with a pilot program for 24 countries in 2015, expanded to 66 countries in 2016, and was mainstreamed in 2018 (IEO, 2019).

[29] The 2015 FSAP was published in March 2016. The FSAP (dated 2016) was conducted in November 2015.

[30] For additional information on FSAPs conducted in SDS see Marston (2022).

[31] See, for example, David and Petri (2013), Leigh and Mansoor (2016), Ostry, Ghosh, and Chamon (2012), Svirydzenka and Petri (2014), and Soto, Thakoor, and Petri (2015).

often crystalized in appendixes[32] and SIPs.[33] Surveillance tools worked sufficiently well—e.g., they were useful in detecting debt and external risks—but it was difficult to adapt them to the specifics of the Mauritian economy, especially the EBA. Relative to the GROWTH framework, surveillance paid constant attention to growth and jobs creation, competitiveness, and workable fiscal and debt sustainability options. Resilience to shocks (at least from the natural disasters perspective) was less of an issue in the case of Mauritius, and the guidelines on the development and deepening of SDS financial sectors were hardly applicable to the Mauritian financial system.

70. While the authorities were overall satisfied with the Fund's surveillance, they pointed to several areas for improvement. They were content with the relevance, timeliness, and coverage of Article IV reports, produced on the regular 12-months cycle. They were also satisfied with the frequency of interactions and staff's supportiveness and disposition, especially during the COVID-19 pandemic when contacts were more frequent. However, they were concerned about occasional lack of depth and specific knowledge about the Mauritian economy, which led to insufficient tailoring in some of staff's work.[34] Officials linked this problem to the high staff turnover (see section below). This criticism did not extend to the FSAP, which they believed was based on a deep knowledge of the financial system that resulted in a clear assessment and useful recommendations. They were also satisfied with the support provided for the subsequent implementation of the FSAP (including through the Article IV process), especially after Mauritius was blacklisted by FATF in 2018. As recommendations (potentially applicable to other SDS), authorities suggested: (i) exploiting comparisons with other international financial and global business centers and small, open, developed states, which they considered the appropriate comparators for Mauritius, including Malta, Latvia, Estonia, and some Caribbean countries;

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[32] In the 7 Article IV reports produced between 2010 and 2020, staff elaborated 24 thematic one-off appendixes/annexes on the following topics: output gap and cyclical adjustment of fiscal balances, long-term growth prospects, fiscal rules and fiscal sustainability, options for environmental tax reform, export performance and outlook, green taxes and ethanol policies, inclusive growth, SOEs financial monitoring and reform, tourism sector competitiveness, energy pricing and subsidy reform, pension reform options, labor market issues and outlook, aspects of the monetary transmission mechanism, banking sector and spillover analysis, offshore financial sector assessment, revenue and expenditure assignments of local governments, considerations for introducing an earned-income tax credit, the failure of British American Investment Co., sectoral macroeconomic risk: balance sheet analysis, increasing female labor force participation, improving domestic revenue mobilization, financial conditions index, Mauritius as a financial center: current standing and prospects, and private savings in Mauritius. Moreover, staff also produced 28 additional appendixes/annexes on more routine aspects, such as: exchange rate and competitiveness assessments, DSA, reserve adequacy assessment, stress-testing the banking system, status of previous AIV and FSAP recommendations implementation, external balance, stability and reserve adequacy, risk assessment matrix, external debt sustainability assessment, summary of the capacity development strategy.

[33] During the evaluation period, staff produced six SIPs: "Implications of International Tax Transparency and Anti-Tax Avoidance Initiatives for Mauritius," "Modernization of the Monetary Policy Framework in Mauritius," and "Boosting International Competitiveness" in 2017, and "Estimating a Financial Conditions Index for Mauritius," "Unlocking Structural Transformation in Mauritius: Challenges and Opportunities," and "Private Savings in Mauritius" in 2019.

[34] Authorities mentioned, as an example, recommendations on inflation targeting which presupposed "standard" transmission mechanisms not to be found in Mauritius.

(ii) greater attention to governance and corruption issues; and (iii) stronger engagement with other stakeholders (i.e. private sector, academia, and civil society), which were crucial for the success of Mauritius, and will acquire even greater relevance as social and environmental dimensions grow in importance. In this sense, it was considered that the Article IV process could potentially be used as a consensus building mechanism by strengthening outreach and consultations during missions.

71. Staff highlighted officials' receptiveness to IMF advice but mixed experiences on the traction of Fund advice. Staff pointed to the importance of maintaining a good relationship with the Mauritian authorities in supporting their development agenda, which took considerable effort. Dialogue was favored by authorities' strong ownership of their policy work and receptiveness, and by the establishment of a closer relationship with senior policy makers, which in turn allowed for better quality of advice. On the data front, staff mentioned some data gaps, but there was consensus that they did not prevent a reasonably good analysis. In terms of achieving traction, staff were more satisfied during the first half of the evaluation period and with the implementation of technical level recommendations, rather than big-picture policy issues. Examples of areas in which traction was substantial, often facilitated by the provision of TA, include the revision of the monetary policy framework, AML/CFT regulations, and tax policy. Traction was weaker in the areas of central bank operations and the pursuit of fiscal consolidation towards the end of the evaluation period.

Program Work and Emergency Financing

72. Mauritius has not had a program with the IMF in decades. Two reasons were brought up during interviews by authorities and staff for the absence of program engagement. First, the country´s relatively good economic situation during the evaluation period made a program unnecessary. Second, there might have been some stigma concerns associated with requesting a program, especially as Mauritius has been trying to project itself as an international financial center.

73. Financial support from the IMF was considered during the pandemic, but it did not come to fruition. In March 2020, faced with the severe impact of COVID-19 in the tourism and offshore financial sectors, the authorities initiated discussions on a RFI request, but disagreements with staff on the required ex ante policy undertakings[35] prevented an agreement, which also stopped a World Bank policy loan. Authorities were not pleased with the outcome of the negotiations and raised evenhandedness concerns, as Mauritius was the only African SDS that did not receive emergency assistance during the pandemic. However, the episode did not substantially affect the Fund´s relationship with Mauritius and the regular engagement, in constructive and cordial terms,

[35] Staff saw as problematic the measures adopted by the Bank of Mauritius, in coordination with the government, in response to the COVID19 crisis: a transfer to the government equivalent to 14 percent of GDP, purchases of government bonds of 3.5 percent of GDP, and the establishment of the Mauritius Investment Corporation, owned and funded by the Bank, to engage in quasi-fiscal operations.

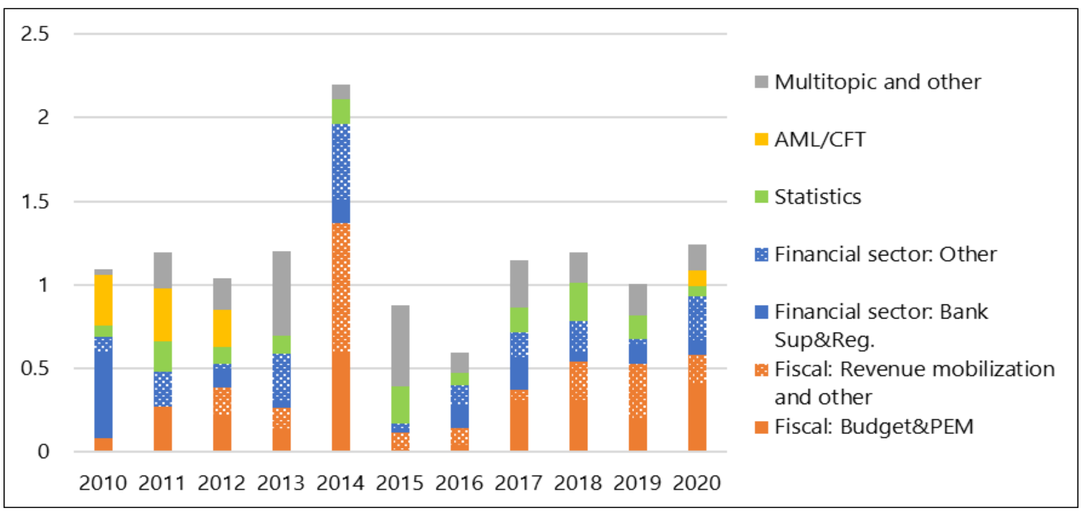
was immediately re-established. At the same time, despite a substantial expected reduction, external reserves were still high and the amount of financing that could have been provided under the RFI (100 percent of quota, approximately US$205 million or 1.5 percent of GDP) was small compared with an estimated financing gap of around US$3 billion, which was largely financed by a transfer from the central bank and resources from the AfDB and bilateral donors.

Capacity Development

74. Mauritius has benefited substantially from IMF CD, although the country ranks 39th out of 45 Sub-Saharan countries in terms of CD received in a recent regional strategy note. Over the evaluation period, there were a large and growing number of TA missions, spanning from seven in 2010 to 21 in 2018, mostly from AFRITAC South but also HQ-provided from MCM, FAD, LEG, and the Statistics Department (STA). Mauritius received CD mostly on the fiscal and financial sector domains, with smaller but constant support on statistics and AML/CFT at the beginning and end of the evaluation period (Figure 10). Article IV reports reflected a good integration between the CD and surveillance activities, especially during the first half of the evaluation period, with constant references to how policy advice could be (or was already being) supported by TA.

Figure 10. Mauritius: Thematic Distribution of CD Provided, 2010–2020*

(In full-time equivalents)



Source: IMF (TIMS data).
Notes: "Fiscal: Revenue mobilization and other" includes mainly fiscal law and revenue mobilization issues. "Multitopic and Other" includes administrative and preparatory work, e.g., scoping missions and the creation of AFRITAC South and ATI. "Financial sector: other" includes central banking, financial crisis preparation and management, monetary and foreign exchange policy and operations issues. PEM=Public Expenditure Management.

75. The authorities were broadly satisfied with the CD provision by the IMF. They appreciated its relevance, usefulness, timeliness, and broad coverage. They were also satisfied with the Fund's responsiveness, as their requests have been regularly met, and with the support received for implementation. Authorities underscored the usefulness of the CD provided by AFRITAC South,

although they were also happy with the quality of missions from HQ. They recognized having benefited a lot from hosting the ATI and AFRITAC South, since having ready access to all the experts had facilitated a very regular engagement, leading to the transmission of knowledge and the absorption of lessons from experiences in other countries.

76. Staff also assessed positively the provision of CD to Mauritius. They believed that good levels of traction had been achieved and pointed to three key factors: (i) authorities' ownership, openness to the Fund's advice, and implementation efforts; (ii) good tailoring of the CD provided; and (iii) the two-way integration of CD and surveillance, in a process by which surveillance pinpointed CD needs and TA delivery was used to inform surveillance advice. Given their local knowledge and expertise, some staff members saw room for AFRITAC South (and RTACs in general) to play a stronger role in surveillance and in the formulation of advice, strengthening its tailoring and design. They also considered that RCDCs could play a coordinating role, bringing key development partners together.

Collaboration with Partners

77. Collaboration with other institutions seems to have been stronger during the first half of the evaluation period. The relationship was closer with the World Bank, but less so with other institutions. Up to 2017 a Joint Managerial Action Plan (JMAP) was published with Article IV reports. The JMAP described each institution's work program for the country on policy advice, lending, and CD and detailed past and expected information sharing agreements, mutual input requests, and joint products and missions (although no items were recorded in the last category since 2011). Towards the end of the evaluation period, coordination with the World Bank was active, although purely informal, and did not lead to the elaboration of joint reports. Some staff members pointed to the lack of program engagement with Mauritius as a factor reducing the need for closer coordination with the World Bank and others. The response to the pandemic has brought an intensified relationship with World Bank, but not with other institutions and donors, who carried out their own lending operations independently.

78. Authorities' views corroborated this temporal evolution. While past authorities saw the IMF´s activities in Mauritius as more coordinated with those of other stakeholders (albeit with room for improvement, especially on relationships with donors), more recent official representatives saw the work of the Fund and other institutions as conducted independently, with some advice being coordinated but not integrated. In their view, there was a meaningful relationship only between the Fund and the World Bank.

Staffing of Country Teams and Engagement of Senior IMF Officials

79. The turnover of staff assigned to Mauritius varied widely. During the evaluation period, Mauritius had five MCs, one of them completed four surveillance cycles, three of them completed one cycle each, and one of them did not complete any Article IV cycles (after deciding to leave the Fund for family reasons).

80. Some staff members lamented the scarcity of resources allocated to the team. Despite Mauritius being a country receptive to Fund advice, and thus a case in which substantive value added is provided, staff generally thought that the team lacked resources. Teams typically consisted of a part-time MC, a full-time economist, a part-time economist, and a part-time young economist. Having smaller teams, while still having to comply with all standard surveillance tasks, meant less time for research and deeper analysis. Beyond the possibility of having additional resources allocated to SDS, staff proposed a number of measures that could increase efficiency if the Fund allowed for greater flexibility: (i) avoid box-ticking by dropping elements of surveillance that may be non-essential for SDS and the use of tools that are, sometimes, difficult to apply in these contexts, such as EBA-lite; (ii) trying to match team members' skills with authorities' demands, maximizing the use of scarce resources; (iii) intensive but longer surveillance cycles (maybe three years) complemented with interim visits and remote consultations; and (iv) giving AFRITAC South (RCDCs in general) a stronger role in surveillance, which could boost tailoring and strengthen the regional perspective.

81. Authorities also had some concerns about staffing of country teams in recent years. They regretted an excessively fast turnover of staff and considered that their tenure, specially of MCs, should cover at least two Article IV cycles. They also opined that, in some cases, staff assigned to Mauritius had been quite young and inexperienced. In their view, these issues had affected the quality of the Fund's work, making it shallower and excessively standard. Nevertheless, authorities were happy about the level of attention received from top IMF management officials, including several visits during the evaluation period.[36]

D. Montenegro

Country Profile

82. Montenegro is an upper middle-income country[37] with good social indicators and improving economic indicators. In 2020, GNI per capita was $7,900 (up from $6920 in 2010) and GNI was $4.91 billion. It has a land area of 13,800 km^2 and a population of 620,000. In 2018, 25 percent of the population lived below the national poverty line though less than 3 percent lived in extreme poverty. The 2018 U-5 mortality rate is low at 3 per 1000 births.[38]

83. Montenegro became independent following a referendum in 2006 after being part of a union with Serbia from 1992. Montenegro submitted an application for EU membership in 2008

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[36] DMD Zhu visited Mauritius in October 2011 and June 2014, and FDMD Lipton visited the country in March 2015.

[37] World Bank Country and lending groups FY2021: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

[38] World Bank Country Profile (GNI, GDP, area, poverty headcount, extreme poverty, child mortality): https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=MNE.

and acquired official candidate status in 2010. An opposition coalition won the August 2020 elections, marking the first change of government in Montenegro's post-independence history.[39]

84. Montenegro has a small, highly open economy and it unilaterally adopted the euro as its currency. It is inherently exposed to global ups and downs and therefore fiscal and financial buffers are needed, particularly in the absence of an exchange rate instrument (IMF, 2010). Travel and tourism are major growth drivers accounting for 32 percent of GDP and 33 of total employment in 2019.[40] Montenegro has a large informal economy and high unemployment (IMF, 2018a). Banks dominate the euroized financial system and account for 90 percent of system assets equivalent to 100 percent of GDP, larger than most SDS financial systems.[41] Unlike many SDS, Montenegro rarely faces significant natural disasters. Although it is in an area with some seismic activity, the last earthquake was in 1979 with 94 deaths. Climate change is expected to increase surface temperatures and decrease rainfall, as is the case elsewhere in central and eastern Europe.

85. Montenegro joined the IMF in 2007. It has a quota of SDR 60.5 million and a voting share of 0.04 percent. Montenegro has had no IMF program engagement and is not eligible for IMF concessional financing from the PRGT, as per capita income is above the PRGT entry threshold for SDS. IMF engagement during the evaluation period has included regular surveillance on the 12-month cycle, an FSAP in 2015 and an RFI disbursement in 2020 (Table 5). Montenegro received increasing amounts of CD support during the second half of the evaluation period (Figure 11). A regional resident representative based in Vienna covering Montenegro, Albania, Kosovo, and North Macedonia was appointed in 2019, supported by in-country local economists in all but Montenegro.

86. A post-independence boom based on unilateral euroization, capital inflows, leverage, and real estate investment was brought to an end by the euro area crisis in 2009 with a deposit run in the banking system, a decline of external inflows, and a large decline in GDP (Figure 12). Adjustment to the euro area shock was buffered by a rapid and large build-up of debt. Public debt, including contingent liabilities, rose from 32 percent to 72 percent of GDP during 2008–2014. The first half of the evaluation period also witnessed a gradual deleveraging of the banking system including reducing NPLs against a background of weak growth. In the second half of the evaluation period, growth picked up and the authorities embarked on a capital-intensive growth strategy. The building of a highway to Serbia, costing 25 percent of GDP and partially completed in 2020, was emblematic of this strategy. Following 2016 elections, the authorities embarked on a medium-term fiscal consolidation of the non-highway budget, in part with an eye on the Maastricht deficit criteria. This effort was partly successful in curbing public debt accumulation although public debt continued on an upward trajectory.

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[39] See https://www.britannica.com/place/Montenegro.

[40] World Travel and Tourism Council 2019 data: https://wttc.org/Research/Economic-Impact.

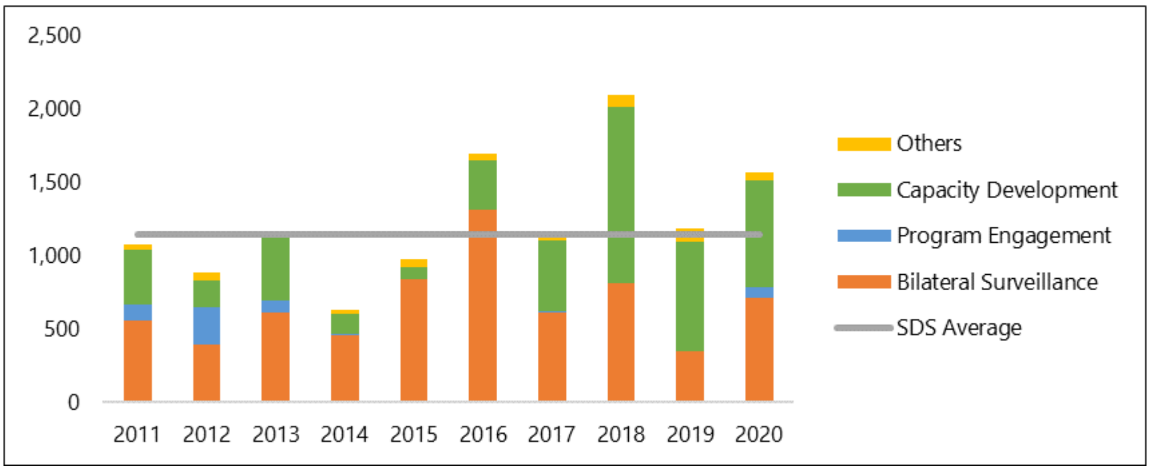
[41] Montenegro has been euroized since 2002 and has no separate legal tender.

Table 5. Montenegro: IMF Engagement, 2010–2020

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

Sources: IMF; IEO calculations.

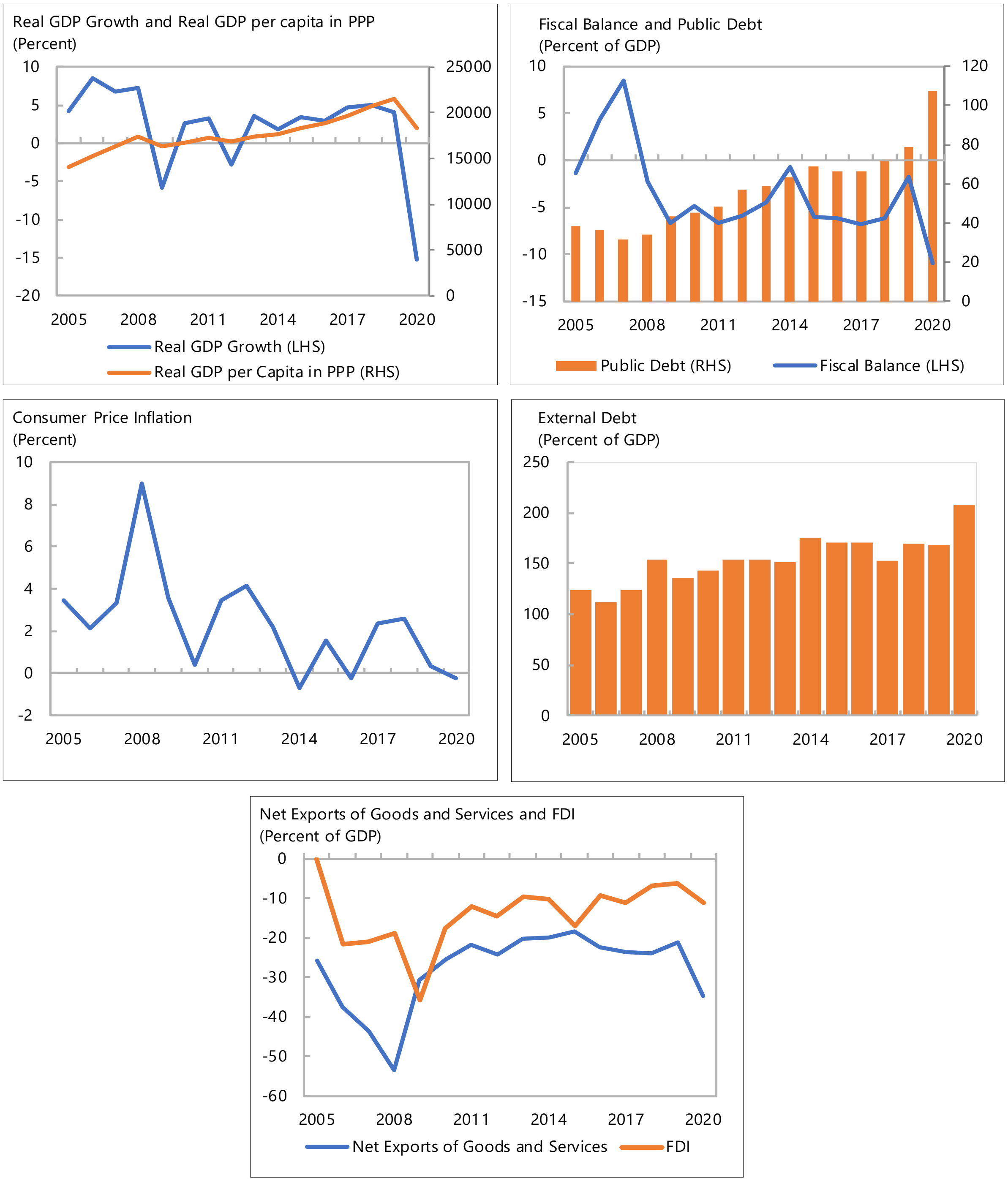
Figure 11. Montenegro: IMF Spending by Activity, 2011–2020
(In thousands of USD)



Sources: IMF (ACES); IEO calculations.

87. The COVID-19 epidemic hit Montenegro hard due to its dependence on tourism receipts (Mooi, 2020). With containment measures including a national curfew, restricted operating hours for retail and hospitality, and temporary restrictions on international arrivals, GDP is estimated to have declined by 15 percent. The fiscal response increased the budget deficit to nearly 11 percent of GDP and public debt is expected to reach a new high of 108 percent of GDP in 2020 (more than double the level a decade earlier). However, market access was retained as Montenegro issued a €750 million Eurobond in December 2020, enabling repayment of debt maturing in March 2021. Four fiscal packages to support the economy have contained a wide variety of measures including wage subsidies for the most affected sectors, tax deferrals, VAT reduction in the hospitality industry, cash support to vulnerable groups, and increased health spending. The central bank introduced support measures including loan moratoria in priority sectors and for unemployed workers, lowered reserve requirements, and a temporary prohibition of bank dividends (except in the form of equity).

Figure 12. Montenegro: Macroeconomic Developments, 2005–2020



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

Main Elements of Fund Engagement

Surveillance

88. Three policy priorities dominated IMF surveillance during the evaluation period: curbing the accumulation of public debt; managing the deleveraging of the banking sector post global financial crisis; and pursuing structural reforms to boost competitiveness especially in the labor market and in the loss-making legacy steel and aluminum industries. These three themes recurred consistently in surveillance as well as technical assistance provision. SIPs in 2017 and 2018 were substantive and tackled issues in considerable depth. Topics included export diversification, fiscal adjustment using FAD tools, macro-financial linkages, long-term growth prospects, structural fiscal balances, and how to improve labor market outcomes. Surveillance priorities and topics are broadly in line with 2017 Staff Guidance on Small States in respect of promoting fiscal sustainability, strengthening financial systems, and bolstering growth.

89. Country authorities generally had a very positive view of the relevance, coverage, quality, and timing of surveillance recommendations, especially since 2017 when a four-year fiscal consolidation plan was launched. Special papers, including one on the infrastructure gap, were particularly valued. However, they would have appreciated more attention to diversification strategies in coordination with other international financial institutions (IFIs).

90. Data gaps in national accounts, debt, and labor markets made surveillance more challenging for staff and could temper the strength of recommendations from application of surveillance tools. The lack of time series data in the early part of the evaluation period, partially due to the country's very recent independence, precluded calculation of some basic economic concepts such as cyclically adjusted data. Some staff believed that more staff training on how to deal with data gaps could be useful.

91. Both staff and officials interviewed felt the usefulness of surveillance tools was uneven. The EBA created some disagreements between SPR and EUR, with the country team arguing that model-based assessments were unreliable and inconclusive, as in other SDS, due to a lack of time series data and large data gaps. Given that the authorities also saw a need for caution using EBA or EBA-lite in dollarized economies, staff's advice was largely based on more traditional unit labor cost data, real effective exchange rate developments, and productivity growth. Staff found the DSA to be more useful in dialogue with the authorities as it could test for various debt rollover risks while publication of the DSA provided leverage for staff recommendations. The authorities did not express views on the usefulness of the DSA in interviews with IEO nor were their views reflected in the published DSA for the 2019 Article IV consultation when debt risks were assessed as high.

92. Some staff found internal reviewers did not show enough flexibility for Montenegro's circumstances, e.g., data gaps. Others believed that demands were not unreasonable, and reviewers' views could usually be accommodated.

93. Financial sector deleveraging was a focus of surveillance during the first half of the evaluation period together with TA support from MCM and LEG. Progress was slow due to weak judicial processes, contract enforcement, deficient property registries, and inadequate tax filing. With gradual progress in financial sector deleveraging, policy advice and accompanying CD shifted to liquidity management operations, bank resolution, and AML/CFT. The FSAP recommended an independent asset quality review of all banks to tackle pockets of vulnerability, time-bound supervisory action plans, and bank resolution planning by the Central Bank of Montenegro. It also recommended improvements to the legal, regulatory, and supervisory frameworks for the banking and insurance sectors. Implementation of the 2015 FSAP (and 2016 FSSA) recommendations has advanced over time. The 2019 Article IV assessed that of the 18 main FSAP recommendations, 44 percent were fully implemented, 33 percent partially implemented or in progress, and 22 percent were not done, including an asset quality review for all banks, although the authorities remain committed to implementation of outstanding recommendations.

94. Staff stressed the importance of building fiscal buffers throughout the evaluation period, with the traction of policy advice increasing as debt vulnerabilities rose. In 2013, staff advised to liquidate a loss-making state enterprise and against contracting a large highway loan. Although staff advice was not followed, some other fiscal measures were taken. By 2015, staff assessed the risks from the debt level to be high. In 2017, the authorities acknowledged a need to take fiscal action in the context of the Article IV consultation and a follow up mission to conclude the consultation assessed the authorities' four-year adjustment strategy with TA support.

95. The traction of surveillance appears to have been more consistent in recent years as debt vulnerabilities increased and the Article IV assessment became more important for rollover of eurobond financing. For example, 2018 Article IV recommendations—which build upon recommendations made in the 2017 Article IV consultation—on public sector employment, local government finances, tax expenditures, banking sector consolidation, and reducing the labor tax wedge were reported as implemented in the 2019 Article IV consultation, along with progress in several other areas. Recommendations on pension reform were attempted but ultimately not successful, while the fiscal consolidation strategy met setbacks due to the rollback of tax increases and new hiring which lowered the targeted improvement of the primary balance over the medium term. Earlier in the evaluation period, staff views on the risks associated with the highway project appeared not to have significant traction with the authorities.

Program Work and Emergency Lending

96. Prior to the COVID-19 pandemic, Montenegro had not made use of Fund financing and primarily relied on Eurobond issuance and World Bank financing for its external financing needs. Benefitting from its proximity to the eurozone and unilateral adoption of the euro, Montenegro issued a 10-year €200 million (US$255 million) Eurobond in 2010. At that time, the Deputy Prime Minister, Igor Luksic, noted "It is our determination to have this type of debt in the long term.

There is no need for an agreement with the IMF."[42] Interviews with staff indicated that as long as market access was maintained and with perceived low-conditionality World Bank policy lending available as a backstop then the authorities' interest in use of Fund resources was not particularly strong. Nonetheless, in 2011 and 2012, the authorities enquired about precautionary use of Fund resources through a PLL or a precautionary SBA in case market financing dried up. Maximum annual and cumulative access to these facilities (up the exceptional access limit) would have been approximately US$85 million annually and US$255 million cumulatively, relatively modest amounts in comparison to eurobond market access.[43] According to staff interviewed, Montenegro was not likely to meet PLL eligibility criteria, given its hitherto limited market access,[44] and in the end a precautionary SBA was not requested. Another factor, mentioned by staff, was a concern among officials that since disbursements under an IMF arrangement are conditional on performance, there was a risk of failure which would have a negative impact on market access.

97. Montenegro requested IMF support for the first time in June 2020 during the COVID-19 pandemic to help address a large adverse shock to tourism and to help finance rising public deficits and received RFI financing of 100 percent of quota (US$83 million or 1.3 percent of 2019 GDP) which was on-lent to the budget. A BOP financing gap of 5.6 percent of GDP was expected to be covered by the RFI (30 percent share), World Bank, EU and another IFI (54 percent share), with the remaining financing unidentified (17 percent). The authorities committed in their letter of intent to halt large capital expenditures until the public finance outlook had significantly improved as well as measures to promote transparency and good governance of crisis-mitigating spending.

98. Montenegrin interviewees noted that the IMF was more responsive and rapid to their request for financial support than either the World Bank or the European Commission, and central bank staff welcomed recommendations to strengthen safeguards on the use of Fund resources. These commitments went alongside a perception by country interviewees that the RFI had strengthened the partnership between the IMF and Montenegro. Country authorities did not mention the adequacy of RFI support, although it was noted that IMF support was larger than that of the World Bank and that ex-post the RFI had a strong positive catalytic effect, including on market financing. The authorities issued a €750 million Eurobond in December 2020 with the IMF financial support and staff's assessment of debt sustainability contributing to favorable terms.

Capacity Development

99. CD provision to Montenegro increased significantly in the second half of the evaluation period. Initially after membership, CD was largely concentrated on strengthening statistical capacity. CD increased over time as rising public indebtedness focused attention on debt and

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[42] https://www.eubusiness.com/news-eu/montenegro-economy.61e/.

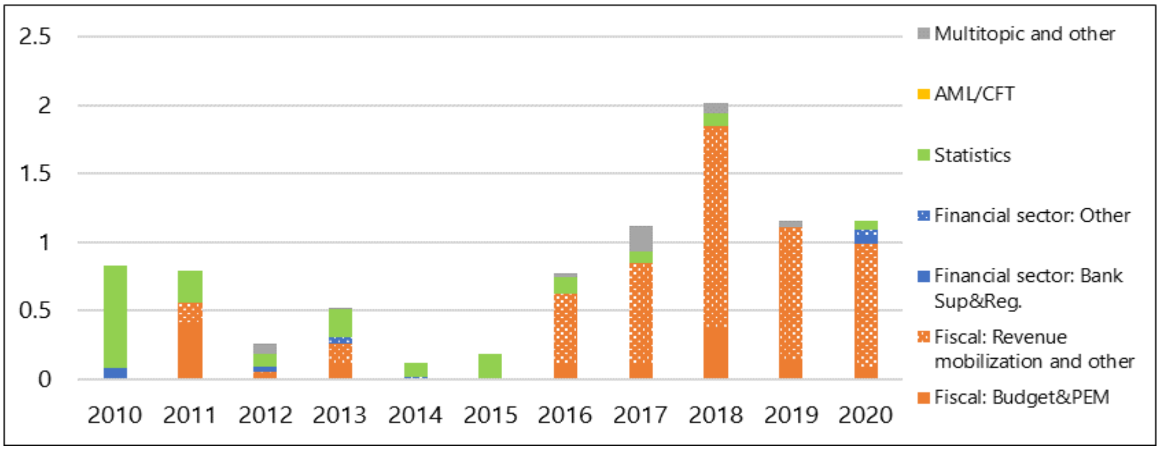
[43] Based on Montenegro's quota of SDR 27.5 million (US$ 42.3 million) and prevailing access limits.

[44] The PLL qualification criterion of a track record of steady sovereign access to international capital markets at favorable terms would not be met. See IMF (2018b).

liability management, capital market development, revenue administration, and a medium-term fiscal consolidation plan, although no CD strategy has been published (Figure 13). Follow up missions to the 2015 FSAP also contributed while the building of statistical capacity continued at broadly similar levels. The scaling up of CD was enabled with bilateral support from the Netherlands-IMF Capacity Development Program for nine Balkan countries in the Executive Board constituency chaired by the Netherlands.[45]

Figure 13. Montenegro: Thematic Distribution of CD Provided, 2010–2020*

(In full-time equivalents)



Sources: IMF (TIMS); IEO calculations.
Notes: "Fiscal: Revenue mobilization and other" includes mainly fiscal law and revenue mobilization issues. "Financial sector: other" includes central banking, financial crisis preparation and management, monetary and foreign exchange policy and operations issues. "Multitopic and Other" includes administrative and preparatory work, e.g., scoping missions. PEM=Public Expenditure Management.

100. Montenegrin interviewees (authorities and other stakeholders) remarked that CD had been useful and impactful and provided direction for country reforms. Areas of impact were in tax administration, bank supervision and resolution, economic statistics, and safeguards recommendations (in the context of the RFI disbursement). One area for improvement noted by country authorities was ensuring that TA recommendations were aligned with European Union accession *acquis* requirements. According to staff interviewees, CD became more impactful later in the evaluation period. In the first half of the evaluation period, the authorities' take-up of TA was limited by turnover in recipient institutions and a lack of leadership regarding implementation of recommendations in the central bank and in the finance ministry, notably regarding tax policy recommendations. In the second half of the evaluation period staff noted impact from TA in tax administration and banking supervision, but less so for tax policy due to political constraints, while some earlier implementation issues still lingered.

[45] See https://www.imf.org/en/News/Articles/2016/07/07/20/04/PR16323-IMF-and-The-Netherlands-Launch-New-Program-to-Boost-Capacity-in-Eastern.

101. The preferred CD delivery modalities depend on the topic. The authorities noted that long-term technical assistance has good results as the experts gain familiarity with country circumstances, e.g., in debt management where four consecutive technical assistance missions from MCM helped build capacity and develop a debt management strategy. Montenegro does not have access to an RCDC although regional advisors, including on tax administration and public financial management, are based in Vienna. Training is provided at IMF HQ, at the Joint Vienna Institute, and through the Center of Excellence in Finance (Slovenia), which currently hosts two IMF (FAD) advisors. Some central bank officials preferred the strategic expertise provided by HQ-sourced TA to the more "hands-on" support provided by regional advisers, because of a sense of better knowledge of international best practices.

102. Staff observed improved integration of CD with surveillance activities over the evaluation period, with TA recommendations being increasingly used as inputs to Article IV reports and Article IV reports highlighted areas where CD could be useful.

Collaboration with Partners

103. Collaboration was reported as closest with the World Bank, both in the field and at HQ, while missions in the field also engaged with the EBRD, the European Commission, and the ECB as regards progress toward EU accession. Initially views of external agencies differed on the highway project with the IMF emphasizing fiscal risks, but these differences narrowed as some of these risks materialized.

Staffing of Country Teams and Engagement of Senior IMF Officials

104. Mission chief tenure averaged 2.3 years during the evaluation period. In the first half of the evaluation period, the mission chief for Montenegro would typically have a second country assignment and be supported by 1 or 1.5 desk economists, with additional EUR staff joining Article IV missions. In the second half of the evaluation period when surveillance intensified the mission chief would be largely focused on Montenegro and the mission team size expanded. A regional resident representative covering four Balkan countries including Montenegro was appointed in 2020. However, staff noted that the usefulness of a regional representative was significantly enhanced if supported by a local economist in country, and the absence of a local economist in Montenegro, due to its relatively small size and budget constraints, made engagement significantly more difficult. Staff interviewees did not see staff turnover as an issue because Montenegro was an attractive mission destination, although country authorities would prefer less rapid turnover of mission chiefs. The authorities commended the expertise of the mission staff, while noting that having a dedicated mission chief was preferable to one covering two assignments. Generally, the authorities and mission chiefs were satisfied with senior staff and management engagement.

E. Seychelles

Country Profile

105. Seychelles is a high-income archipelago country with improving economic indicators and strong social indicators.[46] GNI per capita rose from $10,200 in 2010 to $15,700 in 2018 and 2018 GNI is $1.5 billion. It comprises of 115 islands with an area of 455 km^2, with a population of 100,000, which puts Seychelles in the category of a microstate (population below 200,000). In 2018, 25 percent of the population lived below the national poverty line (down from 39 percent in 2010) and less than 1 percent lived in extreme poverty. Under-5 mortality in 2018 was 15 per 1000 births.[47]

106. Seychelles attained independence from the United Kingdom in 1976. Elections have been freely contested since the 1990s, although the ruling party candidate for president has won each election. In 2015, President Michel was re-elected to a third and final term. In September 2016, the opposition alliance won a majority in the National Assembly for the first time in 40 years. President Michel stepped down in October 2016 handing over executive power to Vice President Faure.[48]

107. Seychelles is heavily dependent on travel and tourism which accounted for 40 percent of 2019 GDP and 44 percent of employment.[49] Tourism and tuna fishing accounted for over half of exports of goods and services. Unemployment is low at 3–5 percent (until the onset of COVID-19) and the continuing expansion of labor-intensive activities (tourism and construction) increasingly relies on expatriate labor. While catastrophic natural disasters have spared Seychelles in recent years, which is ranked 26th out of 33 small states in vulnerability to climate change, it faces significant challenges in the context of climate change. In the long run, rising sea levels could pose a serious threat to livelihoods in coastal zones.

108. Seychelles joined the IMF in 1977. It has a quota of SDR 22.9 million and a voting share of 0.03 percent. Seychelles had its first program engagement in 2008 with an SBA which was replaced by an EFF in 2009. IMF program engagement during the evaluation period in Seychelles was more extensive than in any other SDS with two successive EFF arrangements and use of PCI during 2010–2019, and an RFI drawing in 2020 (Table 6). As a result, Fund spending on Seychelles was largely associated with program engagement (Figure 14). Seychelles is not eligible for IMF concessional financing from the PRGT due to its high per capita income. Fund credit

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[46] World Bank Country and lending groups FY2021. https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

[47] World Bank Country Profile (GNI, GDP, area, poverty headcount, extreme poverty, child mortality): https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=SYC.

[48] See: https://www.britannica.com/place/Seychelles.

[49] World Travel and Tourism Council 2019 data, https://wttc.org/Research/Economic-Impact.

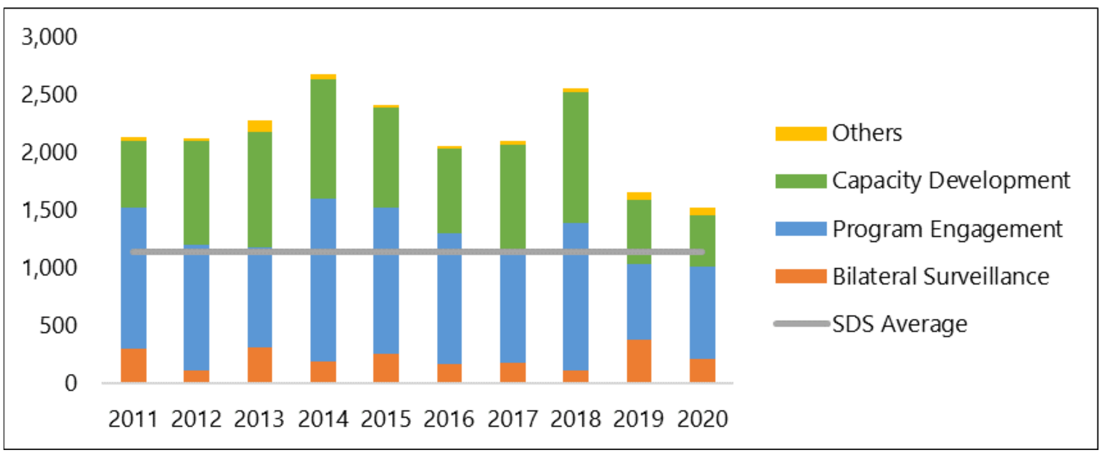
outstanding at end-2020 was 164 percent of quota (SDR 37.6 million). In addition, Seychelles was the first pilot for a CCPA in 2017 which reflected the authorities' interest in the "blue economy" (marine resources including fish and coral reefs) as part of a diversification strategy and vulnerability to climate change from rising sea levels and ocean acidification.

Table 6. Seychelles: IMF Engagement, 2010–2020

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Article IV											
Programs	EFF	EFF	EFF	EFF	EFF2	EFF2	EFF2	EFF2/PCI	PCI	PCI	
Emergency financing											RFI
Other								CCPA			

Sources: IMF; IEO calculations.

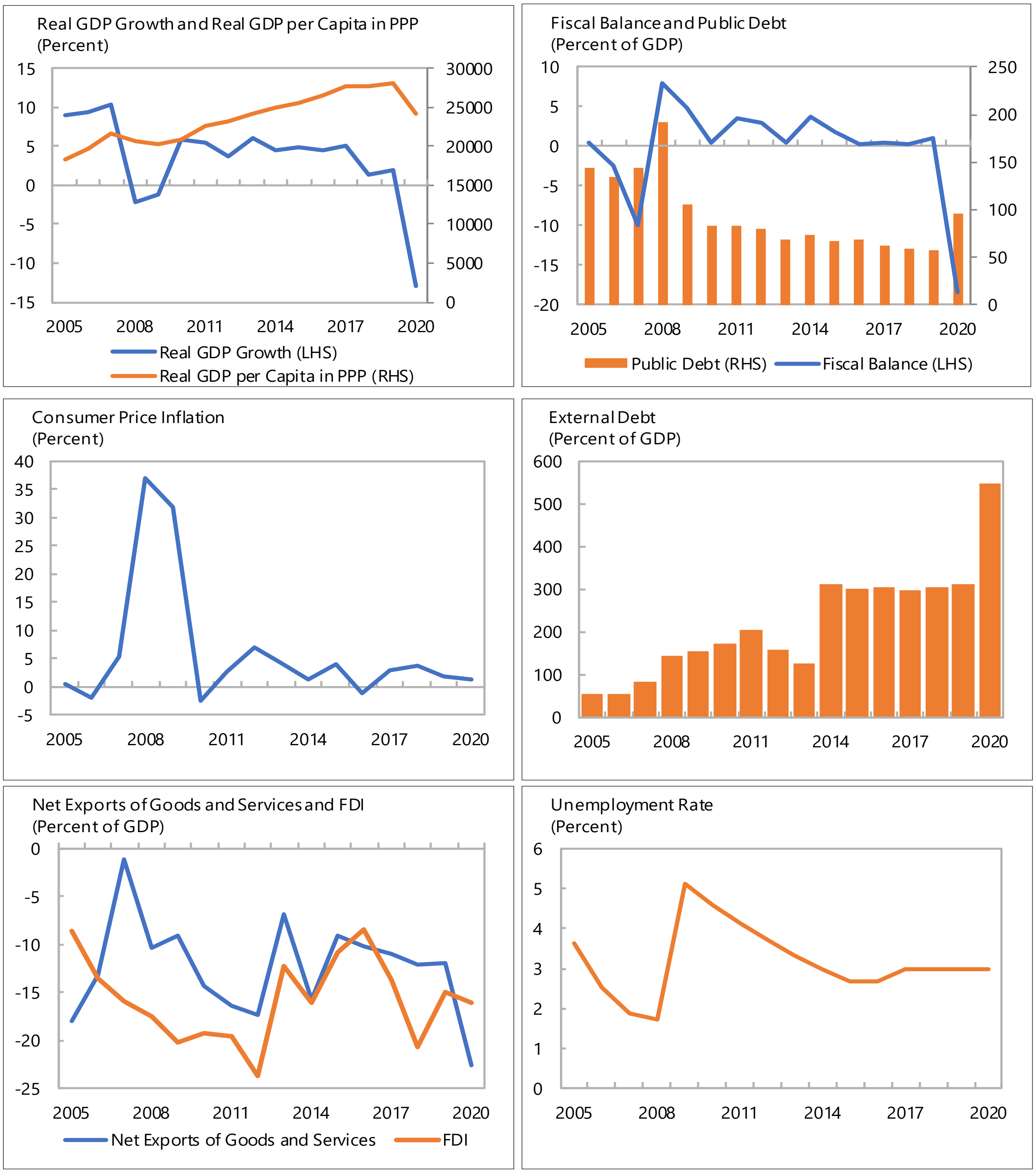
Figure 14. Seychelles: IMF Spending by Activity, 2011–2020
(In thousands of USD)



Sources: IMF (ACES); IEO calculations.

109. In 2008, prior to the evaluation period, Seychelles experienced an acute fiscal and BOP crisis with public debt at 151 percent of GDP, a parallel exchange rate, and reserves almost exhausted (Figure 15). A large fiscal adjustment was implemented aimed at reducing domestic debt supported by a restructuring of official and commercial external debt. The exchange rate was devalued and moved to a floating regime, which is unusual in small states and perhaps unprecedented in a microstate. Progress was made to create room for private investment through divestiture of SOEs, civil service downsizing, and adjustment of administered prices to cost recovery levels (IMF, 2013). Social protection was strengthened though some working poor struggled under economic reform adjustment.

Figure 15. Seychelles: Macroeconomic Developments, 2005–2020



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

110. With exchange rate adjustment and a large fiscal adjustment along with debt relief put in place just prior to the evaluation period, the main outstanding policy priorities during the evaluation window were: inclusive growth with a focus on diversification as Seychelles potentially faced a middle-income trap resulting from limits on labor intensive tourism development while preserving luxury destination status; fiscal buffers to build resilience to external shocks; financial

sector issues including high interest rate spreads, lack of economies of scale, maturity mismatches, and lack of bankable projects; and structural reforms especially to improve the performance of state enterprises. In addition, the floating exchange rate encouraged the development of monetary policy tools to absorb domestic liquidity and a shift from reserve money targeting to a flexible inflation targeting framework.

Main Elements of Fund Engagement

Surveillance

111. All Article IV consultations with Seychelles over the evaluation period took place in parallel to program requests or reviews, i.e., not stand-alone consultations. The surveillance policy priorities over the period were broadly in line with the five key thematic areas in small states staff guidance, i.e., inclusive growth, building resilience to shocks especially those from climate change covered in the 2017 CCPA, improving financial sector performance, and structural reforms to improve competitiveness. Debt sustainability issues had been tackled prior to the evaluation period but have recently resurfaced as a result of the COVID-19 induced shock. Nonetheless, the relatively developed financial system and floating exchange rate posed additional challenges that few other SDS shared—although Seychelles has not had an FSAP, technical assistance has consistently focused on bank supervision and financial market development. A substantive 2017 SIP considered enhancing resilience to natural disasters, climate change implications for public debt, risk management, and blue economy priorities reflecting the authorities' interest in this area and served as a vehicle to integrate the CCPA into bilateral surveillance.

112. Country authorities viewed IMF surveillance as effective and timely with input on the choice of surveillance topics helping to make coverage relevant to their needs and interests. They observed a strengthening of institutional knowledge at the Central Bank and Ministry of Finance through learning about other countries' experiences during the evaluation period. Officials also noted that the intensity of engagement gradually eased over time as Seychelles exited from Fund financial support and transitioned to use of the PCI in 2017. Staff observed that data gaps, e.g., in price statistics and national accounts, posed something of a challenge for surveillance, but that well prioritized TA had helped overcome these constraints.

113. Interviewees valued surveillance tools, in particular the EBA-lite exchange rate assessment in the context of a floating exchange rate, although application of the tools was not without difficulties common to other SDS. While exchange rate misalignment was not a concern early in the evaluation following the float of the rupee, EBAs were inconclusive in 2017 and 2019 with the current account model and real effective exchange rate model giving widely differing conclusions. While the EBA recognized the special circumstances of small tourist dependent states, staff fell back on other indicators and assessed the external position as broadly consistent with fundamentals and desirable policies. It was noted that the high import content of foreign direct investment tends to boost the size of the current account deficit leading to an assessment of overvaluation, while the real effective exchange rate assessment pointed to undervaluation. Staff

also sought to tailor advice to Seychelles' circumstances. For example, the 2014 Article IV recommended relatively high reserve coverage of 180 percent of the Assessing Reserve Adequacy metric due to openness, tourism dependence, and remote island microstate characteristics. The DSA has been helpful to the Ministry of Finance, although it was noted that it needed to take more account of specificities of SDS, in particular flexibility for tail risks such as the COVID-19 shock in tourism dependent economies. Overall, staff noted that the difficulties in tailoring surveillance tools to Seychelles´ particular context repeatedly led to tensions in the review process, in part because of staff turnover in review departments.

114. In 2017, Seychelles was the first pilot for the CCPA, introduced by the Fund in response to growing interest in policies to help adapt to the impact of climate change. The CCPA was carried out jointly with the World Bank and took stock of Seychelles' plans to manage climate from a macroeconomic perspective focusing in particular on identifying financing for climate adaptation and mitigation investments and strengthening institutional processes.

115. The authorities and staff felt that the CCPA covered issues of relevance for Seychelles while noting that the impact of recommendations was somewhat limited by slow implementation rate due to capacity constraints. Authorities also welcomed CCPA recommendations on green finance and financial inclusion and thought that it could be a catalyst for innovation. Staff noted that the most useful aspects of the CCPA were the identification of infrastructure investment requirements for adaptation and related financing needs which, while large, appeared manageable. Some staff noted that the mitigation angle seemed irrelevant for Seychelles (and other SDS) given the very small contribution of SDS to global emissions, although it may be of interest to country authorities hoping to set an example to larger countries. Overall, the tailoring of advice to Seychelles' circumstances, including through the CCPA and SIPs, have supported traction in surveillance engagement.

Program Work and Emergency Financing

116. Seychelles has used Fund financing facilities and non-financial arrangements continuously during the evaluation period with initially elevated levels of the Fund credit reflecting the large size of macroeconomic imbalances in 2008. One notable incentive for program engagement was the high level of official bilateral debt that could be restructured through the Paris Club, in contrast to Caribbean SDS with significant domestic debt that is outside the scope of the Paris Club. Program engagement during the evaluation period began with a four-year EFF arrangement over 2010–2013 (access at 225 percent of quota) and a second three-year EFF arrangement during 2014–2017 (access of 105 percent of quota). Both arrangements were fully disbursed. Staff noted that a longer-term instrument could have been useful in Seychelles, and potentially other SDS in the context of climate change, to provide a longer time horizon to address long-term structural challenges. A three-year Policy Cooperation Instrument (PCI) was requested after the second EFF in 2017 to support disciplined macroeconomic policies serving as a signaling device to domestic and external markets. Four PCI reviews were completed through end-2019.

117. In May 2020, an RFI was approved (access at 100 percent quota, 1.8 percent of 2019 GDP) and on-lent to the budget to address the urgent balance of needs arising from COVID-19. The residual external financing gap of 10.0 percent of GDP was expected to be filled with the RFI (25 percent share), World Bank and the AfDB (44 percent share) and other unidentified budget support (32 percent share). Gross international reserves were also projected to decline in 2020 by US$ 212 million equivalent to 17 percent of GDP. The authorities' Letter of Intent committed to ensure transparency of COVID-19 related emergency fiscal spending. Due to the COVID-19 shock and the uncertainty over the near-term outlook, the fifth and sixth PCI reviews were not completed in the 3-month grace period after the scheduled review dates and the PCI expired at end-2020. IMF engagement pivoted back to discussions on an EFF in November 2020.

118. The program engagement experience under both the EFF and PCI was viewed very positively by country authorities as a tool to discipline macroeconomic policy and keep structural reforms on track. Although the intensity of Fund program engagement was somewhat lower under the PCI than the EFF, country authorities noted that PCI oversight remained important. They noted that program engagement combined with technical assistance has helped build institutions across almost all functions. Country ownership has been key for the success of past programs, exemplified by an inter-agency monitoring committee that met regularly and drafted the Memorandum of Economic and Financial Policies. In addition, program engagement had a strong catalytic impact notably in relation to the World Bank and AfDB and may also have encouraged private investors. In 2018, reflecting improved creditworthiness, Seychelles issued a US$ 15 million "blue bond" linked to marine investments.[50] The access level for Fund financing was not seen as an issue in the past but could be an issue going forward as the COVID-19 induced financing needs are large. Factors that underpinned the successful fiscal adjustment in a microstate were relatively strong administrative capacity, country ownership, and attention paid to complementary reforms that supported inclusive growth. Early success in adjustment and stabilization may also have deepened the role of the IMF as a trusted advisor supporting traction in policy advice later.

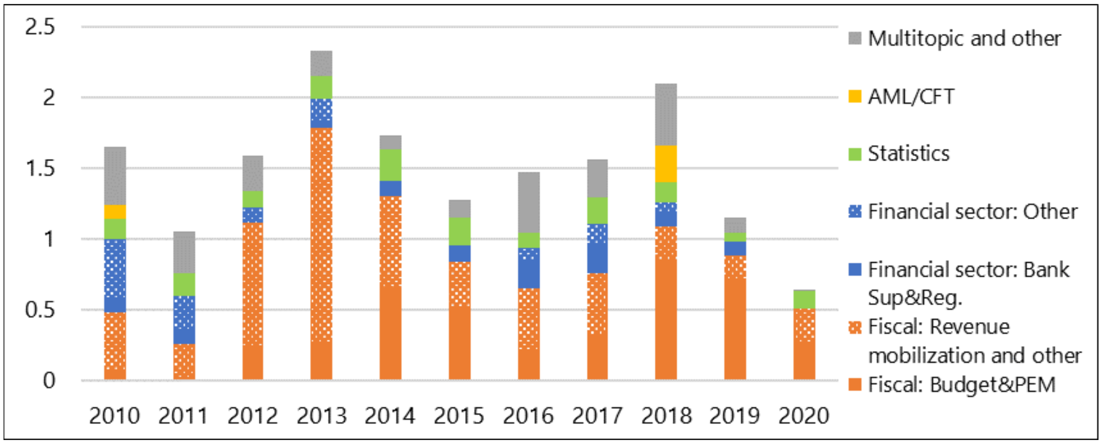
119. IMF assistance during COVID-19 with the RFI was viewed as rapid and timely, although BOP needs arising from the 10 percent of GDP increase in the current account deficit far outstripped the financing available and gross reserves were projected to drop sharply to 100 percent of the Assessing Reserve Adequacy metric assuming projected external support materialized. The RFI also had a catalytic impact with World Bank financing following, and AfDB support expected in June 2021. Virtual discussions have contributed to the slow pace of progress. The authorities noted that the large size of the COVID-19 shock via the tourism channel highlighted the extent to of SDS vulnerabilities. More weight could be given to vulnerability in calibrating access limits to better differentiate the Fund's engagement in SDS compared to non-SDS.

[50] See https://www.worldbank.org/en/news/press-release/2018/10/29/seychelles-launches-worlds-first-sovereign-blue-bond.

Capacity Development

120. CD activities in Seychelles were relatively elevated during the evaluation period with program engagement a driver of TA demand in the first of the evaluation period (Figure 16). CD work initially focused predominantly on fiscal topics with a gradual shift to monetary and financial topics in the second half of the period. In the second half of the evaluation period, climate change issues also rose up the agenda as Seychelles piloted the CCPA.

Figure 16. Seychelles: Thematic Distribution of CD Provided, 2010–2020*
(In full-time equivalents)



Sources: IMF (TIMS); IEO calculations.
Notes: "Fiscal: Revenue mobilization and other" includes mainly fiscal law and revenue mobilization issues. "Financial sector: other" includes central banking, financial crisis preparation and management, monetary and foreign exchange policy and operations issues. "Multitopic and Other" includes administrative and preparatory work, e.g., scoping missions. PEM=Public Expenditure Management.

121. The authorities viewed CD delivery dating back to 2008 as successful with broad coverage and good quality assistance. The authorities have sufficient institutional capacity to leverage the Fund's capacity development tools and instruments effectively with receptive teams at the Central Bank and Ministry of Finance eager to learn and to deliver results. CD has helped in program implementation as well as knowledge transfer. Staff noted that CD was well integrated with the program dialogue, and Seychelles was an early example of the AFR mission team being at the center of the CD strategy, a practice that was subsequently institutionalized in the updated procedures for the CD strategy and area department input to surveillance priorities.

122. As regards CD impact, the authorities pointed to improved competence and capacity achieved through CD as Seychelles' central bank officials now participate in IMF technical assistance missions to other countries in the region. CD impact was seen as strongest in areas where the Fund has a comparative advantage, notably, public financial management, tax administration, monetary operations, and financial sector regulation and supervision.

123. While CD has been delivered across all modalities, CD delivered by AFRITAC-S was welcomed by the authorities as being well tailored, while a long-term advisor at macro-forecasting unit was noted as being particularly effective, as was participation in training in Mauritius. One area noted for improvement is conflicting advice received from HQ departments (AFR, MCM, LEG, FIN) in the context of the EFF safeguards assessment.

Engagement with Partners

124. The authorities noted that IMF coordination with external partners was working well, especially with the World Bank and the AfDB as well as standard setting agencies for AML/CFT and donor country ambassadors. This enabled a clear division of labor in CD activities and enhanced the Fund's catalytic role during COVID-19. Staff noted that the World Bank and AfDB activity in Seychelles was fairly limited by AFR standards and that greater engagement by these institutions would have been of assistance in the analysis of social issues, including inequality and structural reforms.

Staffing of Country Teams and Engagement of Senior Officials

125. Staffing appears not to be a significant issue in Seychelles with frequent and well-staffed missions throughout the evaluation period. The significant commitment of staff resources in program, surveillance, and capacity building activities also paid dividends in IMF relations with Seychelles. However, mission chief turnover was relatively frequent (five mission chiefs with an average tenure of 1.9 years during the evaluation period) and more broadly the rate of team turnover reduced country-specific knowledge of Seychelles. The authorities also noted that it appeared that more senior staff were assigned during the EFF program period compared to the period of PCI engagement (in a departure from normal practice in AFR, one PCI review mission was led by a senior economist). Virtual engagement during the COVID-19 pandemic was difficult according to staff and authorities, particularly as key IMF staff and authorities' interlocutors changed and the time difference constrained the scope for extensive dialogue on a new financial program. In general, the engagement of IMF senior staff, Management, and the relevant Executive Director was viewed as appropriate.

IV. KEY ISSUES AND LESSONS

126. This section discusses more thematically the issues identified in the country case studies in Section III and seeks to draw some relevant lessons.

Surveillance

127. Staff, country authorities, and Executive Directors noted the importance of Fund surveillance to SDS policymakers due to the limited number of other external counterparts to discuss macroeconomic policies (SWZ, CPV, MNE, SYC) and often limited internal capacity or expertise (MNE). External in-country interviewees also had a positive impression of Article IV

surveillance reports noting concrete recommendations, useful tools and macroeconomic analysis (MNE).

128. The traction and value added of surveillance varied across the country studies and evolved during the evaluation period. Evidence suggests that more advanced economies, with stronger institutional capacity, valued policy advice more, considered Fund staff as trusted advisors, and reached higher implementation levels. Recommendations could lead to observable policy changes, particularly where surveillance was intensified and vulnerabilities quite pressing. At the other end of the spectrum, where absorption capacity was lacking, surveillance could draw attention to policy challenges, though often no actions were taken in response. Overburdened counterparts preferred a more gradual approach, especially for fiscal adjustment, limiting the effectiveness of surveillance. On occasion, country authorities noted that surveillance defaulted to a more negative assessment than may be warranted given a country's particular circumstances.[51]

129. Country authorities saw surveillance coverage as broadly adequate and relevant in all country case studies, but with some gaps and room for improvement (see below). Surveillance priorities were broadly in line with SDS guidance with some tailoring to country circumstances. Higher capacity countries were able to set the agenda to cover issues relevant to the authorities' needs and interests (SYC). In Montenegro and Eswatini, when fiscal vulnerabilities were elevated surveillance was at times intense and akin to near-program engagement. Surveillance helped to identify, evaluate, and manage potential macro-financial risks (CPV). In addition, although Article IV consultations were suspended during COVID-19 in 2020, staff's early analysis of the macroeconomic impact of the COVID-19 pandemic communicated virtually was seen as particularly useful (MNE external stakeholder, SWZ).

130. The frequency and modalities of surveillance, i.e., annual consultations in non-program context and bi-annual in a program context, as well as once a year staff visits usually at the time of budget preparation, was seen by most country interlocutors as appropriate (MUS) and left room for more informal engagement when needed (SWZ). Case study countries that were interested in a more formal semi-annual engagement tended to opt for non-financial program engagement through the PSI or PCI (CPV, SYC).

131. Nonetheless, a significant share of country authority interviewees thought surveillance was insufficiently tailored to SDS circumstances, noting "one-size-fits-all" recommendations (CPV) or "standard" Fund policy prescriptions that were not necessarily applicable in SDS circumstances (MUS). Many officials emphasized the need for greater attention to the idiosyncratic nature of vulnerabilities and volatility that is common in SDS (CPV, MNE, SWZ, SYC). Examples include that analysis of infrastructure investments may require special treatment as they tend to be larger in relation in GDP in SDS than in non-SDS (MNE), the need to take better account of the impact of

[51] The value of surveillance is likely perceived as lower in low capacity SDS (non-country case studies) where policies to enhance macroeconomic and financial stability are seen as a lower priority than developmental challenges which may lessen the value of IMF surveillance.

shallow financial markets on monetary policy recommendations due to weak transmission mechanisms (CPV, MUS), the limited scope for liquidity management in small financial markets (CPV), and importance of concrete recommendations to address diseconomies of scale (SWZ). Some Executive Directors identified room for improvement in the framework for surveillance in SDS. In particular, as regards fragile small states (STP, COM), that were not selected as country case studies, it was noted that the IMF alone cannot solve their large development challenges in the context of surveillance and there was scope for a more integrated approach involving IFIs and important donors each specializing in its own areas of comparative advantage.

132. Staff also recognized during interviews that adequate treatment of some topics faced in SDS surveillance could be challenging. The weight of standardized surveillance requirements could leave small mission teams with little time to devote to more strategic issues or in-depth analysis of other topics, and while application of some surveillance tools did not bring much value added where they were not seen as well suited to SDS circumstances. Challenging topics include how to foster accelerated growth and more diversified economies, which often need a focus on industrial policies, sectoral policies, and import-substitution policies which are not areas of IMF comparative advantage. In the less-diversified tourism-dependent case studies surveillance recommendations to improve diversification were felt to lack operational usefulness and more work in this area to provide more granular recommendations would be beneficial (MNE, CPV). Another area where staff acknowledge that advice was often too general is on structural reforms including state enterprise reform. There could be scope to improve the analysis of structural reforms by focusing more on sequencing and technical and political feasibility and/or coordinating more with other IFIs.

133. Staff believed that the quality of research underpinning surveillance in SDS had improved during the evaluation period, at least in part due to the informal inter-departmental small states working group. Cross-country research on tourism shared in the working group was highlighted as being of particular benefit to SDS country teams. Nonetheless, some mission chiefs felt that staffing constraints unduly limited the amount of SDS research. The corpus of Fund knowledge on dollarization, export diversification, and on debt sustainability was also noted as useful for SDS work according to country circumstances.

134. Data availability in SDS was sometimes a limiting factor for the effectiveness of surveillance (CPV) but not a critical one if teams were adaptable (MNE, SYC) and the strength of conclusions is tempered in relation to data quality. For the higher capacity cases, data provision was better but not particularly good relative to the level of development. Common problems reported by mission chiefs were the time taken to address data shortcomings and that reviewers were often insufficiently aware of the data inadequacies and the limits this posed on application of surveillance tools and indicators.

135. Overall, more flexibility in the review process for SDS surveillance would seem warranted, a point frequently underlined by area department staff. Flexibility in Article IV requirements could take more account of limited institutional capacity and data availability as well as the most

relevant issues for analysis. Surveillance requirements are essentially the same for all members and have increased over time (CD strategy, ESA, DSA etc). Taken individually the rationale for each requirement is clear but taken all together the requirements are quite onerous for staff. Some area department staff noted a box-ticking approach to Article IV requirements by reviewers and observed that staff turnover in reviewing departments can limit awareness of country-specific circumstances. Area department staff also perceived that there was very limited knowledge of, or reference to, the SDS Guidance Note by reviewing departments.

136. The usefulness of complex surveillance tools such as DSA and EBA varied across countries. Countries with more advanced policy capabilities could benefit from most analytical tools (MRS, SYC). Conversely, lower capacity and fragile SDS may be less able to benefit from these tools, which were too complex to be applied meaningfully in the country circumstances. To improve usefulness of surveillance tools some interviewees recommended streamlined versions if data availability is constrained (CPV), and more user-friendly tools where policy making capacity is thin (CPV), or more selective use of the tools. While there is guidance on how to adapt tools to SDS circumstances the tools themselves have become too sophisticated for the authorities to fully grasp in lower capacity countries. Several staff welcomed that some flexibility on the DSA was introduced during the COVID-19 pandemic.

137. Among the toolset, DSA was broadly seen as helpful in identifying macro-financial risks and vulnerabilities (SYC, SWZ), though overly complex given often weak/thin institutional capacity in SDS, some country authorities noted that they could not fully engage on the DSA due to staffing gaps (SYC). Aspects of the DSA that were particularly useful were the debt-stabilizing primary balance indicator and the shock scenarios to illustrate the distance from an unsustainable debt situation (CPV) which can form the basis of discissions with country authorities. Conversely, the DSA could do better at flagging vulnerabilities from domestic debt, such as crowding out of the private sector (SWZ). Some staff believe that the DSA results could suggest a degree of precision that was unwarranted in the SDS context. Some country authorities and staff believed that the DSA tool may have a bias towards a too negative assessment in SDS as some countries were assessed as being at high risk of debt distress or in debt distress for many years, but staff still continued to assess the debt as sustainable (staff-STP, EDs - DJI) when taking into account broader considerations. In these cases, there were suggestions to improve the DSA by linking borrowing to investment projects and their positive growth impact. Conversely, the DSA could obscure debt vulnerabilities if staff were too ready to take on-board authorities' over optimistic growth assumptions as results were sensitive to GDP and export projections (CPV). Some country authorities emphasized that the COVID-19 pandemic shock had significantly impacted debt sustainability, and that the application of the DSA could require additional flexibility as normal rules may not apply in an exceptional tail event situation (SYC). Some staff questioned why the DSA should be undertaken annually for low risk of distress cases (MUS). Additionally, staff noted that the DSA was not well adapted for offshore financial centers like Mauritius or Seychelles.

138. The EBA/EBA-lite generally was seen by authorities and staff as providing little value added, due to data gaps (MNE), complexity, no clear bottom line in many cases (CPV, SYC), and difficulties in interpretation in the case of dollarized/euroized economies (MNE/CPV). A less mechanical and more eclectic approach to assessing external balances in SDS would be useful. The external sector annexes in Mauritius' Article IV report in several years during the evaluation period provided a good example of this approach as recommended in Small States Guidance Note which advised staff to "go beyond approaches based on EBA-lite type analysis that are often not adequately tailored for application in small states". Nonetheless, where the exchange rate floats (SYC), there was significantly more interest in the EBA and exchange rate assessment given its more immediate policy relevance. Where the EBA provided mixed signals, there appeared to be a bias in SPR to give more weight to the overvaluation signal. More generally, greater flexibility was requested by mission chiefs in applying EBA to SDS. Other staff cautioned that the EBA may suggest a degree of precision that was unwarranted.

139. The CCPA pilot in the Seychelles was viewed as a useful exercise mainly for climate adaptation investment and associated financing needs, and other island states have expressed interest. There was also interest in potential new work on Disaster Resilience Strategies (SYC) although knowledge of this tool was not widespread (MUS). It was noted that AML/CFT needs to be given greater prominence in terms of surveillance priorities because of the importance of tackling money laundering in SDS, especially those on the FATF grey or blacklists (MUS). An integrated and modular FSSR could help overcome this risk. The fiscal space assessment also is of limited applicability in SDS because of missing or weak output gap data.

Program Engagement

140. The effectiveness of program engagement in AFR+2 SDS depended critically on country circumstances. For higher income non-PRGT eligible countries, staff were generally of the view that the SBA and EFF facilities were adequate to meet SDS needs, although only one country case study used the SBA and EFF (SYC). The results of this engagement were seen as good and were underpinned by strong country ownership. By contrast, the effectiveness of repeated program engagement in lower-income countries where the focus was more on tackling protracted balance of payments problems rather than solving episodic BOP imbalances was less clear.

141. Officials in countries that had relatively frequent program (financial and/or non-financial) engagement, did not have major concerns with the design of the facilities toolkit for SDS (SYC, CPV) with the exception of low access limits (see below). Some country interviewees saw a need for additional flexibility in programs to incorporate public investment for job creation in a context of little fiscal space (CPV). Also, there could be benefits in allowing arrangements to be longer than four years if imbalances are very large. Some country authorities and staff nonetheless saw scope for a lending instrument dedicated for SDS taking into account specific elevated or long-term vulnerabilities from climate change and natural disasters (staff, CPV).

142. The reasons for lack of use of the "workhorse" (ECF/SBA/EFF) facilities in other countries were varied:

- World Bank financing through Development Policy Loans was seen as less restrictive in terms of policy conditions while market financing could be significantly larger than available Fund financing (MNE).
- Program engagement could be perceived as eroding policy sovereignty (SWZ).
- Unsuccessful past program engagement (SWZ) and the risk of program failure due to limited capacity (MNE) raised concerns about stigma associated with program engagement and that an off-track program could have a negative catalytic impact on other sources of external financing (MNE).
- In two cases (MNE and SWZ), where the authorities faced debt vulnerabilities but sought to avoid program engagement for stigma or other reasons, near-program engagement was adopted with staff reports signaling close Fund engagement through detailed fiscal measures and plans backed up by significant technical assistance. This approach helped assure other financing sources of the Fund's positive macro-economic assessment.
- For SDS in a monetary union, i.e., COM and SWZ, membership provided a policy anchor and constraints on macroeconomic policy, lessening the need for Fund program engagement.

143. Emergency funding during the pandemic. Four out of five country case studies and all but one of eight AFR+2 SDS countries requested and used the RFI/RCF during 2020, and Fund resources disbursed were a large multiple of any previous year. The Fund's response to COVID-19 was widely appreciated (MNE, SWZ, CPV, SYC) across several dimensions: it delivered rapidly and well ahead of other IFIs and did not involve ex post conditionality. One counterpart also welcomed the recommendations of the follow-up Safeguards Assessment which were in the process of being implemented (MNE). In some countries the RCF/RFI engagement resulted in a greater sense of partnership with the IMF and positive shift of public perceptions towards the Fund (MNE, SWZ). Staff also commented that coordination with the World Bank and AfDB improved during COVID-19 as their budget support operations relied on the IMF assessment of macroeconomic policies and virtual engagement facilitated contacts (CVP, SWZ). One country case had not used Fund emergency financing during the pandemic because staff were not supportive of policies adopted to use the central bank to provide quasi-fiscal support to the economy (MUS). Looking ahead, in the wake of COVID-19, some authorities were concerned that more elevated debt levels may impact the ability to receive IMF program support due to debt sustainability issues (SYC), unless debt could be restructured. Although it is more difficult to build trust solely on the basis of virtual missions, staff noted that one bonus of virtual engagement during COVID-19 was the ability to bring in functional department specialists, e.g., on bank supervision, which would be more difficult in in-person missions (SWZ).

144. As regards non-financial program support, the PCI is seen as a valuable signaling instrument to financial markets and development partners as well as a useful tool to discipline policy and support implementation of structural reforms (SYC, CPV). Staff emphasized that the scope of reform targets was tailored in line with the authorities' implementation capacity, and that PCI targets were adjusted during the COVID-19 pandemic (CPV), which was viewed as useful flexibility and it also catalyzed other partners' support. On the other hand, non-financial program engagement may not always get traction as evidenced by Cabo Verde's steady increase in debt distress vulnerability while having both PSI and PCI engagement during one-third of the evaluation period.

145. Views differed across countries on the capacity to undertake Fund-supported programs. Capacity was viewed as limited in SWZ, as evidenced by an SMP that went off-track quickly where staff had been over-optimistic on what could be achieved. Capacity was stretched in CPV during the recent PCI where the number and length of missions were viewed as excessive by country authorities, as well as in STP where the ECF required frequent consultation with the Minister given the lack of supporting administrative staff. On the other hand, in SDS with stronger institutions program implementation was generally good (SYC, CPV). Staff noted that data timeliness could be an issue in the program context, especially for scheduled reviews under the PCI (which can only be delayed by up to three months before an interim assessment update is issued).

146. As with surveillance, some area department staff found the internal review process for program engagement lacking in appreciation for SDS circumstances, with a tendency to downplay capacity constraints, to go for first-best solutions, and to adopt a one-size-fits-all approach.

147. The size of access to Fund resources was generally seen as modest and often insufficient, especially in economies heavily dependent on tourism and exposed to larger exogenous shocks, including during COVID-19 (CPV, MNE, SYC) and in some more developed SDS exposed to potentially large capital outflows (SYC, MRS). Concerns about the size of access were lower for RCF/RFI in the context of COVID-19, mitigated by the quick increase in access limits to these facilities, and because the IMF was the first IFI to deliver financing, which brought a positive catalytic impact (MNE, SWZ). Staff noted that the size of access issue could in principle be addressed by seeking exceptional access under an ECF/EFF, e.g., at 1000 percent of quota compared to the temporarily increased annual limit of 100 percent of quota under the RCF/RFI, although no SDS has yet used exceptional access. Some staff felt that the quota formula may not appropriately weight the degree of openness or volatility in SDS. In very small countries, the amount of access per program review was seen as very low in relation to the amount of staff and official resources needed to complete all the program modalities (STP). Some felt that access should be increased further for very large shocks, e.g., above 30 percent of GDP. Others cautioned, however, that more access for disasters could exacerbate already unfavorable debt dynamics (CPV). More IMF debt would mean more senior debt and lead to the IMF being a part of the problem in highly indebted countries.

148. In most cases, especially where debt sustainability is an issue, officials believed that the approval of use of Fund credit gave confidence to other private and/or official creditors and had a strong positive catalytic effect (MNE, SWZ, CPV, SYC). This was particularly apparent with use of the RCF/RFI during the pandemic. On the other hand, non-approval of Fund support could have a negative catalytic effect where countries either have standing credit lines (MUS) or in countries that have unsustainable debt. Use of the standard Fund facilities and the PSI/PCI was also seen to catalyze external financing (CPV, SYC). Outside of the case of COVID-19 and/or in high debt situations, some staff believed the catalytic effect of Fund programs was weak or declining due to the decrease of bilateral official financing which reinforced concerns about adequacy of IMF access or because other international institutions were willing to move ahead without the Fund. Nonetheless, near program engagement in the form of intensified surveillance with detailed fiscal frameworks could provide important signals to financial markets even in the absence of a formal financial program (staff-MNE).

149. In general, the conditionality content of SDS programs was not remarked upon as an issue by case study country authorities, with the exception of the limits on non-concessional borrowing policy in the PRGT for countries at a high risk of debt distress. Such limits were seen by officials as acting as a disincentive to requesting a program given the paucity of concessional financing that is available and as hindering investment and growth.[52] Some staff noted that conditionality in SDS could be adjusted for climate change considerations, e.g., by excluding capital spending on climate resilience from the non-concessional borrowing target. More broadly, conditionality requirements taken together with the concerns about low levels of access may make program engagement more difficult.

Capacity Development

150. Given the limited in-country specialized capacity, CD plays an important role in both low-income and middle/high-income SDS and is well received by country authorities (all country cases). CD is likely more important in SDS, including in middle- and high-income SDS than in larger countries which have greater domestic capacity. Country authorities saw Fund CD as useful for capacity building across a wide range of activities: in the financial sector, economic statistics, monetary policy, and reserve management (CPV), public financial management, tax administration, and monetary operations (SYC), debt restructuring, tax expenditures, tax policy, revenue administration, economic statistics and bank resolution (MNE), and monetary policy and tax policy (SWZ). Country authorities noted that high-income status should not hinder access to technical assistance given limited in-country expertise in small states.

151. Staff also saw CD as a particularly effective form of SDS engagement, especially as regards RCDCs. However, they noted that traction in some countries was quite variable across time depending on country ownership. However, when a countries' macroeconomic situation

[52] Similarly, some non-country case study SDS did not request the DSSI because it blocked non-concessional borrowing.

became more precarious CD impact tended to increase (SWZ, MNE), particularly when delivered in the program context.

152. Resources devoted to CD in AFR+2 increased significantly during the evaluation period and most country authorities were pleased with the response to their TA requests (MNE, MUS, SYC, SWZ), even if not all requests were met (CPV). Some staff indicated that provision is generous and could stretch absorption capacity, given the small number of officials to whom CD is targeted. Other staff noted that "whatever the authorities ask for they get." Financing does not seem to have been an issue in most cases, although resources had been bolstered in one case by Trust Fund financing in the latter half of the evaluation period (MNE). In Seychelles, officials noted that TA provision was markedly more available during program engagement and suggested a gap in non-program situations whereas knowledge acquisition was also valuable.

153. The take-up of CD recommendations and impact varied across the country cases. Officials in most case study countries (CPV, MNE, SYC, MUS) indicated that CD was valuable in providing policy direction for domestic reforms. As with surveillance, achieving impact was most straightforward in higher capacity SDS, but more difficult in countries with political or institutional fragility (SWZ, STP, COM). Examples of impactful TA included inflation targeting (MUS), tax administration and bank supervision (MNE), bank supervision and financial market development (SYC), and high-frequency national accounts (SWZ). Another indicator of CD absorption is employment of SDS staff as Fund experts for capacity development elsewhere in the region (SYC). In some cases, discussions of program support had an important element of technical assistance, e.g., liquidity management framework (SWZ), that was seen as more impactful than normal technical assistance. In other cases, technical assistance was impactful in improving program performance including through a treasury cashflow management plan (CPV). Country officials and staff consistently emphasized the importance of follow-up to CD advice. Staff and some country authorities commented that implementation was often a challenge, because of limited absorption capacity, and that follow up and stocktaking should be regular.

154. The RCDCs were praised by authorities for rapid and hands-on CD provision (CPV, MUS, SWZ, SYC) and for providing an accessible source of follow-up. Hosting an RCDC was seen as particularly beneficial as it enabled regular engagement for staff and the absorption of other country experiences (MUS). As regards drawbacks of the current allocation of RTCs, the regional training center in Mauritius was seen as too distant from one country case study (CPV) nor did it provide Portuguese language training, whereas the Brazil training center could be a more appropriate venue in this case.

155. As regards modalities of CD provision, long-term or resident advisors were emphasized as very effective as the experts could better familiarize themselves to the specific SDS country circumstances (CPV, MNE, SWZ), although HQ missions were also appreciated (MNE, SWZ). Some long-term advisers were financed by external sources which would need to terminate when the external funding ran out (MNE, SWZ). AFRITAC assistance was generally viewed very positively with experts having greater familiarity with the region (SYC, MUS). There appeared to be a clear

division of labor between AFRITACs for implementation and HQ-provided CD for strategic planning (SYC, staff CPV, SWZ). There was also complementarity between strategic advice from HQ and follow up visits on implementation by regional advisers. However, the disruption of international travel imposed extra difficulties in delivering CD in 2020 (CPV). Virtual engagement could provide a useful channel but was not a full substitute, especially where bandwidth was limited. Concerns were raised that SDS with technical constraints risked becoming "CD orphans" in a more travel-constrained world.

156. The FSAP, where undertaken, has been useful and assessed very positively (MNE, MUS). The depth of the FSAP was remarked upon, as well as the usefulness of recommendations and adequate follow up (MUS). There was some support for more frequent FSAP engagement (MNE). Staff noted that the FSAP in Mauritius struggled to address offshore financial center issues due to data gaps at that time. Staff also noted that FSAPs should be more tailored for SDS in terms of prioritizing recommendations in line with implementation capacity. Awareness of the FSAP/FSSR[53] in some country cases seemed limited.

157. Regarding CD integration with surveillance and program activities, respondents noted that CD had traditionally been well integrated with program engagement and recent efforts to improve integration with surveillance were delivering. For example, program discussions guided the choice of CD where program engagement was extensive (SYC and CPV). Mission chiefs said that CD Strategy Notes and Area Department clearance of missions had helped to better integrate CD and surveillance, notably regarding timing and scope of missions, and noted that CD integration is assessed in staff's annual performance reviews. Others noted that the FSAP was viewed as integrating particularly well with CD activities.

158. CD coordination with other providers was assessed as somewhat effective, notably the IMF-WB Climate Change Policy Assessment (SYC). However, it was noted that there is need for better coordination with the World Bank on CD around investment and infrastructure in DSA and macro framework. One interviewee noted that conflicting advice on program safeguards assessments had been received from different IMF departments although without highlighting specific cases (SYC).

External Partners

159. Collaboration with external partners in the country cases was generally viewed by staff and authorities as adequate to good (SYC, MNE, SWZ, staff CPV and MUS). The strongest collaboration was with World Bank counterparts; it was less intense with regional development banks, the European Commission, and bilateral agencies. However, in-country collaboration was less close in countries where the Fund did not have staff on-the-ground compared to where there were staff in place. Some Executive Directors saw a need for a strategic framework to

[53] FSAPs are a voluntary exercise and part of the Fund's CD activity, with the exception of those jurisdictions with systematically important financial sectors, where FSAPs are mandatory and part of the Fund's surveillance.

realize synergies across IFIs with the IMF focused on stability, World Bank on growth strategy and regional banks providing an Africa-specific emphasis.

160. Collaboration was generally more effective where the IMF and World Bank had well-defined joint roles such as in the FSAP (MNE) and DSA (CPV), and the provision of budget support (SWZ) but somewhat less effective for medium-term strategies (MNE). In some cases, World Bank staff accompanied IMF missions (SWZ). Staff noted that LEG coordinated well with other partners on AML/CFT issues. Others noted that there was always room for more coordination, information and advice sharing to enhance synergies and a new framework for collaboration would be welcome (CPV).

Organization and Staffing

161. Authorities were generally appreciative of the quality of IMF country teams but raised concerns about depth of country knowledge. Some commented on the high level of professionalism of staff. However, others believed that IMF staff needed a greater understanding of country specificities, and that this in part could be achieved through lower staff turnover (see below). The more advanced country case studies expressed greater concern about staff quality: officials in one country noted that staff were often quite young and inexperienced (MUS) and in another case study it was noted that staff seniority seemed to have been lowered after exiting program engagement (SYC).

162. The mission chief assignment model differs across departments. In AFR, each SDS has a dedicated mission chief who also carries a departmental policy responsibility, while in EUR and MCD SDS the mission chief typically has a second country assignment. Respondents tend to favor a mission chief dedicated to one country rather than two countries of which the other is typically a larger country (MNE).

163. The size of country teams in SDS follows staffing guidelines from OBP according to program or surveillance status.[54] The composition of mission teams depends on the type of mission (Article IV, program, or staff visit), with country desk economists augmented with one-off area department economist assignments. Economists seconded from other departments, or an RA added to the mission team to make up numbers. Mission chiefs also noted that economists assigned from SPR or FAD are rare in SDS leaving a relatively heavy burden on area department staff and this could be an argument for increased staff allocations. AFR+2 SDS hold surveillance consultations on the normal 12-months cycle outside of program engagement, a staff visit is also conducted once a year (with one less staff member than the Article IV) and all mission chiefs are A15 Deputy Division Chiefs.

[54] Article IV missions, both in SDS and non-SDS, normally have four area department staff (including mission chief and excluding resident representative0, may include a staff member seconded from another department), program review or negotiation missions five staff, and staff visits three staff.

164. Staff often felt that SDS mission teams were stretched. Although policy issues may be less complex than in larger countries, data issues can be more challenging, staff is typically less experienced, and surveillance requirements are just as extensive. Many staff thought that additional staff in SDS teams could be justified because the Fund has greater influence on smaller countries' policies compared to larger countries. One program country team, Cabo Verde, is recruiting a third desk under the COVID-related crisis budget in recognition of the need for additional staff, as noted by country authorities.

165. Filling SDS positions was mentioned as problematic by staff working on some of the case studies (SWZ, CPV, MNE) and particularly difficult in fragile SDS (COM, STP, DJI). As noted in earlier IEO evaluations (e.g., IEO, 2018), in the latter group, there could be few applicants to internal job postings due to a perceived lack of visibility, and limited time to undertake analytical research due to time-intensive routine work. Filling positions was much less of an issue in higher capacity SDS case studies (MRS, SYC) or tourist destinations that are attractive to travel to. Where hiring difficulties exist there can be delays in filling vacancies and a tendency to staff SDS teams with newly recruited mid-career hires (who often will take any position offered) and recent entrants in the Economist Program (EP) (who have no choice).

166. As regards staff turnover, in all country cases bar one (SWZ) authorities thought the rate of mission chief turnover was too high and some considered that there should be a commitment for a minimum of two (MUS) to three years tenure (MNE, SYC). In principle, under staff guidelines, all mission chiefs should serve a three-year tenure which is monitored in the accountability framework, but promotions and departures typically cut short the length of tenure. Mission chiefs thought team turnover in country cases was generally not excessive (CPV, MRS, MNE). Also, one-off RA assignments to mission teams in both AFR and EUR increases turnover which is a cost that is largely borne by country authorities.

167. Country authorities perceive the lack of resident representatives in SDS with programs (such as STP, DJI, and CPV) as a major staffing gap; non-SDS with programs would normally have a Resident Representative. Clearly, there is a trade-off between being able to make a maximum impact in SDS, for example with a resident representative, and the high cost of actually achieving that. Comoros, which has a locally staffed resident representative office, may be an example of a lower cost alternative. Some officials believed resident representatives should be seen as a long-term investment, and a public good that pays a lot of benefits if it helps to avoid a crisis. The expansion of staffing for the COVID-19 crisis may rectify some of these gaps, as the FY2022-2024 Medium-Term Budget proposes three additional resident representatives for AFR+2 SDS (CPV, STP, SYC). Interviewees did not raise staffing levels in non-program countries.

168. Staff and authorities proposed several alternative approaches to filling Resident Representative gaps. A locally staffed resident representative office was seen by staff and authorities as helping with issues such as data collection, follow up on local news, and to engage with the authorities (CPV). An alternative is to have a regional or shared resident representative covering two or more countries. In 2020, EUR appointed a regional representative located in

Vienna to cover Montenegro and three other countries which no longer have program engagement, although Montenegro alone in this group did not benefit from a locally staffed satellite office. While these alternative approaches have value, most interviewees still saw a benefit from dedicated in-country representation.

169. The Small States Staff Guidance Notes (2014 and updated in 2017) were viewed as a useful starting point for SDS engagement by staff that were familiar with them while a significant proportion of staff working on SDS were either not aware of the guidelines or had not read them. Some staff noted that attempts to frame common challenges in the guidelines, e.g., the GROWTh framework, are necessarily quite general and could apply to many other developing countries. However, it was noted that coherence with the guidelines was seldom raised by reviewing departments which may lessen their value in ensuring a consistent approach to SDS issues. Others noted that the guidance might help when first assigned to an SDS or to identify selected issues topics but otherwise was of limited impact on country teams.

V. CONCLUSIONS

Value Added of Engagement

170. In general, Fund surveillance was of significant value to SDS country authorities during the evaluation period, with teams viewed as well organized, capable, and professional. More developed countries, with stronger institutional and policy frameworks, were able to better absorb the Fund's advice. In less developed countries, macroeconomic surveillance had less traction either because it was not viewed as well targeted at domestic policy priorities (growth and investment strategies) or because of implementation constraints. More sophisticated surveillance tools as well as tailored products like the FSAP and CCPA were also seen to be of less policy relevance to economies with limited institutional capacity. The frequency of Article IV consultations appears to have been satisfactory in both program and non-program engagement, although the experience of virtual engagement during COVID-19 may encourage more frequent informal interaction with SDS. Nonetheless the value of surveillance to SDS authorities could be increased if mission teams had better understanding and experience of SDS idiosyncrasies and constraints, and the dialogue would in general be improved with greater on-the-ground presence. From the staff perspective, surveillance requirements for small teams were viewed as quite burdensome and may disincentivize work on small states, e.g., because of limited time for high visibility research. Where administrative capacity is more limited, there could be benefit from some streamlining and simplification, particularly in areas where the authorities saw less value.

171. Although fairly limited in scope, program engagement went well in the country case studies, generating a high level of satisfaction; SBA/EFF engagement in Seychelles and PCI/PSI engagement in Cabo Verde and Seychelles. More developed SDS were able to better use IMF financing programs to successfully tackle debt vulnerabilities and non-financing programs to signal sound macroeconomic policies. Program engagement in less developed SDS is also

valued, but not always successful in addressing large structural obstacles to economic development. Emergency financing was widely seen as timely and adequate, except in the case of exceptionally large shocks. In all cases, IMF financing had a clear catalytic impact in terms of encouraging access to external financing from both other official and from private sources. Engagement via the one staff-monitored program (SMP) appears less successful, as it was not completed and there was no follow-on to an upper credit tranche arrangement as normally expected under the SMP. However, it would be difficult to generalize from this single case.

172. Emergency financing during the COVID-19 pandemic was clearly a "win-win" for authorities in country cases and the IMF. For these authorities, rapid disbursement was highly valued as well as the associated catalytic effect of Fund support, particularly in countries with sustainable debt but elevated debt vulnerabilities. For the IMF, RCF/RFI engagement, along with support from CCRT and DSSI, has revitalized partnerships with SDS in the region. Also, the near universal usage of the RCF/RFI may have changed perceptions of the value of IMF financial support in general for the better, addressing some of the stigma that may have been associated with IMF program engagement during the evaluation period. In the one country which did not qualify for RFI support, the good relationship with the IMF was immediately restored.

173. Country authorities were generally highly appreciative of the quality and availability of CD to SDS. They found high value added in the range of topics at the core of the Fund's expertise and reflected positively on the main delivery modalities (HQ, RTAC, resident advisor) according to circumstances. Authorities appreciated particularly the work of RCDCs, given their more continuous access and local knowledge. As in the case of surveillance and program engagement, more advanced SDS were better able to absorb and act upon capacity development activities, including under specialized tools such as the FSAP, AML/CFT activities, and the CCPA. In general, evaluating the impact of capacity development is complicated by a lack of systematic information on a par with the implementation of Article IV recommendations and compliance with program conditionality.

174. Despite continued interest in considering a differential treatment of SDS, particularly from country authorities, it is not clear whether a distinctive mode of SDS engagement is either needed or feasible, given budget constraints. The AFR+2 case studies and other SDS in the region display some common challenges—although to varying degrees—, such as narrow productive and export bases, significant exposure to volatility, limited or narrow administrative capacity, and significant debt vulnerabilities. However, in many regards, these challenges are similar to those faced by non-SDS countries in the region and, for that reason, a distinct model for Fund engagement with them has not been implemented.

175. As a consequence, there was essentially no difference in mission staffing numbers and mission chief seniority or mission frequency between SDS and non-SDS in the African department (unlike in other departments where SDS mission chiefs may be A14 grade staff), that appears to have been an important factor in the generation of value for IMF engagement in SDS. One exception to this even-handed approach is not placing resident representatives in program

SDS (though this may be remedied in the FY2022 budget). The authorities in SDS case studies generally feel that the overall level of support provided by staff is appropriate and fair given their circumstances but did consistently raise concerns about limited appreciation of country circumstances implied by the staffing approach.

Lessons for Improvement or Adaptation

176. While important progress was made in strengthening attention to topics particularly relevant to SDS during the evaluation period, further attention to adapting the broader surveillance framework for the needs of SDS could be helpful.

- Better knowledge management tools could contribute to better understanding of SDS, improving cross-country comparisons, and make reviewers more aware of SDS circumstances, for example by creating a SDS knowledge exchange site with links to guidance and best practice examples of surveillance, programs, and CD.

- Simplifying the use of surveillance tools and streamlining requirements could reduce the burden on country teams, freeing up time for research and strategic analysis. Such an approach would be particularly appropriate where the tools have inconclusive results, are overly complex for country circumstances, where application is required regardless of the level of risk (DSA), or simply not applicable due to data gaps (fiscal space analysis).

177. While the facilities toolkit appears to have worked well for this group of SDS, especially during COVID-19, there are issues to consider for further improvement. Questions include how to calibrate the appropriate access limits when shocks are very large relative to GDP and whether to have different rules for SDS access to emergency facilities. While in principle exceptional access could address perceived inadequacies in the level of access available for SDS subject to extreme volatility, this has not been utilized. Access limits for emergency facilities were temporarily increased at the onset of the COVID-19 pandemic for the RCF/RFI suggesting that the normal limits may not have been appropriate for large shocks. Accordingly, it may be appropriate to retain these higher limits for SDS and other similarly situated countries facing exceptionally large shocks post-COVID.

178. Capacity development could gain traction with more "boots on the ground" and resources for follow-up. While the assistance of RCDCs is widely welcomed in the implementation of CD recommendations, concerns have been expressed about the limited or intermittent availability of resident advisors. They are demanded especially in lower-income situations, where a deeper understanding than possible from occasional or one-off missions is needed for capacity building. Addressing this perceived gap in CD provision within existing CD budgets would require reallocating funding from other activities.

179. The experience of Africa+2 SDS suggests that the value of surveillance in SDS could be augmented by improving staffing issues; ensuring that staff working on these countries (both in

the area department and in review departments) have greater familiarity with SDS circumstances and idiosyncrasies and are, therefore, able to better tailor advice to country conditions and goals. Actions that could help in this regard include:

- reducing the rate of staff turnover, i.e., meeting or exceeding the existing key performance indicator (KPI) on mission chief tenure; automatic staff moves on promotion could also be reconsidered, in order to serve the membership better.

- reconsidering the general rule of not having a resident representative or local office in cases of program engagement in SDS, which does not appear to be entirely even-handed. While this would be expensive, experimenting with dual or multiple country resident representatives and locally staffed offices could help bring down costs and benefit non-program countries as well.

ANNEX I. REGIONAL BACKGROUND ADDITIONAL INFORMATION

Table AI.1. AFR+2 SDS Country Characteristics

Country	Population (2019, millions)	Income Group (FY2021)	Island/Land-Locked/Coast	Language	Fragile State
Cabo Verde	0.6	Lower middle	Island	LUS	
Comoros	0.9	Lower middle[1]	Island	FRA	Y
Eswatini	1.1	Lower middle	Land-locked	ENG	
Mauritius	1.3	High[2]	Island	ENG/FRA	
Seychelles	0.1	High[3]	Island	ENG	
Sao Tome & Principe	0.2	Lower middle	Island	LUS	Y
Montenegro	0.6	Upper middle	Coast	OTH	
Djibouti	1.1	Lower middle	Coast	FRA/ARA	Y

Sources: IMF World Economic Outlook; World Bank Country and Lending Groups https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups; and IEO staff.
[1] Elevated to upper middle-income in 2019 (FY2020).
[2] Elevated to high income in 2020.
[3] Elevated to high income in 2015.

Table AI.2. AFR+2 Macroeconomic Indicators, 2010–2020

	Average 2010–2019	2020	Average 2010–2020			
Country/ Grouping	GDP Growth	GDP Growth	GDP Growth	Inflation (Period average)	Current Account/GDP	Public Debt (Latest DSA)
			(In percent)			
Cabo Verde	2.8	-14.0	1.2	1.2	-8.1	High risk debt distress
Comoros	3.2	-0.5	2.9	1.9	-2.6	Moderate risk debt distress
Eswatini	2.6	-3.3	2.1	5.6	4.8	Elevated but sustainable (MAC DSA)
Mauritius	3.7	-15.8	1.9	2.9	-6.8	Elevated but sustainable (MAC DSA)
Sao Tome	4.2	-6.5	3.2	8.7	-16.5	In debt distress
Seychelles	4.3	-13.4	2.7	2.3	-20.2	Sustainable (MAC DSA)
Djibouti	6.4	-1.0	5.7	2.1	6.5	High risk debt distress
Montenegro	2.9	-15.2	1.2	1.4	-16.0	High but sustainable (MAC DSA)
AFR+2 SDS	3.5	-11.4	2.2	2.9	-7.4	
AFR+2 non-SDS	2.5	-4.4	1.9	4.5	-3.0	
Western Hemisphere SDS	1.4	-9.1	0.5	4.3	-5.7	
Asia-Pacific SDS	3.7	-6.5	2.7	3.6	0.3	

Source: IMF, WEO April 2021.
Note: Country groups weighted by PPP GDP.

Table AI.3. AFR+2 IMF Financial Support

Country	Last Article IV	PRGT Eligible	Program Engagement	SMP/PSI/PCI[1]	Long-term Program Engagement	Debt Relief Under CCRT (2020)	DSSI Participation (2020/21)[2]
Cabo Verde	2019	Y	2020 RCF	PSI 2010, PCI 2019			Y
Comoros	2018	Y	2009–2013 ECF, 2019 RF, 2020 RCF/RFI	SMP 2016		Y	Y
Eswatini	2019		2020 RFI	SMP 2011			
Mauritius	2019						
Seychelles	2019		2009–2013 EFF, 2014–2017 EFF, 2020 RFI	PCI 2017	Y		
Sao Tome	2018	Y	2012–2015 ECF, 2015–2018 ECF, 2019–2023 ECF, 2020 RCF		Y	Y	Y
Montenegro	2019		2020 RFI				
Djibouti	2019	Y	2008–2012 ECF, 2020 RCF			Y	Y

Sources: IMF; World Bank https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative.
[1] SMP = Staff-Monitored Program, PSI = Policy Support Instrument, PCI = Policy Cooperation Instrument.
[2] DSSI = Debt service suspension initiative.

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