EXECUTIVE SUMMARY

PRINCIPAL FINDINGS

The IMF deserves considerable credit for having substantially stepped up its engagement with its Small Developing States (SDS) members between 2010 and 2020. This is a group of countries that, while very small from the perspective of the global economy, represents 18 percent of the membership and faces persistent economic, environmental, and other forms of vulnerability that pose a special challenge for the IMF. The Fund's improved engagement with SDS over the past decade reflects a number of factors, including the considerable efforts made to develop specific staff guidance for Fund work on SDS relevant to their needs, the increased attention paid to climate change issues, and the rising resources on capacity development work and the strong role of regional centers (which have particular relevance for SDS). The commitment by Board members to champion the cause of SDS work at the Fund as well as the commitment by Management and staff to support these members in the face of continuing resource constraints have also contributed.

That said, the Fund's engagement with SDS has faced a number of serious challenges that have adversely affected its overall value added and traction. Key concerns include difficulties in staffing SDS assignments that have contributed to high rates of turnover; questions about whether the IMF lending architecture is well suited for SDS needs and capacities; and issues about limited institutional capacity in SDS to implement Fund advice and continuing political economy concerns about Fund conditionality.

IMF surveillance is greatly appreciated in SDS and generally considered by country officials as of high quality and well-tailored to their specific needs. Fund surveillance carries a heavier weight than in larger economies because in many SDS the Fund is the principal source of authoritative external macroeconomic analysis and advice, and because IMF surveillance

helps fill capacity gaps. The relevance of IMF policy advice to SDS has benefited from increasing attention at the Fund to climate policy issues, correspondent banking relations, and debt sustainability analysis, and has built on IMF analytical work as well as a growing body of external research on SDS issues.

However, the evaluation found several reasons for concern. Policy advice sometimes lacked actionability and specificity, particularly in areas beyond the Fund's core expertise but still macro-relevant, and access to useful tools such as the Financial Sector Assessment Program (FSAP) and Climate Change Policy Assessment (CCPA) (now replaced by the Climate Macroeconomic Assessment Program, CMAP) was limited. Surveillance was also hampered by low frequency of engagement and high turnover of mission chiefs). Small SDS country teams were challenged to meet standard Fund Article IV surveillance requirements and to apply complex diagnostic tools in view of data and other constraints faced by small states work. These factors reduced the continuity and depth of policy discussions and, ultimately, affected the traction of surveillance.

The overall IMF financing architecture has not been especially well suited to the particular needs of SDS and their use of Fund resources has been substantially less, on a relative basis, than that by other emerging market and developing economies. In particular, SDS made sparse use of Fund Upper Credit Tranche (UCT) programs, although where they did undertake UCT programs the completion rate was high, suggesting adequate support for implementation in the program context. These programs were largely aimed at fiscal adjustment and debt sustainability. During the evaluation period, no SDS requested a UCT program to address recovery from or resilience building for natural disasters and climate change.

Some of the factors behind this reluctance to use UCT programs are deep rooted and may be hard to remedy, including some authorities' aversion to Fund conditionality, particularly when alternative sources of official financing are available. Others fall clearly within the Fund's reach: low access levels relative to financing needs, the high administrative burden of negotiating and monitoring UCT arrangements, the short time frame for Fund-supported programs compared to long-term structural weaknesses, and limited understanding by potential users of the Fund's program framework, including non-financing programs.

By contrast, SDS have been more inclined to use IMF emergency financing, with no ex post conditionality, to help deal both with large climate- and weather-related disasters and with the COVID-19 pandemic. The Fund's capacity to provide large disbursements in the aftermath of a disaster has increased, but access is still quite limited relative to post-disaster financing needs, and repayment terms and conditions are often less attractive than financing from elsewhere. Around one half of SDS came to the Fund for emergency support in the wake of the COVID-19 pandemic but, given that SDS faced larger shocks relative to the size of their economies, the share of financing needs met by the Fund was smaller than for other members, and the need to deplete their international reserves cushions correspondingly greater.

IMF capacity development work is highly valued by SDS in terms of quality, quantity, content, and tailoring to country circumstances. Again, capacity development is particularly important to these countries, given the serious capacity constraints many of them face. The heavy reliance on Regional Capacity Development Centers (RCDCs), whose use SDS pioneered at the Fund, has been a driver of success. RCDCs were closer and more knowledgeable about local circumstances, they supplied the longer-term support these members needed, and they provided a degree of continuity in the Fund-member engagement that is much more difficult to achieve from HQ. RCDCs were not only successful in fulfilling capacity development needs; they also contributed to other IMF functions—palliating the scarcity of resident representatives in SDS and improving the institution´s reputation—and served as useful coordination centers.

The main concern with the capacity development provided to SDS has been insufficient traction and impact. A key obstacle to effective implementation was the limited absorptive capacity in many SDS, compounded in some cases by lack of ownership by officials. On the Fund's side, some concerns were raised regarding insufficient recognition of capacity constraints and the tendency to focus advice on first-best solutions. Increased provision of follow-up support could strengthen capacity development effectiveness, while systematic use of results-based management (RBM) output as RBM and the Capacity Development Management and Administrative Program (CDMAP) mature could provide useful experience relevant for capacity development allocation, capacity development design, and delivery and implementation.

The IMF has struggled to strike the right balance between resource constraints and the commitment to provide adequate support to SDS in all its areas of activity. Often, work on small states has been affected by high turnover and short tenure of staff assigned to SDS, including mission chiefs. Staff working on SDS felt personally rewarded by working on small countries, where their efforts made a tangible difference and were generally well appreciated by country officials. However, institutional incentives for staff to work on SDS assignments were poor, with lower performance ratings and promotion rates for economists working on SDS, contributing to low application rates and more rapid turnover. Use of co-desk assignments with larger countries to fill SDS positions diluted attention to staff's work on specific SDS. The use of staff from non-area and non-functional departments to fill out small country teams compounded problems with continuity of engagement. At the mission chief level, departments had less difficulty in recruiting for SDS assignments, as these can provide a useful career building opportunity, but the result again was limited tenures, as such staff moved on to seek promotion elsewhere. The small size of teams, the absence of functional department economists in missions, and the scarcity of resident representatives were also causes for concern.

RECOMMENDATIONS

Drawing on these findings, the evaluation offers four broad recommendations aimed at further strengthening the impact of the Fund's engagement with its SDS members, together with more specific suggestions for each broad category. These four recommendations cover a focused refresh of the overall approach, operational steps to increase the traction of surveillance and capacity development, suggestions to make better use of the Fund's lending framework to address SDS needs, and further HR and budgetary commitments to support SDS engagement. They are intended to be mutually reinforcing. The recommendations also aim to be SMART (Specific, Measurable, Achievable, Relevant, and Time-Bound). But to be truly effective, they will need to be accompanied by change in the Fund's institutional culture toward SDS to fully recognize the importance of such work for the institution, which will need to be led by Management and senior staff.

Recommendation 1. The Fund should pursue a targeted recalibration of its overall approach for engagement with SDS to strengthen the value added and impact of its work.

The recalibration would build on the strengthened engagement achieved during the evaluation period and seek to enhance the coherence and continuity of SDS work, while still leaving room for flexibility at the area department and country level. The recalibration would have two principal elements: a focused refresh of the SDS Staff Guidance Note (SGN); and steps to support more effective application of the SGN and other commitments in the implementation plan for this evaluation through mechanisms for internal coordination, engagement with the Board, and collaboration with partners.

Recommendation 2. Steps should be taken at the operational level to enhance the focus and traction of the IMF work on SDS in the areas of surveillance and capacity development.

Actions would aim at further adapting processes and tools for the SDS context, deepening integration across Fund activities, better recognizing domestic constraints, and increasing support for implementation.

Recommendation 3. The IMF should consider how to use its lending framework in ways that better address the needs and vulnerabilities of SDS.

Three suggestions are provided, consistent with the principle of uniformity of treatment: greater attention to growth and resilience outcomes in UCT programs, care to implement the newly designed Resilience and Sustainability Trust (RST) to take account of SDS needs and institutional constraints, and increasing access limits under the large natural disaster window for countries with robust macroeconomic frameworks and strong governance standards.

Recommendation 4. The IMF should adopt further HR management and budgetary commitments to increase continuity and impact of staff's engagement with SDS.

Such steps would aim at improving incentives to work on SDS assignments, reduce turnover, avoid gaps in coverage, minimize disruptions from handovers, and strengthen Fund presence on the ground.

BUDGETARY IMPLICATIONS

The recommendations build on initiatives to strengthen IMF engagement with SDS during the evaluation period through further targeted actions to maximize efficiency and value added in the use of resources currently applied for SDS work, and seek to build on existing commitments already included in management implementation plans (MIPs) for other evaluations. Nevertheless, some initial "set-up costs" are expected in implementing the recommendations, for example to update the staff guidance note. In addition, some longer-term increases in resources may be justified in specific areas, such as strengthening field presence, including by building up the role of regional resident representative offices and by providing for somewhat more use of resource-intensive diagnostic tools like CMAP, FSAPs, and Financial Sector Stability Reviews (FSSRs). On the other hand, there could also be some offsetting savings in travel costs from increased use of virtual engagement as well as in-the-field staff, from increased use of regional and cluster approaches to surveillance work, and from greater reliance on partnerships in areas that are macro-critical but where the Fund does not have deep expertise.