STATEMENT BY THE MANAGING DIRECTOR

ON THE INDEPENDENT EVALUATION OFFICE REPORT ON IMF ENGAGEMENT WITH SMALL DEVELOPING STATES EXECUTIVE BOARD MEETING, MAY 6, 2022

I welcome the report of the Independent Evaluation Office (IEO) on IMF Engagement with Small Developing States (SDS), which finds a substantive and well-tailored Fund engagement with SDS across modalities over the last decade. I broadly agree that, going forward, the Fund's continuous high-quality engagement—cognizant of the unique characteristics and challenges faced by SDS—should help enhance traction with this group of members. With the Fund's agenda already well-oriented toward supporting SDS, including through new workstreams, I concur that a targeted recalibration of the Fund's work on SDS would be the most effective at this juncture. However, the four recommendations and their detailed suggestions must be weighed against their budgetary implications, which are inconsistent with the just-approved Medium-Term Strategy and Budget. The report and its recommendations should also be careful to not impinge upon areas that are still unfolding, such as the Resilience and Sustainability Trust (RST), crisis response, and capacity development (CD) provision, to avoid unnecessary duplication of efforts and ensure that a coherent and evenhanded framework is in place. I offer qualified and/or partial support to the recommendations, as discussed below, to serve better our SDS members.

The Fund has significantly stepped up its engagement with SDS over the last decade. In the aftermath of the Global Financial Crisis, the Fund increasingly tailored its toolkit to adjust to the unique characteristics and constraints faced by SDS, focusing on the members with the most pressing needs. The evaluation finds the Fund's engagement in the evaluation period was broadly of high quality, well-tailored, and appropriately adjusted to the evolving circumstances. The evaluation also reveals SDS have been well served within the perimeter of the IMF's mandate, framework, and resources, with outcomes in line with or better than in comparator groups. Over the past few years, the dialogue with SDS at the Fund and external fora (including the World Bank and other institutions) has further strengthened the relationship with this group of members. In addition, the Fund's flagship and regional reports as well as several Board policy papers have showcased SDS-related issues—including inclusive growth, climate change, and resilience-building—helping shape a significant body of knowledge to tailor and strengthen our SDS engagement. These actions have been in line with the Executive Board's calls for strengthening our engagement with SDS over the last decade, including in the context of the 2015 Board paper on Macroeconomic Developments and Selected Issues in Small Developing States, the 2016 Board paper on Small States' Resilience to Natural Disasters and Climate Change—Role for the IMF and the 2017 Board paper on Large Natural Disasters—Enhancing the Financial Safety Net for Developing Countries, among others.

With Fund engagement with SDS already strong and clearly on the right track, I concur with the evaluation that a major overhaul is not needed. There are several new workstreams that have already been launched, many of which are aligned with the special challenges of SDS. These include the RST, the Climate Change Strategy, the FSAP Review, and various Management Implementation Plans (MIPs) in response to IEO recommendations that have recently received Board endorsement. A targeted recalibration of the Fund's overall engagement approach would indeed be the most effective. Thus, I partially support Recommendation 1—particularly to refresh the SDS Guidance Note (SGN) and continue enhancing the coordination mechanisms—albeit with qualifications to remain cost-effective. While I agree with the need to strengthen the focus and traction of surveillance and capacity development, I can only partially support, with qualifications, Recommendation 2. I offer qualifications given that surveillance and its related toolkits must remain consistent with the Fund's policy frameworks and evenhandedness requirements. Budget constraints and the high-cost implications of this recommendation also play a role to my partial support, including in the current global environment, where the need for engagement on emerging (e.g., digital money) or unexpected issues (e.g., global tensions) also requires flexibility in prioritization of Fund resources.

I can partially support Recommendation 3, and with qualifications. I agree that there is room for exploring how Upper Credit Tranche (UCT)-quality Fund-supported programs may be better tailored to SDS, including by further accounting for growth and resilience objectives. I also consider it important that the [newly approved] RST addresses the needs of all eligible members, including SDS. This said, the specific recommendation is somewhat premature as the Trust is yet to be operationalized. I would note that staff has designed the RST with SDS as a key potential eligible group; eligible SDS members facing longer-term structural challenges could qualify for RST financing to help address such challenges and make significant progress toward strengthening their prospective balance of payments (BOP). For this objective to be met, it would be particularly important for SDS members to be able and willing to undertake sometimes difficult reforms to address their macroeconomic vulnerabilities in the context of UCT-quality programs. I do not consider that raising access limits for emergency financing (EF) is the right approach to help members deal with large BOP needs over the longer term—even those emerging recurrently from climate and weather-related disasters. For urgent BOP needs, the Large Natural Disaster Windows of the RCF and Rapid Financing Instrument (RFI) already provide higher access limits than other EF windows, which were recently raised; moreover, EF is meant to have a catalytic effect, not to fill emerging BOP gaps in full.

Finally, I partially support, with qualifications, Recommendation 4 to adopt further HR management and budgetary commitments to increase the continuity and impact of staff's engagement with SDS. While I restate my commitment to strongly support engagement with SDS in line with their special needs, several of the specific proposals can be addressed through various self-reinforcing measures already contained in the MIP on the Board Endorsed Recommendations Categorization of Open Actions, while others lack cost-effectiveness and may lead to unintended adverse consequences, including for staffing of others with macro-critical needs, such as fragile states (Table 1).

I provide below my detailed responses to each of the four recommendations in the evaluation. Prior to that, I would like to emphasize my agreement with the spirit of the recommendations made by the IEO, and the Fund's institutional commitment to SDS. In offering qualifications to these proposals, I seek to strike the right balance between meeting the valuable objective of enhancing engagement with SDS while keeping a strategic and comprehensive view, and fully leveraging our toolkits, structures and workstreams to avoid costly overlaps and duplications. I firmly believe in the importance of providing the needed time for key reforms that are at the core of the IMF's efforts to deliver needed support to its members; this includes the approval and implementation of the RST, the Climate Change Strategy, the FSAP Review, and recently endorsed MIPs, which already address several of the recommendations made by the IEO in this evaluation. I am also mindful of the fact that these recommendations carry substantial budgetary costs, while some of the proposals made to lower net costs (e.g., the use of regional or cluster approaches of CMAPs or FSSAs/FSAPs) are complex and are unlikely to generate the large savings suggested by the IEO; others, such as the higher use of virtual missions to offset the cost of more junior local staff, may have adverse consequences for the quality of engagement and the traction of our advice.

I would also remark that both Management and staff greatly appreciate the IEO's efforts and recommendations. In answering the Board's call for stronger engagement with SDS, I remain deeply committed to working constructively with the IEO, to learn meaningful lessons from its recommendations and implement them to further enhance the Fund's operations, frameworks, and results. In this context, I look forward to future evaluations that rely somewhat less heavily on perception-based surveys and interviews to substantiate recommendations, and to follow more closely the Board-endorsed recommendations in the 2018 Third External Evaluation of the IEO, which stressed the need to deliver shorter and sharper reports with parsimonious, concrete, and measurable recommendations. If the IEO continues to include assessments of implications for enterprise risk in its reports, it would be important that such assessments are based on a sound methodology, clear qualification criteria for risks, and systematically applied rating scales.

Following Board guidance,[1] staff is working on developing a framework for assessing risks from slippages in implementing IEO recommendations and ways to anchor it to the forthcoming institutional Enterprise Risk Management (ERM) framework. Joint efforts in all these areas should help us to continue to leverage IEO evaluations for the purpose of fostering change and continued improvement in the Fund.

RESPONSE TO IEO RECOMMENDATIONS

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.

Summary of Detailed Recommendations:

- Update the SDS Staff Guidance Note (SGN) including : (i) guidance on integrating surveillance, lending, and CD work in SDS work, including by making use of the Climate Macroeconomic Assessment Program (CMAP) and the RST; (ii) application of Article IV (AIV) surveillance requirements and diagnostic tools for SDS; (iii) consideration of how to bring Fund-wide skills and expertise to address SDS challenges, including approaches for to further involve functional departments (FD) in SDS work; (iv) advise on how best to coordinate with partner institutions; and (v) advice on how to foster strong and continuous relations with SDS.
- Coordination Mechanisms could include: (i) tasking the staff-level interdepartmental SDS working group (SDS-WG) with a mandate to oversee SDS work at the Fund, update the SGN refresh and oversee this evaluation's MIP implementation; (ii) requiring the SDS-WG to continue reporting regularly to management and the Board working group,, as well as external partners, on SDS; (iii) tasking the SDS-WG to monitor the implementation of an SDS-focused research workstream on cross-cutting issues and continue to oversee knowledge-sharing; (iv) committing the SDS-WG to conduct a staff review of IMF engagement with SDS within five years, taking account of experience with implementation of the refreshed SGN and other steps taken under the MIP to strengthen Fund engagement with SDS.

I partially support this recommendation with qualifications.

I welcome the recommendation to update the Staff Guidance Note (SGN) on the Fund's Engagement with SDS, which was last updated in 2017. While the core issues and the GROWTH approach of the note remain relevant, the guidance will be refreshed for the current global context and evolving macro-critical priorities. The update will provide a natural vehicle to make several of the recommendations in the evaluation actionable and help energize internal coordination structures and dissemination of SDS knowledge. The SGN should help staff plan on priorities that guide effective engagement with SDS. This said, given SDS heterogeneity and broad resource and trade-off considerations, actual staffing decisions require flexibility and would be best left to relevant departments.

I concur on the need to foster strong collaboration with external partners; as this is being further mainstreamed for the World Bank Group in the recent MIP on Bank-Fund

[1] SU/21/139 of September 24, 2021.

Collaboration and other workstreams (e.g., climate), the SGN would be aligned to such superseding frameworks, while respecting the voluntary nature of inter-institutional collaboration with other partners.

I note, however, that the cost considerations of these recommendations, including of the SGN update, are non-trivial and are not envisaged in the Medium-Term Budget.

I agree, with some qualifications, with the proposals on internal coordination mechanisms, even if I do not concur with the view in the evaluation that internal coordination mechanisms have been uneven and dependent on key individuals. In particular, the staff's SDS Working Group (SDS-WG) will be closely involved in the refresh of the SGN, the MIP's preparation, and its follow up. The SGN update will provide an opportunity to further integrate members from Functional Departments, particularly those dedicated to CD provision, into the SDS-WG.

The SDS-WG will also continue to engage with the Board and external partners, prepare the bi-monthly brief for Management on recent SDS developments, and maintain its coordinating role on knowledge sharing and fostering the SDS-focused analytical agenda.

I do not agree with the proposed five-year review. This proposal seems duplicative given other regular evaluations and reviews that take place for surveillance (e.g., Interim Surveillance Review, Comprehensive Surveillance Review), lending (e.g., Review of Conditionality, Review of LICs Facilities), and CD. There are also new, expected regular reviews (e.g., RST Implementation) and the Periodic Monitoring Reports (PMRs) on actions in MIPs by the OIA, and follow-up evaluations by the IEO itself (e.g., Bank-Fund Collaboration review in three years). These already-planned and provisioned-for reviews can better link SDS engagement to the overall Fund strategy and will allow the Board to consider trade-offs, including vis-à-vis other members and priorities.

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, policy advice, and CD.

Summary of Detailed Recommendations:

- Provide selective attention to current/emerging SDS issues that are macro critical, i.e., including those viewed macro-critical by authorities.
- Apply diagnostic tools consistent with SDS circumstances, including by: (i) further streamlining the application of data-demanding diagnostic tools including debt sustainability analysis (DSAs) and the EBA-lite, by better leveraging built-in flexibility, in recognition of their circumstances and constraints, and (ii) increasing access to CMAPs, FSAPs, and FSSRs, for instance by exploring cluster or regional approaches.
- Preparing tailored strategy engagement notes for non-FCS SDS, possibly on a pilot basis.
- Place greater attention to SDS' institutional capacity constraints and political economy circumstances in providing CD support, by (i) applying ex-ante assessments of institutional capacity and ownership to CD deployment; (ii) linking allocation and provision of CD including to implementation and ownership; (iii) as it evolves, using Resource Budget Management (RBM) to increase transparency on CD progress; (iv) increasing hybrid CD presence; and (v) deepening CD coordination with external partners.

I partially support this recommendation with qualifications.

I endorse the view that surveillance and CD for SDS can—and should—be strongly tailored for SDS. The updated SGN will provide a natural vehicle to update the GROWTh approach based on evolving macro-critical challenges faced by SDS. This said, the coverage for Article IV Consultations would be guided by the Integrated Surveillance Decision, implying that core areas (exchange rate, fiscal, financial, and monetary policies) would be prioritized, and other areas included to the extent that they are assessed to be macro-critical on a case-by-case basis.

The recommendation to develop tailored "Strategy Engagement Notes" would be costly. Country engagement strategies are already expected to be rolled out in the context of the Strategy for Fragile and Conflicted States

(FCS), benefitting those SDS that are also FCS (i.e., 10 out of 34 SDS). In this vein, I see a case for additional Strategy Notes to be rolled out to SDS that are not FCS only on an as-needed basis.

I endorse the view that country teams could better leverage the built-in flexibility in core surveillance tools, such as the DSAs and the EBA-lite, to tailor more to SDS constraints. This is best achieved by strengthening guidance—including through the planned SGN refresh—on how to tailor to the characteristics and constraints of SDS. However, there is limited scope to streamline requirements for SDS for even-handedness reasons. Moreover, these assessments remain key to surveillance, given core mandates, Board-endorsed requirements at the time of the 2021 Comprehensive Surveillance Review (CSR), as well as lending. Data requirements for the DSA cover standard data from teams' macroeconomic projections and similarly for EBA-lite models. Moreover, the LIC DSF is jointly produced with the World Bank, and hence not entirely under the control of the Fund. Nevertheless, strengthening the technical support to country teams on these tools would be important in dealing with the constraints and challenges facing SDS.

The recommendation to expand FSAPs/FSSRs and CMAPs to SDS faces important resource constraints. I also note the voluntary nature of these CD activities, which rely strongly on members' request for assistance. FSAPs/FSSRs are often jointly conducted with the World Bank, so their expansion is not entirely at the Fund's discretion. Other structural issues also preclude a large deployment of these programs to SDS, even on a cluster or regional basis (e.g., regional FSAP's jurisdictional considerations). That said, the updated SGN is expected to provide guidance on integration of CD and surveillance and so it would lay out circumstances when CD should be identified as priority for SDS. With respect to issues related to climate change and resilience-building, these are expected to be addressed in expanded Article IV Consultations, building from Fund's CMAPs, the World Bank's CCDRs, and climate DSA modules, within the contours provided for in the Climate Strategy, and provisions in the Medium-Term Budget. The updated SGN would be in line with this guidance.

I concur with the need to attend challenges on CD but note that many of the issues raised are also common to non-SDS. To avoid a piecemeal approach that could be duplicative and costly, I recommend revisiting these issues in the IEO's forthcoming CD evaluation, which we expect will provide recommendations to encompass the gaps identified in SDS. This would include considerations on the merits of on-the-ground versus virtual missions (which often entail a loss in quality and traction for SDS) or meaningful approaches to better guide CD allocation.

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

Summary of Detailed Recommendations:

- Greater focus of growth and resilience outcomes in UCT-quality programs with SDS, drawing from external expertise and building on commitments included in the MIP on growth and adjustment in Fund-supported programs (IEO 2022).
- Implementing the RST taking into account SDS needs and constraints. This would entail (i) exploiting the use of CMAPs, and (ii) ensuring that the requirement to pair the RST with a UCT-quality program does not deter SDS use and lowering the administrative burden of UCT-quality programs by, for example, providing ground support.
- Raising access limits under for Emergency Financing (EF) instruments for dealing with large natural disasters (LNDs) for countries with robust macroeconomic frameworks and governance standards.

I partially support this recommendation with qualifications.

I support the recommendation to seek greater focus on growth and resilience outcomes in the context of UCT-quality programs with SDS. The recent MIP on Growth and Adjustment in IMF-Supported Programs already provides several actions for improving growth considerations in IMF-supported programs. The refreshed SGN would further elaborate on the appropriate tailoring of program design for SDS, building on the existing GROWTh framework. The new SGN would provide guidance to identify relevant, macro-critical drivers of external sustainability (such as climate change) and related solutions to help address external imbalances to guide program design and conditionality. The SGN would also provide guidance to teams on collaboration with other development partners, based on existing frameworks.

Regarding the recommendation on the RST, while I fully endorse its spirit, I see no need for further action at this time beyond implementing the framework just endorsed by the Board. The RST has been already designed to address the challenges and recommendations provided by the IEO. The proposed design articulates that policy priorities and conditionality will need to assess the technical capacity of potential borrowers. Thus, we need to allow operations to begin, gain meaningful experience, and then build on the design, based on lessons learned from the experience. For this, the RST already calls for a review in three years, or sooner if warranted, to course correct as needed based on experience. I agree that available CMAPs (and other relevant diagnostics) should be well-articulated in UCT-programs with climate-vulnerable SDS.

Regarding the second point in the recommendation, I observe that the RST design and broader efforts to enhance focus on growth and resilience in UCT-quality programs should support tailoring. At the same time, I do not agree that there is a high administrative burden of requesting Fund lending; I missed quantitative evidence that such administrative burden is higher at the Fund than in other IFIs, and stress that the Fund is relatively agile and focused on its lending activities, which often have a narrower footprint than that of other development partners. At the same time, I recognize that many members, including SDS, also need to balance this streamlined approach with strong implementation support, including on the ground. To this end, the RST design already envisages leveraging the synergies between the Fund's surveillance, lending, and CD to help in the design and implementation of the RST reform measures. Fund CD with a medium-term programmatic approach can play an important role in supporting RST reforms.

More generally, linking RST financing and a UCT-quality program is key to provide needed safeguards and address underlying macroeconomic imbalances in eligible members. It is encouraging that the evaluation shows that when SDS request Fund-supported programs, these tend to be completed at a more successful rate than for non-SDS; this bodes well for SDS with ownership and political will to engage in a Fund-supported program.

I do not support the proposal to raise access limits for EF. The IMF recognizes the challenges many SDS face due to frequent and relatively stronger shocks, including from natural disasters; moreover, these challenges may worsen in the future due to climate change. The IMF's work and that of many other expert institutions concludes that the sustainable response to deal with these challenges is a fundamental shift in how countries prepare for shocks and build resilience, and transition to structurally sound frameworks. Raising EF access risks disincentivizing countries from seeking UCT-quality programs that may be more appropriate to encourage this structural transformation and resilience-building that would help members better deal with such shocks.

Moreover, when considering the member's total financing needs, it is important to keep in mind that Fund financing is expected to play a catalytic role. I would also add that EF access limits play a key safeguard role inherent to Fund financing without ex-post conditionality. Of course, *emergency* situations caused by natural disasters triggering short-term BOP needs that can be resolved without the need for major policy adjustments are still expected to occur, and EF should help support them, in line with Fund policy; access limits of the Large Natural Disaster (LND) Window were recently increased with this in mind.

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

Summary of Detailed Recommendations:

- Commitment to reduce SDS MC turnover and avoid gaps in assignments.
- Stronger incentives to work in SDS.
- Limiting use of co-desk assignments except when both positions are in the same division.

- Encouraging greater use of functional department staff.
- Limiting the use of other departmental staff to fill mission teams.
- Increased use of research assistants (RAs) and research officers (ROs) to gather data.
- Depending on experience over the next two years in strengthening incentives to work on SDS, consider adding SDS experience to the promotion-eligible requirement list in the new career framework for fungible macroeconomists.
- Expanding the number of macroeconomists in regional offices and RCDCs.

I partially support this recommendation with qualifications.

I agree with the principle of this recommendation and see the call for continuous and adequate staffing of SDS teams as important. That said, I find the evaluation provides evidence that notwithstanding the small size and low spillover risks, SDS were increasingly better served by the Fund over the last decade, with SDS concerns more clearly identified and efforts made to find solutions, as evidenced by the growing body of high-quality research on SDS-specific issues, and the large share of SDS use of CD, among other efforts.

Ensuring appropriate staff turnover and assignment turnover that supports strong and continuous engagement with SDS is a legitimate concern. However, I note that this is also the case for other non-SDS members; given its importance, the issue is being addressed by the MIP on the Board-Endorsed Recommendations Categorization of Open Actions that was just endorsed by the Board. The MIP introduces an intermediate goal of 2.7-year median tenure for mission chiefs accompanied by measures to strengthen transparency and accountability, with reporting expected to track SDS as an explicit analytical country group, given its relevance. To avoid multiple overlapping initiatives, this MIP should be allowed to progress before SDS-specific measures are considered. Relevant Key Performance Indicators (KPIs) will be reported and closely monitored, including for SDS as a group.

Regarding the proposal to consider adding SDS to the promotion-eligible requirement list in the new career framework, I can support considering this after the planned two-year review of the implementation of this framework and a full assessment of the measures to increase tenure included in the MIP on the Board Endorsed Recommendations Categorization of Open Actions.

It is my view that the choice of increasing field presence and the introduction of specific incentives for staff to work on SDS are best decided by Area Departments (ADs), which face different challenges across regions.
These decisions have different implications both for operations (including cost-effectiveness) and for staff's career development; in addition, some of the proposals, such as the limits on the use of co-desk assignments may have adverse unintended consequences. Flexibility to choose modalities of engagement, including potentially fielding larger/more frequent missions instead of increasing junior field presence (as proposed), and/or increasing the share of RAs/ROs, should also be left to ADs. More broadly, ADs should retain flexibility in developing tailored solutions for the members in their region, given the heterogeneity of the group, which precludes providing one-size-fits-all approaches.

TABLE 1. THE MANAGING DIRECTOR'S POSITION ON IEO RECOMMENDATIONS

RECOMMENDATION	POSITION
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.	PARTIAL AND QUALIFIED SUPPORT
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, policy advice, and CD.	PARTIAL AND QUALIFIED SUPPORT
3. The IMF should consider how to use its lending framework in ways that better address the needs and vulnerabilities of SDS.	PARTIAL AND QUALIFIED SUPPORT
4. The IMF should adopt further HR management and budgetary commitments to increase continuity and impact of staff's engagement with SDS.	PARTIAL AND QUALIFIED SUPPORT

FINAL REMARKS

To conclude, I want to firmly restate my commitment to the evaluation's end objective of supporting SDS. I thank the Executive Board for its commitment to support SDS—this has guided the Fund to secure important gains in its engagement with this group of members over the last decade, while setting it on the right path through a number of important forward-looking initiatives, already in train, that are of high relevance and impact to SDS. I also thank the IEO team for its thorough work and for the guidance provided, which will help us better serve SDS. This is an evolving process, in line with the IMF's ongoing mandate to adjust to member needs.

In that vein, I look forward to implementation of the new workstreams, many of which will help members tackle difficult challenges, which are particularly relevant for SDS. We will strive to better engage with SDS in a cost-effective manner, while ensuring our approach is both tailored and evenhanded.