The Fund’s Engagement with Small Developing States—Staff Guidance Note

The unique economic characteristics and constraints facing small developing states were presented in a March 2013 Fund Board paper *Macroeconomic Issues in Small States and Implications for Fund Engagement*. While all small states have populations of under 1.5 million, they are a diverse group representing various income categories, but all of them face size-related constraints. The IMF has 33 members that are considered small developing states. Three out of four small states are islands or widely dispersed multi-island states, such as in the Pacific region; others are landlocked, and some are located far from major markets.

Based on the findings of the Board paper, the Fund produced a note in May 2014 that provides operational guidance on Fund engagement with small developing countries; including on how small country size might influence the use of Fund facilities and instruments, program design, capacity building activities, and collaboration with other institutions and donors.

Five key thematic areas (G.R.O.W.TH.) are identified as central to the policy dialogue:

- **Growth and job creation.** Small states have experienced relative weak growth since the 1990s. An explicit focus on growth in both surveillance and program-related work is needed.

- **Resilience to shocks.** Small states experience higher macroeconomic volatility and more frequent natural disasters. Macroeconomic policy advice needs to be tailored to provide greater resilience to shocks.

- **Overall competitiveness.** Options to improve relative prices may include exchange rate adjustment (where possible) or measures supportive of internal devaluation (if not), and efforts to improve the business climate, including through regional initiatives.

- **Workable fiscal and debt sustainability options.** With many small states having very high debt burdens, reducing debt to manageable levels requires sustained fiscal consolidation with supporting policies and structural reforms. In cases where the amount of adjustment needed to restore debt sustainability is not feasible or adequate financing is not available, debt restructuring may be needed.

- **Thin financial sectors.** The promotion of deeper and more competitive, yet sound financial sectors contributes to economic growth in a stable macroeconomic environment and more effective policy mechanisms.

The guidance note also considers the special macroeconomic challenges faced by “micro” states, with populations of fewer than 200,000. In practice, many countries with populations larger than 1.5 million have characteristics of “smallness,” and this guidance note applies, in varying degrees, to these countries as well.


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2 The list of the 33 Small Developing States, according to the IMF definition, is presented below. These are IMF members with a population under 1.5 million excluding those defined as advanced market economies according to the World Economic Outlook, as well as fuel exporting countries classified by the World Bank Group as “high income” (Bahrain, Brunei Darussalam, and Equatorial Guinea).
APD small states continued to face challenges in recent months. Natural disasters caused damage and human and economic losses in some small states...

Global food prices remained subdued...

APD small states: Economic Damage and Losses From Recent Natural Disasters

(APD Small States: Economic Damage and Losses From Recent Natural Disasters (In percent of GDP)

APD small states: Commodity Production, January-May, 2014

(APD Small States: Commodity Production, January-May, 2014 (Year-on-year percent change)

APD small states: Inflation, 2014, Latest Available

(APD Small States: Inflation, 2014, Latest Available (In percent)

...floods in Solomon Islands further disrupted gold production while oil output in Timor–Leste continued falling because of depletion of oil reserves under production.

Most tourism-oriented economies experienced robust increases in arrivals so far in 2014...


(Tourism-intensive APD Small States: Tourist Arrivals, 2014, Latest Available (Year-on-year percent change)

...in part due to the appreciation of the Australian and New Zealand dollars since the beginning of this year.

Australia and New Zealand: Nominal Exchange Rate

(Australia and New Zealand: Nominal Exchange Rate (Index, January 2013=100)

...keeping inflation in check in most small states...

Commodity Prices

(Commodity Prices (January 2011=100)

Note: Asia and Pacific developing (APD) small states include: Bhutan, Fiji, Kiribati, Maldives, Marshall Islands, Micronesia, Palau, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

Sources: Country authorities; EM-DAT International Disaster Database; and IMF staff estimates.
Figure 1. APD Small States: Recent Economic Developments (concluded)

...and helping contain the import bill.

(Year-on-year percent change)

[Graph showing import growth for various APD Small States]

Note: January-May for Samoa and Solomon Islands; January-April for Fiji and Maldives; and January-March for Timor-Leste, Tonga, and Vanuatu.

The level of reserves remained broadly adequate and, in some cases, above comparators outside the APD region.

APD Small States: Reserves, 2014, Latest Available
(In months of next year’s imports of goods and services)

[Graph showing reserve levels for various APD Small States]

1/ Indicates the same month as the latest available month in 2014.

Interest rate spreads were unchanged, but still higher than those of Caribbean comparators, reflecting PICs’ structural impediments (e.g., use of land as collateral).

APD Small States: Interest Rate Spreads, May 2014
(In percent)

[Graph showing interest rate spreads for various APD Small States]

Note: March 2014 for Vanuatu. Spreads are computed as the difference between the average lending rate and the average deposit rate.

...partly reflecting commercial banks’ excess liquidity.

APD Small States: Nonloan Assets-to-Total Assets Ratio, 2014Q1
(In percent)

[Graph showing nonloan assets ratio for various APD Small States]

1/ December 2013 for Bhutan.

Note: Nonloan assets = total assets minus total loans. Nonloan assets include currency, deposits, securities, shares and equity, financial derivatives, other financial assets, and nonfinancial assets. The 2007Q4 data reflect the pre-crisis level.

Tax revenue was stable or increased, while nontax revenue declined, mainly in Kiribati because of lower fishing license fees, albeit from a very high base.

(Year-on-year percent change)

[Graph showing fiscal revenue excluding grants for various APD Small States]

Note: January-May for Tuvalu and Vanuatu; January-April for Kiribati; and January-March for Fiji, Samoa, Solomon Islands, and Tonga.

Private sector credit growth also varied across APD small states, still weak in some countries...

APD Small States: Private Credit Growth, 2014, Latest Available
(In percent; year-on-year change)

[Graph showing private credit growth for various APD Small States]

Note: May 2014 for Fiji, Maldives, Samoa, Solomon Islands, Timor-Leste, and Tonga; April 2014 for Vanuatu; and March 2014 for Bhutan and Palau.

Sources: Country authorities; and IMF staff estimates.

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