INTERNATIONAL MONETARY FUND

The Fund's Engagement in Fragile States and Post-Conflict Countries—A Review of Experience—Issues and Options

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ABBREVIATIONS AND ACRONYMS

CPIA	Country Policy and Institutional Assessment
EFF	Extended Fund Facility
ENDA	Emergency Natural Disaster Assistance
EPA	Ex Post Assessment
EPCA	Emergency Post-Conflict Assistance
ERAP	Economic Recovery Assistance Program
ERFA	Economic Recovery Financial Assistance
ESF	Exogenous Shocks Facility
GMR	Global Monitoring Report
GRA	General Resources Account
HIPC	Highly Indebted Poor Countries
IDA	International Development Association
IFIs	International Financial Institutions
LICs	Low-income countries
LICUS	Low-income Country Under Stress
MDBs	Multilateral Development Banks
MDGs	Millennium Development Goals
MONA	Monitoring of Fund Arrangements
MTS	Medium-Term Strategy
ODA	Official Development Assistance
OECD-DAC	Organization for Economic Cooperation and Development-Development Assistance Committee
PFM	Public Financial Management
PRGF	Poverty Reduction and Growth Facility
RTAC	Regional Technical Assistance Center
SBA	Stand-by Arrangement
SMP	Staff-monitored program
UCT	Upper Credit Tranche
UNDP	United Nations Development Program
VAT	Value-Added Tax
WEO	World Economic Outlook

Executive Summary

The international community has stepped up efforts to devise a broad and coordinated approach to engaging more effectively with fragile states, whose economic and social performance is substantially impaired by their weak governance, limited administrative capacity, persistent social tensions, and a tendency to conflict and political instability. Such states increasingly lag behind other low-income countries (LICs) in terms of growth and development, and are at risk of falling into a poverty trap. They are also least likely to achieve the Millennium Development Goals (MDGs), and often receive less aid than warranted by macroeconomic and social needs.

The Fund has been engaged in some form—surveillance, staff-monitored programs (SMPs), financial assistance, and capacity building—in almost all fragile states to improve economic management and performance, though it has not adopted a specific and differentiated policy toward them. However, the Fund's Medium-Term Strategy (MTS) calls for greater flexibility in program design in fragile states (including post-conflict countries), while focusing on the Fund's core areas of competence.

A review of the Fund's engagement in fragile states indicates that it has been broadly effective. Macroeconomic performance improved in fragile states that implemented the reforms agreed on with the Fund, or recommended by it. Program engagement with the Fund also generally led to increased net external financing, and in almost all cases, facilitated access to debt relief.

However, the review also reveals certain gaps in the Fund's engagement which have significant implications for certain fragile states. The Fund has often been unable to give a strong and clear signal to external partners of fragile states where it has not been engaged financially—these states have therefore often been unable to mobilize adequate external support. Deep-seated capacity constraints in many fragile states contributed to program performance that was, on average, weaker than that of non-fragile states, with particular difficulty in implementing structural reforms. In some cases, therefore, the transition to an upper credit tranche (UCT)-standard arrangement may have been premature. Similarly, the route to financial assistance and establishment of a Heavily Indebted Poor Countries (HIPC) Initiative track record is significantly more difficult for those fragile states without access to the Fund's emergency post-conflict assistance (EPCA).

A more systematic, graduated approach could improve the coherence of the Fund's engagement. A medium-term framework that explicitly adjusts Fund policy advice and monitoring, capacity building, signaling, and financial assistance to a country's evolving capacity to formulate and implement macroeconomic policy, and that builds on the country's commitment to reform, would allow the Fund to offer LIC fragile states an engagement that is better attuned to their deep-rooted problems.

The paper therefore proposes a new approach—the "Economic Recovery Assistance Program" (ERAP)—which does not involve a major change in the Fund's policies or instruments, but rather combines the modes of the Fund's present engagement with fragile states into a consistent medium-term policy framework, and expands the financing options available for fragile members which are not in a post-conflict situation. Overcoming deep-seated fragility and moving to sustained macroeconomic stability and growth typically requires several years of well-coordinated support. The ERAP would support the implementation of economic reforms of progressively rising ambition, and would set out a trajectory for alleviating the country's capacity weaknesses through technical assistance that is closely coordinated with other providers, culminating in the restored ability of the fragile state to manage its economy effectively.

The ERAP would be available in two phases over five years. The first phase would be a non-financing phase, emphasizing capacity building and macroeconomic policy support. Once sufficient implementation capacity has been established, and provided a balance-of-payments financing need exists, the country could enter **the second phase** which would provide Fund financial support (the "Economic Recovery Financial Assistance"—ERFA),to any eligible low-income fragile state under terms and conditions similar to the existing Emergency Post-Conflict Assistance (EPCA). Non-LIC post-conflict countries would continue to be eligible for EPCA under the existing policy. Successful implementation of Phase two would provide a track record to assess readiness for transition to a UCT-standard program. It is proposed that financial support to fragile states under the ERFA be on concessional, possibly PRGF terms, and that, for HIPC-eligible fragile states, the ERFA would count toward the decision point track record under the enhanced HIPC Initiative. In both phases of the ERAP, the staff would agree with the authorities on policy objectives, a reform program, and performance benchmarks in the areas of capacity building, macroeconomic policies, and structural reforms. Twice a year, staff would assess the member's performance and prospects of progressing to the second phase of ERAP or to a UCT-standard arrangement and report on these to the Board.

To give a clear and transparent signal of the Fund's commitment to provide sustained structured support, the Board would formally endorse the economic program supported under the ERAP and the staff's assessments of progress throughout the program. These assessments would be based on progress against the agreed benchmarks, as well as future policy intentions and commitment. The Board's endorsement of these assessments, would be made public, providing a clear signal for donors, allowing them to anchor their expectations for the country's macroeconomic policies and outcomes. The Board would also approve the provision of financial assistance in the second phase.

I. INTRODUCTION

1. **Fragile states have characteristics that substantially impair their economic and social performance.** These include weak governance, limited administrative capacity, chronic humanitarian crises, persistent social tensions, and often, violence or the legacy of armed conflict and civil war. In these countries the poor quality of policies, institutions and governance substantially impairs economic performance, the delivery of basic social services, and the efficacy of donor assistance.[1] Such states are least likely to achieve the Millennium Development Goals (MDGs).[2] They also have considerable negative spillover effects on economic growth in neighboring countries.[3]

2. **The international community is increasingly concerned with the impact of state fragility** and has stepped up efforts to devise a broad and coordinated approach to engaging more effectively with fragile states. In 2005, donors endorsed the establishment of good practice principles for engagement in fragile states in the framework of the OECD Development Assistance Committee (OECD-DAC) (Annex Box 1). The multilateral development banks (MDBs) have been working individually towards more effective and rapid responses to fragility; and they agreed in October 2007 on principles for harmonizing their approaches (Annex Box 2). In parallel, the UN Peacebuilding Commission (in which the Fund participates) was established in 2005; and a UN system-wide approach to post-conflict recovery and employment generation is being developed.

3. **The Fund has been actively engaged in some form with almost all fragile states** with the aim of improving economic management and performance, although it has not adopted a specific and differentiated policy toward them. However, the Fund's MTS calls for greater flexibility in program design in fragile states (including post-conflict countries) as part of its recommendations on the Fund's role in LICs.[4] In particular, the MTS envisages programs with a more flexible conditionality and a more central role for technical cooperation and capacity building. In addition, the Fund's engagement with fragile states needs to be effectively coordinated with the evolving international approach.

4. **This paper reviews the modes and objectives of the Fund's engagement with fragile states and post-conflict countries**.[5] It examines the rationale for this engagement, and assesses its effectiveness. The review finds that the Fund's present approach has been broadly effective, but that there is scope for an engagement that is better attuned to the needs of fragile states. The paper proposes possible options for a better engagement. Following the Board's views and guidance on the proposed approach, staff would conduct outreach with interested parties, including donors and member countries, before presenting a final proposal for Board consideration.

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[1] Collier (1999) and Chauvet and Collier (2004) identify sizeable reductions in the annual rate of the economic growth during periods of conflict and in peacetime economies of fragile states of some 2-3 percentage points.
[2] See IMF and World Bank (2007), page 45.
[3] Estimates of spillover effects are reported in Murdoch and Sandler (2002) and Collier and Hoeffler (2004) for civil wars, and in Chauvet and Collier (2004) for neighbors of fragile states. A typical neighbor of a fragile state loses 1.6 percentage points of its economic growth rate.
[4] See IMF 2006f, and Implementing the Fund's Medium-Term Strategy—Working Group Report.
[5] This review focuses primarily on LICs, but also includes non-LIC post-conflict countries that have used EPCA.

5. **The remainder of this paper is organized as follows**. Section II deals with definitional issues, the range of Fund engagement with fragile states, and key policy issues. Section III presents summary results of the review of past engagement, including under EPCA, and summarizes the key conclusions and policy implications from the review. Section IV presents possible options for revising the scope of the Fund's engagement. Section V provides estimates of the implications of the proposed new approach to fragile states for staff resources. Section VI presents issues for consideration by Executive Directors.

II. An Overview of Fund Support for Post-Conflict and Fragile States

A. Characteristics of Fragile States

6. **This paper does not seek to define a Fund-endorsed list of fragile states.** Rather, it takes the view that the form and scope of engagement by the Fund with these states, and how this may differ from its engagement with non-fragile states, are best determined by the underlying characteristics of fragile states, particularly their institutional and policy implementation weaknesses (Box 1).[6]

Box 1: Characteristics of Fragile States

- Fragile states exhibit a mix of institutional and policy implementation weaknesses. They tend to under-perform across all the dimensions of the World Bank's Country Policy and Institutional Assessment (CPIA) index (economic management, structural policies, and social policies, with particular shortcomings in the quality of public sector institutions). Their fragility tends to persist over time.

- They are prone to political conflict and instability, posing a risk of negative spillovers for their neighbors and the wider global community, through spread of conflict, refugee flows, and barriers to trade and investment.

- Their economic performance and ability to deliver basic social services is weak, compounded by poor policies and institutions and political conflict. Revenue per capita in fragile states has been stagnant on average over the last 25 years. Income poverty is twice as high as in other low-income countries; infant mortality rate is a third higher; life expectancy is 12 years lower; and the maternal mortality rate is about 20 percent higher (World Bank Independent Evaluation Group, 2007).

- They tend to receive considerably less external assistance than other low-income countries, as a direct result of these characteristics.[1] Their financial relations with the international community are often complicated by high levels of debt and protracted arrears. Donors have been willing to support post-conflict countries in the early stages of their recovery, but support has tapered off after this initial phase. Support to other fragile states, including some with relatively stronger governance indicators, is often even less firm, except where donors may have political motives.

[1] Dollar and Levin (2005) find that fragile states as a group are under-aided, and that aid to fragile states tends to be more volatile than aid to other low-income countries.

[6] The paper sets out below eligibility criteria for the proposed Fund engagement with fragile states that are based on these characteristics (see Section IV. A., and Box 4).

7. **However, to review past Fund engagement it is necessary to identify a group of relevant states that ex post could be considered fragile.**[7] Thus, for analytic purposes only, this paper uses the group of countries identified by the World Bank under its Low-Income Country Under Stress (LICUS) Initiative as fragile, owing to their weak performance in the CPIA index (Annex Box 3). While there is no universally accepted single definition of fragile states, the Bank's approach has gained wide currency and is being used, for example, by the Fragile States Group of the OECD-DAC. Other agencies, in particular, the MDBs, use broadly similar definitions.

B. Fund Engagement in Fragile States

8. **The Fund has been actively engaged in almost all the states reviewed, with the aim of improving economic management and performance; strengthening essential capacity; and, in some cases, helping to meet balance-of-payments needs and catalyze external support** (Box 2).[8] The engagement has taken several forms, consistent with the Fund's mandate: macroeconomic policy advice in a surveillance-only context; staff-monitored programs (SMPs) intended to establish a track record of performance; technical assistance and support for capacity building in the Fund's areas of expertise; and financial assistance, either under EPCA, or under upper-credit tranche (UCT) arrangements, often leading to debt relief under the enhanced (HIPC) Initiative (Box 3). During the period under review (2000-2005 for fragile states, and 1995-2005 for countries with EPCA programs), there have been financial programs with 24 members (of which 12 under EPCA). Of the members that did not receive financial assistance, seven had SMPs, and in ten the relationship was largely limited to Fund surveillance and/or technical assistance.

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[7] Note that in the following, the term "fragile state" is assumed to include post-conflict states as a subset. Where the distinction between post-conflict and non-post-conflict fragile states is salient, particularly as regards the results of the review of performance below, this is explicitly noted.

[8] However, with a small number of fragile states, Fund involvement has been minimal. For example, there has been virtually no engagement with Somalia since 1989, owing to the absence of an internationally recognized government and the security situation. In the interim, the UNDP, other UN agencies, and the World Bank have undertaken several projects and provided Somalia with technical assistance, including in some of the Fund's core areas, such as central banking.

Box 2: Sample for the Review of Fragile States and Post-Conflict Countries, 2000-05 [1/] [2/]

	EPCA 1995-2005		UCT Arrangement	SMP 2000-05		Article IV Consultation/ Surveillance only
			Post-Conflict Fragile States			
(UCT)	Albania [3/] (UCT)		**Chad**	**Afghanistan** (UCT)	(UCT)	**Côte d'Ivoire** (EPCA)
	Bosnia & Herzegovina [3/] (UCT)		**Congo, Dem. Rep of**	Angola		**Eritrea**
(SMP)	**Burundi** (UCT)			**Liberia**		**Somalia** [4/]
(SMP)	**Central African Republic** (UCT)			**Sudan**		Timor-Leste [5/]
(SMP)	**Congo, Republic of** (UCT)					
(SMP)	**Guinea-Bissau** (UCT)					
(SMP)	**Haiti** (UCT)					
	Iraq (UCT)					
(SMP)	**Rwanda** [3/] (UCT)					
	Fmr Serbia and Montenegro [3/] (UCT)					
(UCT)	**Sierra Leone** (UCT)					
(SMP)	Tajikistan [3/] (UCT)					
			Other Fragile States			
			Cambodia	**Comoros**		Kiribati
			Cameroon	**Togo**		Myanmar
			Djibouti	Uzbekistan		Solomon Islands
			Gambia, The			Tonga
			Guinea			Vanuatu
			Lao P.D.R.		(UCT)	Zimbabwe
			Niger			
		(SMP)	**Sao Tome & Principe** (SMP)			
			Papua New Guinea			
			Nigeria			

Source: See Annex Box 3. Countries in bold text are HIPC-eligible.
[1/] For the review, all countries with EPCA programs during 1995-2005 were included in the sample. For all other countries, the sample period is 2000-05.
[2/] For each country, the form of engagement reviewed is either the EPCA program, or, for non-EPCA users, the level of engagement is ranked in the following order: (i) UCT arrangement; (ii) SMP; and (iii) Article IV Consultations. For each country, the form of program engagement preceding/following the classification is shown in parenthesis before/after the country name. The pre/post program period is limited to two years.
[3/] These countries received EPCA during 1995-99, for which years the World Bank LICUS list of fragile states is not available.
[4/] No Article IV consultation discussions since 1989 because of security conditions and absence of internationally recognized government.
[5/] Fund member since July 2002.

9. **The Fund has not adopted a special policy on fragile states distinct from the approach used in other low-income members.** However, fragile states can benefit from the Emergency Post-Conflict Assistance (EPCA) and Emergency Natural Disaster Assistance (ENDA) policies if they meet the eligibility criteria. EPCA is based on the notion that conflicts, like natural disasters, are essentially temporary negative shocks that require only a

relatively short period of reform and assistance before a UCT-standard arrangement can be implemented (Box 3).[9]

Box 3: Emergency Post Conflict Assistance

Emergency Post-Conflict Assistance (EPCA) was introduced in 1995 as an extension of the Fund's emergency assistance policy related to natural disasters and is available to post-conflict countries meeting specific eligibility criteria. EPCA is available to all Fund member countries—it is not restricted to members eligible for a Poverty Reduction and Growth Facility (PRGF) Arrangement or fragile states.[1]

Financial assistance under EPCA can be provided in situations where: (i) there is an urgent balance of payments need to help rebuild reserves and meet essential current payments, and a role for the Fund in catalyzing support from other official sources; (ii) the country's institutional and administrative capacity is disrupted as a result of the conflict, so that the member is not yet able to develop and implement a comprehensive economic program that could be supported by a UCT-standard Fund arrangement; (iii) there is nonetheless sufficient capacity for policy planning and implementation, and demonstrated commitment on the part of the authorities (in order to provide adequate safeguards for the use of Fund resources); and (iv) Fund support would be part of a concerted international effort to address the aftermath of the conflict in a comprehensive way.

Operational requirements for financial assistance include: a statement of economic policies; a quantified macroeconomic framework to the extent possible; and a statement by the authorities of their intention to move as soon as possible to an upper credit tranche stand-by or extended arrangement, or to an arrangement under the PRGF. Each EPCA purchase is a stand-alone purchase subject to Board approval and thus the key form of conditionality is through prior actions. Additional access to EPCA is possible through successive stand-alone purchases, up to applicable access limits.

In November 2000, the Executive Board converted emergency assistance into a special policy, so that it would not be subject to the level-based surcharge. As a result, access under emergency assistance does not count toward the limits on access under the credit tranches and the Extended Fund Facility (EFF). In 2001, the EPCA Subsidy Account was established to subsidize the interest rate on EPCA to 0.5 percent for PRGF-eligible (or low-income) post-conflict countries. In 2004, the Board extended the period during which EPCA financial support can be provided to up to three years, with access capped at 25 percent of quota in any one year, and a cumulative ceiling of 50 percent of quota. Access can be tranched to help ensure the effective use of Fund resources and provide an incentive to develop a comprehensive economic program.

[1] See *Summing Up by the Chairman—Fund Involvement in Post-Conflict Countries* (http://www.imf.org/external/pubs/ft/sd/index.asp?decision=EBM/95/82). For subsequent reviews of EPCA and modifications, see IMF 1999, 2001, and 2004a.

C. Key Policy Issues

10. **Fragile states are often unable to mobilize sufficient international support at the critical early stages of their reform efforts.** This is in part due to their inability to implement a comprehensive macroeconomic framework that ensures that their reform strategy is macroeconomically viable. Donors seek assurances of continuing improvement in policy planning and implementation, public financial management, and governance

[9] Fourteen post-conflict countries have sought assistance under EPCA since it was introduced in 1995, including Lebanon and Côte d'Ivoire in 2007.

systems.[10] The absence of a signal of the Fund's engagement over the medium term may thus compromise the ability of fragile states to attract sufficient donor support.[11]

11. **Debt relief and arrears clearance are also important to unlock external support and help fragile states attain a sustainable external position.** However, Paris Club creditors have generally not been prepared to provide debt relief in the absence of a Board-approved UCT-standard financial arrangement, and most multilateral agencies cannot continue to lend when countries have arrears to them (though some can provide relatively small grants).

12. **The more entrenched the institutional and political weaknesses are, the more time is required to build the capacity to use external support effectively,** and execute appropriate macroeconomic and structural policies. Progress toward these development objectives also depends on advances on the political and security fronts. Often, the agencies and actors responsible for political, security, and economic affairs are different from those engaged in development assistance and humanitarian aid, complicating the necessary "whole of government" approach. This problem highlights the need for robust and appropriate coordination mechanisms among external partners, between these partners and the recipient government, and within the government itself.

13. **An important consideration, therefore, is how the Fund's engagement in fragile states fits into broader international efforts.** The Fund's assistance to countries in establishing a feasible macroeconomic framework, and in strengthening the capacity to implement it, is a critical point of reference for other donors. The timeliness and form of the Fund's engagement in fragile states is also important for triggering or enhancing a concerted international effort. However, many of the problems faced by fragile states are developmental in nature, and may also reflect political and security-related problems. Thus, coordination with other institutions is required for the Fund's interventions to be effective, particularly in the provision of capacity-building support.

14. **The Fund must balance the possible advantages of the signal provided by financial assistance to fragile states against downside risks to the Fund**—the possibility of poor program implementation, and the ensuing risk of non-repayment. While post-conflict countries need only demonstrate the capacity to implement the EPCA, with its less ambitious objectives,[12] present policies require fragile states that are not post-conflict to demonstrate the capacity to implement a UCT-standard arrangement in order to receive Fund financial

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[10] Collier (2007) argues that early forward-looking efforts to improve public financial management provide assurances of good governance and are key to attracting large aid inflows. Moreover, such inflows avoid the need to rely on higher taxation of a narrow, recovering private sector and inflationary domestic financing for meeting large recovery and reconstruction spending needs.

[11] The Executive Board has opposed facilitating early transitions to PRGF arrangements by applying less stringent conditionality standards, especially when administrative capacity is still lacking. Instead, to help foster program implementation and to strengthen signals to donors, Directors have called for more frequent assessments of the member country's policy performance. See IMF 2004a.

[12] The Fund's MTS explicitly recognizes that for some countries, such as post-conflict countries, an UCT conditionality standard "may be unreasonable", and calls for a facility with "a more flexible standard and a larger capacity-building component—beyond that available through Emergency Post-Conflict Assistance." See IMF 2006f, paragraph 32.

assistance. This requires a careful assessment of implementation capacity and the degree of ownership of reforms, in a precarious economic, political, and technical setting. Where this assessment precludes the Fund's immediate financial assistance, other ways must be found for the Fund to play the important role expected of it in the concerted international support effort.

15. **Outside commentators have called for a longer-term and more predictable engagement by the Fund in fragile states**, with more nuanced signals and more flexible modes of assistance that take into account the evolving economic, political, and social context. This would include program conditionality that can feasibly be implemented in a fragile situation, and a program length tailored to country needs, as well as greater emphasis on capacity building.[13] There have also been calls for more flexible links between Fund-supported programs and Paris Club debt relief, and for a different approach to the problem of multilateral arrears that would help avoid net repayments to creditors. Some observers have also called on Paris Club creditors to demonstrate flexibility by explicitly allowing for the deferral of arrears and maturities falling due to them during the period of an EPCA-supported program.[14]

III. Review of Fund Engagement with Fragile States and Post-Conflict Countries

16. **To assess the effectiveness of the Fund's approach to fragile states, its engagement with these members during 2000-05 (and with all members receiving EPCA during 1995–2005) was reviewed** along several key dimensions: improving macroeconomic performance and implementing structural reforms; building capacity through technical assistance and training; transiting to UCT-standard programs; catalyzing aid; and facilitating access to debt relief and the clearance of external arrears. The details of this review are contained in the Appendix, and the main results are presented below.[15]

A. Summary of the Review

Macroeconomic and Structural Reforms: Objectives and Performance

17. **The primary macroeconomic objectives** of Fund-supported programs and SMPs with fragile states were to strengthen growth and macroeconomic stability. External assistance was critical to achieving inflation goals, increasing spending, and avoiding domestic arrears accumulation. The structural agenda generally contained immediate steps to strengthen core areas of economic management.

18. **Fragile states with Fund-supported programs and SMPs achieved broadly positive macroeconomic outcomes, but program implementation was weaker than in**

[13] Some have stressed the importance of a Fund-supported macroeconomic framework and capacity building in public financial management systems, given the rising importance of budget support as a mode of aid delivery in fragile states.
[14] See Fayolle (2006), and Raffinot and Rosellini (2007).
[15] The performance of the group of fragile and post-conflict states assessed in the review was compared to the performance of the broader group of LICs with UCT-standard arrangements during the review period, which served as a benchmark.

non-fragile states—programs with fragile states were also more likely to go "off-track" than programs with non-fragile states. Moreover, performance on structural objectives was weaker than with respect to quantitative targets. In some programs, the structural reform agenda may have been overambitious, in view of severe administrative capacity constraints; the coverage and sequencing of measures may have been inappropriate; and insufficient attention may have been paid to public financial management, governance, and generating the political consensus for reform.[16]

19. **Macroeconomic performance also improved in those surveillance-only members that implemented the policies suggested by the Fund.** By contrast, performance was notably less strong in the countries that did not implement appropriate policies—often, poor policy implementation was due to conflict or political factors, while in other cases it reflected an unwillingness to implement policy recommendations.

Capacity Building through Technical Assistance and Training

20. **Virtually all fragile states with programs experienced a step up in Fund-provided technical assistance** (measured in staff-years),[17] especially post-conflict countries. However, these countries often received less than the average amount of technical assistance provided to non-fragile states as a group, in part because of security concerns and absorption constraints.[18] In most cases, the countries also benefited from increased access to Fund training, especially under UCT-standard and EPCA-supported programs.

21. **The success of technical assistance and training depended on it being provided in a manner that was responsive to countries' political, institutional, and capacity constraints**.[19] In some cases, delays in delivering necessary technical assistance may have contributed to difficulties in meeting program objectives.[20] The close involvement of area departments and resident representatives in identifying and prioritizing country needs in the context of overall excess demand was important to ensuring successful assistance.

Transition from EPCA to UCT-standard programs

22. **The length of transitions to UCT-standard programs varied considerably**; longer transitions generally reflected an unsettled security situation and renewed bouts of conflict,

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[16] These findings are drawn from Ex Post Assessments (EPAs) conducted for ten of the fragile states covered by the review.

[17] Due to limitations in the availability of data, technical assistance (staff-years) includes only provision from headquarters and not that from Regional Technical Assistance Centers (RTACs). Staff-years is only a partial and crude indicator of the quality and value of technical assistance. Outputs and results also reflect the authorities' responsiveness to technical assistance, and their capacity to implement reforms.

[18] See Appendix 1, and Independent Evaluation Office, 2005, IMF 2004b, 2004c, 2004d, 2004e. In some of these cases, other donors may have provided most of the technical assistance received.

[19] See IMF 2004b and 2004d.

[20] For example, the Ex Post Assessment for Guinea-Bissau (IMF 2004g, paragraph 13) identified delays in donor technical assistance as contributing to delays in the reconstruction of the administrative infrastructure, an area of focus under the EPCA-supported programs. Initial delays were related to security conditions.

or continued deep underlying institutional and policy weaknesses.[21] In many members, prolonged capacity weaknesses affected the first successor UCT-standard programs following EPCA, and their performance fell short of that of non-fragile states with UCT-standard programs. However, performance improved in second successor programs and was then, on average, in line with that of programs in non-fragile states.

Fund Financing and Catalytic Role

23. **Net Fund disbursements increased for most of the fragile states with Board-approved programs**. New disbursements reversed net repayments in almost half of these cases. Net official development assistance (ODA) was an important element of macroeconomic programs, but amounts varied considerably (between two percent and 50 percent of GDP); states emerging from violent conflict typically received more than other fragile states.

24. **Good program performance in fragile states has generally led to a net increase in external financing**. A surveillance-only or SMP relationship was often considered sufficient by donors where there was already a strong political commitment by donors to provide financial support, macroeconomic performance was positive, and the reform commitment of the authorities was clear. In these countries, the Fund's engagement was an important part of a coordinated international response. As expected, however, external financing was low in cases of uneven program implementation, or weak commitment to reform.

Debt Relief and Arrears Clearance

25. **In almost all cases, EPCA and UCT-standard programs facilitated the access of fragile states to debt relief**. The time taken by the EPCA users to reach the HIPC initiative decision point varied considerably,[22] and recent users have taken advantage of the EPCA-supported program to reach the decision point at the time of the transition to a PRGF arrangement or soon after.[23] However, in some countries the existence of significant arrears to multilateral creditors has delayed the onset of EPCA and UCT-standard programs and impeded the flow of financial assistance.

B. Policy Challenges Raised by the Review

26. **The review leads to the conclusion that the Fund's engagement has been broadly effective in helping many fragile states strengthen their macroeconomic performance, rebuild core macroeconomic capacity, and mobilize external support.** The present range of instruments used in this engagement has been adequate, though with some room for improvement. The relatively weaker program performance of fragile states, even when

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[21] EPCA policy was modified in 1999 and 2004 to allow for EPCA engagement for up to three years, partly in response to the extended transition times in countries where more time was needed to strengthen capacity.

[22] Section III, paragraph 1(b) of the PRGF-HIPC Trust Instrument.

[23] Haiti and Guinea-Bissau reached the HIPC decision point at the time of the approval of a new PRGF arrangement following two consecutive 12-month EPCA-supported programs. In the cases of Central African Republic, the Republic of Congo, and Sierra Leone, the decision point was reached at the time of the first review under the PRGF arrangement that followed EPCA.

commitment to reform was strong, seems to confirm that the requirements of UCT-standard programs may be too ambitious for some fragile states, given their capacity constraints. In non-program fragile states, successful engagement through intensive technical assistance and SMPs has been possible in countries committed to reform and enjoying strong donor support.

27. **The difficulty of some fragile states in making a successful transition from an EPCA-supported program, SMP, or surveillance-only engagement to a UCT-standard arrangement may also be a sign that, in some instances, the move was undertaken too early.** The depth of the capacity weakness may have been underestimated or the authorities' commitment to reform overestimated. In some countries, recurrent political instability also played a role. There may also have been pressures to make an early transition in order to mobilize urgently needed external financing, and to advance quickly to debt relief.

28. **For non-post-conflict fragile states, the signals emanating from the Fund through SMPs, assessment letters, and surveillance may be insufficient to catalyze donor support** as they do not provide an explicit and systematic medium-term approach for Fund policy advice and monitoring, capacity building, and signaling.[24] As a consequence, external support to these fragile states may fall short of requirements.[25]

29. **While EPCA users can begin to build a track record for HIPC Initiative debt relief prior to approval of a PRGF, this is not possible for non-post-conflict LIC fragile states.** The latter countries thus take longer to establish a track record for HIPC Initiative debt relief.[26]

30. **These conclusions point to the advantages of a more graduated and longer-term approach by the Fund, creating an opportunity for more informed step-by-step assessments of macroeconomic prospects and management capacities**.[27] Overcoming severe fragility and achieving a successful transition to macroeconomic stability and sustained growth typically takes several years of well-coordinated external support.[28] Clear

[24] An SMP can be an effective signaling tool when it is expected to culminate in a UCT-standard program, or the resumption of an interrupted one, as it gives a clear indication of where the process will end. For a fragile LIC whose capacity weaknesses preclude prompt access to the PRGF, this element would be absent. The stand-alone SMP would give donors the assurance of a consistent macroeconomic framework, but little information on the prospects for strengthening implementation capacity toward the UCT-standard level.

[25] By contrast, financial assistance under EPCA and its catalytic effect helps to address an urgent balance-of-payments need evidenced by external debt servicing difficulties and pressure on reserves. This need is often deepened by the import content of emergency reconstruction and humanitarian spending aimed at reversing the negative economic and institutional impact of the conflict and thus breaking the "conflict trap".

[26] The Fund decided in 1998 to consider, on a case-by-case basis, programs supported by emergency post-conflict assistance as part of the track record leading to the decision point (see IMF 1998). In 2001, the Board decided that if significant progress had been made towards macroeconomic stability, governance, capacity-building, and monitoring, consideration could be given to having an early decision point for post-conflict countries combined with a relatively longer interim period before the completion point (see IMF 2001).

[27] For example, a surveillance-only relationship may be the only suitable engagement where the absence of political commitment to reform or other political economy factors cripple policy making, render sustained implementation of even a relatively modest macroeconomic program unlikely, and preclude the effective use of technical assistance.

[28] Based on quantitative analysis, Chauvet and Collier (2004) argue that in fragile states where there is an incipient turnaround, early technical assistance sustained over the medium term significantly reduces the risk that reform efforts will collapse and accelerates progress to a sustained turnaround in economic performance.

signals from the Fund would be required throughout that period. The Fund's engagement would need to focus on rebuilding or strengthening the institutional capacity to absorb macroeconomic policy advice and implement basic economic reforms; catalyzing the needed international support; and dealing with arrears and preparing the countries for debt relief. The ultimate objective would be for the member to move to a Fund-supported program that meets UCT standards.

31. **A more systematic, graduated medium-term engagement with fragile states will ensure that the Fund's support can effectively respond to the challenges set out above.** However, based on the review, no major changes in policies and only certain adaptations of existing instruments seem warranted to achieve this objective (although, as noted below, a new financing instrument may be needed). Nonetheless, the analysis does point to some areas where some changes in approach could help fill some of the gaps that loom large for certain members.

IV. Options for Reform

A. Program Engagement

32. **The staff proposes a new medium-term approach—tentatively called the Economic Recovery Assistance Program (ERAP)—for the Fund's engagement with LIC fragile states.** Rather than creating an entirely new instrument, the proposed approach draws on the existing EPCA policy and combines it with the modes of the Fund's present non-financial engagement with fragile states into a consistent package with a clear medium-term horizon which emphasizes the rebuilding of the member's implementation capacity. Financing would be provided to eligible low-income fragile states (post-conflict and non-post conflict) under modalities similar to those of the existing EPCA, though adapted to be more appropriate for LIC fragile states and to address a broader (non-conflict-related) balance-of-payments need. The eligibility criteria and conditions of the present EPCA (see Box 3) would apply, duly adjusted to include non-post-conflict situations, to enable members to enter the ERAP and benefit from the Board's endorsement of their reform program at a relatively early stage in the capacity-building process. EPCA would continue to be available in its present form to non-LIC countries that meet the eligibility criteria set out in Box 3.

33. **The ERAP would be available to eligible members in two phases** (Box 4). The **first phase** would emphasize capacity building and the strengthening of macroeconomic policy, but would not provide financial assistance. Staff would support and monitor the implementation of a macroeconomic reform program agreed with the authorities. Once sufficient implementation capacity has been established (as evidenced by successful implementation of the macroeconomic program in the first phase), and provided a clear balance-of-payments financing need exists, the member could enter into **the second phase** (tentatively called the Economic Recovery Financial Assistance—ERFA). In this phase, the member could request financial support, which the Fund would provide under a format similar to EPCA in the form of outright purchases but on more concessional terms (Section

IV.C).[29] Successful implementation of the economic program in this phase would provide a track record to assess readiness for transition to a UCT-standard program, and would count towards the HIPC Initiative decision point track record, as does EPCA. The sequencing is explicitly designed to intensify the engagement in step with the strengthening of capacity to implement macroeconomic policies—this is the aspect of state fragility where the Fund can have the largest positive impact. The entire engagement would be intended from the outset to culminate in the successful transition to a PRGF arrangement.

[29] The current provisions of EPCA in terms of access, phasing, and the modalities of purchases (see Box 3 above) could be applied to the ERFA.

Box 4: Eligibility Criteria for the ERAP

Fund's assistance under the Economic Recovery Assistance Program (ERAP) will be available to **low-income, PRGF-eligible member countries meeting all or most of the characteristics of state fragility set out in Box 1, specifically:**

- They display institutional and administrative capacity weaknesses, including as a result of recent conflict, that prevent implementation of a comprehensive economic program supported by a UCT-standard arrangement with the Fund, although basic economic functions are strong enough for the country to start reducing macroeconomic imbalances.[1]
- They demonstrate a commitment to policy reform and strengthening capacity, and government ownership of the reform package.
- Transition to a UCT-standard Fund-supported program is considered possible within five years.

The staff's support for a member country's request for an ERAP, and the Board's review and endorsement of the member's economic program, would depend critically on the staff's assessment that the member will be able to achieve the transition to a UCT-standard program within the envisaged timeframe. The quality of the macroeconomic program to be implemented under the ERAP with Fund support and monitoring will depend on the member's specific circumstances.

For entry into phase two (the financing phase—ERFA) of the ERAP, the basic eligibility criteria would be supplemented by the following considerations:

- The member's institutional and administrative capacity though still weak, offers firm prospect for transitioning into a UCT-standard Fund-supported program within about two years.
- The member has sufficient capacity for policy planning and implementation, and demonstrated commitment on the part of the authorities (to provide adequate safeguards for the use of Fund resources).
- There is a balance-of-payments need to rebuild reserves and meet essential current payments, including on debt service, and additional balance-of-payments pressures will likely emerge with the implementation of the more ambitious reform program.
- Fund support would be part of a concerted international effort, and the Fund's financial assistance would play a critical role in catalyzing external financial support, and provide a coherent macroeconomic framework into which that support can be disbursed.

In requesting access under the ERFA, the authorities would prepare a statement of their economic policies, including quantified macroeconomic framework; and declare their intention to move as soon as possible to a PRGF arrangement. For members transitioning from phase one, satisfactory implementation of the phase one macroeconomic program monitored by the staff would be expected.

[1] A CPIA score signaling fragility as defined by the World Bank would be useful to inform staff's assessment of possible shortcomings in program implementation capacity, although the CPIA would not determine ERAP eligibility.

34. **Eligible members could begin in either phase, depending on their initial circumstances, and could remain under the ERAP for up to five years** (a maximum of three years in phase one; two years in phase two). Staff and the Board would determine the appropriate entry point into the ERAP, primarily based on the member's institutional and implementation capacity, commitment to reform, and drawing on the views of the

international community.[30] The assessment that a member should enter ERAP would imply the expectation that capacity will continue to improve, such that the ERAP phases can be completed broadly within the envisaged timeframe. The entry standards for phase two (ERFA) would be the same whether transitioning from phase one, or entering directly (Box 5).

35. **Members seeking entry to phase one of the ERAP would submit their macroeconomic program agreed with Fund staff and management in a statement to the Board for review and for its formal endorsement**, which would be made public**.** The Board's endorsement of the member's macroeconomic program, for example expressed in a Chairman's summing up, would signal the Fund's commitment to provide capacity-building and policy support, and to monitor regularly the member's progress under the macroeconomic program. The Board's endorsement would also signal its agreement that the economic program and related capacity-building efforts carried out under the ERAP would enable the member to achieve the transition to a UCT-standard program within the envisaged timeframe. Semi-annually, the staff would assess and report on the authorities' progress and plans to the Board, which would review its endorsement, and make its own assessment of performance. These assessments would be based on progress against agreed benchmarks and broader performance in implementing the macroeconomic program, as well as future policy intentions.[31] The member would be encouraged to publish its program and related Fund documents (including on technical assistance) so as to strengthen signaling and donor coordination. For those members with exceptionally weak capacity, the ERAP would more heavily emphasize capacity building, with only a basic macroeconomic reform program and a minimal structural component. Under phase one, members would not be expected to eliminate completely internal and external imbalances, and financing gaps would take longer to close. As implementation capacity is strengthened under phase one, a more ambitious macroeconomic and structural reform program would be put in place to enhance performance and further reduce internal and external imbalances.[32] Members in the first phase would be expected to transition to the second phase within three years (assuming balance-of-payments financing need), or to graduate from the ERAP.[33]

[30] A country's present economic performance and the extent of external support would also be important factors, in particular, to reduce the possibility that phase two of the ERAP would be used by countries performing poorly due to a recent deterioration in the willingness to reform. This would preclude the use of the ERFA by recent PRGF users for which a SMP would be more appropriate to reestablish a track record for a resumption of financial assistance under a PRGF arrangement.

[31] The program supported under the ERAP will contain a significant capacity-building component, for which progress will be tracked using agreed benchmarks. However, the Board's endorsement of the ERAP request and of the subsequent reviews will cover the macroeconomic program under the ERAP only—it should not be taken as assessing progress against the agreed benchmarks for technical assistance, although this evaluation will necessarily influence staff's views of the likelihood of successfully completing the program.

[32] The structural reform component would need to be carefully defined to be consistent with the need for "state-building" in many fragile states, and to avoid overwhelming either the nascent implementation capacity, or the political consensus for reform.

[33] The presumption would be three years, but management would retain discretion to extend this phase. Also, should capacity improvements during the first phase be such that the country becomes capable of implementing a UCT-standard program, the second phase of the ERAP could be bypassed, and the country could request support under a PRGF arrangement.

Box 5: Overview of Proposed Economic Recovery Assistance Program for Fragile States

Phase one of ERAP (non-financing phase)—Up to three years

Country Characteristics/Role	IMF Role	Expected Donor Role

• Countries would have varying degrees of weak capacity in key institutions that limits basic economic functions and coherent economic planning, and weakens policy implementation.
• Technical assistance programs can help improve the performance of key institutions.
• Authorities produce a statement of intent identifying capacity-building needs and a modest macroeconomic framework (and monitoring framework) to prevent further deterioration and begin stabilization.
	• Staff assesses country intentions, management approves staff monitoring of the program, and recommends review and endorsement by the Board.
	• Board endorses the member's program under the ERAP.
	• The Fund issues a public statement of the Board's endorsement that signals the Fund's intention of a multi-year engagement consisting of:
	  ○ Comprehensive capacity-building and technical assistance program to re-establish core economic functions and measures needed for implementing more ambitious macroeconomic policies.
	  ○ Basic economic reform program and limited structural reforms.
	  ○ Monitoring of program implementation.
	• Staff reports semi-annually to the Board on progress against monitoring benchmarks, including technical assistance and capacity-building progress, and some key quantitative macroeconomic objectives.
	• Board renews (or modifies) its endorsement of the economic adjustment program, and issues a public statement.
	• Management can extend phase one beyond three years.
		• Concerted international effort underway.
		• Donors provide grants/aid and humanitarian aid and seek signals from the Fund on progress in core macroeconomic capacity building.
		• Donors coordinate (including with the Fund) on possible overlaps and gaps in technical assistance.

• **Phase two of ERAP—ERFA (financing phase)—Up to two years**

Country Characteristics/Role	IMF Role	Expected Donor Role
• Authorities request access to financing under the ERFA. • Capacity constraints are no longer widespread and binding. • Technical assistance should remove the remaining constraints to successful UCT-standard program implementation. • Authorities provide a statement of economic policies; a quantified macroeconomic framework to the extent possible; and a statement of intent to move to an arrangement under the PRGF. • Good program performance is expected. • Absence of domestic arrears accumulation indicates strengthened Public Finance Management (PFM) systems.	• Staff assesses country intentions and recommends approval by the Board. • The Board's role is essentially the same as under an EPCA-supported program (Board approval required for program and financial support in the form of an outright purchase/loan in support of the program). • Staff continues to provide policy advice and support the implementation of the economic program under the ERFA. The technical assistance program now addresses more complicated structural reforms. • Program would aim to establish a track record and demonstrate capacity to move to UCT-standard program. • Staff conducts a safeguards assessment. • Staff reports to the Board on a semi-annual basis. • The Board approves tranches of financial support in the form of an outright purchase/loan, and issues a public statement of renewed (or modified) endorsement of the economic adjustment program.	• Donors are building up a regular development cooperation relationship, with greater use of country systems and more program-based support. • Donors are interested in more detailed assessments of macroeconomic performance. • Donor technical assistance focuses on PFM reforms and deepening capacity in social sector ministries.

Exit from ERAP when:

- Board approves the request for a UCT-standard arrangement.
- Country does not successfully complete phase one, or is unable to successfully transition to UCT-standard arrangement after two years in phase two.

36. **Financing under the second-phase (the ERFA) would be provided on concessional terms.**[34] Members requesting the ERFA would follow procedures similar to EPCA, including Board approval.[35] Readiness for entry into this phase would be assessed using modified EPCA criteria, drawing on the member's track record of the ERAP under phase one (Boxes 4 and 5). This second phase could last up to two years with semi-annual assessments, and would serve to build up a track record to assess if the member could successfully transition to a UCT-standard program. In the event of persistently poor implementation, a member could return to the first phase (again, with Board endorsement as described above) or the ERAP could be completely suspended if the economic, political, or security situation deteriorated and there was little prospect of immediate future progress.[36]

37. **The transition to the second phase of the ERAP would generally be associated with an increased balance-of-payments need and higher financing requirements.** [37] The economic program undertaken in the second phase would require a deeper adjustment and a more comprehensive reform effort than in the first phase, in order to achieve substantial progress in stabilizing the economy and reducing imbalances. The financial support of donors would be necessary and critical to launching and sustaining this adjustment effort.

38. **Access policy under the ERFA would be similar to EPCA**, with drawings of no more than 25 percent of quota in any one year and a cumulative ceiling of 50 percent of quota. There would also be a presumption that access would be tranched with respect to both the first and second 25 percent of quota access.

39. **The Board's regular review and endorsement of the economic program in the context of the multi-year ERAP would provide better signaling than under present non-financial forms of engagement.** First, the signaling would be more transparent and predictable than stand-alone SMPs or assessment letters. This is because the signal would reflect not only the member's present performance but also indicate the Fund's views on its prospects for moving to the next stage (either the ERFA or PRGF arrangement).[38] Second, regular staff assessments and Board discussions would also provide an opportunity to adapt the framework as necessary; gauge the level of domestic ownership and commitment; and determine when a transition to the second phase, or the conclusion of the ERAP, would be appropriate.

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[34] See Section IV.C. below for a discussion of possible options for providing concessional support under the ERFA.

[35] Resources would be made available in the form of low-access outright purchases/loans rather than under an arrangement.

[36] It would be necessary to define appropriate thresholds for suspending support in phase one of the ERAP, where the engagement is more heavily weighted towards technical assistance.

[37] Countries eligible for the ERAP will be facing protracted balance-of-payments problems. The implementation of the ERFA-supported program would increase their balance-of-payments need through the need to rebuild reserves and meet essential current payments; and they would face higher immediate financing requirements, for example, to meet debt service payments.

[38] Donors would thus be better able to gauge the improvement in those aspects of capacity covered by the Fund that are relevant to their own operations.

Box 6. Would the ERAP have helped?

For several of the fragile states the review of experience and EPAs of Fund engagement point to difficulties in program implementation that imply program engagement (through either EPCA and/or a PRGF arrangement) was premature, or the program objectives were overambitious. Moreover, inconsistent program performance may have contributed to shortfalls or delays in external financial assistance. These problems primarily reflected either insufficient capacity to implement the program and/or inadequate ownership of the reform effort (e.g., Guinea (IMF 2004i), Guinea-Bissau (IMF 2004g), and Sierra Leone (IMF 2005e)). While this may have been due to the difficulty of estimating capacity or reform commitment, the lack of appropriate and timely capacity-building support may also have been a contributory factor (e.g., Guinea-Bissau (IMF 2004g)). However, moving ahead with Fund financial assistance may have been considered necessary in order to provide early balance-of-payments support and to mobilize other sources of external financing. Also, pressures to move toward debt relief as soon as possible may have existed.

The ERAP's structured, progressive medium-term approach, with an emphasis on ownership, capacity building, and coordination with other external partners, would facilitate a more measured response to the particular situation facing fragile states. This approach, with its explicit objectives of strengthening capacity and reaching a UCT-standard program within a well-defined time frame, together with the regular reviews of progress and the explicit involvement of the Board, would provide stronger assurances that needed technical assistance was provided in a timely and coordinated fashion. It would also strengthen the Fund's signal which would help mobilize the external financing that is so critical at the early stages of the reform effort. In turn, this would provide a stronger foundation on which to move to a UCT-standard program. In addition, ERFA would make available early balance-of-payments support to non-post-conflict fragile states under more flexible conditions than a UCT-standard program.

40. **To recap, the proposed ERAP is intended to combine the various existing aspects of the Fund's engagement in fragile states into a systematic medium-term approach that better meets the needs of these members.** It would provide a roadmap for reinforcing capacity and strengthening economic performance to restore the member's ability to implement a UCT-standard arrangement with the Fund. Regular Board review and endorsement would signal the member's progress to domestic stakeholders and external development partners. The ERAP would also provide a framework for coordinating the technical assistance provided by development partners in the Fund's core areas in step with the evolving capacity of the members. The eligibility of all low-income fragile states would place non-post-conflict members on an equal footing with members now eligible for EPCA. In addition, providing financial assistance under the ERFA on concessional terms (see below) would better align such assistance with the needs of fragile states.

B. Debt Relief and Arrears Clearance

41. **Staff proposes that performance under the ERFA could be counted toward the decision point track record for purposes of the HIPC Initiative on a case-by-case basis,** as is now the case under EPCA.[39] This provision would put all HIPC-eligible fragile states on the same footing, by eliminating the more favorable situation presently enjoyed by post-conflict EPCA users.[40, 41] Achievement of the completion point would continue to require that a UCT-standard arrangement be in place.

42. **While the Fund's arrears policy would continue to apply under the ERFA, arrears would be handled with the same flexibility now available under EPCAs.**[42] Members would not be expected to eliminate arrears to bilateral creditors prior to approval of the second phase of the ERAP.[43] Regarding multilateral creditors, Fund financial assistance (including under EPCA) requires at least the existence of an agreed framework between the country and the World Bank for the clearance of arrears to the Bank, and coordinated arrears clearance plans for other MDBs.[44] This has led to delays in approving both EPCA and UCT-standard arrangements in some cases where the arrears to other IFIs have been substantial, and in particular when financial assistance from other IFIs has been a significant and needed part of the concerted international support.[45] The MDBs and IDA are currently considering more flexible ways of clearing arrears to them, including grants to assist the clearance of arrears.[46] Bilateral creditors may also consider alternative options for handling the arrears of fragile states benefiting from an EPCA or ERAP.

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[39] See IMF 2001. The ERFA would need to be added to the list of facilities in the PRGF-HIPC Trust Instrument which countries can use to build a track record toward the HIPC Initiative decision point.

[40] Under present rules, a post-conflict country's performance under EPCA (which is of less than UCT standard) can count toward the HIPC track record, while a non-post-conflict fragile state has to accumulate its entire track record under a UCT-standard program. In January 2008, the Board modified the PRGF-HIPC Trust Instrument to allow members to build a decision point track record on the basis of an SMP in cases where the Board agrees with staff's assessment that policies under the SMP are of UCT quality. This amendment allows countries to build a track record towards the decision point in cases where the lack of financing assurances for resources needed for debt relief and/or arrears clearance prevent the approval of a Fund-supported program even if the member's policies would be sufficient to warrant Fund support. See IMF 2007b and IMF 2008.

[41] Of the seven fragile states eligible for debt relief under the HIPC Initiative that had not yet reached the decision point by the end of the period under review, only two members (Comoros and Togo) are non post-conflict. Both had SMPs in place during the period reviewed (see Appendix Tables 4 and 5).

[42] This reflects the longer program view that the arrears will eventually be cleared under the successor PRGF program. At the time of approval of their EPCAs, all countries (except Iraq) had external arrears, as well as external financing gaps expected to be financed by further arrears accumulation.

[43] Board approval of requests for UCT-standard arrangements typically requires that arrears to Paris Club creditors be cleared, either through payment, or through explicit financing assurances from Paris Club creditors prior to the request for a UCT-standard arrangement.

[44] In 1999, the Board "endorsed a continuation of the case-by-case approach, which allows for sequential clearance of arrears to the international financial institutions in appropriate circumstances and the development of arrears clearance plans in individual cases, in coordination with other creditors," (IMF 1999).

[45] The Bank-Fund Concordat includes the principle that neither Bretton Woods Institution should extend new loans and credits to countries in arrears to the other.

[46] See, for example, the recent proposals by IDA for pre-arrears-clearance grants, and extending the eligibility for exceptional treatment for arrears clearance (see IDA 2007a, 2007b, and 2007c). Also, see IMF 2001 on the framework for the clearance of arrears to multilateral creditors.

C. Concessionality of Financial Support

43. **It is proposed that financial support to low-income fragile states under the ERAP be on concessional terms.** Concessional financing would be more attuned to the needs of fragile states, particularly during the period before they are able to implement a UCT-standard Fund-supported program and access debt relief. Furthermore, making the ERAP and the ERFA available only to PRGF-eligible countries would argue in favor of providing financial support on concessional terms such as those extended under the PRGF. Concessional terms for the ERFA would also be consistent with the views expressed by the Executive Board at its last full discussion of the financing terms of EPCA in 1999.[47]

Possible options for concessional financing

44. **In choosing between possible ways of providing financial support under the ERFA on concessional terms, three issues bear consideration:** the desired degree of concessionality; the administrative complexity of implementation; and the need to raise additional financial resources. Each proposed option has different advantages and disadvantages and staff seeks the Board's guidance on which might be considered most appropriate.

45. **Concessional terms could be provided in a variety of ways.**[48] One option would be to provide the ERFA through a new GRA facility on EFF financing terms with the rate of charge on the financing subsidized to 0.5 percent using donor resources. While this option would introduce more concessional terms (grant element of 27 percent) than under EPCA (17 percent), it would still be less concessional than the PRGF (33 percent).[49] Alternatively, the ERFA could be provided on PRGF financing terms. This could be accomplished in one of two ways: (i) establishing a new ERFA Trust (administered by the Fund with a loan account consisting of loan resources provided by member countries and a subsidy account for donor resources to subsidize the interest rate); or (ii) integrating the ERFA into the existing PRGF-ESF Trust (including loan and subsidy accounts), and creating a new window for the ERFA.

46. **Implementation of the three options involves differing degrees of complexity.** Establishing a new GRA facility with a special repurchase period would require an 85 percent majority of the total voting power of the Fund. Under the Articles, access to the ERFA could not be limited to LICs, although interest rate subsidies could be restricted to

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[47] See IMF 1999. At that time, the Board did not support establishing a new facility with longer maturities and lower charges in the GRA. It also did not support financing EPCA from the ESAF, because it did not wish to place additional demands on ESAF resources as the financing of the interim ESAF was still not secured. Concerns were also expressed about muddying the purposes of the ESAF and its UCT conditionality standard. Subsequently, in 2001 the EPCA subsidy account for PRGF-eligible countries was established (http://www.imf.org/external/pubs/ft/sd/index.asp?decision=12481-(01/45)). In more recent Board discussions of EPCA requests, some Executive Directors have proposed that EPCA be provided to LICs on PRGF terms.
[48] For reference, the current structure of Fund financial support to LICs is shown in Annex Figure 1.
[49] The grant element is calculated on the basis of a subsidized interest rate of 0.5 percent per annum and taking into account the GRA burden sharing adjustment.

LICs. Additional interest subsidy contributions would be needed.[50] Amending the PRGF-ESF Trust to include the ERFA (a "PRGF-ESF-ERFA Trust"), would also require an 85 percent majority of voting power. In addition, the agreement of all contributors to the loan and subsidy accounts of the RPGF-ESF Trust would be needed, so that existing loan and subsidy resources could be used to meet the additional demands of ERFA operations.[51] Establishing a new ERFA Trust would require a majority of the votes cast, and opening discussions with members for new loan and subsidy resources. Also, some form of protection, e.g., a reserve account, would need to be established for lenders against the risk of non-repayment of principal and interest.[52]

47. **Staff tentatively estimates that the demand for the ERFA is likely to be relatively small (in the order of one to two requests a year).** This estimate assumes that the number of post-conflict cases requesting Fund assistance is similar to the frequency under EPCA in the past. It also takes account of the number of members presently considered fragile that are either unlikely to request the Fund's assistance; do not demonstrate the requisite degree of commitment to reform; or are likely to progress directly to a PRGF arrangement. This estimated frequency of requests would allow the ERFA to be integrated into the PRGF-ESF Trust without the immediate need to seek additional resources. It is also the basis for the estimate of the staff resource requirements (see Section V below).

D. Implications for Technical Assistance

48. **The design of the proposed ERAP expects members to make sufficient progress in strengthening capacity during each phase to enable the country to transition successfully to the next stage.** This underscores the importance of capacity-building support and technical assistance, both from the Fund and other providers.

49. **The first phase of the ERAP serves the purpose of demonstrating the capacity to implement fully a modest macroeconomic program,** and the capacity improvements during this phase would be expected to restore a country's ability to implement a more ambitious program supported by the ERFA within three years. The experience during this first phase would give valuable insights into the suitability of the capacity-building strategy and allow technical assistance providers to refocus their support as needed.[53] The transition to the second phase implies the judgment that the process of restoring the capacity to implement a PRGF arrangement can essentially be completed within two years.

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[50] Currently available subsidy resources for emergency assistance are estimated to be sufficient to cover existing needs (see IMF 2007a). However, new large requests would require additional subsidy contributions.

[51] Sixteen lenders have provided loan resources and 43 countries contributed to the subsidy accounts.

[52] If this were provided by the reserve account for the PRGF-ESF Trust, it would require an 85 percent majority of the voting power and the agreement of all contributors to the PRGF-ESF Trust Loan Account. Integrating the ERFA into the PRGF-ESF Trust would have implications for interim PRGF operations and the timing of a move to a self-sustained PRGF.

[53] The logical first reaction to persistent failure to achieve the objectives of the program would be to review the capacity-building effort and the priorities of technical assistance. Suspension of technical assistance provision, however, would only be considered if the commitment to the capacity-building strategy is no longer evident.

50. **Clearly, technical assistance from the Fund will be a major aspect of the Fund's engagement throughout the ERAP**. However, in many, if not most, fragile states, the initiation of an ERAP will have been preceded by considerable technical assistance from the Fund—it is not expected that the rebuilding of capacity should begin and be completed during the ERAP. A country's participation in the ERAP might perhaps occasion some shifts in the emphasis of the technical assistance program, and careful consideration of the strategic framework for technical assistance provision in the country, but in most instances would usually not require a substantial increase in the overall volume of technical assistance provided.

51. **The effectiveness of Fund technical assistance often depends on complementary support from other providers.** This underscores the importance of the close coordination among all providers of their capacity-building support. However, the Fund need not always provide the required technical assistance, even in its own areas of core competence; this could be done by other donors or agencies, with the Fund playing more of a coordinating role.[54] Also, there could be greater scope for external funding of Fund-provided technical assistance.

52. **Staff will explore establishing a trust fund to support its technical assistance work in fragile states**, building on its existing partnerships with donors. These partnerships have generally enhanced collaboration, which is increasing the effectiveness of technical assistance from other providers, as well as the Fund. With strong donor interest in strengthening the capacity of fragile states, leveraging such partnerships could be instrumental in coordinating technical assistance effectively.

V. Resource Estimates

53. **The initiation of an ERAP with a fragile member state would entail some step-up in the staff resources devoted to the member**, as it moves from a surveillance-only or SMP-type relationship to the more structured medium-term engagement of the ERAP. Similarly, the transition from phase one under the ERAP to the ERFA would require additional staff work, in terms of monitoring formally and reporting to the Board on performance under a Board-approved financial program. By contrast, in most fragile states the Fund is already active in providing substantial technical assistance. The engagement under the ERAP may require an initial additional input of resources in helping the country map out the medium-term capacity-building strategy and setting up the framework of coordination with other providers, but it is not expected that the ERAP per se will increase resource requirements for technical assistance in a major way.

54. **To estimate the incremental resource requirements implied by the ERAP, staff has compared the average annual resource requirements for the various forms of Fund engagement:** a typical fragile state with a surveillance-only relationship; a typical SMP

[54] The Fund's actual role in supporting capacity building could range from providing (or participating in) the diagnosis of the capacity constraints; advising on the formulation of the medium- to long-term capacity-building strategy that would guide interventions; providing technical assistance (including through RTACs); and supporting the work of short- or long-term advisors in the field in the Fund's core areas.

country; a typical EPCA user; and a typical PRGF country.[55] While acknowledging the shortcomings of the approach, staff used the difference between the resource levels needed for the typical surveillance-only fragile state and those needed for a member implementing a SMP as a proxy of the incremental requirements for introducing an ERAP. Similarly, the transition to the ERFA implies additional resources similar to the difference between the member with an SMP and the typical EPCA user; while the transition to the PRGF arrangement would imply additional resource needs roughly equivalent to the difference between the EPCA user and the member implementing a PRGF arrangement. In addition, the increased staff cost is based on a preliminary estimate that there would be about one new request for the ERAP on average each year, and that each member entering the ERAP proceeds through its two stages to reach a PRGF arrangement within 5 years.

55. **Using this methodology, the transition from a surveillance-only type relationship to an ERAP would incur, on average, an additional staff cost of about 1 staff year (Annex Box 4).** Moving from the first to the second phase of the ERAP would entail virtually no incremental cost. The shift from the ERFA to a PRGF arrangement would require 0.5 additional staff years, primarily owing to HIPC-related work. The total incremental cost of introducing the ERAP would be 4-4.5 staff years spread out over a five year period.[56] It is expected that these incremental costs can be absorbed within the existing complement of staff.

VI. Issues for Discussion

56. In discussing the scope for enhancing the effectiveness of the Fund's engagement with states characterized by fragility, Executive Directors may wish to consider the following questions:

- Do Directors agree that for the Fund to play a more effective role in a concerted international effort to support fragile member states, its engagement should take a longer-term view of the process of recovery and institution-building?

- Do Directors consider that a flexible medium-term programmatic approach, such as the proposed ERAP, would enhance the overall effectiveness of the Fund's role in these countries?

- Do Directors agree that eligibility for Fund financial assistance under the proposed ERAP should be decided case-by-case, drawing on a limited set of criteria based on the specific characteristics of fragility that affect members' economic performance, similar to the present approach under EPCA?

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[55] These estimates concern only the time spent by area department staff on the regular work on each type of country and by other departments in reviewing related documents.

[56] Note that these estimates do not include the costs of supporting member countries under the PRGF, as these are accounted for separately.

- Do Directors agree that technical assistance, closely coordinated with other providers, should remain a central element of the Fund's engagement with fragile states, particularly under the proposed ERAP?

- What are Directors' views on the appropriate terms and modalities of Fund financial support to fragile states prior to their reaching a UCT-standard program? Which of the proposed options for concessional financing do Directors consider most appropriate?

- Do Directors see scope for extending the present treatment of the HIPC initiative track record requirement under EPCA to phase two (ERFA) of the ERAP?

Appendix: Review of Fund Engagement with Fragile States and Post-Conflict Countries

A. Scope and Methodology of the Review

57. **This appendix reviews the effectiveness of Fund engagement with fragile states during 2000-05 and under EPCA** along several key dimensions: improving macroeconomic policy and performance; strengthening policy implementation capacity; providing balance of payments support and effective signals to catalyze external aid; and facilitating access to debt relief and the clearance of external arrears.

58. **To examine and compare the experience of the Fund's engagement with fragile states, the review distinguishes between four groups:** (i) countries that used EPCA during 1995-2005; (ii) countries with a UCT-standard Fund arrangement during 2000-05; (iii) countries that had an SMP and no other form of program engagement during 2000-05; and (iv) countries where Fund engagement was limited to Article IV surveillance. The analysis draws on a number of sources—an extensive document review; other recent relevant evaluations, such as Ex Post Assessments (EPAs); and reviews of Fund technical assistance.

59. **The review examines overall macroeconomic performance in the countries sampled**. It also assesses how well the programs supported by EPCA, Fund arrangements, and SMPs in fragile states have been implemented, including by constructing a summary performance index that compares outcomes and program targets (Appendix Box 1).[57] In addition, the review considers how long the eventual transition from EPCA-supported programs or SMPs to UCT-standard arrangements took, and how successful it was. Furthermore, fragile state performance is compared with that of the broader set of countries with UCT-standard arrangements during 2000-05, which serves as a benchmark. The review distinguishes between performance relative to quantitative and structural targets, as this may yield insights into capacity weaknesses. The review further examines capacity building through technical assistance and training, how net repayments to the Fund and inflows of external resources evolved during and after the engagement, and the progress of eligible states toward debt relief under the HIPC Initiative.[58]

[57] Program implementation is measured by a performance index similar to the one used in the 2005 Review of the Conditionality Guidelines (see IMF 2005a and 2005b).

[58] Some of these aspects—notably signaling, financing, and technical assistance—have been considered more broadly on previous occasions by the Board, and the conclusions of those discussions as they pertain to fragile states and post-conflict countries are taken into account here.

Appendix Box 1: Methodology for the Program Performance (Implementation) Indices

The methodology follows the 2005 Review of the 2002 Conditionality Guidelines (IMF 2005a and IMF 2005b).

Performance (implementation) index. **Structural performance criteria** (SPCs) met on time were given the value 2; and all SPCs waived, met with delay, or not met, zero.[1] Structural benchmarks (SBMs) met on time were scored a 2; and SBMs met with delay, or partially met, 1; and SBMs that were missed were given a value of zero. Those SBMs pending, but not reported as final, are not included in the calculations. **Quantitative performance criteria** (QPCs) met were given a value 2, or zero when missed.[2] Prior actions were excluded for calculating the performance indices, as they have, by design, a much higher average implementation rate, and changes in the number of prior actions relative to other program targets would have a large effect on the index and limit its usefulness as a measure of in-program performance. For programs supported by Emergency Post-Conflict Assistance (EPCA) and staff-monitored programs (SMPs), quantitative and structural targets/measures that were identified for monitoring purposes in staff reports were scored in a similar fashion to QPCs and SBMs.[3] Scores for each individual PC, BM or monitored target were averaged to give a performance score for each upper credit tranche (UCT) arrangement, EPCA program or SMP. Group averages give equal weight to each country's UCT arrangement, EPCA program or SMP.[4] Contiguous and overlapping EPCA programs or SMPs that were six to nine months in length were treated as one program (for greater comparability to other programs).[5] Successive and contiguous 12-month programs were considered as distinct programs, as successor programs were not necessarily anticipated ex ante.[6]

Comparability of UCT-standard programs, EPCA programs and SMPs. Performance indices for UCT and for other programs are not strictly comparable due to: (1) different program standards; (2) under non-UCT programs monitored targets/measures may not have the same degree of priority as PCs and BMs under UCT arrangements, as evidenced by a tendency to have a larger number of monitored structural measures; and (3) differences in the length and frequency of periods of permanently off-track performance.

Calculation of the incidence of "permanently off-track" PRGF programs, and of PRGF program performance indicators adjusted for off-track periods. A *"permanently off-track" program* is defined as one in which no program reviews took place for more than six months prior to the scheduled end of the program. Only arrangements that had expired as of September 1, 2007 are included. For *adjusted performance indices,* performance scores were discounted by an off-track adjustor factor—the ratio of actual reviews to expected reviews during the elapsed period of the program (through December 2006).

Sample Size: UCT programs, 1995-2005, 231; UCT programs, 2000-05, 113, of which fragile states, 18 (16 PRGF/ESAF, 1 SBA, 1 PSI), non-fragile states 85 (37 PRGF, 48 SBA/EFF); includes arrangements approved 4Q1999 to 4Q2005. EPCA programs, 1995-2005, 12. SMPs, 2000-2005, 14, of which Sudan, 6.

[1] The scoring for SPCs differs from that used for the 2005 Review of the Conditionality Guidelines (IMF 2005a) where SPCs met with delay, or partially met were scored as 1.

[2] A quantitative index was not reported in the 2005 review of conditionality.

[3] EPCA programs and SMPs do not distinguish differences in the importance of structural measures that are strictly comparable to differences between SPCs and SBMs.

[4] Averages across all targets/measures would over-represent programs with a large number of conditions.

[5] This applied to EPCA programs for Burundi, Guinea-Bissau, and Haiti.

[6] Comoros and Sudan had 2 and 6 successive and contiguous annual SMPs, respectively.

Data Sources: For UCT programs, MONA database; for EPCA programs and SMPs, staff reports.

60. **The review undertakes a more limited assessment of the Fund's Article IV surveillance role in fragile states** where this has been the only form of engagement, in part, because surveillance effectiveness is handled in other Board papers. Instead, the review looks only at the extent to which members implemented policy advice delivered in the context of Article IV consultations.

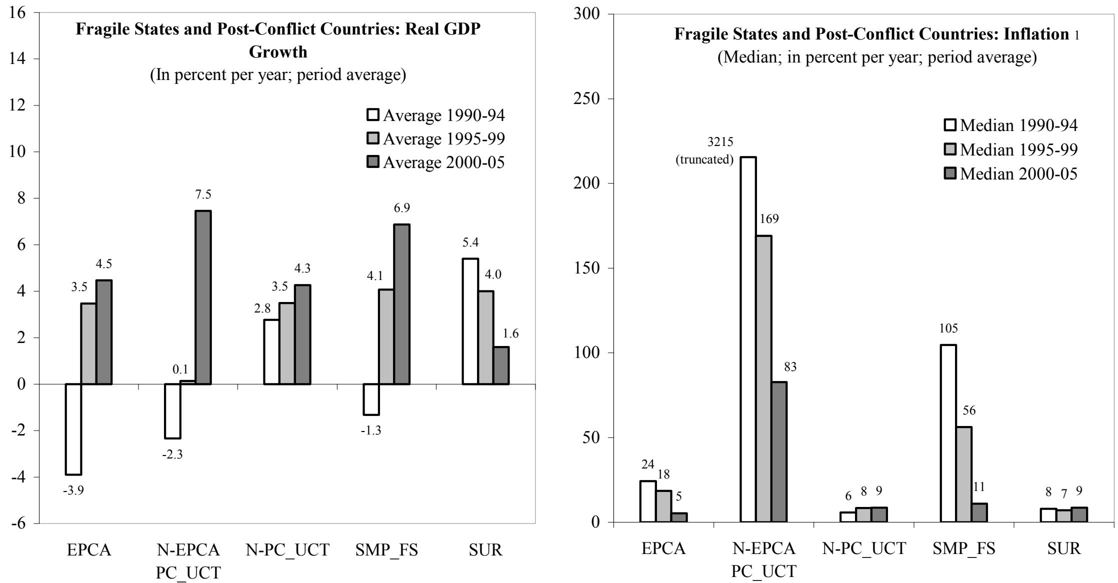
61. **The results of the review confirm the negative effect of weak institutional, administrative, and human resource capacities on the implementation of economic and structural reforms in fragile states.** Fragile states with Fund-supported programs achieved broadly positive macroeconomic outcomes, but program implementation was weaker than in non-fragile states, particularly relative to the macroeconomic quantitative program targets. Moreover, performance relative to structural objectives was weaker than on quantitative targets.

B. Macroeconomic Objectives and Performance

62. **The primary macroeconomic objectives of the Fund's engagement in fragile states and post-conflict countries were to strengthen growth and macroeconomic stability.** External assistance was critical to the achievement of the inflation goals and increases in spending. Policies were mostly centered on fiscal consolidation supported by tighter monetary policy and structural reforms to enhance growth, and generally sought only modest changes in the import coverage of international reserves while accommodating increased (donor-financed) imports for higher government capital reconstruction spending. The focus and the degree of expected adjustment reflected the initial conditions in each country. *In post-conflict countries*, growth recovery and disinflation were prominent early concerns, with domestic revenues and expenditure (particularly donor-financed capital spending) targeted to rise relative to GDP, so as to increase spending on urgent post-conflict needs. In *non-post conflict fragile states,* which generally had less severe initial macroeconomic conditions, policies often emphasized consolidating macroeconomic stability, and reforms to promote sustained higher growth and poverty reduction over the medium term.

63. **Most fragile states that had Fund-supported programs and SMPs generally achieved improved macroeconomic outcomes in the three years following the start of the program** (Appendix Figures 1 and 2, Table 1, and Box 2). Moreover, during the period under review, economic growth strengthened compared with earlier years, with post-conflict countries registering a sharp turnaround. Inflationary pressures were also reined in, with inflation rates falling to, or maintained at, single-digit levels. External and fiscal imbalances were reduced, with declines in both the external current account and overall fiscal deficits (including grants). In addition, the import coverage of official reserves increased modestly. These broad improvements in economic performance were not replicated in surveillance-only countries, as earlier trends continued during 2000-05, with stable and low inflation but a steady fall in growth.

Appendix Figure 1. Growth Recovers and Inflation Falls



Source: WEO.

Country Groups: EPCA -- Emergency Post-conflict assistance; N-EPCA PC_UCT -- Non-EPCA post-conflict Upper Credit Tranche programs; N-PC_UCT -- Non post-conflict Upper Credit Tranche programs; SMP_FS -- Fragile states with Staff Monitored Programs; SUR -- Article IV Consultation/Surveillance countries.

[1] The large declines reflect the impact of program measures in a few high inflation countries. See Appendix Table 1.

Appendix Table 1. Fragile States and Post-Conflict Countries: Macroeconomic Indicators

(Units are indicated)

	EPCA Countries, 1990-95 Period Averages (12)			Non-EPCA Post-conflict Countries UCT Programs, 2000-2005 (2)			Non-Post Conflict Fragile States, UCT Programs, 2000-2005 (10)			Fragile States with Staff-Monitored Programs, 2000-05 (7)			Fragile States with Surveillance, 2000-05 (10)			**Non-fragile PRGF Programs, UCT, 2000-05 (30)**		
	1990-94	1995-99	2000-05	1990-94	1995-99	2000-05	1990-94	1995-99	2000-05	1990-94	1995-99	2000-05	1990-94	1995-99	2000-05	**1990-94**	**1995-99**	**2000-05**
Real GDP growth, in percent per year																		
Average	-3.9	3.5	4.5	-2.3	0.1	7.5	2.8	3.5	4.3	-1.3	4.1	6.9	5.4	4.0	1.6	**-0.2**	**4.6**	**5.0**
Median	-2.3	1.8	4.8	-2.3	0.1	7.5	3.3	3.9	3.9	0.1	3.6	6.0	3.8	3.8	1.3	**2.4**	**4.5**	**4.8**
Inflation, in percent per year																		
Average	191.7 [1]	36.8	9.9	3215.6 [2]	169.0 [2]	82.8 [2]	21.2	16.4	7.8	342.1 [4]	329.1 [4]	30.8 [4]	11.9	11.2	33.4	**591.2**	**18.3**	**7.1**
Median	24.2	18.4	5.3	3215.6 [3]	169.0 [3]	82.8 [3]	5.8	8.4	8.6	104.6 [4]	56.2 [4]	10.9 [4]	7.9	7.0	8.6	**21.6**	**9.6**	**5.4**
External current account balance, in percent of GDP																		
Average	-9.0	-7.8	-5.9	-8.9	-6.4	-19.0	-8.0	-7.7	-5.7	-9.3	-10.9	-2.6	-3.7	-2.1	-1.9	**-9.7**	**-9.0**	**-7.1**
Median	-8.2	-7.2	-5.3	-8.9	-6.4	-19.0	-2.6	-5.1	-3.8	-6.5	-12.4	-0.3	-5.5	-2.7	-1.1	**-6.7**	**-7.0**	**-6.2**
Overall fiscal balance, in percent of GDP																		
Average	-10.1	-5.8	-3.4	-11.7	-5.2	-4.3	-7.2	-6.0	-2.8	-10.6	-6.6	-0.8	-6.1	-6.8	-8.7	**-7.7**	**-4.3**	**-3.7**
Median	-9.2	-5.1	-3.0	-11.7	-5.2	-4.3	-4.6	-3.1	-2.9	-6.6	-4.1	-0.8	-6.0	-4.3	-4.5	**-5.6**	**-3.7**	**-3.4**
External reserves, in months of imports																		
Average	2.8	3.7	4.0	1.7	2.2	1.3	2.4	2.7	3.6	3.2	2.6	3.6	2.7	2.5	2.6	**2.4**	**3.3**	**4.2**
Median	2.0	3.3	4.0	1.7	2.2	1.3	2.3	2.6	3.2	4.4	1.6	2.3	2.3	2.0	3.4	**1.7**	**2.8**	**3.9**
Broad money growth, in percent per year																		
Average	118.7 [1]	31.2	21.8	1459.2 [2]	186.1 [2]	80.0 [2]	23.7	18.9	20.9	338.4 [4]	232.5 [4]	40.1 [4]	17.0	20.0	42.2	**287.4**	**22.0**	**18.8**
Median	26.2	26.4	18.9	1459.2 [3]	186.1 [3]	80.0 [3]	16.3	12.7	23.7	81.6 [4]	46.5 [4]	29.0 [4]	14.7	9.7	12.3	**34.6**	**16.5**	**15.8**
Fiscal revenues and grants, in percent of GDP																		
Average	21.6	18.6	25.7	9.9	9.7	11.5	21.9	20.9	25.5	25.0	24.5	22.9	39.9	36.7	33.3	**21.4**	**21.3**	**23.2**
Median	24.3	16.7	24.2	9.9	9.7	11.5	22.0	17.6	18.8	29.8	20.9	16.9	35.9	29.8	28.8	**19.1**	**19.6**	**21.2**
Fiscal expenditures and net lending, in percent of GDP																		
Average	31.7	24.4	29.1	21.6	14.9	15.8	29.1	26.9	28.3	35.6	31.1	23.8	46.0	43.5	42.0	**29.1**	**25.6**	**26.9**
Median	26.9	20.2	29.0	21.6	14.9	15.8	23.7	22.5	22.6	32.6	25.4	18.4	40.3	34.6	33.0	**23.6**	**22.8**	**25.1**

Source: WEO.

[1] Reflects Tajikistan where exceptionally high rates of inflation and broad money growth occurred in 1993-94; (data available only for 1993-94) and disinflation under EPCA-supported program in 1997.

[2] Reflects hyperinflation and very high rates of broad money growth in the Democratic Republic of Congo and disinflation under PRGF-supported program in 2002.

[3] With only two observations, the median of the country averages is identical to the average of the countries.

[4] Reflects high inflation and broad money growth rates 1990-2000, and disinflation under the 2000 SMP, 2000-05 SMP, and 2002 SMP in Angola, Sudan, and Uzbekistan, respectively.

Appendix Box 2: Comparisons of Performance against Structural and Quantitative Program Targets [1]

A. EPCA and Post-EPCA UCT-standard Programs 1995-2005

Type of Indicator	*EPCA Programs*	*1st UCT program following EPCA*	*All UCT Programs*
Structural	1.29	1.24	1.32
Quantitative	1.33	1.68	1.72

B. PRGF Programs, 2000-05

			Adjusted for off-track program periods [2]	
Type of Indicator	*PRGF programs with non-fragile states*	*PRGF programs with fragile states*	*PRGF programs with non-fragile states*	*PRGF programs with fragile states*
Structural	1.36	1.32	1.00	0.78
Quantitative	1.78	1.66	1.29	1.04

C. Staff-Monitored Program, 2000-05

Type of Indicator	*Staff Monitored Programs with fragile states*	*PRGF Programs with fragile states*
Structural	1.27	1.32
Quantitative	1.34	1.66

Sources: Fund staff estimates.

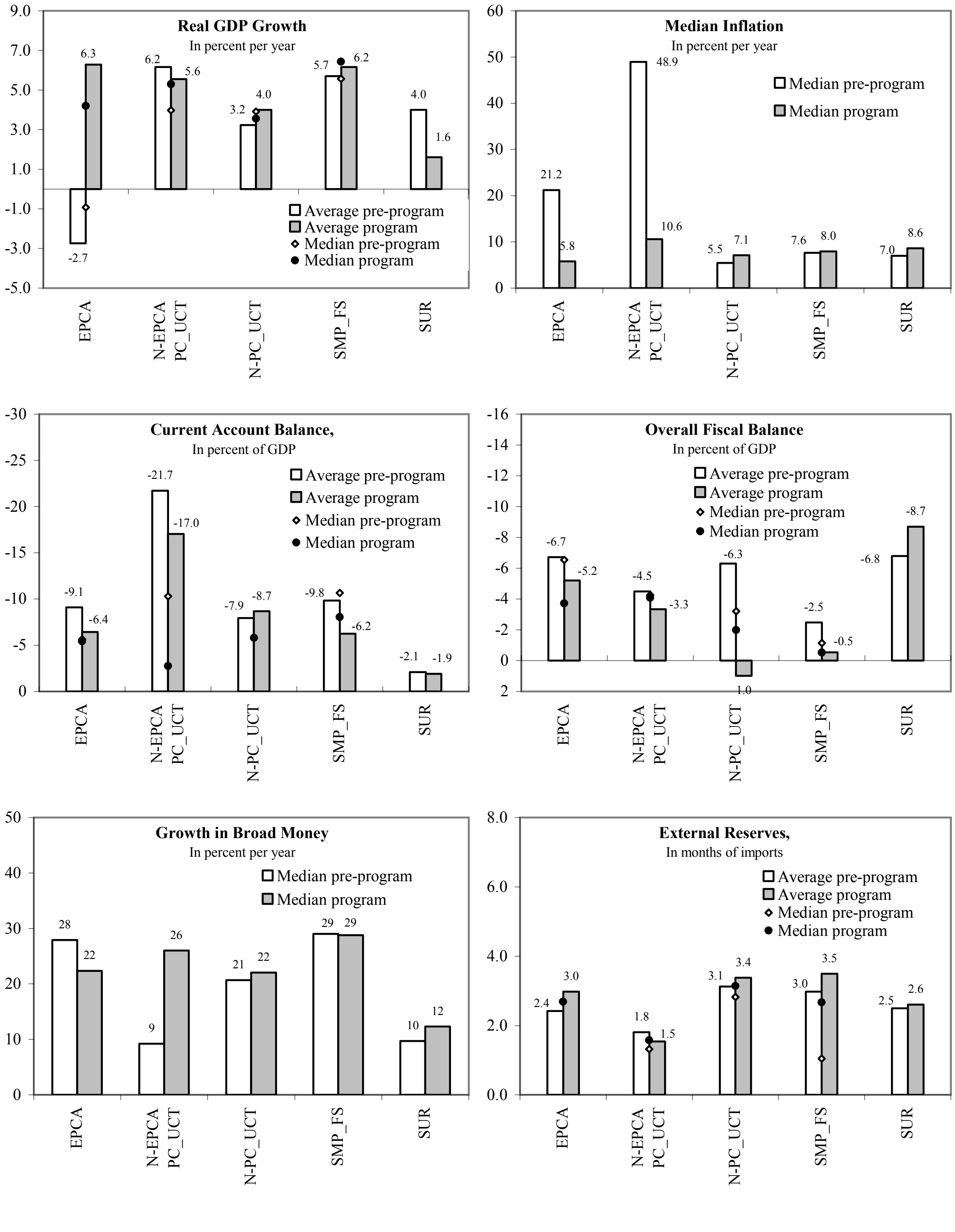
[1] See Appendix Box 1 for a description of the methodology for performance index. The index ranges from 0 (not met) to 2 (fully met). An increase of about 0.1 in the implementation index is equivalent to 5 percent of conditions changing from not met to fully met, and vice versa for a decrease.

[2] Performance is adjusted for permanently off-track periods by reducing the scores by the ratio of the number of completed reviews to expected reviews during the program. Permanently off-track periods are those where no programs took place for more than six months prior to the scheduled end of the program.

64. **Although overall macroeconomic performance was broadly positive, the performance of fragile states relative to specific program objectives and targets was mixed** (Appendix Table 1, Box 2, and Figures 2 and 3), and was generally weaker than that of non-fragile states with UCT-standard programs during the period reviewed:

- *Under EPCA*, growth objectives tended to be too optimistic; disinflation was usually greater than targeted, and was associated with broad money growth that was less

Appendix Figure 2. Fragile States and Post-Conflict Countries: Macroeconomic Developments During the Pre-Program and Program Periods [1]



Sources: WEO; Staff Reports.

Country Groups: EPCA -- Emergency Post-conflict assistance; N-EPCA PC_UCT -- Non-EPCA post-conflict Upper Credit Tranche programs; N-PC_UCT -- Non post-conflict Upper Credit Tranche programs; SMP_FS -- Fragile states with Staff Monitored Programs; SUR -- Article IV Consultation/Surveillance countries.

[1] Pre-program period is the three years prior to the program. Program period is defined as the year the program began and the subsequent two years. For surveillance-only countries, the pre/post-program periods correspond to 1995-1999 and 2000-2005, respectively.

pronounced than targeted.[59] The adjustment in the overall fiscal balance (both before and after grants) was in the majority of cases greater than programmed (though current expenditures exceeded the program targets in two-thirds of the cases for which data are available). International reserves targets were broadly met.

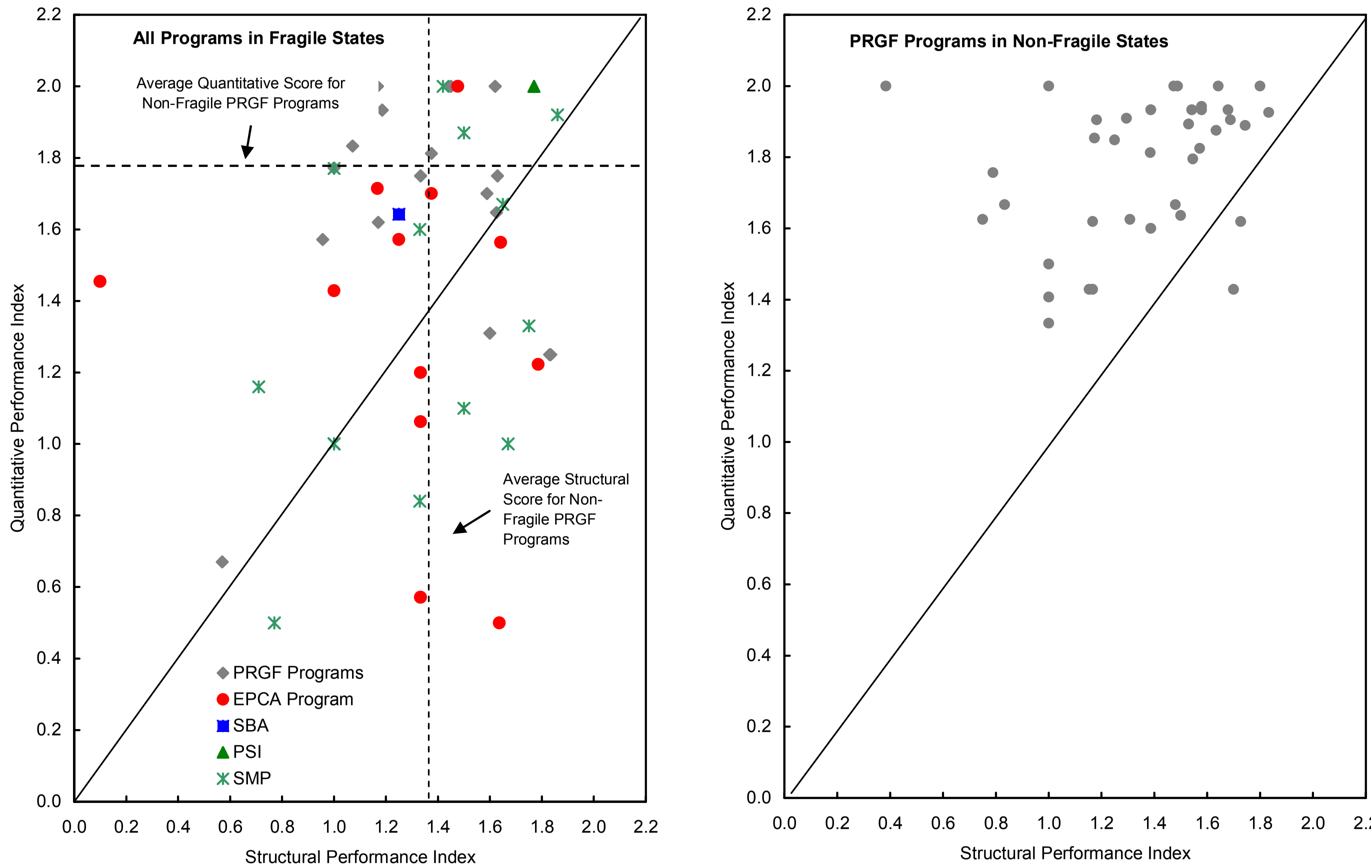
- *UCT-standard programs in fragile states* were more prone to interruption, and their implementation was generally weaker than in non-fragile states.[60] Most countries with on-track UCT-standard programs met their growth objectives, but tended to overshoot somewhat on inflation, as broad money growth exceeded targets, and fiscal adjustment was weaker than programmed, typically reflecting revenue shortfalls. Improvements in the current account deficit (after grants) and reserve cover were broadly as programmed, or somewhat stronger.

- *In the countries with SMPs*, three went off-track early on, while in a fourth policies were more expansionary than programmed, resulting in higher inflation and fiscal expansion. For the others, developments were broadly in line with program objectives. The growth objective was somewhat exceeded and inflation slightly above target. Fiscal consolidation was broadly in line with, or exceeded the program targets. Reserves targets were exceeded, owing to high donor inflows or oil export prices.

[59] In the post-conflict countries, the decline in inflation was not matched by a contraction of the money supply, as money demand picked up with the recovery of activity. However, the less-than-programmed growth of broad money reflected in part a more pronounced fiscal adjustment than programmed, and in some cases, it may also have been the result of a resumption of financial intermediation through the formal banking sector, as confidence returned with improved economic and security prospects.

[60] Forty-two percent of PRGF-supported programs in non-post-conflict fragile states went permanently off-track, compared to 24 percent for non-fragile states. By contrast, only 2 of 15 EPCA programs went off-track (owing to renewed bouts of conflict), as did 3 of the 14 SMPs.

Appendix Figure 3. Fragile States and Post-Conflict Countries: Program Quantitative and Structural Performance Indices [1]
(0 = not met; 2 = fully met)



Sources: Staff reports and calculations.

[1] Dashed lines in the left hand chart represent the mean score of the structural and quantitative performance indices of non-fragile PRGF programs shown in the right hand chart.

65. **Among the surveillance-only countries, there was a clear distinction between countries that were receptive to Fund advice and those that were not.** Implementation of Fund advice was relatively strong in the Pacific Island economies (Kiribati, Solomon Islands, Tonga, and Vanuatu), which enjoyed considerable donor support and domestic commitment to reforms. In some cases, progress in fiscal consolidation was mixed, and in general the implementation of progress in structural reform was slower than recommended and narrower in range. In the other countries, the ability to implement Fund policy recommendations was constrained by the effects of conflicts or political factors. Only two countries displayed no willingness to implement policy recommendations, including those repeatedly highlighted as essential for restoring macroeconomic stability.

C. Structural Reforms

66. **The structural reform agenda under Fund-supported programs in fragile states typically contained immediate measures in the areas of tax policy and administration; public expenditure management; and monetary and exchange rate policies**. The structural agenda also often entailed reforms aimed at improving economic flexibility, efficiency, and longer-term growth prospects (such as banking sector reform, public enterprise restructuring, and privatization). In the post-conflict cases, the recovery effort usually also included structural reforms related to the provision of social services (i.e., education and health); rebuilding public capital infrastructure (especially utilities); and the reform of the security sector (demobilization, reintegration, and police force restructuring) and the judiciary. These reforms reflected urgent social priorities essential to anchor peace and restore private sector activity. All programs stressed transparency and anti-corruption.

67. **Fragile states were more successful in meeting macroeconomic objectives of programs supported by the Fund than in implementing structural reforms**. The index indicates that program performance on quantitative targets was somewhat better than on structural targets, but in both areas below that of the benchmark group of non-fragile UCT-standard arrangements (see Appendix Box 1).[61] Actual implementation of reforms seems not to have been directly correlated with the number of reforms included in the program—and while the scope and depth of reforms increased progressively, performance was quite consistent over time.[62]

68. **The ability to implement structural reforms seemed to be particularly affected by security conditions, technical capacity constraints, and political economy factors.** The existence of an SMP prior to the financial program may have contributed to better performance in some countries. Moreover, shortfalls in external support, and delays in the delivery of technical assistance (in some cases owing to political instability) may also have contributed to targets being missed. EPAs conducted in ten of the sample countries found that in all of them, the timetable for the (structural) reforms was overambitious in view of the severe administrative capacity constraints, the extent of which was not always known ex

[61]However, this overall statement masks some interesting differences. Performance on structural targets in PRGF and EPCA programs and SMPs was less weak relative to the benchmark group than performance relative to quantitative targets. (see also Appendix Box 2).

[62] In fact, the best performers among the countries examined for the review had more targets. This would indicate that in some post-conflict cases, the structural targets may have helped to ensure step-by-step policy implementation; served as a blueprint for reforms; and kept the authorities focused.

ante.[63] The EPAs also found that, in some cases, the coverage and sequencing of reform measures was not always appropriate; and insufficient attention was paid to public financial management and governance reforms, and to generating the political consensus for reform.

D. Capacity Building through Technical Assistance and Training

69. **Fund technical assistance was a critical component of the Fund's engagement in most fragile states examined under the review**, reflecting the need to buttress the weak capacity to formulate and implement economic policies. The review found that close coordination with other technical assistance providers was important, but even where this was present, there are indications that insufficient levels of technical assistance were provided.

70. **While virtually all fragile states with programs experienced a step up in Fund-provided technical assistance (measured in staff-years),[64] especially in post-conflict countries, they often received less Fund technical assistance than the average amount provided to non-fragile states as a group,** possibly because of security concerns and absorption constraints (Appendix Figure 4 and Table 2).[65] In addition, while Fund technical assistance increased during UCT-standard programs with fragile states, it remained for the most part below levels that would have been expected, in all countries except Cambodia and the Democratic Republic of Congo.[66] Technical assistance was also a major aspect of the Fund's engagement in many of those fragile states where there was no program relationship, particularly in those countries that enjoyed a major donor engagement—ensuring close coordination among all technical assistance providers proved critical to success, for example, in Afghanistan prior to the SMP and in Timor Leste (see IMF 2004b and 2004d). Fund-provided training also contributed to the capacity-building effort, and some countries (e.g., Burundi and Iraq) benefited from substantially higher access to Fund training courses.

71. **The technical assistance provided to fragile states was closely tailored to their specific requirements.** Recent reviews of the Fund's technical assistance to post-conflict countries in the monetary and fiscal areas provide insights that are relevant to other fragile

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[63] The EPAs cover five countries that received, at some point, EPCA (Albania (IMF 2005d); Guinea-Bissau (IMF 2004g); Rwanda (IMF 2006a); Sierra Leone (IMF 2005e); Tajikistan (IMF 2006b)), and five non post-conflict fragile states (Cambodia (IMF 2004h); The Gambia (IMF 2005f); Guinea (IMF 2004i); Lao P.D.R. (IMF 2006c); and Togo (IMF 2006d)).

[64] These data refer to technical assistance delivered from headquarters and excludes that provided through the regional technical assistance centers (RTACs). Staff-years is only a partial and crude indictor of the quality and value of technical assistance. Output and results also reflect the authorities' responsiveness to technical assistance and their capacity to implement reforms. The fall in technical assistance under SMPs reflects Sudan, which had six successive SMPs during the review period, and thus assistance under a program is also counted as pre-program assistance in successor programs. Also, in Afghanistan there was a large surge in technical assistance in the three post-conflict years prior to the SMP.

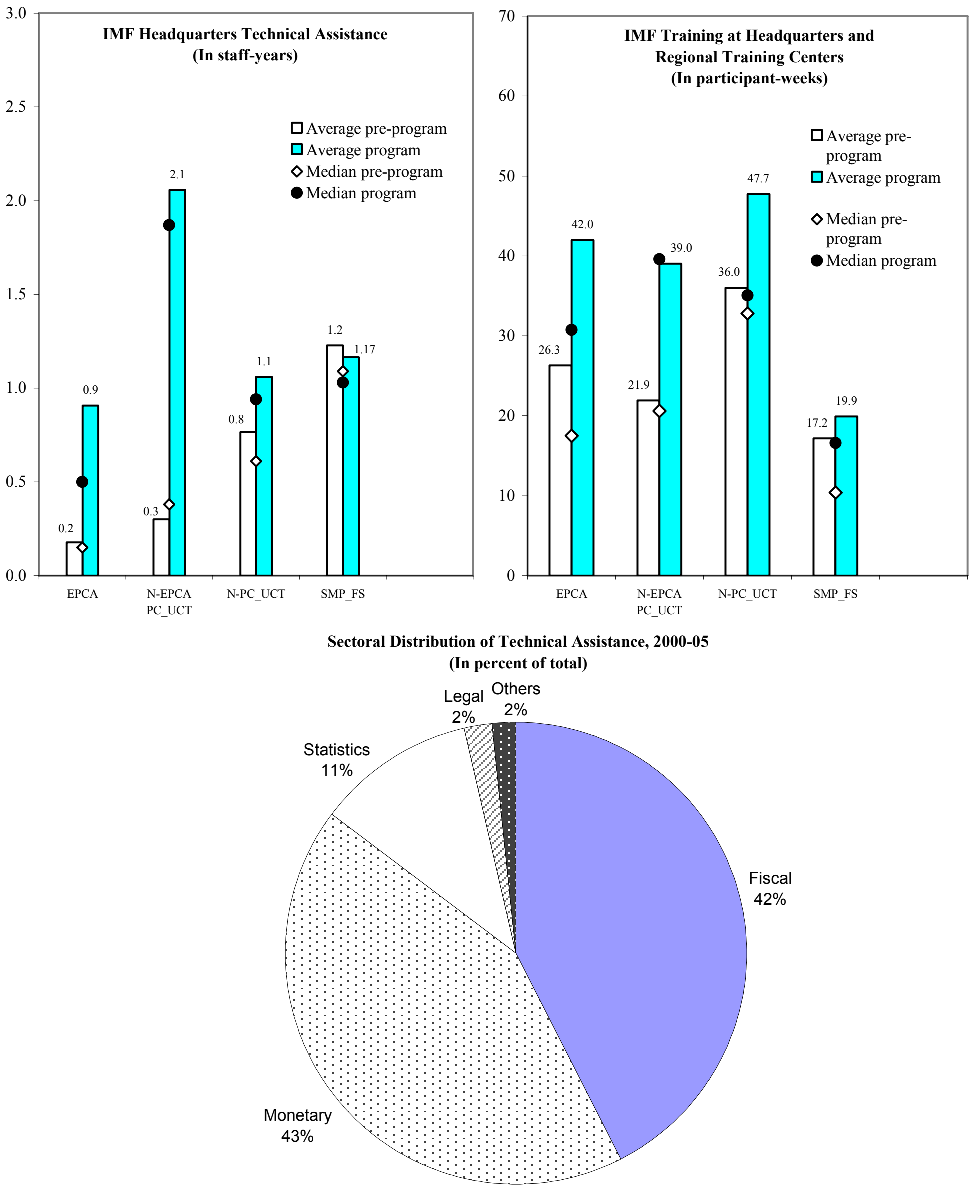
[65] This may also reflect the fact that in some of these cases, other donors provided most of the technical assistance received.

[66] In seven of the twelve fragile states with UCT-standard programs examined in this review (of which two were SBAs), there was a perceptible increase in Fund technical assistance during the on-track period of the program. The 2005 IEO evaluation of Fund technical assistance found that the direct effect of having a PRGF-supported program, after controlling for per capita income and population levels, is an increase in the yearly volume of technical assistance during the program period by two or three person-years, whereas there was no significant change for countries with SBAs (see IEO 2005, Vol. 1, pg. 37). Only two of ten fragile states with PRGF–supported programs covered in this review received such an increase.

states.[67] The success of technical assistance in such countries depended on it being provided in a manner that was responsive to their political, institutional, and capacity constraints, with careful sequencing that matched the degree of country ownership, overall capacity, and institutional strength. These reviews also found that capacity constraints often initially require the pursuit of policies that are not first-best—these should gradually be replaced by preferable policies.[68]

[67] See IMF 2004b and 2004d.
[68] For example, to raise domestic revenues, early emphasis and reliance on easily monitorable border taxes often preceded broader income tax reforms, a reduction in customs tariffs, and the eventual introduction of a VAT.

Appendix Figure 4. Fragile States and Post-Conflict Countries: IMF Technical Assistance and IMF Institute Training During the Pre-Program and Program Periods [1]
(In staff-years and participant-weeks)



Sources: OTM; IMF Institute.

[1] Data on technical assistance covers only that delivered from IMF headquarters and excludes resources deployed from the Fund's regional technical assistance centres (RTACs). Data on training covers IMF Headquarter and regional training centers (RTC), and excludes training delivered at RTACs, and by other departments, e.g., STA.

Country Groups: EPCA -- Emergency Post-conflict assistance; N-EPCA PC_UCT -- Non-EPCA post-conflict Upper Credit Tranche programs; N-PC_UCT -- Non post-conflict UCT programs; SMP_FS -- Fragile states with Staff Monitored Programs; SUR -- Art. IV Consultation/Surveillance countries.

Period Covered: Pre-program period is the three years prior to the program. Program period is defined as the year the program began and the subsequent two years.

Appendix Table 2. IMF Technical Assistance and IMF Institute Training [1]
(In staff-years; and participant-weeks)

	Averages		Period Averages	
	3-Year Pre-program t-3 to t-1	3-Year Program t0 to t+2	FY 1998-99	**FY 2000-05**
IMF HQ Technical Assistance (staff-years)				
EPCA Programs in Post-conflict Countries, 1995-2005 (12)	0.18	0.91	1.46	**1.41**
Upper Credit Tranche Programs in Non-EPCA Post-conflict Countries, 2000-05 (2)	0.30	2.06	0.88	**2.27**
Upper Credit Tranche Programs in Non-Post-conflict Fragile States, 2000-2005 (10)	0.76	1.06	0.88	**1.40**
Staff Monitored Programs, 2000-05 (7)	1.23	1.17	1.48	**0.93**
Cases of Surveillance, 2000-2005 (10)	..	..	0.64	**1.19**
Upper Credit Tranche Programs in Non-Fragile States, 2000-05 (30)	1.50	1.34	1.52	**1.21**
IMF Institute HQ and RTC Training (participant-weeks)				
EPCA Programs in Post-conflict Countries, 1995-2005 (12)	26.3	42.0	28.0	**49.9**
Upper Credit Tranche Programs in Non-EPCA Post-conflict Countries, 2000-05 (2)	21.9	39.0	14.3	**33.2**
Upper Credit Tranche Programs in Non-Post-conflict Fragile States, 2000-2005 (10)	36.0	47.7	32.5	**54.5**
Staff Monitored Programs, 2000-05 (7)	17.2	19.9	23.1	**27.4**
Cases of Surveillance, 2000-2005 (10)	..	..	21.4	**26.5**
Upper Credit Tranche Programs in Non-Fragile States, 2000-05 (30)	..	..	..	**..**

Sources: Office of Technical Assistance Management; and IMF Institute.

[1] The data on technical assistance covers only that from IMF headquarters and excludes resources deployed from the Fund's regional technical assistance centers (RTACs). Data on training covers IMF headquarters and regional training centers and excludes training delivered at RTACs and by other departments, e.g., STA. Numbers in parenthesis indicate number of countries in the group.

72. **However, there was evidence of delays in delivering necessary technical assistance that may have contributed to difficulties in meeting program objectives** in some countries, particularly in the areas of structural reforms. Support from other providers for core reforms in public financial management and governance may not have been sufficiently timely, impeding successful implementation of programmed structural reforms.[69] In some cases, this may have reflected political instability or the security situation.

73. **Fund training has also contributed to improving policy formulation and implementation in fragile states.** For member countries seeking closer engagement with the Fund, the role of area departments and resident representatives has been critical in identifying and prioritizing technical assistance needs as well as suitable candidates for Fund-provided training courses in the context of large excess demand. Indeed, virtually all fragile states experienced an increase in Fund provided training (measured in participant weeks), in particular under UCT-standard and EPCA-supported programs (Appendix Figure 4 and Table 2).[70]

E. Transition from EPCA to UCT

74. **While EPCA is intended to be a relatively short ramp to a UCT-standard arrangement, the time taken to move to a successor Fund arrangement has varied considerably** (see Appendix Table 3). Of the 12 EPCA users, seven moved to a UCT-standard arrangement within 15 months or less of the start of their EPCA-supported programs, while the remaining users achieved this within three years.[71] Longer transitions generally reflected unsettled security and bouts of conflict, or continued deep underlying institutional and policy weaknesses that needed more time to be sufficiently strengthened to move to a UCT-standard arrangement.[72]

75. **Prolonged capacity weakness affected performance in the first successor programs to EPCA in many cases** (Appendix Box 2). The program performance index of EPCA users under a first successor UCT-standard program fell short of the average for all UCT-standard programs during 1995-2005. For those EPCA users that had a second successor program in place by 2005 (roughly half the original group), program performance improved and was, on average, in line with that of all UCT-standard programs.[73]

[69] For example, the Ex Post Assessment for Guinea-Bissau (IMF 2004g, paragraph 13) identified delays in donor technical assistance as contributing to delays in the reconstruction of the administrative infrastructure, an area of focus under the EPCA-supported programs. Initial delays were related to security conditions.
[70] These data refer to training delivered by the INS at headquarters and regional training centers.
[71] An exception was the Republic of Congo—almost six and a half years.
[72] Indeed, partly in response to the extended transition times, the EPCA policy was modified in 1999 and 2004 to allow for EPCA engagement for up to three years.
[73] However, the robustness of these conclusions is limited by the small sample size.

Appendix Table 3. Sample Countries With Emergency Post-Conflict Assistance (EPCA) and Subsequent Fund-supported Programs

Country	EPCA Approved on	EPCA in millions of SDRs	EPCA in % of Quota	EPCA Duration in months	Subsequent Programs	Program Approved on	Program Expiry Date	Time between first EPCA purchase and subsequent IMF arrangement (months)
Albania	11/7/1997	8.8	25.0	6.0	PRGF	5/31/1998	7/31/2001	7
Albania	..	..	..		PRGF	6/21/2002	11/20/2005	
Albania	..	..	..		PRGF	1/27/2006	1/26/2009	
Bosnia and Herzegovina	12/20/1995	30.3	25.0	12	SBA	5/29/1998	5/29/2001	29
Bosnia and Herzegovina	..	..	..		SBA	8/2/2002	2/29/2004	
Burundi	10/9/2002	9.6	12.5	9.0	..	..	..	
Burundi	5/5/2003	9.6	12.5	9.0	PRGF	1/23/2004	1/22/2007	15
Central African Republic	7/23/2004	5.6	10.0	6.0	..	..	..	
Central African Republic	1/27/2006	7.0	12.5	12.0	PRGF	12/22/2006	12/21/2009	29
Congo, Republic of	7/15/1998	7.2	12.5	6.0	..	..	..	
Congo, Republic of	11/17/2000	10.6	12.5	12.0	SMP	7/1/2001	6/31/2002	
Congo, Republic of	..	..	..		SMP	1/1/2003	9/30/2003	
Congo, Republic of	..	..	..		SMP	1/1/2004	6/30/2004	
Congo, Republic of	..	..	..		PRGF	12/6/2004	12/5/2007	77
Guinea-Bissau	9/14/1999	2.1	15.0	6.0	..	..	..	
Guinea-Bissau [1]	1/7/2000	1.4	10.0	..	PRGF	12/15/2000	12/14/2003	15
Guinea-Bissau	..	..	..	..	SMP	4/1/2005	12/31/2005	
Haiti	1/10/2005	10.2	12.5	12.0	..	..	..	
Haiti	10/19/2005	10.2	12.5	..	PRGF	11/20/2006	11/19/2009	22
Iraq	9/29/2004	297.1	25.0	..	Precautionary SBA	12/23/2005	3/23/2007 [2]	15
Rwanda	4/22/1997	8.9	15.0	12.0	..	..	..	
Rwanda	12/12/1997	6.0	10.0	..	PRGF	6/24/1998	1/31/2002	14
Rwanda	..	..	..	..	PRGF	8/12/2002	6/11/2006	
Frmr. Serbia and Montenegro	12/20/2000	116.9	25.0	6.0	SBA	6/11/2001	3/10/2002	6
Frmr. Serbia and Montenegro	..	..	..	..	EFF	5/14/2002	5/13/2005	
Sierra Leone	11/9/1998	11.6	15.0	12.0	..	..	..	
Sierra Leone	12/17/1999	15.6	15.0	12.0	..	..	..	
Sierra Leone	9/8/2000	10.4	10.0	..	PRGF	9/25/2001	6/25/2005	35
Sierra Leone	..	..	..		PRGF	5/10/2006	5/9/2009	
Tajikistan	12/19/1997	7.5	12.5	9.0	..	..	..	
Tajikistan	4/1/1998	7.5	12.5	..	PRGF	6/24/1998	12/24/2001	6
Tajikistan	..	..	..	..	SMP	1/1/2002	6/30/2002	
Tajikistan	..	..	..	..	PRGF	12/11/2002	2/10/2006	
Average for all 12 countries								22
Middle-Income Countries (Fmr. Serbia and Montenegro, Bosnia and Herzegovina, and Iraq)								17
Low-Income Countries (all others)								24

[1] This item refers to the second purchase under EPCA approved for Guinea-Bissau in September 1999.

[2] The SBA with Iraq was extended until December 28, 2007.

F. Fund Financing and Catalytic Role

76. **Net Fund disbursements increased for most of the countries with programs examined in the review** (Appendix Figure 5 and Table 4).[74] New disbursements reversed net repayments in almost half of these cases, though net repayments to the Fund resumed when programs went off-track. In three-quarters of UCT-standard programs with non-post-conflict countries, net disbursements from the Fund were positive but their average level declined, reflecting primarily the reduction in access in countries that had previously had a PRGF arrangement.[75]

77. **The IMF has played an important role in catalyzing support from donors in the majority of countries reviewed** (Appendix Figure 6). External financing (net ODA) was a critical element of the macroeconomic program in the countries reviewed, ranging from about 2 percent of GDP to almost 50 percent of GDP. In several countries, debt relief and humanitarian assistance were important, and account for much of the variation in assistance across countries and time periods. More generally, about half of the fragile states examined received less ODA in 2005 than in 2001, although states recovering from violent conflict typically received more than other fragile states.[76]

78. **The nature and centrality of the Fund's financing role varied across countries, depending on country needs, the role of bilateral donors, and other factors**. Net aid flows were sensitive to performance under Fund-supported programs. Likewise, in the majority of surveillance cases, periods of good (bad) macroeconomic performance were associated with rising (falling) aid flows:

- *In EPCA countries*, total (net) external financing flows generally rose during the EPCA period and the following two years, though often by less than programmed. Most of the increase was in the form of grants. Humanitarian assistance was often more important than other forms of ODA in the immediate post-conflict period (and usually preceded the Fund's program involvement).

- *In countries with UCT-standard programs*, net external financing (net ODA as a percent of GDP) generally increased while the programs were on-track, but fell when the program went off-track or expired.

- *Countries with SMP-only relationships* with the Fund had mixed success in attracting aid flows, broadly reflecting program performance. Where there was strong political support from bilateral donors, the successful implementation of an SMP was often a sufficient signal to mobilize considerable flows. Elsewhere, although the SMPs were seen as part of a concerted international effort, donor support remained modest in the face of poor implementation.

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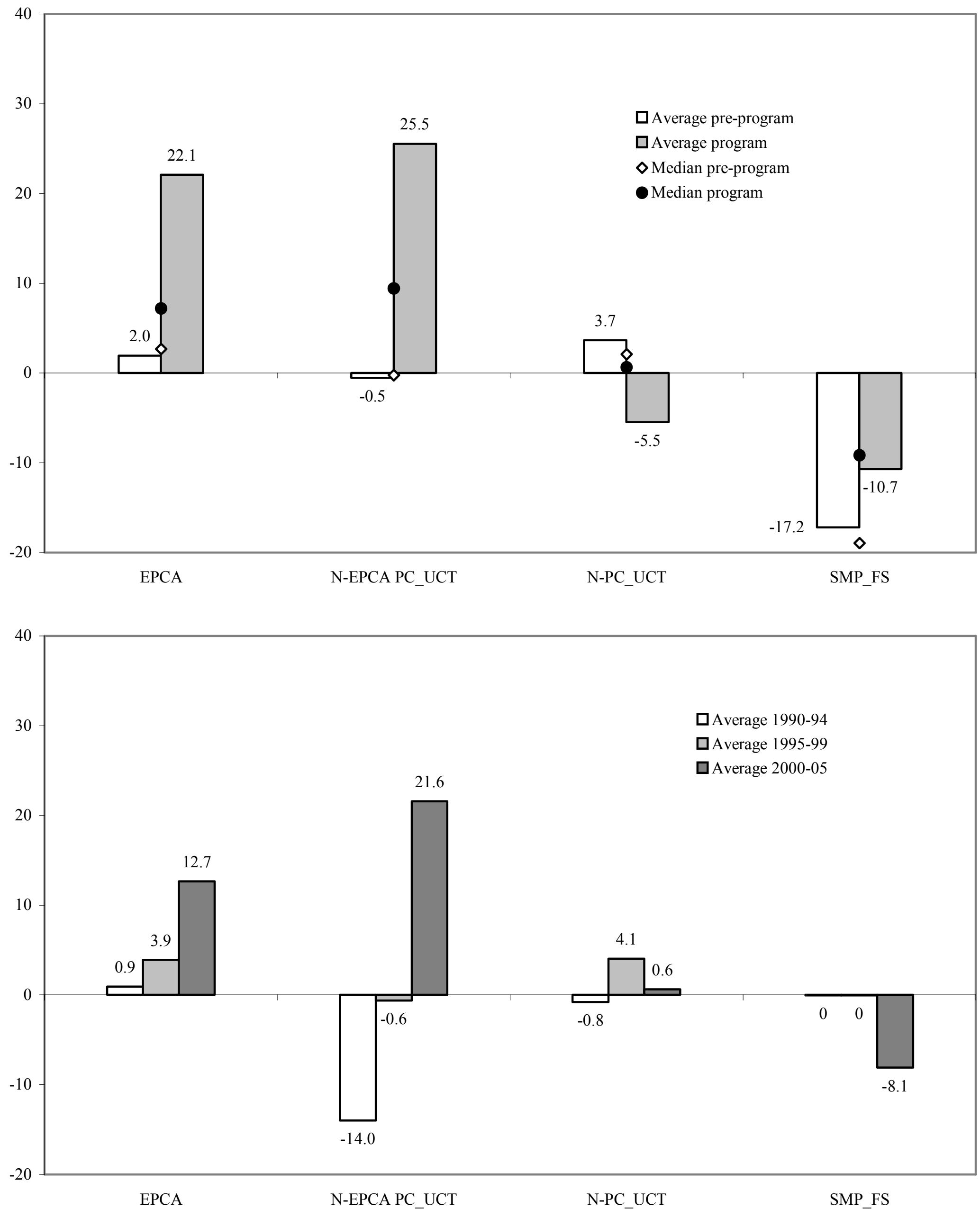
[74] For countries with SMPs the zero net disbursements shown for 1990-94 and 1995-99 are a result of averaging. During both these periods there were countries with zero, negative and positive net disbursements. During 2000-05, no countries had positive net disbursements.

[75] Excluding Cameroon's large repayment to the Fund in 2006, the average pre-program level of net disbursements was SDR3.7 million and the post-program level was SDR3.0 million.

[76] See IMF and World Bank 2007, Chapter 4.

- *A surveillance-only relationship with the Fund* was sufficient for generating donor support only where strong lead donors stepped in. This was the case in the Pacific region, where Australia and New Zealand had a strong presence in Timor-Leste after independence. In the remaining surveillance-only countries, external aid remained low, and was often conditioned on closer engagement with the Fund.

Appendix Figure 5. Fragile States and Post-Conflict Countries:
Net Disbursements From the IMF [1]
(In millions of SDRs)



Sources: Fund Accounts.

Country Groups: EPCA -- Emergency Post-conflict assistance; N-EPCA PC_UCT -- Non-EPCA post-conflict Upper Credit Tranche programs; N-PC_UCT -- Non post-conflict, UCT programs; SMP_FS -- Fragile states with Staff Monitored Programs.

Period Covered: Pre-program period is the three years prior to the program. Program period is defined as the year the program began and the subsequent two years.

[1] Net disbursements for surveillance countries are not shown. In this group two countries had significant net payments and disbursements. Côte d'Ivoire made, on average, net payments during 1990-94 and 2000-05, and received net disbursements during 1995-99. Zimbabwe received net disbursements during 1990-94 and 1995-99, and made net payments during 2000-05.

Appendix Table 4: Net Disbursements from the IMF

(In millions of SDRs) [1]

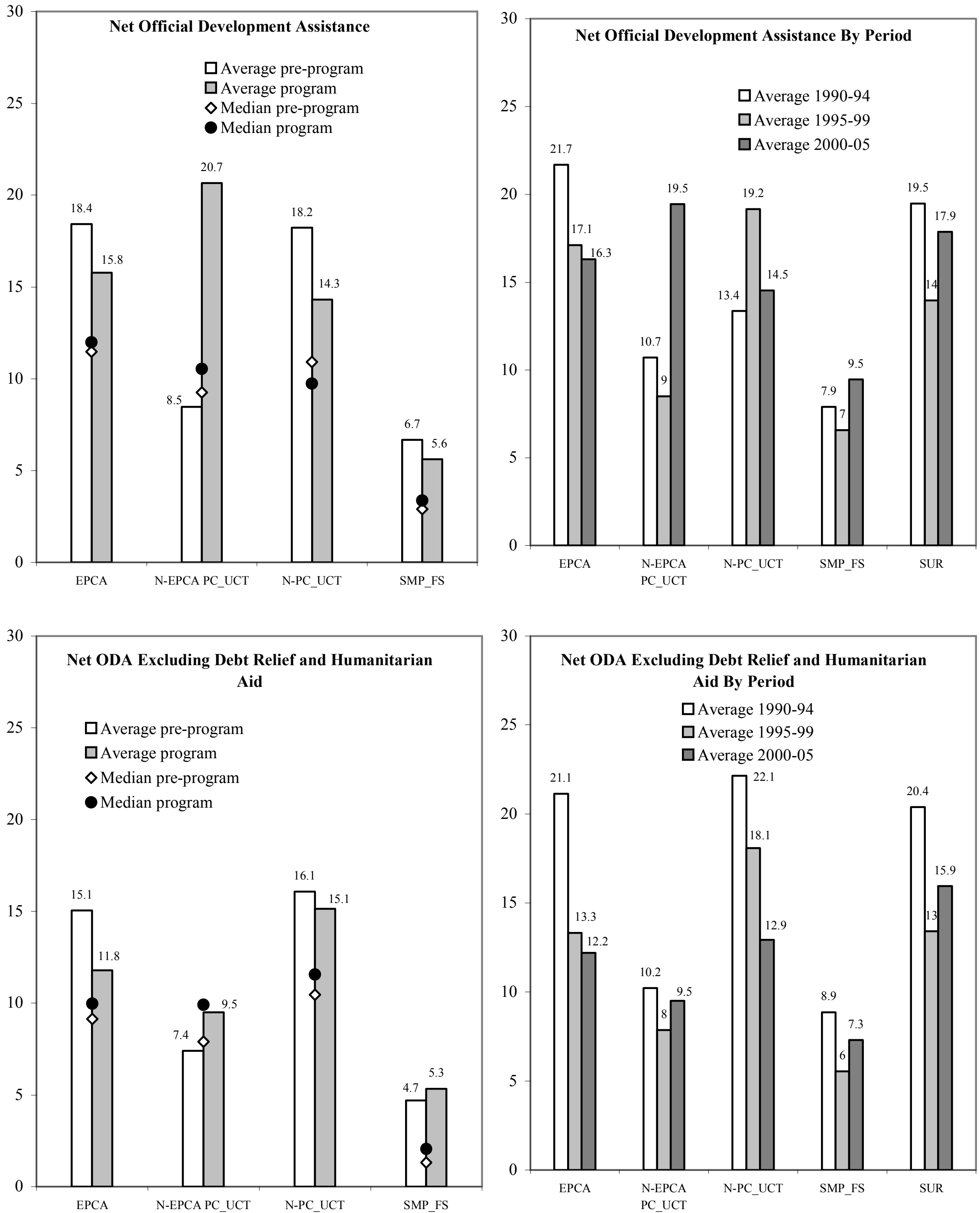
	Average		Period Averages		
	3-Year Pre-program t-3 to t-1	3-Year Program t0 to t+2	1990-94	1995-99	2000-05
EPCA Programs in Post-conflict Countries, 1995-2005 (12)	2.0	22.1	0.9	3.9	12.7
Upper Credit Tranche Programs in Non-EPCA Post-conflict Countries, 2000-05 (2)	-0.5	25.5	-14.0	-0.6	21.6
Upper Credit Tranche Programs in Non-Post-conflict Fragile States, 2000-2005 (10)	3.7	-5.5	-0.8	4.1	0.6
Staff Monitored Programs, 2000-05 (7)	-17.2	-10.7	0.0	0.0	-8.1
Cases of Surveillance, 2000-2005 (10) [2]	-5.1	-11.7	3.4	4.8	-8.4
Upper Credit Tranche Programs in Non-Fragile States, 2000-05 (30)	-3.3	-8.2	5.7	4.7	-6.8

Source: Fund Accounts.

[1] Numbers in parenthesis indicate number of countries in the group. Sample includes 41 EPCAs and fragile states, and 34 non-fragile program countries

[2] Includes significant net disbursements/payments to/from Côte d'Ivoire and Zimbabwe.

Appendix Figure 6. Fragile States and Post-Conflict Countries: Net Official Development Assistance
(In percent of GDP)



Source: OECD Stat.
Country Groups: EPCA -- Emergency Post-conflict assistance; N-EPCA PC_UCT -- Non-EPCA post-conflict Upper Credit Tranche programs; N-PC_UCT -- Non post-conflict, UCT programs; SMP_FS -- Fragile states with Staff Monitored Programs; SUR -- Article IV Consultation/Surveillance countries..
Period Covered: Pre-program period is the three years prior to the program. Program period is defined as the year the program began and the subsequent two years.

G. Debt Relief and Arrears Clearance

79. **Seven of the 12 EPCA users were eligible for assistance under the HIPC Initiative and performance under their EPCA-supported programs has counted towards the decision point track record requirement**.[77] The time taken by the EPCA users to reach the HIPC Initiative decision point varied considerably, reflecting gaps or off-track periods in EPCA and successor programs. However, recent EPCA users have taken advantage of the EPCA program to meet the HIPC Initiative track record requirements, and reached the decision point at the time of the transition to a PRGF arrangement, or soon thereafter (Central African Republic, Haiti). Broadly speaking, therefore, the use of EPCA has facilitated countries' access to debt relief.

80. **Eleven of the non-EPCA countries with UCT-standard programs in the sample received some form of debt relief during 2000-05** (Appendix Table 5). The programs of the three countries that received non-HIPC Paris Club treatments went off-track shortly afterwards. Of the eight countries that received HIPC assistance, three remained on-track with their programs in the ensuing period and have reached the completion point. Four of the six eligible countries in this group have benefited from debt cancellation under the MDRI (Cameroon, Niger, São Tomé and Principé, and Cambodia, only from the IMF).

81. **The existence of significant arrears to multilateral creditors has impeded the flow of financial assistance to some countries.** The requirement of at least the existence of an agreed framework between the country and the World Bank for the clearance of arrears to the Bank, and of coordinated arrears clearance plans for other MDBs (including under EPCA),[78] has delayed the onset of EPCA and UCT-standard programs, and hindered the mobilization of international support in some cases. The delay reflected the presence of substantial arrears to other IFIs, in particular when their financial support was a significant and needed part of the concerted international support. In addition, the availability of World Bank pre-arrears clearance grants requires that other creditors not make net financial withdrawals from the country.

[77] Of these seven, four had an EPCA program in place and were able to begin fulfilling this requirement within 12 months after the conflict. Of the remaining three, continuing security and political issues delayed engagement through EPCA in Burundi and the Central African Republic, while the EPCA policy was not established until after the immediate post-conflict period in Rwanda.

[78] In 1999, the Board "endorsed a continuation of the case-by-case approach, which allows for sequential clearance of arrears to the international financial institutions in appropriate circumstances and the development of arrears clearance plans in individual cases, in coordination with other creditors." (IMF 1999).

Appendix Table 5: Debt Relief for Fragile States and Post-Conflict Countries

HIPC Eligible				
	EPCA	Non-EPCA Financial Programs (PRGF)	Staff-Monitored Programs	Surveillance Only
Completion point	Rwanda ** Sierra Leone **	Cameroon ** Gambia, The Niger ** Sao Tome and Principe **	..	..
Decision point	Burundi Central African Republic Congo, Republic of Guinea-Bissau Haiti	Afghanistan Chad Congo, Democratic Republic of Guinea	..	..
Pre-decision point			Comoros Liberia Sudan Togo	Côte d'Ivoire [1] Eritrea Somalia [2]

Non-HIPC Eligible				
	EPCA	Non-EPCA Financial Programs	Staff-Monitored Programs	Surveillance only
Paris Club debt relief received outside the HIPC framework	Albania Bosnia & Herzegovina Iraq Fmr Serbia & Montenegro Tajikistan **	Cambodia ** Djibouti Nigeria		
No Paris Club debt relief received		Lao, PDR Papua New Guinea	Angola Uzbekistan	Timor-Leste Kiribati Myanmar Solomon Islands Tonga Vanuatu Zimbabwe

Notes:
** Received relief under MDRI.
[1] Received EPCA in 2007, after the sample period.
[2] In the absence of an internationally-recognized government, Somalia has been unable to exercise its membership rights, including Article IV consultations and requests for financial and technical assistance.

Annex Box 1: OECD Principles for good international engagement in fragile states

1. **Take context as the starting point**. Sound political analysis is needed to adapt international responses to country and regional context.
2. **Do no harm**. International decisions to suspend aid-financed activities must be carefully judged for their impact. Increased transparency in transactions between partner governments and companies needs to be a priority.
3. **Focus on state-building**, by supporting the *legitimacy and accountability* of states, and strengthening the *capacity* of state structures to fulfil their core functions.
4. **Prioritise prevention.**
5. **Recognise the links between political, security, and development objectives.** A "whole of government" approach is needed, involving those responsible for security, political, and economic affairs, as well as those responsible for development aid and humanitarian assistance.
6. **Promote non-discrimination as a basis for inclusive and stable societies.** International interventions in fragile states should consistently promote gender equity, social inclusion, and human rights.
7. **Align with local priorities** where governments demonstrate political will to foster development. Where it is not possible, consult with a range of national stakeholders and seek opportunities for partial alignment at the sectoral or regional level.
8. **Agree on practical coordination mechanisms between international actors.** Initiatives can take the form of joint donor offices, an agreed division of labor among donors, delegated co-operation arrangements, multi-donor trust funds, and common reporting and financial requirements.
9. **Act fast … but stay engaged long enough**; and improve aid predictability.
10. **Avoid pockets of exclusion** (aid orphans) through coordination of field presence, determination of aid flows in relation to absorptive capacity, and mechanisms to respond to positive developments in these countries.

Source: OECD-DAC.

Annex Box 2: Harmonizing the Engagement with Fragile States—the Multilateral Development Banks Approach

In October 2007, the Heads of the Multilateral Development Banks (MDBs—(World Bank, Asian Development Bank, African Development Bank, Inter American Development Bank, and European Bank for Reconstruction and Development) joined by the Islamic Development Bank agreed on a set of common goals, guiding principles, and operational approaches and working arrangements designed to deepen their collaboration and strengthen their engagement in fragile situations.

The goals are to strengthen national ownership of recovery and reform, build capacity and accountability in national institutions, and contribute to peace-building through economic and social programs that minimize the risk of conflict and help consolidate stability. These elements could support scaling up by the international community of assistance to fragile situations and are critical for longer-term growth and poverty reduction.

The guiding principles are that engagement needs to: (1) be characterized by increased speed, stronger sensitivity to political economy and conflict dynamics, greater sharing of cross-country experiences, a hands-on approach to supporting counterpart institutions, and a willingness to stay closely engaged in difficult situations over the long term; (2) be adapted to each country context, taking into account the different requirements of situations of deteriorating governance, prolonged crisis, post-conflict and political transition, and gradual reform; (3) support and reinforce the OECD-DAC principles of good international engagement in fragile situations; and (4) be coordinated with the United Nations and other regional, bilateral, and international partners, supporting integrated programs that address key linkages between peace-building, governance, and development.

The operational approaches and implementation arrangements are to: (1) adopt a shared approach to identifying fragility, including through regular exchanges of information on institutional performance, and consultations on priority country situations; (2) undertake, where appropriate, joint conflict, governance, and risk and vulnerability analyses and, to the extent possible, program resources through joint assistance strategies; (3) adopt, with the UN and other partners, a shared platform for post-conflict and post-disaster recovery planning and joint monitoring and results frameworks for post-crisis transitions; (4) improve the effectiveness of capacity-building work by agreeing on country-level division of labor for technical assistance, including sector-specific lead roles; sharing information on rosters of expertise; and consulting on local hiring approaches; (5) improve the speed of response to natural and/or man-made crises and emergencies by delegating higher levels of authority to staff in the field, institutionalizing successful models of rapid response, simplifying project processing, adopting a shared communications protocol for emergencies, and establishing common targets for response times; and (6) working together to improve field-based staffing presence, including, where appropriate, the use of shared premises or facilities.

Annex Box 3: The Sample Group of Fragile States and Post-Conflict Countries for the Historical Review of Fund Engagement

Fragile States, 2000-05

The World Bank's LICUS/Fragile States Initiative identifies a year-by-year "dynamic" list of IDA-eligible countries that are fragile, if the country received a score of 3.2 or below on the Bank's Country Policy and Institutional Assessment (CPIA) index and the CPIA governance sub-index. The CPIA measures the quality of economic and sectoral policies and the quality of institutions in IDA-eligible countries. Member countries that appear on the dynamic list in at least two of the six years during 2000-2005 are included in the review.[1] Under this approach, 36 countries are identified as fragile (seven of which received Emergency Post-Conflict Assistance (EPCA) during 1995-2005), with just under 50 percent of these typically affected by armed conflicts in recent years.

Post-Conflict Countries, 2000-05

Post-conflict countries include (i) all countries supported by EPCA in 2000-05; (ii) countries in conflict any year during 2000-05; and (iii) countries in conflict any year during 1995-99 which were also considered fragile in 2000-05. A country was defined to be in conflict where conflict was intermediate or major according to the Uppsala University's classification,[2] excluding countries in which the conflict was localized. Uppsala University classifies "intermediate conflict" as those that resulted in at least 25 battle-related deaths per year and an accumulated total of at least 1,000 deaths but fewer than 1,000 in any given year; and "major conflict" as those with at least 1,000 battle-related deaths per year.

Countries Receiving EPCA, 1995-2005

The 12 countries receiving EPCA during 1995-2005 were included in the review. All seven EPCA-users during 2000-05 were fragile (see above). For the five countries receiving EPCA during 1995-99, the World Bank's LICUS classification is not available.

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[1] This list differs from that appearing in the 2007 Global Monitoring Report (GMR) (p. 63, footnote 2) because the GMR only includes those countries falling below the aggregate CPIA and sub-governance threshold in 2005. The list does not include the West Bank and Gaza and Kosovo because they are not member countries, and Mauritania, which was newly classified as fragile in 2005.

[2] Uppsala University, Uppsala Conflict Database. Available via the Internet: http://www.pcr.uu.se/database.

Annex Box 4. Indicative Estimates of Incremental Resource Requirements Associated with the ERAP

The introduction of the ERAP is estimated to result in an additional staff annual resource requirement per country of about 0.5-1.5 staff–years.

To make an approximate estimate of the possible impact on resource requirements of introducing the ERAP, staff compared the staff resources allocated over the last two-three years to a typical surveillance-only country; to a country undertaking an SMP; to an EPCA user; and to a PRGF user. As the introduction of an ERAP should not of itself generate a substantial and immediate new demand for Fund technical assistance in most cases, the estimates exclude technical assistance and consider only the allocation of staff resources to bilateral surveillance activities and program/near-program work (and the associated review work) in each of the representative countries.[1] The incremental resource requirements of shifting from one level of Fund engagement to the next are proxied by the difference between the requirements for each level.

In the representative case, the shift from a surveillance-only relationship to the first phase of the ERAP would entail an increase in near-program (SMP-type) work, while surveillance-only activity would remain largely unchanged, resulting in an increase of roughly 1.5 staff years (see table). However, there would be virtually no incremental resource requirement in moving from an existing SMP or near program-type relationship to an ERAP. There would be relatively little impact on overall resource requirements as countries move into the ERFA, as the intensity of work required to monitor the economic program and report to the Executive Board is similar under both phases of the ERAP. Finally, in progressing to a PRGF arrangement, the qualitative change in the intensity of work is relatively minor (with more intensive program work largely compensated by reduced surveillance-specific activities), and total resource requirements could increase by around 0.5 staff years due to the work related to debt relief under the HIPC Initiative and MDRI.

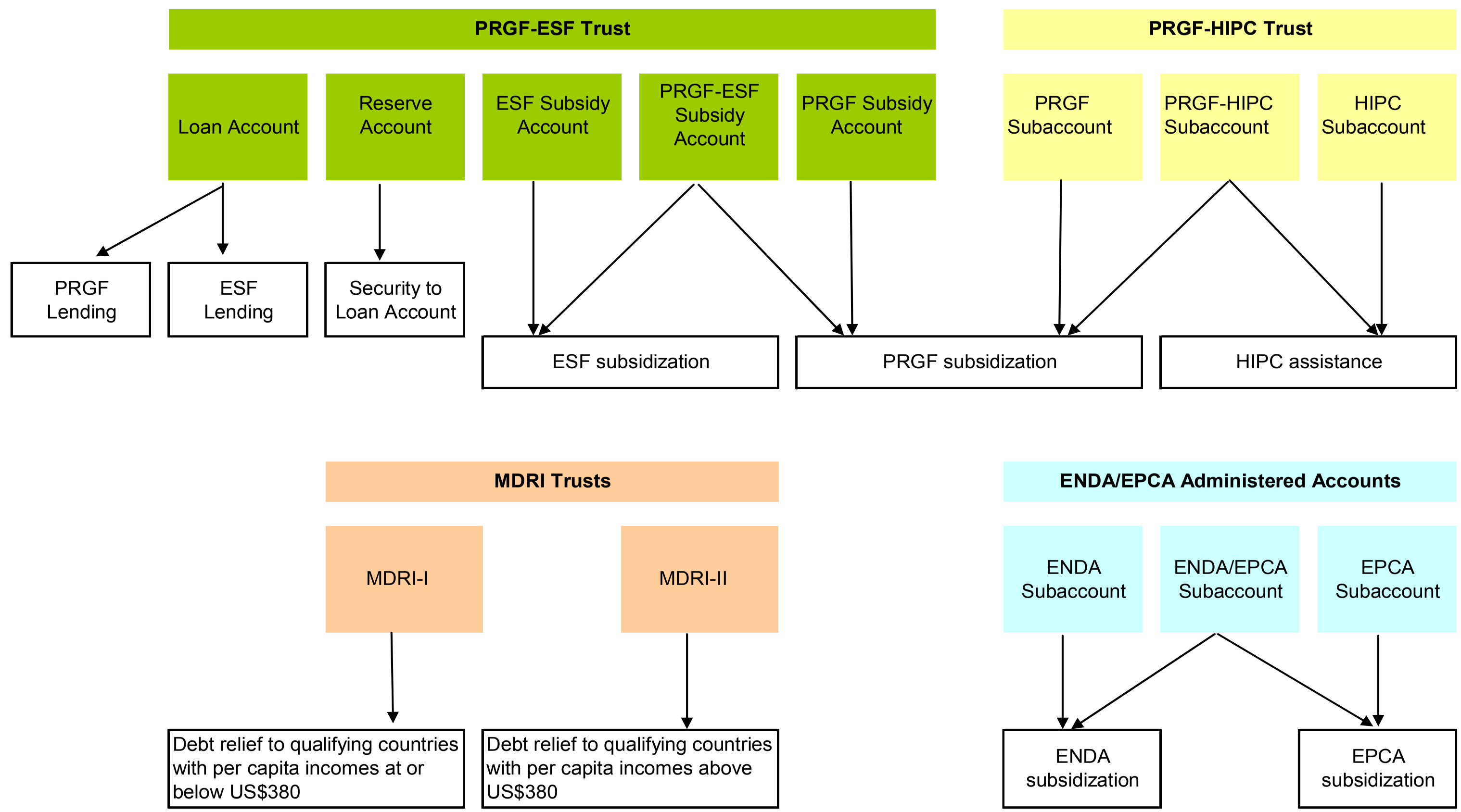
Incremental Staff Resource Requirements
(Per representative country, in staff-years)

	Article IV-bilateral surveillance	Program/Near-Program Relationship	HIPC-related work	Total
Surveillance-Only	1.9	0.1	0.0	2.0
SMP (proxy for ERAP-I)	2.0	1.5	0.0	3.5
EPCA (proxy for ERFA)	0.8	2.5	0.1	3.4
PRGF (in a fragile state)	0.4	3.0	0.5	3.9
Incremental Resource Requirement for a shift from:				
• Surveillance-only to ERAP I		1.5		
• ERAP I to ERFA		-0.1		
• ERFA to PRGF		0.5		

Source: IMF, based on Time Reporting System, (TRS) data for FY 2006-2008.

[1] The conduct of “other” work (such as regional surveillance, GDDS work, etc.) does not necessarily depend directly on the status of the member’s relations with the Fund, although the timing of some activities, such as an FSAP, may be coordinated with the surveillance- or program-related work program.

Annex Figure 1. Financial Structure of the Fund's Concessional Operations



Source: Finance Department.

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