The IMF is preparing a Strategy to strengthen its engagement with fragile and conflict-affected states (FCS). Building on the Fund’s long-standing experience in FCS, the Strategy will (i) further articulate the IMF’s role in helping countries to exit from fragility; and (ii) identify specific measures to enhance the impact of the Fund’s engagement over the next three years. Overall, the Strategy is expected to strengthen the IMF’s ability to support FCS in correcting balance of payments (BOP) disequilibria, promoting macroeconomic stability, and building the institutions needed to deliver good policies for sustainable and inclusive economic growth. The Strategy also seeks to complement the efforts of other actors and organizations supporting FCS and focus on the IMF’s comparative advantage. The FCS Strategy will be submitted for consideration and approval to the IMF’s Executive Board in December 2021.

The IMF values stakeholder engagement to shape its policies and programs. This Concept Note has therefore been prepared as a basis for consultations with external partners and stakeholders. First, it explains the rationale for the IMF’s FCS Strategy, emphasizing the macro-criticality and relevance of fragility and conflict for the Fund’s mandate. Second, the Note offers an overview of the IMF’s comparative advantage in working with FCS, the progress to date, and remaining challenges. Third, the Note distills the key elements of the proposed FCS Strategy: a renewed vision for the Fund’s FCS engagement, as well as a set of initial measures to enhance the impact of IMF support given the very specific policy space in FCS. These measures encompass the Fund’s strategic positioning, engagement modalities, and instruments. Implementation will take place gradually between 2022-2025. The Strategy is expected to further tailor the Fund’s instruments to the case-specific manifestations of fragility and conflict, thereby increasing its effectiveness.
Consultations with external partners will take place between July 30 – September 3, 2021. The IMF will seek views on the following key questions, in addition to other comments and recommendations which may contribute to the FCS Strategy’s development:

**Box 1: Questions for External Partners and Stakeholders**

- What are your views on the envisaged IMF FCS Strategy?
- Which specific areas do you see for the IMF to further enhance its effectiveness to support FCS in achieving macroeconomic stability to help them exit from fragility?
- Given the mandates, core competencies, and comparative advantages of various actors and organizations involved in FCS, what are the main topics, issues, and modes of cooperation you foresee?
I. THE CASE FOR ENHANCING THE IMF’S ENGAGEMENT IN FCS

A. The Global State of Fragility and Conflict: A Snapshot

State fragility and conflict continue to be among the most enduring challenges of our time. If current trends persist, fragile and conflict-affected states (FCS) may host 60 percent of the global poor by 2030 although they will comprise just over 10 percent of the world’s population.1 Even before the COVID-19 pandemic, levels of violence were at their 30-year peak2 and almost 80 million people around the world had become forcefully displaced.3 Climate change, food insecurity, and high youth unemployment in many FCS may further exacerbate these trends. For example, about 155 million people across the globe experience acute food insecurity – with 66 percent in just 10 countries affected by fragility and conflict.4 In the next 10 years, climate change could push an additional 100 million people into poverty.5 According to one study, only 18 percent of FCS are on track to meet selected targets for achieving the Sustainable Development Goals (SDGs) by 2030.6

B. The Economic Impact of the Global Pandemic in FCS

The COVID-19 pandemic has exacerbated the income divergence between FCS and the rest of the world. The pandemic hit FCS harder than other advanced economies (AE) and emerging and developing economies (EMDE). Real GDP growth contracted by 5.6 percent in 2020 or 9.5 percentage points lower than the estimated pre-pandemic projection of 4 percent.7 Current projections suggest that per capita incomes in FCS will recover to their 2019 level only after 2024 (Figure 1). This will result in an increased share of the population living in extreme

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7 IMF Staff Analysis.
poverty in FCS. Furthermore, FCS’ global share of extreme poverty is expected to rise from 30 to 38 percent by 2024. In addition to the divergence between countries, the pandemic has resulted in income divergence within countries given the asymmetric nature of the COVID-19 shock across populations. Greater income divergence and spiking food insecurity are likely to further destabilize FCS and erase some of the hard-won peace and stability gains, resulting in spillovers to neighboring countries. *FCS are at a significant risk of falling even further behind.*

C. Reducing Fragility and Preventing Conflict are International Priorities

The growing costs associated with fragility and conflict and the potential of spillover effects emanating from FCS to destabilize entire regions are at the top of today’s global agenda. To prevent conflict and promote transitions from fragility, international organizations have stepped up their work in FCS based on their mandates, comparative advantage, and core competencies. The United Nations (UN) 2030 Agenda for Sustainable Development has put the commitment to promote peaceful, just, and inclusive societies at the heart of the UN’s efforts in FCS. The World Bank has increased concessional resources to FCS and adopted a *Strategy for Fragility, Conflict and Violence: 2020-2025* to support countries at risk of conflict, in active conflict, or coping with large inflows of refugees. Reducing fragility and promoting resilience are key priorities for both the Africa Development Bank and the Asian Development Bank. Multilateral institutions such as the OECD assess and monitor fragility and conflict risks globally, and regularly track the volume of financing to FCS – including government revenues, private investments, and remittances.

D. Fragility and Conflict are Macro-Critical Challenges

Fragility and conflict impose heavy human costs, but also affect countries’ balance of payments (BOP) positions, distorting good policies and disrupting financial flows. Fragility and conflict undermine the development of productive resources in FCS, leaving countries with few

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8 IMF Staff Analysis.
options to correct imbalances in their BOP. Even when fragility has not turned into full-blown conflict, economies still suffer: growth and GDP per capita in low-income FCS are consistently below those of peers in the same income group, while inflation is higher.\textsuperscript{17} The poverty rate in non-FCS developing economies fell from 26 to 5 percent since 2000. But this improvement did not take place in FCS, where the policy space is constrained by a fractured political environment, weak institutions and a limited provision of public goods, as well as various forms of violence.\textsuperscript{18} Furthermore, governance challenges such as weak capacity, elite capture, and corruption constrain the policy space and also make it difficult for the state to manage or mitigate risks linked to social, economic, political, security, or environmental and climatic factors.\textsuperscript{19} Once conflict starts, it leads to loss of lives and the destruction of physical and social capital. The economic costs of conflict often exceed 10 percent of GDP per year and can reach 25 percent of GDP, also leading to inflation and deteriorated fiscal and external balances.\textsuperscript{20}

E. Frailty and Conflict are Relevant to the IMF’s Mandate

Macroeconomic stability and inclusive growth are essential to promote resilience and foster transitions out of fragility. Strong, well-governed, and accountable institutions that effectively implement fiscal, monetary, financial sector and other structural policies can play a crucial role in preventing state fragility from turning into failure (Diagram 1). At each stage of the fragility and conflict spectrum – from situations where fragility risks and tensions are emerging, to those countries caught in active conflicts or protracted fragility traps, to those vulnerable to external spillovers of conflict – the IMF has a key role to play in supporting FCS. \textit{Fragility and conflict are relevant to the IMF’s mandate, and the Fund will do its part in international and government-led efforts to help members exit from fragility.}

\textbf{The outcomes of any IMF engagement in FCS are critically influenced by political, military, and security decisions – including by national and international actors – which lie outside of the Fund’s control.}\textsuperscript{21} Good macroeconomic policy is one out of many interlinked variables that can make a difference – and in some cases, it may not be the most decisive one.\textsuperscript{22} However, within

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{17}Ibid. \\
\item \textsuperscript{19}OECD, States of Fragility 2016: Understanding Violence (Paris: OECD, 2016). \\
\end{itemize}
\end{footnotesize}
its mandate, comparative advantage, and core competencies, the Fund will strengthen its support to FCS to help them transition to the sustained inclusive growth required to exit fragility.

Diagram 1: The Nexus Between Peace, Macroeconomic Stability, and Growth

II. IMF ENGAGEMENT, PROGRESS MADE, AND REMAINING CHALLENGES

A. The Fund’s Comparative Advantage in FCS

The IMF has had a long-standing engagement with FCS encompassing the full range of activities: surveillance, capacity development, and lending. Surveillance (Article IV consultations) and capacity development (CD) are especially important in FCS, as they represent key vehicles of engagement to evaluate policy options and build core institutions, especially if the Fund is not lending. CD is often the centerpiece of Fund engagement in FCS, especially aimed to help with macroeconomic stabilization, support long-term institution building efforts, and create more jobs. Between January 2010–March 2020, about 30 percent of approved financing for upper-credit tranche (UCT)-quality programs and more than 50 percent of requests for emergency financing have gone to FCS. Thus, in the decade preceding the pandemic, 28 FCS have benefitted from 90 IMF-supported programs and financing totaling US$20 billion (see Annex I). The Fund’s comparative advantage is thus based on the following key elements:

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24 The Rapid Credit Facility (RCF) and Rapid Financing Instrument (RCI).
25 IMF Staff Analysis.
• **Promoting macroeconomic stability and laying the foundations for sustained growth:** Inclusive, sustainable economic growth is key to prevent the emergence of high conflict risks and foster the transition out of fragility. The IMF’s engagement has an essential role to play in helping FCS make progress in restoring macroeconomic stability, through the primary program goals focus on helping correct BOP imbalances and achieve the viability of their external sector.

• **Building institutional capacity:** CD on public financial management (PFM), tax policy, and revenue administration, central banking, financial supervision and regulation, financial stability and payment systems, anticorruption and preventing illicit financial flows, and basic macroeconomic statistics and frameworks – all core areas of Fund expertise – are essential ingredients to prevent and/or exit from fragility.

• **Providing financial assistance, when appropriate:** While multilateral development banks (MDBs) will play the main role in financing long-term country-driven solutions for inclusive and sustainable growth, the Fund’s own financial assistance can help countries meet BOP needs.

• **Catalyzing donor support:** Fund engagement in FCS can be instrumental in catalyzing donor assistance. As shown by the IMF’s response to the COVID crisis, multilateral and bilateral debt relief can play an important role in improving the long-term financial position of FCS.26

The IMF has also played a **critical role** in the international response to the COVID-19 pandemic in FCS through emergency financing and initiatives aimed at improving debt sustainability. The Fund has responded quickly to the financing needs of FCS: 28 members listed as FCS have received emergency financial support worth US$4.8 billion, and US$458 million in assistance from the Catastrophe Containment and Relief Trust (CCRT). The IMF and the World Bank have actively supported the G20 Debt Service Suspension Initiative (DSSI) in which 19 eligible FCS have requested to participate since its inception in May 2020.27 A request for IMF financing (or a pre-existing IMF-supported program) is a requirement for countries to benefit from a debt treatment under the G20 Common Framework beyond the DSSI. Moreover, over 900 remote CD engagements with FCS occurred since the onset of the COVID-19 pandemic.

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27 IMF Staff Analysis.
B. Remaining Challenges

Despite the progress to date, more can be done to further strengthen the Fund’s FCS engagement. Previous IMF reports and analyses28 have identified a series of remaining challenges, including the need for: (i) greater country specificity and realism in IMF policy advice, tailored to the special needs of FCS; (ii) greater differentiation in the application of conditionality; (iii) enhanced adequacy of existing financing instruments, which can be better fine-tuned to the characteristics of FCS; (iv) intensified CD provision, as more local follow-up support was necessary to meet the long-term needs of institution building; (v) improving strategic partnerships, especially with international organizations that have a broader local footprint; (vi) the need to better attract and support staff working on FCS; and (vii) limited field presence.29

The IMF is already tackling these challenges.30 For example, the Fund has piloted medium-term Country Engagement Strategies (CES) in five FCS to better anchor its engagement in the particular political, social, governance, and institutional conditions.31 The IMF’s concessional facilities were modified in 2019 to allow for higher levels of access and better respond to the needs of low-income countries (LICs), including FCS.32 For instance, the Fund increased access limits of the Poverty Reduction and Growth Trust (PRGT), which provides concessional (interest rate free) support to eligible low-income FCS. The IMF has also lengthened the initial maximum duration of ECF arrangements. Moreover, the 2018 review of the IMF’s Capacity Development Strategy includes an FCS focus,33 while an important human resources (HR) reform was initiated in 2020 to attract more staff to work on FCS.

C. Towards an Explicit and Differentiated Approach to FCS

While these are positive steps, further efforts are needed to enhance the IMF’s impact in FCS. The special characteristics of FCS – the limited provision of security and other public goods, a fractured political and social environment, weak state and human resource capacity, low levels of trust, and

31 CES pilots include Afghanistan, Central African Republic, Djibouti, Haiti, and Madagascar.
governance challenges, and potential for spillovers – generate a radically different policy space requiring well-tailored approaches. The Fund’s efforts are now being systematized into a coherent, explicit, and differentiated approach to FCS, which adjusts macroeconomic policy advice, program design, and CD delivery to the case-specific manifestations of fragility and conflict. As program outcomes in FCS are critically influenced by actors and events outside of the realm of economic policymaking, it is important for the Fund to fully leverage its partners, clearly articulate its role in FCS and how its instruments can be deployed across the fragility and conflict spectrum. Building on past engagements and lessons learned, the FCS Strategy aims to achieve these goals.

III. PUTTING FORWARD AN FCS STRATEGY FOR THE IMF

A. Vision, Objectives, and Scope

The FCS Strategy, which is currently under development, aims to provide a renewed vision for the IMF’s role in FCS: Through long-term engagement and working with partners, the Fund will enhance its effectiveness to support FCS in achieving macroeconomic stability to help them exit from fragility, strengthen their resilience, and promote sustainable and inclusive economic growth.

First, the FCS Strategy will articulate how the IMF’s comparative advantage, core competencies, mandate, and instruments can be further leveraged to achieve this vision across the fragility and conflict spectrum. This includes FCS where fragility is intensifying and conflict risks may be emerging, those already caught in active conflict or protracted fragility traps, as well as FCS threatened by external conflict spillovers (Diagram 2).

Second, the FCS Strategy will articulate how the Fund can enhance its tailoring of surveillance, macroeconomic policy advice, CD provision, and program design to the specific manifestations of fragility and conflict. It will thus clarify how modalities of engagement can be further customized to the special characteristics and unique policy space of FCS, recognizing that there is considerable heterogeneity within the group of countries which requires agility and flexibility.

Diagram 2: Fragility and Conflict Spectrum

- Incipient or Active Conflict
- Post-conflict reconstruction, escaping the fragility trap (risk of relapse)
- High institutional and social fragility – emerging risks of conflict
- Spillovers of conflict: insecurity, refugees

FRAGILITY AND CONFLICT SPECTRUM
Third, the FCS Strategy will spell out how the Fund will do its part relative to other partners. It will explain how the IMF will work together with other organizations in the FCS space, including development, humanitarian, peace and security actors – based on the respective mandates, comparative advantage, and complementarities to maximize collective impact at the country-level.

B. Initial FCS Strategy Proposals Under Consideration

Initial proposals have been prepared based on lessons learned from the Fund’s FCS engagement. These proposals are summarized below and will be refined and revised through internal and external consultations, feedback from IMF Management, and guidance from the Executive Board. Implementation will be gradual over the next three years, with built-in flexibility that will allow for course corrections, as needed.

Strategic positioning of the IMF in FCS

1. Consider adopting the methodology, thresholds, and criteria of the World Bank’s recently revised FCS list. The World Bank’s updated FCS list accounts for different intensities of conflict and types of fragility. A more granular identification and classification of FCS would help orient Fund engagement in diverse fragile situations more effectively. Ensuring that the IMF and World Bank approaches are consistent and coordinated would also achieve greater alignment between international financial institutions with the same shareholders.

2. Identify and apply a set of broad engagement principles based on lessons learned from the Fund’s experience aimed at enhancing the Fund’s effectiveness in FCS. These principles would help tailor the IMF’s approach to the case-specific manifestations of fragility, thereby increasing its effectiveness.

3. Spell out the role of the Fund within the broader array of international efforts to tackle fragility and conflict: development, humanitarian, peace and security. The Strategy will articulate how the Fund will work with partners to support FCS, based on its mandate and comparative advantage.

IMF Engagement Modalities and Instruments

4. Roll out Country Engagement Strategies (CES) in FCS to promote an integrated delivery of IMF support across all instruments: surveillance, CD, and lending. CES will also anchor the Fund’s engagement in the medium-to-long term, factoring in the drivers of fragility and conflict into IMF support. CES will benefit from a broader perspective on structural reforms informed by
governance and political economy analysis to support the profound changes necessary for inclusive and sustained growth in FCS. Lastly, CES would be an opportunity for strengthened mission-driven partnerships and further engagement with country authorities.

5. **Working closely with national authorities, significantly scale-up CD assistance with increased capacity placed in closer geographical proximity to the FCS (health and security situations permitting).** The objective is to make the IMF’s CD delivery more responsive to the needs of national authorities, and more impactful. Deploying more experts in country offices and Regional Capacity Development Centers (RCDCs) will also help tailor the CD offer to the manifestations of fragility and conflict, and better assess absorptive capacity.

6. Provide concrete proposals to better **tailor conditionality and program design for FCS**, including by promoting a **well-articulated link between the structural agenda in the program and the long-term strategy**, as informed by the CES.

7. **Review the lending toolkit to ensure it is fit for purpose in FCS.** The Strategy will explore possible options to increase to flexibility of instruments, while safeguarding Fund resources.

8. **Enhance mission-driven partnerships, based on a clear division of labor that reflects mandates, core competencies, and comparative advantages.** The Strategy will explore ways to share analytics more systematically with the World Bank. Risk and Resilience Assessments (RRAs) that assess the drivers of fragility and conflict and security sector public expenditure reviews (PERs) undertaken by the World Bank and United Nations (UN) will be considered. Additionally, the Strategy will assess ways to leverage the field presence of UN and other partners, especially in insecure, high-threat environments.

**Staff Support and Resources**

9. **Enhance support for staff at HQ (in Area and Functional Departments) and strengthen the role of Resident Representatives in FCS.** The FCS Strategy will explore ways to increase the coverage of FCS by Resident Representatives, deploying long-term experts, and resident advisors.

10. **Strengthen career incentives to attract and nurture talent,** as well as recognize staff who develop experience and expertise on FCS.

11. **Develop an FCS learning curriculum and activate an FCS Community of Practice.** The curriculum will provide staff with hands-on, practical skills needed for surveillance and program
work. The Community of Practice will leverage staff experience and lessons learned, while facilitating the systematic sharing of best practices.

C.   Key Next Steps

The remaining milestones for the preparation of the FCS Strategy are planned as follows:

- **July-September 2021**: Further development of the FCS Strategy based on guidance from the Executive Board, internal deliberations, and external consultations with partners.

- **September 2021**: Informal Board Presentations to update Executive Directors on the FCS Strategy, including its budgetary impact and options for the lending toolkit.

- **October 2021**: Public high-level discussions at IMF-World Bank Annual Meetings.

- **October-December 2021**: Finalization of FCS Strategy based on feedback received from internal and external stakeholders, and submission of the Strategy to the Board for consideration and approval.
ANNEX I: THE IMF’S ENGAGEMENT IN FCS – AN OVERVIEW

The IMF has helped many FCS achieve macroeconomic stabilization, lay the foundations for sustained growth, and build progressively stronger institutions. More specifically:

- **Article IV consultations**, an IMF member obligation, allow the Fund to provide policy advice to authorities. As most Article IV reports are published, they also provide macroeconomic assessments to other international partners, as well as monitor risks to the economy. Article IV consultations normally held every 12-months, though some FCS – for example, those with IMF-supported programs – are on a 24-month cycle.

- **Capacity development (CD)** is often the area where the Fund can make a critical contribution in FCS, especially to help with macroeconomic stabilization and promote inclusive economic growth. CD in FCS accounted for over one-quarter of Fund CD spending over the last four years. Activities generally focus on core operational issues such as basic revenue administration functions, budget execution and control, developing banking regulations, strengthening central banks, and improving statistical capacity. Africa, Asia Pacific, and the Middle East and Central Asia regions are the largest recipients of the Fund’s CD support.

- **When appropriate, the IMF has also provided financing to FCS.** Between January 2010–March 2020, about 30 percent of approved financing for upper-credit tranche (UCT)-quality programs and more than 50 percent of requests for emergency financing have gone to FCS. Most FCS are supported by the Extended Credit Facility (ECF), and repeated use is common. FCS also benefited from 18 disbursements channeled through the Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI). Meanwhile, there have been 25 Staff Monitored Programs (SMPs) for FCS, reflecting efforts to help them build a track record toward a UCT-quality program.\(^{34}\) More frequent use of emergency financing and SMPs reflects capacity constraints, weak track record of policy

\(^{34}\) There have been only two SMPs for non-FCS since 2010.
implementation, and vulnerability to shocks that cause urgent BOP needs in FCS. IMF financing also plays a catalytic role in helping FCSs to mobilize resources from other creditors and donors. Overall, prior to the COVID-19 pandemic, the IMF had supported 28 FCS with 90 programs and financings totaling US$20 billion over the past decade (Table 1).

Figure 1.2: Number of Fund Financing Instruments for FCS

![Bar chart showing the number of emergency financing and IMF programs from 2010 to 2021.]

1/ As of 05/24/2021; IMF Staff Analysis.

Figure 1.3: Fund Financial Support for FCS \(^1\) (in billions of SDR)

![Line chart showing emergency financing, IMF programs, and outstanding credit from 2010 to 2021.]

1/ Latest approved amount of each program, including augmentations if any.
2/ As of 05/24/2021; Source: IMF Staff Analysis.
Table 1: IMF-supported FCS Programs and Financings (January 2010-March 2020\(^1\))

<table>
<thead>
<tr>
<th>Type of Program and Financing</th>
<th>No. of Programs/Financings</th>
<th>Total Amount Approved (Billions of USD)</th>
<th>No. of Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extended Credit Facility (ECF) / Extended Fund Facility (EFF)</td>
<td>40</td>
<td>8.4</td>
<td>20</td>
</tr>
<tr>
<td>Standby Credit Facility (SCF) / Standby Agreement (SBA)</td>
<td>7</td>
<td>9.5</td>
<td>3</td>
</tr>
<tr>
<td>Rapid Credit Facility (RCF) / Rapid Financing Instrument (RCI)</td>
<td>18</td>
<td>2.2</td>
<td>13</td>
</tr>
<tr>
<td>Policy Coordination Instrument (PCI) / Policy Support Instrument (PSI)</td>
<td>0</td>
<td>0.0</td>
<td>0</td>
</tr>
<tr>
<td>Staff Monitored Program (SMP)</td>
<td>25</td>
<td>0.0</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>90</strong></td>
<td><strong>20.0</strong></td>
<td><strong>28(^2)</strong></td>
</tr>
</tbody>
</table>

Source: FIN and Staff calculations.
1/ As of April 4, 2021; IMF Staff Analysis
2/ Some countries received support from multiple programs and financings.