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The IMF Strategy for Fragile and Conflict-Affected States

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IMF POLICY PAPER

IMF STRATEGY FOR FRAGILE AND CONFLICT-AFFECTED STATES (FCS)

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IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 9, 2022 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on February 14, 2022, for the Executive Board's consideration on March 9, 2022.

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International Monetary Fund
Washington, D.C.



IMF Executive Board Supports New Strategy for Fragile and Conflict-Affected States

FOR IMMEDIATE RELEASE

Washington, DC—March 14, 2022: On March 9, the Executive Board of the International Monetary Fund (IMF) discussed a proposed [strategy paper](#) for strengthening IMF support to fragile and conflict affected states (FCS). This paper is a response to the needs of members states and the Board-endorsed recommendations of the 2018 Independent Evaluation Office (IEO) Report on *The IMF and Fragile States*.

FCS are home to nearly 1 billion people facing a variety of protracted challenges: from reduced institutional capacity and limited public service delivery, to forced displacement and war. Fragility and conflict are also exacerbated by climate change, food insecurity, gender inequalities, and more recently by the economic repercussions of COVID-19. The pandemic has disproportionately affected FCS in terms of the impact on per capita incomes, inflation, and public debt. Today, FCS are at a significant risk of falling behind in their post-pandemic recovery, but also in achieving the [Sustainable Development Goals](#).

The Strategy paper makes the case that the implications of fragility and conflict are macro-critical: they destabilize balance of payments (BOP) positions, disrupt trade and financial flows, and hinder the development of productive resources. Moreover, crises originating in FCS can also affect economic outcomes in neighboring countries and regions. Addressing these challenges requires a well-tailored approach which factors in the drivers of fragility, political economy dynamics, and specific constraints to reform in each country, in coordination with other partners.

Executive Board Assessment¹

Executive Directors welcomed the opportunity to discuss the Fund's strategy for fragile and conflict-affected states (FCS). They concurred that addressing fragility and conflict is an important policy priority for the international community, especially given the disproportionate economic impact of the pandemic in FCS, and the interlinkages with climate change, food insecurity, and persistent gender disparities. Directors agreed that the implications of fragility and conflict are macro-critical and relevant to the Fund's mandate—both in terms of the long-run economic impact on members, but also because spillovers originating in FCS can undermine macroeconomic stability and growth prospects in neighboring countries and regions.

¹ At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors noted that about one fifth of Fund members are classified as FCS. They agreed that the Fund has an important role to play, within its mandate, to help these countries exit from fragility and support them to achieve macroeconomic stability, enhance resilience, strengthen governance, and promote inclusive growth. Directors expressed strong support for the proposed FCS strategy and its measures, which responds to the Board-endorsed recommendations of the 2018 Independent Evaluation Office Report on The IMF and Fragile States and builds on actions under the related Management Implementation Plan. They welcomed the inclusive process through which the FCS strategy was developed, with extensive consultations with the World Bank, the UN system, and other partners and stakeholders.

Directors endorsed the proposed principles of engagement to ensure that the Fund's mandate and comparative advantage will be effectively leveraged to help country authorities in FCS achieve better macroeconomic outcomes. They emphasized the importance of focusing engagement on areas within the Fund's core competencies; promoting greater tailoring of instruments to the country-specific manifestations of fragility and conflict; as well as strategically enhancing partnerships with humanitarian, development, peace, and security actors. Directors noted that country ownership and effective communication with the public are key to advancing reforms in FCS.

Directors strongly supported the proposal to roll out Country Engagement Strategies (CES) across FCS. They concurred that the CES is an important vehicle to identify the key drivers of fragility and conflict to better tailor Fund engagement; support the integration of surveillance, capacity development (CD), and lending programs; inform program design and conditionality; and support a stronger dialogue with country authorities and partners. Directors emphasized the importance of consultations with country authorities throughout the CES process, as well as leveraging other institutions' analyses and expertise. Many Directors suggested considering a faster rollout of CES than proposed, if feasible. These Directors also suggested keeping the option of preparing CES for countries not formally defined as FCS but that are at high risk.

Directors generally agreed with the proposed measures to further calibrate the Fund's instruments and modalities of engagement to FCS conditions. They supported an expanded field presence to ensure that stepped-up CD provision in FCS is better tailored to local absorptive capacity and coordinated with other development partners. Directors emphasized the critical role that Fund CD can play in supporting FCS to progressively build institutions that effectively perform macroeconomic policy functions, noting the alignment between the FCS strategy and the FY23-25 CD priorities.

With regard to the lending toolkit, Directors supported the view that FCS that can implement UCT-quality programs should be encouraged to do so. They supported making full use of existing flexibility in the lending toolkit and enhancing program design through realistic macroeconomic frameworks and parsimonious and tailored conditionality aligned with institutional capacity and informed by the CES. Many Directors underlined that floating tranches should not be attached to core aspects of the program so as not to disincentivize reforms.

Directors noted that the recognition of post-program financing gaps should be accompanied with the appropriate safeguards. A few Directors suggested considering post program assessments for defunct arrangements. To address situations where there is an urgent balance-of-payment need and UCT-quality programs are not possible, most Directors expressed openness to using the flexibility of having concurrent staff-monitored programs and RCF/RFI, as this should support the transition to a UCT-quality arrangement, and looked forward to proposals for targeted adjustments to the RCF framework. Many Directors also suggested exploring in the future options for a new ECF window enabling shorter-duration arrangements to transition to longer-term UCT-quality programs. Lastly, Directors noted that the proposed Resilience and Sustainability Trust (RST) could help FCS address their long-term structural challenges, but many Directors expressed concerns that many FCS may not qualify for the RST if a UCT-quality program is required. Directors requested that more information and a clear justification on the approach adopted in a country be included in staff reports for Board discussion.

Directors supported enhancing partnerships to amplify the impact of Fund engagement in FCS by leveraging complementarities while avoiding duplication of efforts and leveraging the Fund's engagement to catalyze increased donor support. Collaboration with the World Bank is especially critical and the adoption of its methodology for FCS classification as proposed in the FCS strategy is an important step to ensure greater consistency of approaches between the two institutions. A few Directors underlined the importance of robust Country Policy and Institutional Assessments. Directors emphasized the need to ensure a smooth transition to the new FCS classification methodology, which should not result in diminished support to countries that will be dropped from the current internal IMF FCS list.

Directors agreed with the resource allocation proposal, consistent with the FY23-25 Medium-Term Budget, as per the budget augmentation framework. They agreed with the proposed FCS engagement model focused on closer support and follow-up with country authorities and partners. Directors supported the initiatives to enhance the expertise, recognition, and accountability of staff working on FCS, along with appropriate incentives. Directors acknowledged the inherent risks in FCS engagement and the importance of risk mitigation. Many Directors stressed that the Fund should be prepared to accept residual risks when sufficiently assessed and justified to fulfill its unique mandate and be able to best serve its membership.

Directors looked forward to the planned operational guidance to help staff effectively implement the FCS strategy, as well as to annual updates on progress made. A number of Directors suggested having a timeframe for reviewing implementation of the FCS Strategy.



February 14, 2022

THE IMF STRATEGY FOR FRAGILE AND CONFLICT-AFFECTED STATES

EXECUTIVE SUMMARY

Supporting fragile and conflict-affected states (FCS) is an important priority on the international policy agenda. FCS are home to nearly 1 billion people facing a variety of protracted challenges: from reduced institutional capacity and limited public service delivery, to forced displacement and war. Fragility and conflict are also exacerbated by climate change, food insecurity, and gender disparities. The economic impact of the COVID-19 pandemic has been most severe in FCS, as per capita incomes are estimated to recover to 2019 levels only after 2024. Debt and inflationary pressures have also mounted. *FCS are at a significant risk of falling behind in their post-pandemic recovery, but also in achieving the Sustainable Development Goals.*

About a fifth of IMF members are classified as FCS. In these countries, fragility and/or conflict destabilize balance of payments (BOP) positions, disrupt trade and financial flows, and hinder the development of productive resources. The effects are persistent over time: exit from fragility can take decades, as the policy space for reforms is constrained and trade-offs between short and long-run policy objectives are difficult to make. Progress is prone to high risks and recurrent setbacks. Moreover, social, economic, political, and security crises in FCS can also threaten macroeconomic stability and growth prospects in neighboring countries and regions. *The implications of fragility and conflict are thus macro-critical and directly relevant to the IMF's mandate. Addressing them requires a tailored approach that factors in the drivers of fragility, political economy dynamics, and specific constraints to reform in each country.*

This paper proposes a comprehensive Strategy to strengthen IMF support to FCS in accordance with the Fund's mandate and comparative advantage. Through long-term engagement and working with partners, the Fund will enhance its effectiveness in supporting FCS to achieve macroeconomic stability, strengthen their resilience, and promote inclusive growth to help them exit from fragility. Given the inherent complexity of FCS contexts, reforms are influenced by many factors outside the Fund's control. Nevertheless, within the scope of its mandate and comparative advantage, the Fund is committed to doing its part. *As such, the Strategy proposes concrete measures to tailor IMF engagement, instruments, and policy advice to the specific manifestations of fragility and conflict.*

The Strategy is a response to the Board-endorsed recommendations of the 2018 Independent Evaluation Office (IEO) Report on *The IMF and Fragile States*. The Report recognized the Fund's long-standing role in helping FCS promote sustainable economic growth, achieve macroeconomic stability, and progressively build stronger and more accountable institutions. Yet, the IEO also noted that important challenges remain in tailoring program design and conditionality to FCS circumstances; the realism and country specificity of policy advice; the provision of capacity development amid limited absorptive capacity; and the flexibility of the lending toolkit. There is also scope for improving strategic partnerships—especially with international and regional organizations that have a wider field presence—and strengthening support to IMF staff, including attracting talent.

The FCS Strategy draws on these insights and lessons learned. It proposes a framework and a set of measures that will allow the Fund to address these challenges and be better positioned to support the most vulnerable members. These include:

- Adopting **principles of engagement** to ensure that the IMF's **mandate and comparative advantage** will be effectively leveraged to help country authorities in FCS achieve better macroeconomic outcomes. Greater tailoring to the fragility and conflict context is one such key principle, underscoring the importance of focusing on the distributional aspects of macroeconomic adjustments and calibrating the pace and timing of structural reforms to political economy dynamics and institutional capacities.
- Rolling out **Country Engagement Strategies (CES)** across FCS. CES will identify key drivers of fragility and conflict to better tailor Fund engagement, support the integration of surveillance, capacity development, and lending programs, inform program design and conditionality, as well as the dialogue with country authorities and partners.
- Calibrating **IMF modalities of engagement** to better serve the needs of FCS. **Surveillance and analytics** will address more systematically the macro-critical implications of fragility and conflict drivers such as governance and corruption, food insecurity, climate change, or regional spillovers from conflict. An expanded IMF field presence will ensure that **capacity development (CD)** intensifies support for institution-building efforts, is better tailored to local absorptive capacity, and better coordinated with other development partners. To help country authorities in FCS successfully implement medium-term upper-credit tranche (UCT)-quality programs, the Fund will make full use of the existing **flexibility of its lending toolkit to improve program design and streamline conditionality, tailored to the specific situation of each FCS** and informed by the analysis in the CES. For FCS facing an urgent BOP need but where a UCT-quality program is not feasible, emergency financing instruments can be used provided that all requirements are met. In such cases, the combination of Staff Monitored Programs (SMPs) with emergency financing represents a useful component of the Fund's existing policy toolkit to support country authorities building a track-record of policy reform implementation ahead of a medium-term program.

- **Enhancing partnerships to amplify the Fund’s comparative advantage.** The Strategy spells out how the IMF will work with development, humanitarian, as well as peace and security actors, based on respective mandates. **Collaboration with the World Bank will also be strengthened.** The Fund will adopt the **methodology, thresholds, and criteria of the Bank’s FCS list**, which will help achieve greater consistency between institutions with the same shareholders and complementary mandates. The Fund and Bank will also share diagnostics more systematically—including fragility and conflict assessments—and deepen cooperation on macro-structural reforms based on best practices.

To achieve these goals, the Strategy will benefit from additional resources reflected in the FY23-25 Medium-Term Budget, as per the budget augmentation framework discussed by the Board in December 2021. The new resources will allow the Fund to significantly expand its footprint in FCS. An additional 40 local economists will be recruited to strengthen country offices. The coverage of FCS by Resident Representatives will also grow, thus enabling closer support and follow-up with country authorities and local partners. With expected donor contributions, the Fund’s ability to provide CD regionally and in-country will increase by 70 percent to enhance its assistance to FCS governments undertaking policy reforms. Resources will also allow the Fund to stabilize the financial position of Regional Capacity Development Centers (RCDCs).

The Strategy also provides measures to better support staff working on FCS. These include the implementation of a career development framework featuring stronger incentives for experienced staff to work on FCS and a new learning curriculum to expand staff skillsets. Moreover, a Fund-wide recognition scheme for institutional priorities, including for FCS work, will be considered to acknowledge exceptional staff contributions. Staff will also benefit from the activation of a dedicated community of practice focusing on FCS.

Given the inherent risks in FCS engagement, the Strategy will be phased in starting in FY22, with implementation gradually accelerating between FY23-FY25. This will allow for course corrections and effective risk management, recognizing the intrinsic volatility of the fragility and conflict landscape. Progress will be carefully monitored through a set of indicators, starting with a new *Staff Guidance Note on the Implementation of the FCS Strategy* that will address operational implications of the proposed measures.

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Abbreviations and Acronyms

AML/CFT	Anti-Money Laundering / Countering the Finance of Terrorism	IEO	Independent Evaluation Office
BOP	Balance of Payments	LICs	Low-Income Countries
CCRT	Catastrophe Containment and Relief Trust	LTX	Long-term experts
CD	Capacity development	MICs	Middle-Income Countries
CES	Country Engagement Strategy	MDBs	Multilateral development banks
CPI	Consumer Price Index	ODA	Official Development Aid
CPIA	Country Policy and Institutional Assessment	OECD	Organization for Economic Cooperation and Development
CSO	Civil society organization	PER	Public expenditure review
CtR	Capacity to repay	PFM	Public Financial Management
DSA	Debt Sustainability Analysis	PPFG	Post Program Financing Gap
DSSI	Debt Service Suspension Initiative	PRGT	Poverty Reduction and Growth Trust
ECF	Extended Credit Facility	RCF	Rapid Credit Facility
EMDEs	Emerging Markets and Developing Economies	RCDC	Regional Capacity Development Center
FCS	Fragile and Conflict-affected States	RFI	Rapid Financing Instrument
FDI	Foreign direct investment	RRA	Risk and Resilience Assessment of the World Bank
FM	Fiscal Monitor	RTAC	Regional Technical Assistance Center
FTE	Full-time equivalent	RST	Resilience and Sustainability Trust
GDP	Gross Domestic Product	SDGs	Sustainable Development Goals
FY	Fiscal Year	SDR	Special Drawing Rights
GFSR	Global Financial Stability Report	SMP	Staff Monitored Program
HDP	Humanitarian-Development-Peace nexus	UCT	Upper-Credit Tranche
HIPC	Heavily Indebted Poor Countries	UN	United Nations
HR	Human resources	UNHCR	United Nations High Commissioner for Refugees
HQ	Headquarters	WEO	World Economic Outlook
ICD	Institute for Capacity Development	WFP	World Food Program
IDPs	Internally Displaced Persons		

INTRODUCTION

1. This paper proposes a comprehensive IMF Strategy for Fragile and Conflict-affected States (FCS). The objective of the Strategy is to strengthen the IMF's ability to support FCS in attaining macroeconomic stability, correcting balance of payments (BOP) imbalances, and progressively building institutions that can deliver sustainable and inclusive growth. To that end, the Strategy builds on the Fund's long-standing engagement with FCS, providing a framework with key principles of engagement and a set of measures that will enable the Fund to: (i) better understand and adapt to evolving conditions in FCS; (ii) enhance assistance to country authorities; and (iii) strengthen collaboration with partners. While the Strategy is primarily focused on FCS, it is also relevant for countries at risk of becoming fragile and conflict-affected—whether due to internal factors or external shocks and spillovers.¹

2. The paper proceeds as follows: First, it focuses on the macro-criticality of fragility and conflict, underscoring the need for a tailored approach to tackle persistent macroeconomic policy challenges. It also gives a brief overview of the Fund's FCS engagement, and the challenges identified by the 2018 Independent Evaluation Office (IEO) Report on *The IMF and Fragile States*. Second, the paper presents concrete proposals to better tailor the IMF's approach, instruments, and policy advice to the case-specific manifestations of fragility and conflict—including by leveraging partnerships with humanitarian, development, peace, and security actors. Third, the paper provides an overview of the FCS Strategy resource allocation, measures to support staff, and indicators to track implementation progress between FY23-FY25. The Strategy benefited from extensive consultations with members, the World Bank and MDBs, the United Nations (UN) system, think tanks, academia, and civil society organizations (Annex I).

THE MACRO-CRITICAL IMPLICATIONS OF FRAGILITY AND CONFLICT

State fragility and conflict undermine macroeconomic stability and inclusive growth for about a fifth of IMF members, while neighboring countries must contend with spillover effects. The COVID-19 pandemic has disproportionately affected FCS in terms of growth, inflation, and public debt. Today, these countries are at a significant risk of falling even further behind the rest of the world. Supporting FCS to implement reforms is particularly challenging given that policy space is constrained by weak state capacity, poor governance, social tensions and, at times, active conflict. Attention to these factors is critical to addressing macroeconomic policy challenges. The Fund has had a long-standing engagement in FCS, but more can be done to enhance the impact and traction of its support.

¹ Fragility and conflict can generate cross-border impacts (e.g., forced displacement, regional security crises, illicit flows, food insecurity), which can have significant macroeconomic consequences for neighboring countries, affecting their BOP or domestic stability. The transmission channels and impact on BOP and domestic stability are similar to those of socio-political and geopolitical factors examined in the 2021 *Comprehensive Surveillance Review* (Overview and Background papers).

A. The Global Fragility Landscape: A Snapshot

3. State fragility and conflict continue to be among the most enduring challenges of our time. FCS are home to almost 1 billion people, nearly double the level of 20 years ago.² These countries are usually trapped in a mix of interlocking characteristics which makes it hard to sustain progress. FCS typically display low levels of administrative capacity, limited provision of rule of law and basic services to the population, and high levels of social polarization. As a result, the private sector remains under-developed and incomes fall below those in more stable LICs and MICs.³ FCS are generally unable to manage or mitigate risks effectively, including those linked to social, economic, political, governance, security, or environmental and climatic factors.⁴ According to estimates, fragile states may host 60 percent of the global poor by 2030 although they will account for just 10 percent of the world's population.⁵ More than half of FCS are at risk of a major natural disaster, including many LICs in the Asia-Pacific region.⁶ While not all FCS face active conflict, most are at risk: global levels of violence are at their 30-year high⁷ and 82.4 million people worldwide are now forcefully displaced, internally and across borders.⁸ The worsening global fragility landscape thus threatens the achievement of the Sustainable Development Goals (SDGs).

4. Fragility and conflict interact with—and are often exacerbated by—the compound effects of other trends. Most of the bottom 35 countries ranked according to their vulnerability to climate change and readiness to improve resilience are FCS.⁹ Out of the 155 million people who are acutely food insecure and in need of urgent assistance, two-thirds live in FCS such as Afghanistan, the Democratic Republic of Congo, Syria, or Yemen.¹⁰ Furthermore, a considerable fraction of youth in FCS is not in employment, education, or training, more than half of which is women.¹¹ This puts greater pressure on social spending in countries with already limited fiscal space and weak social protection systems. With many FCS facing a youth bulge and unable to generate the jobs, growing unemployment or underemployment exacerbate the risk of social unrest. Gender inequality is particularly acute in FCS: women are more vulnerable to gender-based violence and often face much greater economic hardships than men as compared with the situation in more stable societies.¹² Countries with higher levels of gender equality tend to be more stable and grow faster.¹³

5. FCS are a heterogeneous group of LICs and MICs. The 2018 IEO report emphasized that there is no universal definition of FCS and no fixed list of fragile states. Some countries not classified as FCS may share elements of fragility and may slip into conflict when they cannot effectively manage stresses. Others may suffer from protracted spillovers emanating from FCS: 73 percent of

² World Bank (2020a).

³ Commission on State Fragility, Growth and Development (2018).

⁴ OECD (2016).

⁵ Corral et al (2020).

⁶ IMF (2019a).

⁷ International Institute for Security Studies (2021).

⁸ United Nations High Commissioner for Refugees (UNCHR) (2021).

⁹ Notre Dame Global Adaptation Initiative (2019).

¹⁰ Global Network Against Food Crises (2021).

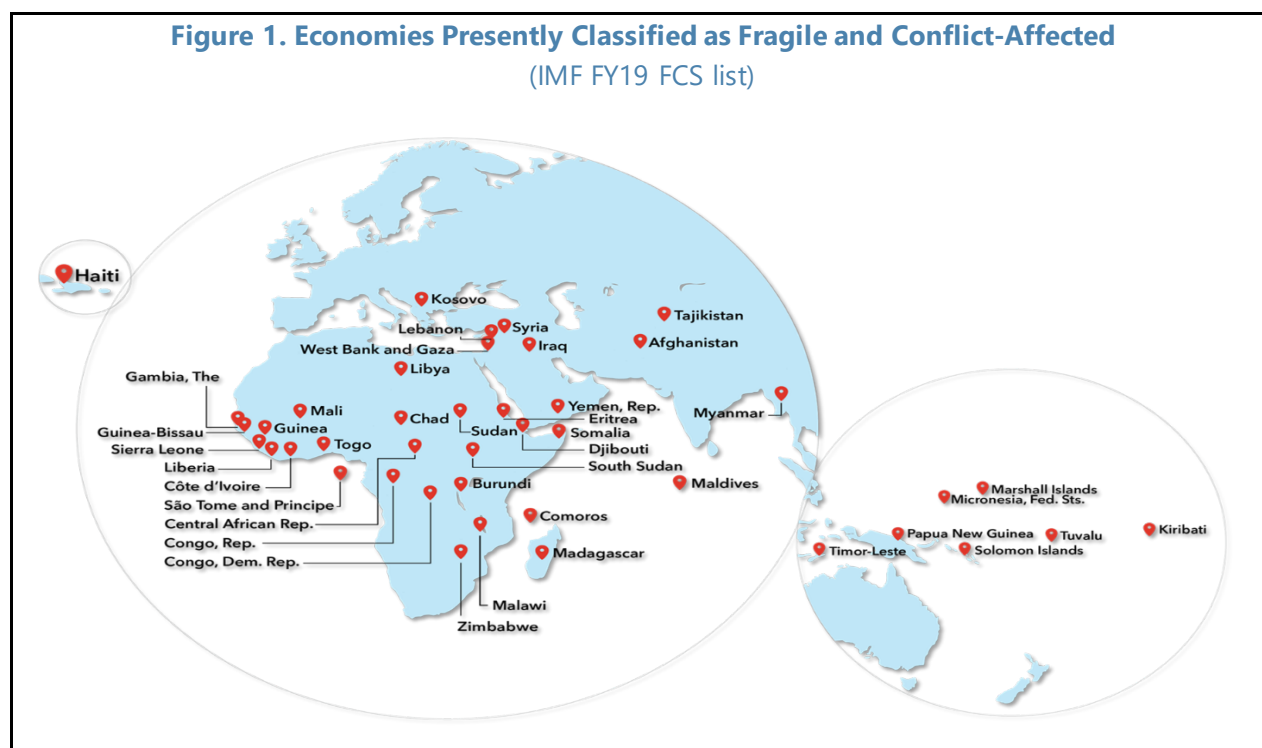
¹¹ OECD (2021).

¹² World Bank (2013).

¹³ IMF (2018a).

the world's 26 million refugees are hosted in neighboring states.¹⁴ This has significant impacts on income distribution, productivity, labor supply, tax base, and consumption patterns.¹⁵

6. For practical purposes, the Fund presently maintains an internal FCS list comprising 42 economies, or about 20 percent of IMF membership (Figure 1). The list includes all economies that meet either one or both of the following criteria. The first criterion is a Country Policy and Institutional Assessment (CPIA) score of below 3.2 (out of maximum of 6), calculated as the average over the past three years for which published data are available. The CPIA rates the quality of countries institutions and policies against criteria grouped in four clusters: (i) economic management; (ii) structural policies; (iii) policies for social inclusion and equity; and (iv) public sector management and institutions.¹⁶ The second criterion is the presence of a United Nations (UN) or a regional peacekeeping or peacebuilding mission during the preceding three years. FCS range from economies stuck in persistent fragility traps, to those caught up in war. *Aspects related to fragility and/or conflict are directly or indirectly critical for a substantial subset of IMF members.*



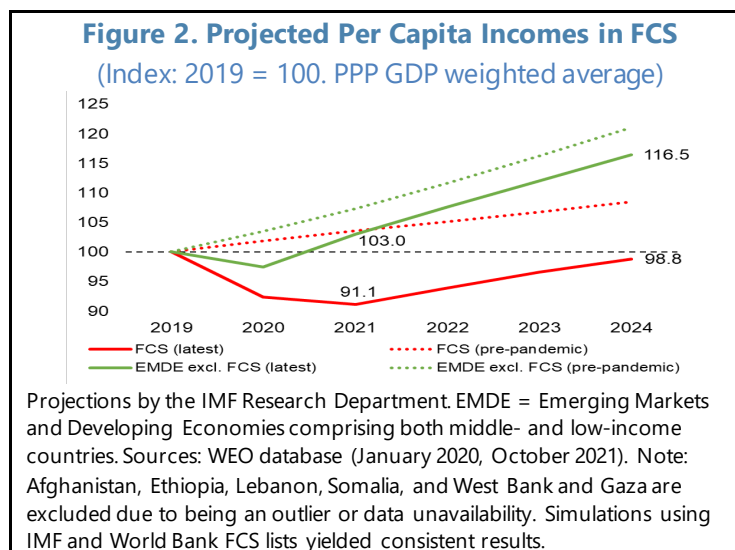
7. The challenges faced by FCS have been exacerbated by the disproportionate economic impact of the COVID-19 pandemic. Per capita real GDP growth for 2020 in FCS was 9.4 percentage points lower than the estimated pre-pandemic projection, dropping from 1.9 percent growth to a 7.5 percent contraction. This decline is significantly higher than the estimated impact in emerging markets and developing economies (EMDEs). Current projections suggest that per capita incomes in

¹⁴ UNHCR (2021).

¹⁵ Borjas and Monras (2017).

¹⁶ The "quality" of policies and institutions refers to how conducive they are to fostering poverty reduction, sustainable growth, and the effective use of development assistance. World Bank (2017).

FCS will not recover to their 2019 level by 2024 (**Figure 2**).¹⁷ This will likely increase the share of the population living in extreme poverty in FCS from 30 to 38 percent by 2024.¹⁸ Debt and inflation pressures in FCS have also risen. Compared to pre-COVID-19 projections, public debt in FCS rose by 17 percentage points to 78 percent of GDP in 2021. Consumer prices surged 9 percentage points above their pre-pandemic projections. Greater income divergence and spiking food insecurity are likely to heighten social tensions and further destabilize FCS, potentially erasing hard-won peace gains.¹⁹ *FCS are thus at a significant risk of falling even further behind the rest of the world.*



B. Macroeconomic Policy Challenges Associated with Fragility and Conflict

8. Fragility and conflict impose heavy human costs on populations and can have long-lasting economic consequences. They undermine growth prospects, exacerbate fiscal vulnerabilities, destabilize BOP positions, and disrupt financial flows. An extensive body of research shows that FCS display lower growth rates and per capita GDP levels, higher inflation, and a greater incidence of extreme poverty than non-FCS.²⁰ Poorer macroeconomic outcomes persist over decades: about 21 countries have been consistently classified as FCS for more than 14 years.²¹ If fragility paves the way to conflict, economic costs can range from 10 to 25 percent of GDP, increasing inflation and deteriorating fiscal and external balances.²² Depressed economic activity as well as declining trade and investment also affect neighboring countries.²³ FCS can undermine regional stability through security, political, social, and economic linkages.

9. Fragility and conflict also create a radically different policy space in FCS compared to more stable countries. While FCS are heterogeneous, reforms tend to be constrained by a set of common features that differentiate them from other LICs and MICs. These include:

¹⁷ Bousquet (2022).

¹⁸ The ratio of extreme poverty in FCS to the total extreme poverty over the world. We follow Lakner and others (2020) assuming no change in inequality and the elasticity of 0.85 from aggregate value added to household income and consumption, using the data from World Bank's PovcalNet, Health Nutrition and Population Statistic, and World Economic Outlook (WEO) databases.

¹⁹ United Nations (2020).

²⁰ Chami, R. Espinoza, and P. Montiel (2021); Corral et al (2020).

²¹ Ibid. Post-conflict recovery can take as much as 30 years (World Bank, 2011).

²² IMF (2015a). IMF (2019b). Research has focused primarily on Sub-Saharan Africa and the Middle East and Central Asia regions. See also de Imus, Pierre, and Rother (2017).

²³ Rother et al (2016).

- **Difficulties in providing public goods:** FCS struggle to deliver security and rule of law that are perceived to be enforced unfairly; social protection against natural or human-made disasters, as well as infrastructure and public services necessary for economic and social development.
- **Rising inequality among groups and deep grievances against the state:** As a result of the uneven delivery of public goods, elite capture or corruption, governments in FCS are generally not perceived as impartially delivering on the social contract, lacking in trust and legitimacy. FCS tend to be the lowest performing in the Worldwide Governance Indicators (WGI) and in Transparency International's Corruption Perception Index.
- **Increased risks of violence:** Conflicts can occur when organized groups or institutions, including the state, use violence to settle grievances or assert power. The reform process may itself temporarily elevate the risk of instability, as new policies may trigger resistance from powerful entrenched interests committed to preserving access to rents.²⁴

10. These factors alter the way the macroeconomy operates. They increase trade-offs between rising spending needs, the difficulties in raising extra revenue, and elevated debt levels while shortening time-horizons for policymakers. Social tensions and the lack of state legitimacy undermine revenue mobilization while low administrative capacity and the lack of human capital result in inefficient spending. As a result, FCS struggle with a variety of macroeconomic policy challenges (see **Table 1** for examples) which will manifest themselves differently depending on country context. Addressing them requires technical expertise, as well as granular knowledge of local political economy dynamics and changing FCS conditions.

11. Lastly, data quality challenges are most acute in FCS. IMF estimates based on the World Bank's Statistical Capacity Indicators show that scores for FCS are the weakest in import and export price indices, national accounts, the consumer price index (CPI), and government finance statistics. According to assessments of data adequacy for surveillance produced by IMF staff country teams, over 70 percent of countries rated with serious shortcomings in statistics are FCS.²⁵ Staff capacity limitations, under-staffing, funding-related constraints for national statistical systems, source data problems, and poor information technology infrastructure are among the most frequent issues.

²⁴ These points are summarized based on Chami, R. Espinoza, and P. Montiel (2021); and United Nation and World Bank (2018).

²⁵ Medina Cas et al (2022).

Table 1. Examples of Macroeconomic Policy Challenges in FCS

Fiscal Sector	Monetary & Financial Sector	External Sector
<ul style="list-style-type: none"> • Low tax capacity, heavy reliance on commodity revenues and import duties. • Ineffective tax policy, legislation, and compliance. • Weak tax and customs administration, low compliance. • Lack of budget control over expenditures, weak PFM • Public expenditures more skewed towards wages and security, away from social benefits and infrastructure. • Pro-deficit bias and reliance on external grants and concessional financing. • High debt levels with limited transparency. 	<ul style="list-style-type: none"> • Weak central banks, regulation, and supervision. • Fiscal dominance, and recourse to monetary financing. • Shallow and underdeveloped financial markets, lacking financial infrastructures, and low financial intermediation. Heavy reliance on informal institutions. • Low levels of domestic savings. • Limited savings beyond the banking sector due to lack of non-bank financial institutions. 	<ul style="list-style-type: none"> • Weaker and more volatile external positions and heightened vulnerability to external shocks. • Heavy dependence on remittances • Official Development Assistance (ODA) dependence • Lower foreign direct investment (FDI) than in non-FCS. • Uneven distribution of remittances, FDI, and ODA across FCS. • Especially in active or post-conflict FCS: Multiple currencies in circulation, foreign exchange restrictions and parallel exchange rates.

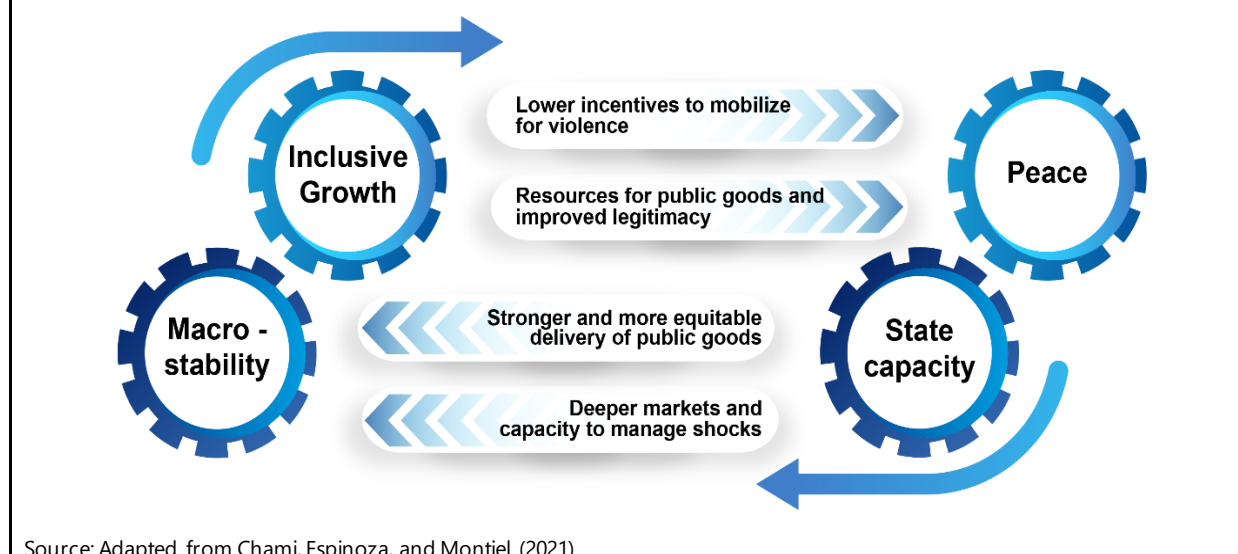
Source: IMF (2017); Baer, Gupta, Mansour, and Pattanayak (2021). IMF Staff Analysis (2021).

C. The Rationale for Enhancing the IMF's Engagement in FCS

12. In line with its mandate, the Fund is a global institution with a responsibility to help members address threats to their macroeconomic stability—including those stemming from fragility and conflict.²⁶ On the one hand, fragility and conflict undermine macroeconomic stability and the development of productive resources, creating or exacerbating BOP needs. On the other hand, macroeconomic policies can help create the conditions in which countries can enter or exit fragility (**Figure 3**). Macroeconomic and structural policies can also entail unintended consequences. For example, reducing rents to influential groups or increasing the price of basic goods can trigger social discontent and raise incentives to mobilize for violence unless they are accompanied by targeted support to vulnerable people. Fiscal measures that place a disproportionate burden of adjustment on vulnerable people risk creating unrest that in FCS could trigger a move from fragility to failure.²⁷ *Peace, stability, and macroeconomics are therefore intertwined.*

²⁶ IMF (2018b).

²⁷ Chami, R. Espinoza, and P. Montiel (2021).

Figure 3. The Nexus between Inclusive Growth, Macroeconomic Stability, and Peace

13. The outcomes of IMF engagement with many FCS are critically influenced by political, military, and security factors—mainly by actors outside the Fund’s control.²⁸ Macroeconomic policy is one out of many interlinked variables that can play a positive role—and in some cases, it may not be the most decisive one. Progress is not linear and prone to setbacks. However, strong and accountable institutions that effectively implement macro-fiscal and monetary policies can play an essential role in preventing countries from becoming fragile and supporting a sustainable post-crisis recovery. As argued by the 2018 IEO report, the Fund’s efforts must be systematized into a coherent, explicit, and differentiated approach to FCS.

D. Overview of IMF Engagement, Progress Made, and Remaining Challenges

14. FCS are a top priority on the international policy agenda. International organizations have stepped up their work in FCS based on their mandates, comparative advantage, and core competencies with the objective of finding solutions to prevent conflict and promote transition from fragility. The UN 2030 Agenda for Sustainable Development has placed commitments to promote peaceful, just, and inclusive societies at the heart of the UN system’s global efforts.²⁹ The World Bank has increased concessional resources to FCS and adopted a new strategy to support countries at risk of conflict, in active conflict, or coping with large inflows of refugees.³⁰ The African Development Bank and the Asian Development Bank have aligned themselves with global priorities to reduce fragility and promote resilience.³¹ The OECD has made it a priority to assess and monitor

²⁸ IMF (2018c).

²⁹ United Nations (2015).

³⁰ See World Bank Group *Strategy for Fragility, Conflict, and Violence 2020–2025*.

³¹ See African Development Bank, *Addressing Fragility and Building Resilience in Africa: 2014–2019*; Asian Development Bank, *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*.

fragility and conflict risks globally, and regularly tracks the changing volumes of government revenues, private investments, and remittances in FCS.³²

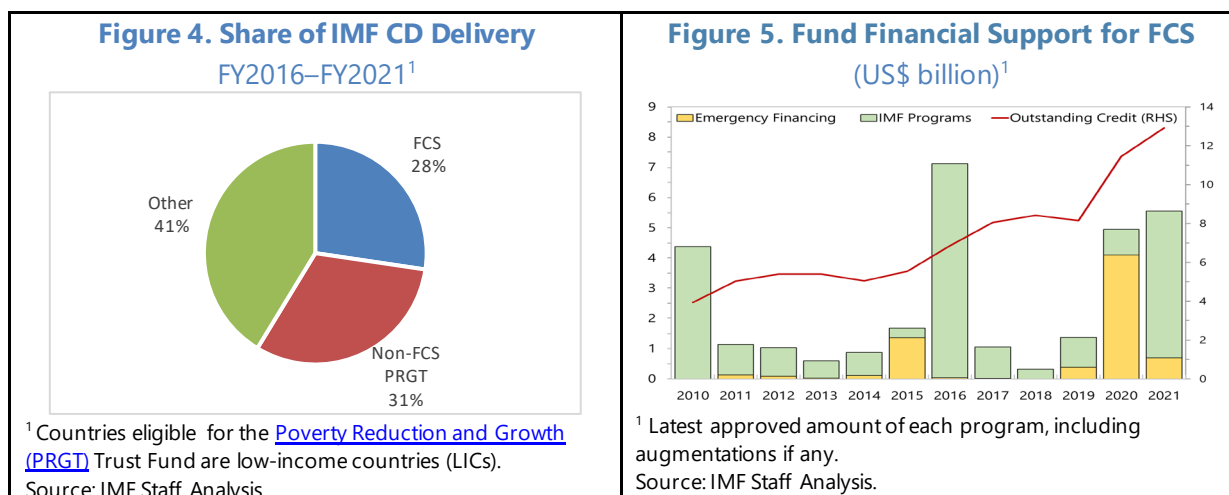
15. The IMF too has had a long-standing engagement with FCS encompassing the full range of activities: surveillance, capacity development, and lending. The IMF has helped many FCS achieve macroeconomic stabilization, lay the foundations for sustained inclusive growth, and build progressively stronger institutions. More specifically:

- **Surveillance:** Through Article IV consultations, an obligation under the Articles of Agreement, the Fund provides analysis and policy advice to assist members in addressing risks to their BOP positions and domestic stability, as well as global economic and financial stability. As most Article IV reports are published, they also provide macroeconomic assessments and a discussion of risks to the full range of international partners. Article IV consultations are normally held every 12-months, though a number of FCS are on a 24-month cycle.³³ Surveillance is the primary mode of engagement with FCS when they are not in a program relationship with the Fund.
- **Capacity development:** This is often an area where the Fund can make a critical contribution in FCS, especially to help build institutions and human capital needed to implement sound macroeconomic policies. Support for FCS accounted for nearly 30 percent of Fund CD spending over the last six years (**Figure 4**). Activities generally focus on core operational issues such as basic revenue administration functions, tax policy, core public financial management (PFM) systems, cash management, developing banking regulations, strengthening central banks, enhancing AML/CFT frameworks, and improving statistical capacity. Africa, Asia Pacific, and the Western Hemisphere regions are the largest recipients of the Fund's CD support.
- **Lending to FCS:** Between January 2010 and December 2021, the IMF supported 28 FCS with 88 programs and financing totaling US\$20 billion. About 30 percent of approved financing requests for [upper-credit tranche \(UCT\)](#)-quality programs and more than 50 percent of emergency financing requests from LICs have come from FCS. Most FCS engagements are supported by the [Extended Credit Facility](#) (ECF), and repeated use is common. The Fund has provided emergency financing to deal with shocks, such as the 2014-2015 Ebola outbreak and to address other urgent BOP needs, including those arising from natural disasters. The use of emergency financings increased enormously in 2020, as the Fund helped FCS cope with the pandemic (**Figure 5**). FCS benefited from 18 disbursements under the [Rapid Credit Facility \(RCF\)](#) and [Rapid Financing Instrument \(RFI\)](#). In addition, there have been 23 [Staff Monitored Programs](#) (SMPs) for FCS seeking to build a track record toward a UCT-quality program.³⁴ Frequent use of emergency financing and SMPs reflects capacity constraints, a weak track record of policy 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.

³² OECD (2020).

³³ FCS on a 24-month cycle are either those with programs or certain small states with no programs.

³⁴ There have been only two SMPs for non-FCS since 2010.



16. The IMF has also played a [critical role](#) in the international response to the COVID-19 pandemic in FCS through emergency financing and debt sustainability initiatives. The Fund responded quickly to the financing needs of FCS: 28 FCS members received emergency financial support worth US\$7.5 billion, and US\$625 million in debt service relief assistance from the Catastrophe Containment and Relief Trust ([CCRT](#)). The IMF and the World Bank have actively supported the implementation of the G20 [Debt Service Suspension Initiative \(DSSI\)](#) in which 24 eligible FCS requested to participate. A request for an IMF-supported program (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](#).³⁵ FCS also benefited from US\$16.2 billion from the recent general SDR allocation. This allocation will in the first instance boost foreign exchange reserves, supporting external stability and confidence. A number of countries are already using these new SDRs to finance vital imports. In addition, Fund staff have conducted over 1,000 remote CD engagements with FCS since the onset of the COVID-19 pandemic.

17. Despite progress to date, more can be done to further strengthen the Fund's FCS engagement. The 2018 IEO Report and previous analyses noted persistent challenges in engaging with FCS.³⁶ The IEO highlighted the following issues (i) the need to provide **greater country specificity and realism in IMF policy advice**, with due consideration given to FCS conditions, and **greater tailoring of conditionality** to political, governance, and social contexts; (ii) responding to **the growing capacity building needs of FCS while tailoring CD delivery to their absorption capacity**—including by providing the **sustained in-country follow-up** necessary to build effective institutions and develop human capital in very challenging circumstances; (iii) enhanced **adequacy of existing financing instruments**, which can be better fine-tuned to the characteristics of FCS; (iv) **improving strategic partnerships**, especially with international organizations that have a more extensive local footprint in FCS; (v) **strengthening support to staff** and attracting talent to work on FCS; (vi) finding pragmatic ways to **increase field presence**, with due considerations for security risk

³⁵ One of the three countries that have so far requested treatments under the Common Framework is an FCS (Chad).

³⁶ For a discussion of remaining challenges, see Independent Evaluation Office (2018). Three FCS-focused policy papers have been presented to the Executive Board ([2008](#), [2011](#) and [2015](#)) and a Staff Guidance Note ([2012](#)).

management.³⁷ To resolve them, bolder actions are required for the Fund to maximize its impact in FCS, where long-term, patient modalities of engagement did not fit well with the IMF's standard operations.

18. The IMF has already started to tackle some of these challenges. Following the management implementation plan to advance the recommendations of the IEO report, the Fund piloted Country Engagement Strategies (CES) in six FCS—Afghanistan, Haiti, Djibouti, Central African Republic, Democratic Republic of Congo and Madagascar—to better anchor its engagement in the particular political, social, governance, and institutional conditions.³⁸ CES aim to identify key elements of fragility, the political and social context, and how surveillance, CD, and lending can be better integrated and linked to these factors. The IMF's concessional facilities were modified in the 2018-2019 facilities review for LICs. Since 2018, the Fund has nearly doubled access limits under the Poverty Reduction and Growth Trust (PRGT), which provides concessional support to eligible low-income FCS and endorsed the use of flexibility allowed under the Extended Credit Facility (ECF) to enable FCS to focus on near-term objectives.³⁹ The 2018 review of the IMF's *Capacity Development Strategy* included an FCS focus,⁴⁰ while an important human resources reform was initiated in 2020 to attract more staff to work on FCS. In 2021, the IMF's membership backed efforts to create a new Resilience and Sustainability Trust (RST) to support countries dealing with long-term structural challenges such as climate change. This would benefit vulnerable low and middle-income FCS with an on track UCT-quality program, including small states, supporting their policy reforms to build economic resilience and sustainability.

19. While these are positive steps, further efforts are needed to enhance the IMF's impact in FCS. The constrained policy space in FCS requires better tailored approaches. Fund engagement in terms of policy design, reporting requirements, and internal processes could be more differentiated in response to the heterogenous nature of FCS. The IMF Executive Board has noted that there is scope for better tailoring and streamlining program objectives and structural conditions, particularly for FCS, in light of their economic circumstances and capacity constraints.⁴¹

20. It is also 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.

Ultimately, this Strategy must strengthen the IMF's ability to fulfill its mission in its engagement with FCS in line with its mandate and comparative advantage. *Building on past engagements and lessons learned, the FCS Strategy aims to achieve these goals.*

³⁷ IMF (2018c), pp. 2-3, p. 31.

³⁸ IMF (2018d).

³⁹ IMF (2021a, 2019c, and 2019d).

⁴⁰ IMF (2018e).

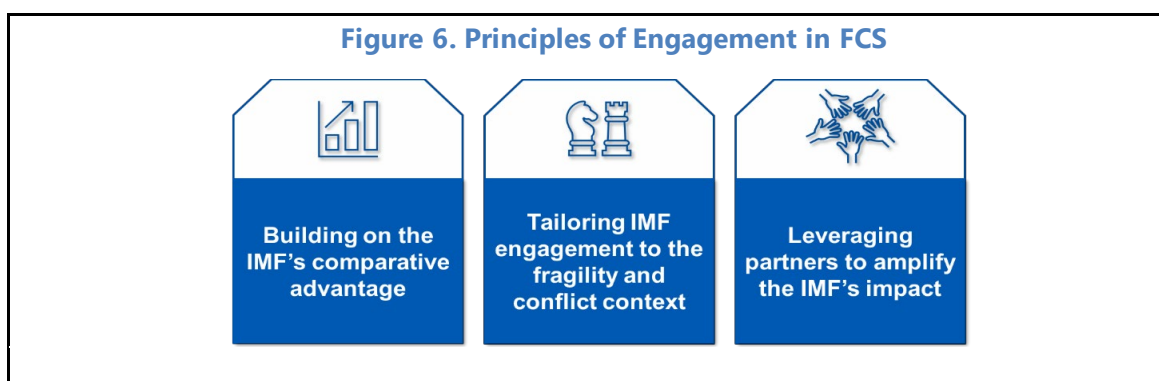
⁴¹ IMF (2019c).

FCS STRATEGY: ENHANCING THE EFFECTIVENESS OF IMF CORE ACTIVITIES IN FCS

The Strategy provides 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, promoting sustainable and inclusive growth, and strengthening their resilience to help them exit from fragility. The objective is to develop a coherent, explicit, and differentiated approach to FCS which tailors the Fund's engagement, instruments, and policy advice to the macroeconomically relevant manifestations of fragility and conflict. This section provides the strategic outlook for the Fund's FCS support based on engagement principles and broad directions to calibrate Fund instruments to FCS circumstances. It then develops specific proposals on rolling out Country Engagement Strategies (CES), strengthening IMF core functions, and enhancing partnerships.

A. Principles of Engagement

21. Lessons learned from the Fund's engagement and progress made in FCS point to three guiding principles to orient the IMF's approach under the proposed FCS Strategy. These are: (i) building on the Fund's comparative advantage; (ii) tailoring Fund engagement and instruments to macro-critical manifestations of fragility and conflict; and (iii) leveraging partners (Figure 6). This section discusses them in broad terms, while the operational implications will be presented in a forthcoming *Staff Guidance Note on the Implementation of the FCS Strategy*.



Principle 1: Building on IMF's Comparative Advantage

22. The Fund's comparative advantage in FCS is based on the following key pillars:

- **Promoting macroeconomic stability and laying the foundations for inclusive growth:** Safeguarding or restoring macroeconomic stability through tailored policy advice and helping address BOP and domestic imbalances is essential to achieve sustainable economic growth. Providing fair opportunities to all members of society is a key ingredient to prevent the emergence of fragility and conflict risks, as well as to foster successful exits from fragility.
- **Building institutional capacity:** CD provision in core areas of Fund expertise is essential to help FCS get on the path towards stability. These core areas include tax policy and revenue

administration, public financial management (PFM), monetary policy and central banking, financial supervision and regulation, financial stability and payment systems, anticorruption and preventing illicit financial flows, as well as basic macroeconomic statistics and frameworks.

- **Providing financial assistance, when appropriate:** While multilateral development banks (MDBs) play the main role in financing long-term country-driven solutions for inclusive and sustainable growth, the Fund's own lending instruments can help countries meet BOP needs including those arising from fiscal financing gaps.
- **Catalyzing donor support:** Fund engagement with 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 ensuring liquidity provision for FCS and improving their long-term financial position.⁴²

Principle 2: Tailoring to the Fragility and Conflict Context

23. An appropriately tailored approach to FCS is consistent with the Fund's tenet to treat members evenhandedly. Ensuring the uniformity of treatment is a long-standing and central tenet of the Fund's operations. This principle does not require, however, that all member countries be treated identically, but that members in similar circumstances should be treated similarly.⁴³ As per IMF engagement with all countries, policy advice, CD delivery, and conditionality under a Fund-supported program should reflect sound, objective analysis tailored to country circumstances, including the choice of issues analyzed, depth of analysis, and analytical approaches and tools.

24. It is therefore important for the Fund to tailor its surveillance, CD delivery, and conditionality to the circumstances in FCS. The causes and deep-rooted drivers of fragility vary significantly from country to country and can also change over time for each FCS. FCS display a range of macro-critical fragilities stemming from political, social, economic, and environmental factors.⁴⁴ In some countries, fragility or conflict risks may take years to build up before erupting into full-blown crises, which is why prevention has become a key international priority.⁴⁵ Other FCS may already suffer from active conflict, which disrupts trade, investment, and private sector development. Small FCS face yet another specific set of challenges that are unique to their remoteness, size of the economy, and heightened vulnerabilities to climate change and natural disasters.

25. In any given setting, the Fund determines the feasibility and modalities of its engagement. The range of policy priorities will vary, as the goals of increasing tax revenues, financing public services, and ensuring debt sustainability are all interlinked. There is, however, a set of cross-cutting policy objectives that are typically important across many FCS, where lack of institutional capacity for macroeconomic policy functions is a persistent feature. These include:

⁴² Adapted from IMF (2011).

⁴³ IMF (2016a).

⁴⁴ Reflecting the coverage of Fund surveillance – as laid out in the *Comprehensive Surveillance Review* (2021) – the term macro-critical is used to refer to specific country circumstances in which fragility and conflict impact economic policies that significantly influence present or prospective BOP or domestic stability, and macroeconomic sustainability. See *Background Paper on the Surveillance Priority Ensuring Economic Sustainability* (2021).

⁴⁵ United Nations and World Bank (2018).

- **For fiscal policy:** (i) Defining an appropriate fiscal framework; (ii) securing tax and customs revenues that can be administered easily; (iii) strengthening core PFM systems to enable FCS to meet their basic spending needs efficiently; and (iii) reinforcing transparency and accountability. Efforts to tackle corruption simultaneously with revenue and expenditure policy reforms are essential to build effective fiscal institutions. Furthermore, strategies also need to balance wage and security-related expenditures with social and growth-enhancing spending.⁴⁶
- **For exchange rate and monetary policies:** (i) Advising members on the mix of policies to achieve stability under their exchange rate regime; (ii) policies to help achieve price stability in view of the close link between inflation and poverty.
- **For financial sector policy:** Developing capacity for supervising and regulating the banking sector and the relevant nonbank financial intermediaries (including for AML/CFT reasons), but also providing basic banking and payments services. Sustainable financial deepening can be an important driver of growth, and FCS can benefit the most from financial inclusion facilitated by digital money and fintech. Digital money can help lower costs of doing business, spurring innovation, competition, and market integration.

26. Given the potential for instability and social unrest across many FCS, attention to distributional aspects of macroeconomic adjustments is especially important. Program design and conditionality can focus on protecting social outcomes through minimum floors for social spending and reform measures to protect vulnerable groups. Quantitative objectives should incorporate the costs of essential cohesion-building initiatives addressing inequalities including targets for poverty-reducing (e.g., spending on health, education, and social protection). While these measures may help FCS make progress, they may also be relevant in countries that are at risk of becoming fragile or conflict affected.

27. The pace and timing of Fund-supported macroeconomic adjustment and structural reforms should be flexible and calibrated to the political and social context. For example, rationalizing public spending or enhanced exchange rate flexibility may be necessary for restoring macroeconomic stability and sustainability under certain circumstances. But fast-paced reforms which upset delicate social and political equilibria may tilt the country context towards fragility rather than resilience. This is crucial in pivotal moments,⁴⁷ when macroeconomic policy advice can allow for short-term, feasible objectives to show early success and build public support for initiatives that advance peacebuilding, economic inclusion, governance and accountability, fiscal space creation to improve public service delivery, and employment generation. When external support, technical assistance, and government ownership align, the Fund can encourage comprehensive structural reform agendas that strengthen economic fundamentals over the long run.

28. The Fund's engagement should also take into account the different levels of country ownership, transparency, and accountability in FCS. Promoting ownership and leveraging authorities' plans under their longer-term development agendas—such as increasing employment rates or advancing SDG targets—can facilitate the implementation of policies and reform options.

⁴⁶ IMF (2017b).

⁴⁷ Commission on State Fragility, Growth and Development (2018); and Collier (2021).

Assisting authorities in their communication and outreach to the population and external stakeholders can also help strengthen ownership.⁴⁸

29. Other adaptations to Fund engagement in FCS will depend on the specific stage of the fragility and conflict spectrum. When fragility and conflict risks are high, cooperation with partners can strengthen the Fund's forecasting of potential economic impacts, thereby contributing to international prevention efforts. Multilateral coordination on early warning analytics can also be more structurally integrated into IMF core activities to enhance contingency planning. When countries experience active conflict, it is important to help maintain the core operational capacity of macroeconomic policy institutions. In such situations, the Fund will conduct surveillance where feasible, may provide CD if the authorities have the capacity to absorb such advice, and could lend subject to adequate safeguards and other policy requirements. However, it is important to recognize that Fund engagement in some FCS will remain limited, particularly in situations where lending may be precluded because of unsustainable debt.⁴⁹ These situations will be further elaborated in the forthcoming *Staff Guidance Note on the Implementation of the FCS Strategy*, which will explore concrete ways to leverage partner organizations to enhance the Fund's understanding of developments on the ground, promote appropriate macroeconomic policies, and catalyze financial support on appropriate terms, with a view to limiting economic dislocation and facilitating prompt reengagement, when this becomes feasible.

30. Lastly, fragility and conflict may also entail macroeconomic impacts for other members. Forced displacement, regional security crises, climate-related risks and natural disasters may affect macroeconomic stability and growth prospects in FCS and non-FCS alike. In addition to analysis, the Fund can also leverage its convening power to build consensus with authorities and partners on how to manage and mitigate the effects of regional shocks, boost resilience, and promote inclusive growth.

Principle 3: Leveraging Partners

31. While keeping with the Fund's mandate and core roles, leveraging partners is critical to amplify the impact of IMF support to FCS. Issues such as forced displacement, food insecurity, or the growth in security sector expenditures shape macroeconomic outcomes in FCS. As such, partners' analytics, insights, and field presence can help identify specific measures to be included in policy advice, analytics, capacity building, and Fund-supported programs. It is therefore essential for the Fund to engage strategically with organizations whose core competencies enable the IMF to maximize its own comparative advantage. More specifically:

- **Development actors'** longer-term engagement and expertise in sectors such as health, education, social protection, mining, or agriculture are beneficial for effectively tailored and well-sequenced Fund support to FCS.

⁴⁸ IMF (2019c).

⁴⁹ The Fund may not be able to engage with some regimes because of a lack of recognition or dealing by the international community – as represented by members comprising a majority of the total voting power in the Fund – or due to uncertainty regarding such dealing or recognition. In cases of uncertainty, this constraint to engagement cannot be overcome until certainty reemerges.

- The Fund can leverage the continuous field presence and local knowledge of **humanitarian actors** (including civil society organizations), while assessing FCS's budget dependence on humanitarian aid in protracted-conflict contexts.
- **Peace and security actors** are vital counterparts in conflict-affected FCS, as they can help identify pivotal moments, assess political economy dynamics, and contribute to analyses of the fiscal impact of security crises.

B. Identification and Classification of FCS

32. As mentioned in the first section, the Fund presently maintains an internal FCS list comprising 42 economies.⁵⁰ The criteria currently used for FCS classification by the IMF—a CPIA score of less than 3.2 or the presence of a UN peacekeeping mission in the past three years—are similar, but not identical to those used by the World Bank.

33. The World Bank's FCS list is public and contains 39 countries in FY22.⁵¹ It is updated annually and reflects a differentiated approach to FCS which captures the typology and severity of challenges faced by this heterogeneous group of countries. In addition to the CPIA score (below 3.0 out of a maximum of 6) or the presence of a peacekeeping mission, indicators also account for conflict-related deaths and the flight of refugees across international borders. As such, the list distinguishes between two categories of FCS:

- LICs and MICs suffering from **high levels of institutional and social fragility** due to the relatively poor quality of economic management, structural policies, public sector institutions, and social inclusion policies (e.g., Lebanon or Sudan), or to flight across borders of refugees recognized internationally as in need of protection (e.g., Venezuela).⁵² These challenges are sometimes compounded by threats posed by external shocks, such as climate change and natural disasters, as in the case of some small states (e.g., Solomon Islands, Timor-Leste).
- Countries caught in conflict, whether **high-intensity** (e.g., Yemen, Syria, Somalia) or **medium-intensity** (e.g., Burkina Faso, Mozambique), as measured by the number of conflict-related deaths per year.⁵³

34. Moving forward, the Fund will adopt the methodology, thresholds, and criteria of the World Bank's FCS list, as described in paragraph 33. An updated, well-grounded FCS list will help tailor the Fund's engagement to the unique conditions in FCS by better capturing the nuances

⁵⁰ This IMF's FCS list was first developed in 2008 and updated every three years, in 2011 and 2015. Since then, the FCS list has been updated regularly every two years, ending in 2019. Staff has at times applied judgement in determining if members exited the list.

⁵¹ World Bank (2021a)

⁵² World Bank (2021b).

⁵³ Countries in medium-intensity conflict are defined as: (i) countries with (a) an absolute number above 250 according to Armed Conflict Location Event Data Project (ACLED) and 150 according to the Uppsala Conflict Data Program (UCDP), and (b) between 2 and 10 per 100,000 population according to ACLED and between 1 and 10 according to UCDP; or (ii) countries with a rapid deterioration of the security situation, measured by (a) a lower number of conflict deaths relative to the population between 1 and 2 (ACLED) and 0.5 and 1 (UCDP) and (b) more than doubling in casualties in the last year. Countries in high intensity conflict are defined as those with: (i) an absolute number above 250 according to ACLED and 150 according to UCDP; and (ii) a number of conflict deaths relative to the population above 10 per 100,000 according to ACLED and UCDP, reflecting widespread and intense violence across many parts of the country.

between fragility and conflict-related challenges. Adopting the same methodology as the World Bank will also facilitate a more effective international response and reduce the risk of inconsistencies between institutions with the same shareholders and complementary mandates.⁵⁴

35. Given the complexity of FCS, the list is not meant to be exhaustive—any methodology will have inescapable limitations. The continued use of the CPIA to measure institutional and social fragility is consistent with core objectives of the Fund, since this indicator ranks the quality of economic management, structural policies, and public sector institutions.⁵⁵

36. The list will function as a tool to help guide IMF engagement in difficult and complex environments.⁵⁶ The specific uses are:

- **Guide the tailoring of policy advice and CD to FCS**, in line with the Strategy and its various measures (such as rolling out of Country Engagement Strategies to tailor Fund's engagement to key drivers of fragility and conflict, CD provision, support to staff), and consistent with the Fund's surveillance policy.
- **Guide the prioritization of CD activities in FCS**, which are currently a growth area for the Fund, with an explicit aim to increase their share in overall IMF provision of CD, subject to demand and absorption capacity.
- Monitor the **implementation of the new HR policy** requiring two years of FCS or LIC experience for fungible economists seeking promotion, which becomes effective in July 2023. FCS classification will continue to be interpreted in order to avoid undue and disruptive staffing shifts in response to FCS status changes.
- Monitor and **report to the Board on the implementation progress of the Strategy**.

37. The details regarding the uses and operational implications of the FCS list will be elaborated in the forthcoming *Staff Guidance Note on the Implementation of the FCS Strategy*. The Note will also set up internal arrangements for moving to the use of the new FCS list, as well as for situations when countries transition on and off the FCS list in order to minimize the impact of Fund work and human resource allocations.

C. Rolling out Country Engagement Strategies (CES)

38. CES will provide an assessment of fragility and conflict drivers and will serve as a high-level longer-term strategic anchor for Fund's engagement with FCS. They will help ensure that decisions on program design and conditionality are informed by an assessment of country-specific fragility and conflict contexts, institutional constraints to reform implementation, the distribution of

⁵⁴ While the methodology for FCS classification will be the same, the Fund will maintain autonomy and ownership in its application and publish its FCS list annually. The Fund may also update its methodology (in consultation with the World Bank, as appropriate) if this is considered necessary. It will also retain autonomy to decide whether any future methodological changes made by the World Bank would need to be replicated by the IMF.

⁵⁵ World Bank (2017).

⁵⁶ The list of FCS will not determine qualification for Fund financing under the Fund's lending instruments. The latter is subject to observance of the specific qualification criteria under Fund policies governing the use of such instruments.

corruption rents and political economy considerations. CES will also identify the main risks to Fund engagement and help guide the prioritization and sequencing of structural reforms and CD activities. As such, CES will allow the Fund to gain greater traction with country authorities and leverage partners' expertise in ways that amplify the IMF's comparative advantage.

39. Pilot CES have been valuable in tailoring modalities of engagement in FCS, and in strengthening the integration of surveillance, CD, and lending. They helped deepen the awareness and understanding among country teams and reviewers of drivers of fragility, and how these affect the pace and sequencing of reforms. In addition, CES have proved useful in better tailoring program design and conditionality to FCS circumstances. Internally within Departments, they also enabled a smoother handover process as new staff transitioned on to FCS teams. At the same time, CES preparation requires time and effort, including to allow for necessary engagement with country authorities, Functional Departments, and partners.

40. Given the heterogeneity of FCS, Area Department country teams will tailor the coverage of CES as needed to reflect specific country circumstances. However, while staying focused, concise, and flexible, all CES will cover to varying degrees the following six key pillars:

- **A candid assessment of fragility and conflict drivers** covering the salient political economy, social, economic, governance and corruption, climate, and security issues. CES will discuss how these factors shape macroeconomic outcomes. They will draw on existing diagnostics and institutional knowledge within the Fund, but also tap the expertise of partners, including the World Bank's Risk and Resilience Assessments (RRAs).
- **An overview of possible constraints to reform implementation**, including lessons from past IMF engagement to inform the calibration, prioritization, and sequencing of reform efforts. CES will address political economy and capacity constraints. An explicit discussion of governance vulnerabilities, including corruption risks, and money laundering/terrorism financing risks.
- **An overview of policies and reforms**, including prioritization and sequencing, that are needed to improve resilience and promote inclusive economic growth. CES will articulate how the policies will factor in the underlying causes of fragility, institutional and capacity weaknesses, and governance concerns.
- **An outline of sequenced CD priorities needed to support surveillance and CD**, given local absorption capacity and complementarities with development and other partners, as well as the demand from authorities.
- **The scope for partnerships** to (i) promote information sharing on issues that may affect macro-critical reforms and complementarities on CD; and (ii) advance the understanding of fragility and conflict risks to help tailor engagement and maximize the impact of Fund support.

- **An identification of the main risks to Fund engagement** (including for CD delivery and program success) stemming from fragility and conflict-related constraints in the near term (1–3 years) and the medium/long-term (3–5 years).⁵⁷

41. CES will also provide the critical context for the policy advice and reform strategy underpinning the IMF’s engagements with FCS on surveillance, CD delivery, and lending (Table 2).⁵⁸ For heavy users of CD, strategies and priorities agreed with country authorities and identified in surveillance and/or lending will continue to be outlined in CD Country Strategy Notes.

42. CES will be developed through a broad consultative process led by Area Department country teams. Insights from various stakeholders will be crucial for understanding the key challenges and facilitate a prioritization of the medium-term reform agenda:

- **Sustained engagement with country authorities.** Staff will enhance dialogue with country authorities to discuss the main elements of the CES, with the aim to build a shared understanding of medium-term reform priorities, as well as the issues and ways the Fund can add most value.
- **Internally, country teams will actively consult staff from Functional Departments and Regional Capacity Development Centers (RCDCs),** where relevant. The goal is to promote a shared understanding of the engagement strategy, including on policy design, sequencing of CD, and partnerships with CD providers.
- **External consultations with partners.** The preparation of the CES is an opportunity to tap into the resources, knowledge, and field presence of partner organizations, including multilateral development banks and bilateral donors, as well as humanitarian, peace, and security actors in areas that are macro-critical. The World Bank’s Risk and Resilience Assessments, which assess drivers of fragility and conflict, can be highly useful in this regard. Open two-way information sharing will enhance the implementation of the CES. In addition, CES will draw on the Fund’s engagement with CSOs, the private sector, members of parliament, and other civil society actors.

⁵⁷ For High-Risk Locations (HRLs), CES will also draw on Country Engagement Plans (CEPs) which provide a security forecast for staff footprint planning purposes.

⁵⁸ CES would inform Fund engagement without preempting the internal review process, nor the decisions of the Executive Board.

Table 2. Linking CES with Core IMF Functions

Surveillance	Capacity Development	Programs
<ul style="list-style-type: none"> • Inform the diagnostics and thematic focus of Article IV Consultations. • Provide the fragility context to tailor policy advice, e.g., sequencing of structural reforms. • Identify the capacity constraints that limit the adoption of policy recommendations; • Where the Fund's engagement has been limited (e.g., Libya, Venezuela), CES could present a contingency plan for re-engagement if and when such opportunity arises. 	<ul style="list-style-type: none"> • Delineate a list of sequenced priorities, with objectives and outcomes clearly mapped to surveillance and program priorities, and reflecting demand from the authorities. • Distinguish and sequence medium and longer-term reform needs from more immediate priorities, including those originated from shocks (e.g., COVID-19). • CES would also support complementarity of medium-term CD plans in close collaboration with Functional Departments, and with technical support provided by development partners. 	<ul style="list-style-type: none"> • Provide the context to tailor the program design to the country's fragility and conflict drivers, e.g., calibration of macro-adjustment. • Facilitate the identification of a parsimonious set of quantitative indicators and reform priorities to inform program conditionality. • Map out capacity development to support reform implementation. • Inform internal discussions of program risks.

43. The preparation of the CES will result in two output documents:

- **First, the full-fledged stand-alone CES will be a confidential staff-level assessment that covers the six key pillars mentioned above.** It will be flexible in format and length, allowing for customization by Area Department FCS country teams. CES will benefit from feedback from Functional Departments and may also be informed by analytical work of staff, e.g., selected issues papers, working papers, etc.
- **Second, for each new or updated CES, a summary will be incorporated in the relevant Policy Note and Staff Report (Article IV or program document).**⁵⁹ While summaries should address potential sensitivities from country authorities related to publication, they should be detailed enough to motivate and clearly indicate the roadmap for Fund engagement in coming years. The summary of the CES will also facilitate the communication with other stakeholders, including the public,⁶⁰ and the *Staff Guidance Note on the Implementation of the FCS Strategy* will provide guidance on the scope of information to be included in the summary.

⁵⁹ The requirement will be a 2-3 page-summary (though could be longer if the country team deems it necessary), referenced in the main text of the staff report. The Summary of the CES will be included in the relevant Article IV or program document.

⁶⁰ The Summary of the CES will be published in the relevant Article IV or program document. For countries where the Fund's engagement has been limited and with excessively delayed Article IV consultations, such as those experiencing active conflict, there would be no expectation of publication given the absence of a publishing platform.

44. In terms of timing, CES for about half of FCS will be completed within 18 months of the issuance of the *Staff Guidance Note on the Implementation of the FCS Strategy*. Thereafter, CES will be updated at least once every three years, though staff may undertake more frequent updates when warranted. Within that timeframe, country teams can decide when developments or further updates of the CES add the most value to enhance engagement—for instance, before the Article IV consultation, initiation of new program discussions, the conclusion of an existing program,⁶¹ or a political or structural change that creates a “pivotal moment.”

45. Progress on the roll-out of the CES will be monitored through the following indicators:

- The ***Staff Guidance Note on the Implementation of the FCS Strategy*** will be prepared to support the CES roll-out providing further details on operational aspects—by **October 2022**.
- **The number of countries that have implemented a CES.** Circumstances permitting, it is expected that a half of FCS (about 20 countries in total) will have completed a CES within 18 months of the issuance of the updated *Staff Guidance Note*.⁶²—by **April 2024**.
- A **survey of FCS Mission Chiefs** will take stock of initial lessons learned on the successes and possible areas for improvement of CES—by **October 2024**.

D. Strengthening IMF Core Functions in FCS

Surveillance and Analytics

Article IV Consultations (bilateral surveillance)

46. Article IV consultations for FCS will be well-tailored to their specific circumstances, while observing the minimum obligations and requirements of surveillance.⁶³ The Fund seeks to provide effective surveillance through in-depth analysis and policy advice to all its members to assist them in addressing risks to stability and achieve strong and durable growth. To further strengthen Article IVs in FCS, a key pillar of surveillance will be an analysis of how fragility and conflict drivers - as reflected in the summary of the CES to be included in the Staff Report—affect macroeconomic stability and economic growth prospects. This will help staff to provide granular advice on how reforms can be implemented amid capacity constraints, and to integrate policy advice with capacity development. The application of standard tools and frameworks should reflect limited data availability.

47. Social factors and the robustness of institutions should feature more prominently in analysis and policy advice. FCS Article IVs currently tend to focus on macro-fiscal issues, inclusive growth, institution building, governance and corruption. The CES will contain—depending on country circumstances—the Fund’s assessment of relevant fragility and conflict drivers, factoring in

⁶¹ The CES would be distinct from an ex-post peer review assessment (PRA) in that the CES maps the engagement strategy in a forward-looking manner while the PRA focuses (more narrowly) on past program experience. The PRA applies to a small number of countries with long term program engagement and is intended to assess the appropriateness of the Fund’s overall approach and soundness of its advice in the context of previous Fund arrangements. Findings of the PRA can inform the CES.

⁶² Including the CES undertaken at the pilot phase, the Fund would roll out about 16 new CES.

⁶³ Detailed guidance will be included in the forthcoming 2022 Guidance Note for Surveillance under Article IV.

analysis of poverty, inequality, gender issues, internal displacement, elite capture and rent-seeking behavior, security sector spending, and related issues that require special attention in FCS. Where macro-critical, these aspects will be factored into the analysis and formulation of staff advice contained in the Staff Report.

48. Surveillance will further strengthen the focus on governance issues in FCS. As needed, more in-depth analysis on corruption and governance issues—drawing on the Fund’s governance diagnostics—will inform surveillance to focus policy advice on opportunities to reduce corruption with the greatest impact.

49. The enhanced FCS engagement will leverage the Fund’s growing climate change workstream. Under the Climate Change Strategy, the Fund plans to increase coverage of climate adaptation and resilience building, alongside transition management and mitigation in Article IV consultations. A significant increase in FCS coverage can be expected given that climate adaptation and resilience building are likely to be macro-critical in over half the FCS, and that climate shocks could exacerbate drivers of fragility in the context of weak coping mechanisms. Article IV reports can also cover macro-critical issues related to transition management to a low-carbon economy which are relevant to natural resource-dependent FCS. Synergies will continue to be explored in Financial Sector Assessment Programs (FSAP), Financial Sector Stability Reviews (FSSRs), and climate-related CD.

Flagship Reports

50. Issues related to FCS have been featured occasionally in the analytical themes of flagship chapters in recent years. The World Economic Outlook (WEO) has provided references FCS-specific concerns related to conflict, growth and migration, education losses and social unrest during COVID-19, or in assessing of impacts from natural disasters.⁶⁴ The Fiscal Monitor (FM) includes a discussion of safety nets in LICs, noting recently that solutions to the COVID-19 crisis had to be adapted to the reality of each country in light of spending needs in healthcare, education and infrastructure.⁶⁵ The FM thus argued that LICs needed to deliver more with less by reprioritizing spending and enhancing its efficiency, but that these countries would also need further official financial support and debt relief.

51. Going forward, FCS issues will be covered more regularly in our multilateral surveillance, including the flagship reports. This demonstrates the importance of integrating FCS in global economic analysis, in line with the Fund’s obligation to oversee the global economy. Thus, FCS perspectives and relevant topics will be addressed in the Fund’s multilateral surveillance products, including the WEO and the Fiscal Monitor (FM) where possible, and included in the Global Financial Stability Report (GFSR), where relevant.

⁶⁴ “Who Suffers Most from Climate Change? The Case of Natural Disasters” April 2021 WEO, Chapter 1, Box 1.2; “Education Losses during the Pandemic and the Role of Infrastructure”, April 2021 WEO, Chapter 2, Box 2.2.; “Social Unrest During COVID-19” October 2020 WEO Chapter 1, Box 1.4; “Conflict, Growth, and Migration.” April 2017 WEO, Chapter 1, Box 1.1.

⁶⁵ IMF (2020b).

Analytics

52. The Fund’s analytical products cover a range of FCS, and topics relevant for FCS.

Although a major challenge of analyzing FCS is limited data availability, the Fund has provided many databases, toolkits, and model-based frameworks that include FCS or have been applied to FCS.⁶⁶ The analyses cover a wide range of areas from economic diversification and trade; food security; nowcasting; economic uncertainty; debt-investment-growth nexus; climate change and natural disasters; to structural reforms and monetary policy frameworks, especially relevant to FCS.

53. Under the FCS Strategy, FCS will be increasingly covered in ongoing analytical work while the Fund’s research agenda will continue to grow on topics relevant to FCS. The Fund will strengthen its analyses on FCS as they experience the impacts of the COVID-19 pandemic and other priority issues such as effects of climate change, natural disasters and fragility in FCS, the impacts of forced displacement, food insecurity, and regional security crises.

54. The quality of data is a key challenge in advancing analytical work, as well as Fund surveillance. The assessment of data adequacy requires interagency cooperation and depends on data coverage, accuracy and reliability, periodicity, and timeliness. These factors are often undermined by social, political, or economic instability, low data collection capacities, as well as disruptions caused by conflict.

55. The Fund will continue to explore innovative methods to address data shortcomings in FCS. For instance, ongoing Fund research and CD are using remote sensing and other Big Data sources to produce nowcasts of quarterly real GDP growth and other high-frequency indicators for countries where such economic statistics are not published or provided to the Fund, including many FCS.⁶⁷ In addition, efforts to increase implementation of the IMF’s Data Dissemination Initiatives in FCS will contribute to promoting data transparency and accountability of government policies.

Capacity Development

56. The provision of CD is a centerpiece of the Fund’s FCS engagement, with program design and policy advice closely linked to institutional capacity. CD provision to FCS has increased markedly over the last decade, reflecting their large needs and importance for the Fund’s CD priorities. Nevertheless, CD delivery in FCS has faced several constraints such as: (i) varying levels of political ownership; (ii) limited absorption capacity; (iii) financing and personnel rigidities, including difficulties in attracting qualified staff to work on FCS; and (iv) higher security risks.

57. FCS continue to express strong interest in Fund CD support. In addition to core issues such as tax policy, basic revenue administration and public financial management, central banking, banking regulation and supervision, AML/CFT, and statistics, the demand for CD is expanding into

⁶⁶ For example, the Fund has developed models, named DIG/DIGNAR (Debt, Investment, Growth, and Natural Resources) as well as DIGNAR-19, the latest extension, that provide a structural dynamic general equilibrium framework to coherently capture macroeconomic feedback loops. The models capture many relevant features of FCS such as shocks to the natural resource sector, pandemic-related declines in labor supply, and disruptions in trade and remittances.

⁶⁷ Medina Cas et al (2022).

new areas. These include: the adoption of financial technologies, tackling cybersecurity risks to protect assets and preserve financial stability, or introducing central bank digital currencies aimed at raising financial inclusion, as well as strengthening mechanisms for preventing and sanctioning corruption.

58. The FCS Strategy will comprehensively enhance CD delivery to FCS. The objective is to ensure that the Fund CD is readily available to meet FCS' growing needs, responds to local circumstances and absorptive capacity, and can adjust swiftly to changes when required. The CD scale-up in FCS will build on lessons learned, including from the 2018 IEO Report on *The IMF and Fragile States* and the 2018 *Capacity Development Strategy Review*.⁶⁸ The CD scale-up follows a structured increase using the Fund-wide CD prioritization framework and will comprise three interlinked elements: (i) fostering close integration with surveillance and lending; (ii) enhancing mode of delivery in FCS by increasing field presence; and (iii) ensuring CD assistance is better tailored to FCS conditions.

Integrating CD with Surveillance and Lending

59. The integration of CD with other core functions will build on the CES and relevant operational guidelines. CD strategies will (i) capture the CES diagnosis of the macro-critical drivers of fragility; (ii) embed it in overall macroeconomic policy priorities; (iii) place it in the context of development partners' activities; and (iv) adapt it to local capacity constraints. For example, in Haiti the pilot CES pointed to gaps in tracking the use of public expenditure, leading to more CD resources focused on that area. These measures will complement the *Operational Guidelines for Integrating Capacity Development with Surveillance and Lending* issued in April 2021.

60. CD support is most effective when it informs program design and surveillance recommendations. This will require resources, and the increased number of local economists and coverage of FCS by Resident Representatives will help reinforce integration by strengthening day-to-day contact and coordination with both country authorities and partners. For example, in the Central African Republic the Resident Representative and Fund CD staff hold monthly meetings with other CD providers to eliminate the risk of duplication of efforts and maximize synergies.

Enhancing the Mode of Delivery of CD in FCS

61. The Fund will strengthen CD delivery in FCS by stepping up its field presence, with some HQ-support. A total increase of 30 additional experts—out of which at least 20 will be placed as long-term experts (LTX) in Regional Capacity Development Centers (RCDCs)—will help address the growing CD needs in FCS. This will also improve the Fund's response to the context-specific delivery challenges, such as the time required to build strong country relationships and understanding of local circumstances. An enhanced dialogue with country authorities will also translate high-level recommendations into properly sequenced implementation steps, consistent with local absorptive capacity. This will also help track progress on reforms, adjust provision to emerging issues, and foster closer coordination with partners. Moreover, building on the lessons

⁶⁸ IMF (2018e).

learned from the pandemic, it will be important to provide CD flexibly, including through hybrid delivery modes or a mix of remote and field missions to account for connectivity challenges.

62. Raising the capacity of RCDCs covering FCS will serve as the main vehicle for scaling-up field presence. RCDCs are critical to CD delivery in FCS. They are home to LTX who are specialists in specific core areas of the Fund. Almost all the Fund's current FCS are covered by an RCDC (**Figure 7**). As those experts are not tied to a single country, facilitating CD through RCDCs allows for flexibility and therefore effective tailoring of CD through rapid reprioritization.

Figure 7. Currently Designated FCS Covered by IMF Regional Capacity Development Centers



RTACs*	FCS
AFRITAC Central	Chad, Dem. Rep. of Congo, Burundi, Central African Republic, Rep. of Congo, Sao Tome and Principe
AFRITAC East	Eritrea, Malawi, South Sudan
AFRITAC South	Comoros, Madagascar, Zimbabwe
AFRITAC West	Cote d'Ivoire, Mali, Guinea, Guinea Bissau, Togo
AFRITAC West 2	the Gambia, Liberia, Sierra Leone
CARTAC	Haiti

*Regional Technical Assistance Centers

RTACs*	FCS
METAC	Lebanon, Libya, Syria, Sudan, West Bank and Gaza, Yemen, Afghanistan, Iraq, Djibouti
PFTAC	the Federated States of Micronesia, Kiribati, Marshall Islands, Papua New Guinea, Solomon Islands, Timor Leste, Tuvalu
SARTTAC	Maldives
CCAMTAC	Tajikistan
CDOT	Myanmar

**Supporting twenty fragile and conflict-affected states in sub-Saharan Africa

63. The allocation of additional long-term experts to RCDCs will focus on those with low advisor to FCS ratio and a strong demand in clearly identified CD areas.⁶⁹ The current coverage of long-term experts for each fragile state varies widely across the different RCDCs. This partly reflects the differing level of demand and capacity in the FCS and non-FCS covered by the various RCDCs, but also differences in donor priorities among regions.

64. Securing the necessary donor support to add 20 long-term experts will allow for a 40 percent increase in the delivery capacity in relevant RCDCs covering FCS. This is especially important as an RCDC advisor typically makes 10-12 country visits each year and provides ongoing

⁶⁹ METAC, key AFRITACS, and PFTAC.

remote support to key counterparts, organizing regular tailored training and workshop events that enable peer learning.

65. Under the Strategy, the capacity scale-up will follow a structural increase in RCDC resources. This will ensure that all workstreams key to regional surveillance and program priorities are suitably covered in each RCDC and FCS are provided with dedicated and tailored support.

66. When FCS require intensive support that cannot be provided by RCDCs, additional in-country resident advisors will be deployed, conditional upon strong country ownership and adequate absorption capacity. Located in FCS, these experts can closely track progress with reforms and provide quick ad-hoc, hands-on support. To support institutional reforms, in-country experts will broadly be doubled to 21 from the Fund's current level of 11.

67. More HQ support for FCS will ensure effectiveness and Fund consistency in CD provision. Backstopping by Functional Department experts at HQ, which will be built over time, is essential to ensure high-quality of Fund CD leveraging links to overall reform strategies and specific advice based on experience in similar countries and circumstances.

68. The scale-up of CD to FCS will continue to be demand-driven and managed through the Fund-wide CD prioritization framework. CD growth in FCS—which will manifest itself not only in volume, but also in the share of overall delivery—is an explicit institutional objective. Guided by regional strategy notes, Area Departments place the highest weight on FCS (along with program countries) in prioritizing country demand to be included in the CD work planning⁷⁰. The prioritization of CD will remain flexible to adjust to the rapidly evolving conditions in FCS in a manner consistent with demand and absorptive capacity and support already provided by the Fund and other development partners.

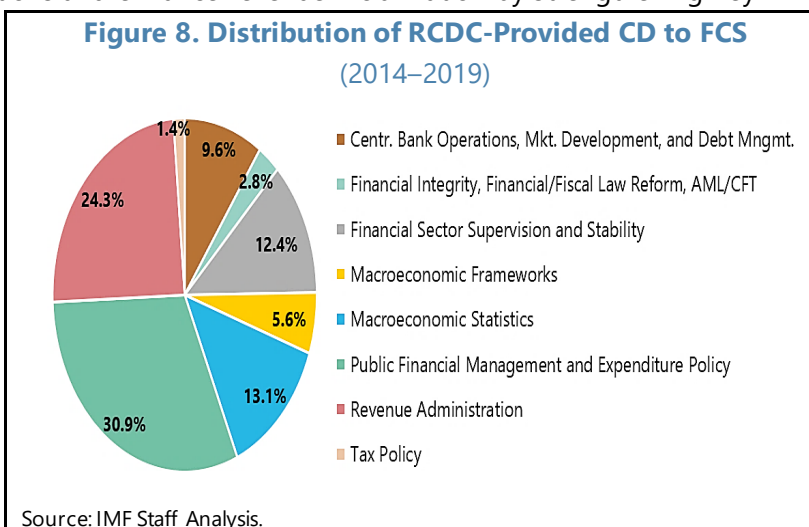
Tailoring CD Support to FCS Conditions

69. Tailoring the content of CD is critical to strike an effective balance between FCS needs and their absorptive capacity. The Fund's CD tailored approach follows three integrated steps: (i) aim for CD results that are commonly associated with the level of capacity in a FCS (e.g., focusing deliverables on basic needs in the most challenging stages); (ii) add more country-specific granularity by leveraging field presence, e.g., calibrate to FCS context including authorities' readiness to engage, reflect tailoring in realistic results-based management (RBM) milestones and indicators; and (iii) maintain flexibility to adjust CD work planning and delivery to rapidly evolving conditions.

⁷⁰ CD prioritization in FCS will be in line with the Fund's resource allocation process embodied in CD Management and Administration Program (CDMAP).

70. The increase in CD capacity will help ensure FCS have access to responsive and tailored support in all core areas of Fund expertise. Building on the RCDC support already provided (Figure 8), CD will focus on core areas that are critical for FCS, in accordance with the graduated approach developed by Functional Departments—strengthening basic functions in the most challenging stages of fragility and then phasing in more sophisticated reforms as absorptive capacity increases:

- **Domestic revenue mobilization:** In low-capacity FCS, the focus is to modernize tax systems, including customs administrations and enhance revenue mobilization by strengthening key functions (e.g., revenue administration, taxpayer registration, reducing tax evasion, strengthening customs controls, tax policy and legislation). As capacity grows, assistance may increasingly involve broader diagnostic work such as medium-term revenue strategies focused on more comprehensive administrative measures.



- **Public Financial Management (PFM):** Establish core functions (e.g., a well-functioning annual budget, basic payment systems), then modernize PFM institutions with a graduated approach (e.g., stronger oversight of state-owned enterprises, strengthened accountability and control frameworks). Integrated tax policy-revenue-administration-PFM support is critical to ensure that recommended measures are coherent and can be implemented within existing capacities.
- **Anticorruption and Rule of Law:** Establish priorities for reform and strengthen the legal and organizational framework for anticorruption; enhance transparency (including asset declarations); foster collaboration between audit institutions and anticorruption bodies; and address governance constraints in the enforcement of contracts and property rights.
- **Debt Management:** Focus on the fundamentals, such as creating a principal debt management entity and strengthening its role in debt management decision making, enacting appropriate legislation, developing capacity in debt sustainability analysis, as well as improving basic policies and procedures, including for debt transparency. As FCS capacities increase, the goal is to develop domestic debt markets (e.g., formulate and implement a medium-term debt management strategy).
- **Central Bank Operations:** Strengthen the monetary policy and operations framework, establish foreign exchange markets and set up central bank governance. As capacities increase, CD further develops the operational toolkit towards price stability and financial stability objectives (e.g., a framework for Emergency Liquidity Assistance, deepening liquidity management operations).

- **Bank Supervision:** Establish regulatory and supervisory frameworks proportionate to the level of risks and complexity (e.g., set up basic prudential rules and report for regulation, develop and formalize supervisory function). Over the medium-term, CD may focus on aligning regulations progressively with international standards or moving from compliance to risk-based supervision.
- **Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) and broader financial integrity:** Enhance the legal and institutional framework and effectiveness of AML/CFT systems to focus on key proceeds of crimes (e.g., corruption, tax evasion, environmental crimes) and terrorism financing.
- **Macroeconomic Statistics:** Crisis and conflict often interrupt data compilation in FCS. CD identifies source data or surveys and re-establishes basic data collection and reporting systems, in cooperation with PFM and monetary authorities. As capacities evolve, the scope widens to enhance data quality and timelines, and improve reporting frameworks.
- **Macroeconomic Frameworks:** Assist authorities in building robust macroeconomic frameworks and strengthen forecasting and policy analysis. As capacity grows, macroeconomic frameworks are adapted to integrate more sophisticated tools that deepen forecasting and policy analysis.

71. Partnerships will be leveraged to maximize the impact of greater field presence. The complementarity, quality, and tailoring of capacity building will be improved by closer upfront coordination of CD efforts across partners, securing donor support for Fund-provided CD, and by expanding partnerships with leading experts. The increase in the number of resident advisors will also provide more opportunities for coordination. Furthermore, Resident Representatives in FCS will play a stronger role in leveraging partnerships for effective CD provision which avoids duplication and overburdening authorities.

72. Progress on the Fund's CD scale-up in FCS will be measured through indicators that track: (i) CD delivery, both aggregate and by core workstreams; (ii) field presence, by modality; (iii) progress towards targeted results; and (iv) advancements in CD, surveillance, and lending integration. The proposed indicators are:

- **Improved effectiveness and ratings of sustainability** of Fund CD in FCS, as measured by relevant RCDC evaluations from a present baseline of 2.5 (moderate).⁷¹
- The year-to-year **aggregate increase in CD delivery** over the FCS Strategy implementation period (FY22-FY25) from the current baseline of US\$48.2 million, in response to country demand.
- The **increase in the number of long-term experts in relevant RCDCs and in-country resident advisors** to an equivalent of 2 per FCS from the present baseline of 1.5 (METAC, key AFRITACs, PFTAC).
- **RCDCs to highlight increased FCS coverage** in work programs and annual reports.

⁷¹ RCDC evaluations occur on 5-year cycles and receive ratings on relevance, efficiency, effectiveness and sustainability on a 4-point scale: 1 (poor), 2 (moderate), 3 (good), 4 (very good/excellent).

- **The increase in the number of FCS with clearly articulated CD priorities** in CES throughout the Strategy implementation period (presently, this is the situation in just 4 FCS).

Lending Toolkit, Program, Design, and Conditionality

73. The FCS Strategy proposes measures to make full use of the existing flexibility of the Fund's financing toolkit and better adapt the Fund's financial engagement to specific country circumstances. The 2018 IEO report identified several areas where the Fund's lending framework in FCS could be improved. The report characterized the relatively short-term nature of the Fund's financing toolkit as not inherently well-suited to FCS and identified a gap between emergency financing instruments (with limited conditions) and those for more sustained support (through UCT-quality programs) with more stringent conditionality. Furthermore, the report argued that the application of conditionality appears to have differed little between FCS and other countries.

74. Since the 2018 IEO report, the Fund has adopted wide-ranging reforms to its LIC facilities which will benefit FCS that are PRGT eligible. The *2018-19 Review of Facilities for Low Income Countries* increased access limits under the PRGT, extended the initial maximum duration of Extended Credit Facility (ECF) arrangements, and approved proposals to make the LIC facilities more responsive to the needs of FCS through targeted increases in access under emergency financing. In addition, Directors supported the use of the existing flexibility under the ECF.⁷² In July 2021, the Executive Board approved policy reforms and a funding package to better support LICs in responding to the COVID-19 pandemic. The reforms included (i) raising the normal annual/cumulative limits on concessional lending under the PRGT;⁷³ (ii) eliminating the hard limits on exceptional access to PRGT resources for the poorest LICs; (iii) simplifying the framework for blending concessional and non-concessional resources; and (iv) strengthening safeguards to address risks to debt sustainability and capacity to repay the Fund.

75. As shown above, FCS are a heterogeneous group. They require an agile lending toolkit and better tailored program design and conditionality to address the full spectrum of macro-critical fragilities. Since most PRGT-eligible FCS face protracted BOP problems, the current 3-5 year ECF arrangement should remain the standard instrument for financial engagement for fragile LICs that have the capacity to implement UCT-quality programs. However, the Fund may need to engage with FCS through a range of modalities (e.g. SMPs, emergency assistance) over a sustained period, depending on the prevailing circumstances, informed by the CES. Experience has shown that Fund-supported programs for FCS displayed lower success rates than for other members, to a very large extent due to political shocks. This reality underscores the inherent risk in the Fund's financial engagement, but also the importance of appropriate tailoring of program design. Financial engagement with FCS should continue to be carefully balanced with the need to safeguard Fund resources and countries' debt sustainability.

⁷² Specifically, Executive Directors endorsed the call for greater flexibility in the design of ECF-supported programs for countries needing to focus on near-term objectives, while meeting UCT-quality standards and maintaining consistency with the provisions of the ECF (The Acting Chair's Summing Up- 2018-19 Review of Facilities for Low-Income Countries- Reform Proposals (SU/19/71).

⁷³ Normal cumulative access limits under the PRGT have been increased from 225 percent of quota prior to the 2018/19 LIC Facilities Review to 435 percent of quota at present.

76. Building on recent reforms and diagnostics, the FCS Strategy identifies several further improvements in the application of the existing lending toolkit. While the Fund's principal mode of financial engagement is through medium-term UCT-quality programs, the agility of the toolkit can be further improved to meet FCS circumstances. Specifically:

- **For FCS that can implement UCT-quality programs:** Staff will make full use of the existing flexibility to improve program design, including through more realistic macroeconomic frameworks. As per the principles of engagement outlined above, conditionality should be streamlined and tailored to unique circumstances of each member, including the fragility and conflict context, while ensuring that programs are appropriately ambitious to preserve or restore macroeconomic stability and external viability. Programs should also address underlying structural challenges to help members exit from fragility.
- **For FCS facing urgent BOP needs, but where the implementation of a UCT program is not feasible:** In such cases, Fund financial support can be provided through emergency financial assistance through the Rapid Credit facility (RCF) and/or Rapid Financing Instrument (RFI), provided that all other qualification requirements are met. Such countries could also benefit from concurrent Staff Monitored Programs (SMPs) and emergency financial assistance, including repeated use if applicable policies are met.
- Looking further ahead, staff will continue to work on the potential to address longer-term structural challenges in FCS through the **Resilience and Sustainability Trust (RST)**.

77. More experience would be needed to assess whether the potential gap in the toolkit identified by the IEO in 2018 has been adequately addressed. The Executive Board's call as part of the *2018-19 Review of Facilities for Low Income Countries* for the use of flexibility in the design of ECF-supported programs occurred shortly before the pandemic, and the increase in the Fund's emergency financing support to members. Consequently, there has been limited experience under this approach. If further experience demonstrates that such flexibility, together with proposals in this Strategy, are insufficient to meet the needs of FCS members effectively, this gap would be considered in the context of the comprehensive review of LIC facilities planned for 2024–2025.

Strengthen Program Design Through Realistic Macroeconomic Frameworks and Tailored Conditionality

78. Staff envisages making full use of existing flexibility to better tailor program design coupled with parsimonious conditionality to ensure that UCT-quality programs for FCS focus on the most important and impactful measures. The streamlining of conditionality in the face of the challenges associated with fragility and conflict should not compromise the strength of the UCT-quality of programs. On the contrary, it would help promote ambitious programs by focusing FCS members' limited capacities on the most critical measures. Lower priority goals can distract country authorities with limited capacity operating in a complex social-political environment.

79. CES will help guide the prioritization and sequencing of tailored structural reforms in FCS. As mentioned above, CES will identify drivers of fragility and conflict to inform the prioritization and sequencing of structural reforms. This will help ensure that policies are carefully prioritized with

the aim of protecting social outcomes—where they are macro-critical for program objectives—and fostering inclusive and sustainable growth, consistent with the Fund’s 2019 *Strategy on Social Spending*. Heightened uncertainty and limited capacity can justify the greater use of indicative targets under certain circumstances.

80. A realistic macroeconomic framework in FCS is a precondition for further enhancing robust program design. The macroeconomic framework should properly reflect the structure of the economy (e.g., lack of diversification), internalize implementation capacity constraints, as well as the risk of reform reversal. Importantly, programs should avoid overly optimistic assumptions that BOP problems would be resolved within the program period in cases where it is not feasible. Given the multi-dimensional nature of risks, programs should where possible present alternative policies that could be put into effect if shocks materialize, and staff should monitor possible unintended consequences of the authorities’ programs.

81. Explicitly recognizing the existence of post program financing gaps (PPFGs) could strengthen realism in the Fund’s engagement in FCS, while being accompanied by appropriate safeguards. Towards this end, any program documents should include a detailed discussion on availability of financing sources other than the Fund. The presence of PPFGs and uncertainty on how they would be filled should be taken into account in Capacity to Repay (CtR) and debt sustainability analyses (DSAs). Therefore, it would be important to identify risks to the medium-term viability of a country with PPFGs building on sensitivity analysis, provide early warnings on risks to the Fund’s balance sheets, and assess the robustness of adequate CtR and debt sustainability.

82. Well-designed Floating Tranches⁷⁴ can also give the authorities greater flexibility in setting the timetable for implementing selected structural reforms, and are likely to enhance ownership. Policies supported by floating tranches should be consistent with existing Board guidance and reflect country-specific circumstances, where the authorities are committed to reform measures but cannot pin down the exact time needed to garner broad support, build capacity, and adopt legislation and regulations.

83. The new *Staff Guidance Note on the Implementation of the FCS Strategy* will be essential to ensure better tailored program design and streamlined conditionality for Fund-supported programs for FCS.⁷⁵ The Note will provide more concrete and operational advice to Staff. Key elements of tailored conditionality will entail:

- **Reinforcing parsimony**, for example by focusing on a set of key priorities and targets that are macro-critical, fragility-sensitive, and within the current implementation capacity.

⁷⁴ Floating Tranches are disbursements made not according to a fixed schedule, but only once certain policy actions have been undertaken or program targets achieved.

⁷⁵ The new *Guidance Note on the Implementation of the FCS Strategy* will supersede and update the 2012 *Guidance Note on the Fund’s Engagement with Countries in Fragile Situations*.

- Building on concrete examples and lessons learned to **better adapt program focus and targets to evolving country circumstances.**

84. The updated staff guidance will be grounded on the core principles of IMF program engagement. It will be consistent with the 2002 Board-endorsed *Guidelines on Conditionality*, build on the findings of the 2018 IEO Report and 2018 *Review of Conditionality*, and incorporate the 2018 *Framework for Enhanced Engagement on Governance*. The new guidance should ensure that the Fund takes full advantage of the flexibility in the toolkit

Combined use of SMPs and Emergency Financing, where Appropriate

85. While most FCS have been able to implement UCT-quality programs, the Fund has at times faced practical challenges in helping those FCS that are unable to do so. SMPs are the main tool to build a track record toward a UCT-quality program, although the transition rate has been limited in the past.

86. In line with Fund policy, for FCS facing urgent BOP needs and where a UCT-quality program is not feasible, the concurrent use of SMPs and emergency financing could help the country address its BOP need while moving towards a UCT-quality program.⁷⁶ To support the agility of the toolkit and ensure the effectiveness of this combined use where appropriate, staff envisages developing further operational guidance on the concurrent use of SMPs and RCF/RFI, including repeated disbursements/purchases if applicable policies are met. Staff may also come to the Board to propose targeted adjustments to the RCF framework.

Longer Maturities

87. FCS could also benefit from more favorable financial terms, including longer maturities of lending. In this context, financial assistance under the envisaged Resilience and Sustainability Trust (RST) could help “top-up” an on-track UCT quality program to support countries—including eligible FCS—in coping with the longer-term challenge of transforming economies to become more resilient to shocks and achieve sustainable and inclusive growth. The RST would help members address macro-critical structural challenges that entail significant macroeconomic risks to long-term resilience and sustainability, such as climate change and pandemic preparedness. Most of the 35 countries considered vulnerable to climate change are FCS.⁷⁷ These countries have also suffered the harshest economic impacts of the COVID-19 pandemic. Eligible countries would include all LICs, developing and vulnerable small states, and MICs which meet RST eligibility criteria. The longer maturities of RST financing would temporarily

⁷⁶ In cases where a country facing an urgent BOP need seeks to build a track record for a UCT-quality program or repeated use of the emergency financing, use of an SMP to build such a track record concurrently with the RCF would normally be the preferred option. However, under the current policy, the RCF with appropriate policy undertakings can also be used to build the policy track record (See *The Chairman’s Summing Up Financing for Development: Enhancing the Financial Safety Net for Developing Countries—Further Considerations*, BUFF/16/84).

⁷⁷ Notre Dame Global Adaptation Initiative (2019).

alleviate repayment pressures on FCS and better align the repayment schedule with the longer-term financing needs associated with longer-term structural issues. Staff work in this area is ongoing.

Catalytic Effect of Fund Support

88. The IMF’s financial and non-financial engagement can help catalyze more concessional funding for FCS. The Fund can support countries’ efforts to develop and implement reforms and institutional change, promote sustainable policies, progressively build the core institutions needed for macroeconomic stability and help authorities build a track record of policy implementation. The Fund’s engagement provides the donor community with a degree of assurance that their financial support would be used effectively, benefiting from a more transparent and more sustainable macroeconomic framework. In particular, the Fund’s commitment to provide capacity development and policy support, and to regularly oversee progress under the economic adjustment program is a critical point of reference for other donors—signaling that public finances and the broader policy framework are benefitting from the Fund’s guidance and monitoring. Thus, strengthened programs can have significant positive spillovers. The FCS Strategy and enhanced financial and non-financial engagement with FCS are expected to help countries benefit from higher levels of donor support, including grants and concessional loans. Staff will update the guidance note on SMPs in 2022, clarifying the role of this instrument for FCS and other members seeking to build a track record.

E. Enhancing Partnerships

89. Enhanced cooperation with development, humanitarian, peace, and security actors is a key principle of engagement under the proposed FCS Strategy. Collaboration with the World Bank⁷⁸, other MDBs,⁷⁹ the UN system, as well as and bilateral partners allows for a comprehensive support to FCS authorities that combines shorter and longer-term approaches to promote resilience and help countries to exit fragility. Working across the humanitarian-development-peace (HDP) nexus⁸⁰ can also enhance the impact of Fund engagement. Under the Strategy, partnerships will be strengthened in several ways.

90. First, the Fund will seek to systematize its partnerships based on their contributions to the IMF’s mission and partners’ expertise in relevant areas. All partnerships will be within the IMF’s mandate and existing frameworks of engagement with country authorities. Maintaining the Fund’s core role as a trusted advisor to authorities is critical to fulfilling its mandate.

⁷⁸ The overarching framework for IMF collaboration with the World Bank is governed by the 1989 Concordat, supplemented by the Joint Management Action Plan (JMAP) and special regimes for joint products.

⁷⁹ Engagement with Multilateral Development Banks is being defined at the institutional level through frequent discussions at the country team and senior staff level, the MDB Coordination Group, and the Joint Management Action Plan (JMAP) with the Bank—which includes an FCS component since 2007; In 2018/ 2019 a MDB Working Group together with the IMF was set up to facilitate exchange on lessons learned, best practices, knowledge, and analysis to advance cooperation on FCS.

⁸⁰ The HDP Nexus initiatives focus on strengthening coherence and building more complementarity between humanitarian, development, and peace actions, particularly in fragile and conflict-affected situations with the aim to effectively reduce people’s needs, risks, and vulnerabilities. See OECD (2019), *DAC Recommendation on the Humanitarian-Development-Peace Nexus*, OECD/LEGAL/5019.

91. Second, the Fund will expand its range of partners. Highly complex FCS settings require a multidisciplinary understanding of fragility and conflict. The goal is to cast a wide net and leverage both traditional and non-traditional partners, such as humanitarian organizations, CSOs, think tanks, the private sector, and subnational authorities. Expanding outreach and consultations to a diversity of actors leads to more robust Fund outcomes and can also help uncover blind spots in situations where specific measures of IMF-supported programs might potentially entail negative impacts.

92. Third, modalities of collaboration should remain flexible and dynamic. Given the heterogenous nature of FCS, partnerships should adapt to the specific situation and challenges to ensure the Fund's engagement is conflict sensitive. However, regardless of the context, it will be important to ensure reciprocity and regular two-way information sharing that strengthens a common understanding of multidimensional fragility and risk settings.

93. Fourth, partnerships will be strengthened across IMF core activities. Article IV consultations, program design, CD, as well as CES present opportunities to join forces with partners who complement the Fund's technical, operational, and strategic work in FCS at various stages of the fragility and conflict spectrum. For example, the close collaboration of the IMF with bilateral donors, the World Bank, regional development banks, and the UN was essential to reach HIPC decision points for Somalia in 2020 and Sudan in 2021.

94. In some FCS, Fund engagement is constrained due to limited field presence, conflict intensity, or on occasion the lack of (or uncertainty about) government recognition. In these contexts, partners can help verify progress towards stability, particularly by sharing information that enhances our understanding of developments in the ground and helps the Fund promote appropriate macroeconomic policies, and catalyze support. Regular dialogue with UN Resident Coordinators, access to the UN Common Country Analysis, or exchanges with staff of UN agencies operating on the frontlines of crises such as the World Food Program (WFP) or the UN Office for the Coordination of Humanitarian Affairs (OCHA) can be particularly helpful. In Haiti, the Fund collaborated closely with WFP during a period of limited Fund presence on designing reforms to a system of cash transfers. In the Asia-Pacific region, where in-country offices are few, strong collaboration with the Asian Development Bank and World Bank and regional bilateral partners reinforce the Fund's support to small island FCS.

95. Thematically, the Fund will seek to strengthen partnerships with organizations whose core areas of expertise complement its own. Key topics of interest include:

- **Climate change:** The Fund's policy guidance on climate mitigation, adaptation, and transition to a low-carbon economy in FCS can be leveraged through enhanced cooperation with partners (e.g., the World Bank, UN, OECD, International Energy Agency, bilateral agencies). *The Fund relies on analysis by development partners to assess the impact of natural disasters, thus providing the basis for engagement and potential financing.*
- **Food Security:** The impact of conflict reduces agricultural production capacities while the rise in food prices can involve significant BOP effects through higher import bills caused by a deterioration in the terms of trade. Exchange rate policy can play an important role in adjusting to food price shocks. *Based on previous engagements, the Fund will draw on the local presence,*

expertise, data, and coordination activities of partners such as WFP and FAO to leverage fiscal and macroeconomic adjustments in addressing food insecurity and recovering production capacity.

- **Peace and Security:** FCS often have high levels of security expenditure relative to their budget.⁸¹ Public expenditure reviews (PERs) of the security sector that have been carried out by the World Bank and the UN can be important to inform policy dialogue on fiscal space, fiscal sustainability, and PFM, but also to understand how insecurity affects macroeconomic stability and inclusive growth. *Based on on-going engagements, the Fund will seek further cooperation with World Bank and UN to explore conflict-sensitive macroeconomic frameworks and ensure that surveillance takes into account the fiscal impact of security spending, when this is macro-critical. In conflict-affected countries undergoing peace transitions, Fund staff can also benefit from regular exchanges with the UN Peacebuilding Support Office.*
- **Forced Displacement:** Large inflows and outflows of refugees, as well as movements of IDPs, entail significant macroeconomic impacts, including on growth, inequality and gender inclusion, and public spending. *In developing the CES and respective policy advice, staff will engage with partners such as the office of the UN High Commissioner for Refugees (UNHCR) and the World Bank to leverage their knowledge of the forced displacement challenge, as well as their analytics.*
- **Gender and inclusion:** Policies that promote gender equality and youth inclusion can be important to build resilience in many FCS, prevent relapse into conflict, and foster transitions from fragility to stability. Women and girls face specific and heightened vulnerabilities in FCS contexts, deepening fragility. The lack of job opportunities and education for youth may trigger social unrest, with pervasive losses in productivity and human capital. *The CES presents the opportunity to align the Fund's strategic workstreams on gender and FCS, while building on contributions and analyses from specialized agencies such as UN Women, or the World Bank.*

Strengthening Collaboration with the World Bank in FCS

96. Given their closely connected mandates, the IMF and the World Bank share natural complementarities in supporting FCS. The Fund works to foster global monetary cooperation, secure financial stability, facilitate international trade, build capacity, promote high employment and sustainable economic growth. The Fund's main comparative advantages are clearly spelled out in the second section of the paper. The Bank provides financing, technical assistance, and analytics to support long-term economic development to end extreme poverty and build shared prosperity. It also works on fostering private sector investment and development.

97. The Fund's proposed FCS Strategy and the Bank's Strategy for Fragility, Conflict, and Violence 2020-2025 will further strengthen these complementarities. The Bank's Strategy aims to enhance its effectiveness to support countries in addressing the drivers and impacts of fragility and strengthen resilience. It sets out core principles and pillars of engagement to assist FCS in upstream efforts on prevention, coping with rising tensions, during periods of conflict, post-crisis recovery, and external spillovers. The Fund and Bank strategies share some common principles, including: (i) tailoring engagement to the specific manifestations of fragility and conflict; (ii) building institutions and systems that can deliver on inclusive growth; and (iii) strengthening dialogue with

⁸¹ United Nations (2019).

country authorities and partners. Those same common principles will be critical to ensure consistency and complementarity of Bank and Fund approaches in FCS. The remit of the Fund's proposed FCS Strategy will focus solely on issues that are pertinent to its mandate and comparative advantage, complementing the World Bank's efforts.

98. The IMF's engagement in FCS can benefit from the Bank's expertise, including to inform the conditionality of Fund-supported programs. World Bank expertise on structural reforms is especially important in this regard, especially on social safety nets, subsidies, labor markets, public procurement, and distributional analysis. The Bank has also developed expertise on other macro-critical issues such as the impact of climate change; inclusion and gender; private sector development and jobs; forced displacement; PERs; and public sector governance. Similarly, the Bank can benefit from IMF assessments of macroeconomic frameworks, debt issues, and financial stability which can serve as inputs to Bank operations.

99. Core areas where the two institutions will strengthen collaboration in FCS include:

- **Relying on common methodology, thresholds, and criteria for FCS classification:** This will ensure a more effective international response to FCS and reduce the risks of inconsistencies. Fund and Bank staff will exchange information regularly on the evolution of global fragility and conflict trends, including as part of the annual update of the FCS list. While the methodology, thresholds, and criteria for classifying FCS will be the same, each institution will apply the classification and its uses in line with their mandates and strategies.
- **Sharing information and analytics more systematically:** As a follow-up to the 2020 IEO report on *IMF Collaboration with the World Bank on Macro-Structural Issues*, the two institutions have been developing a *Guidance Note on Information Sharing between IMF and World Bank Staff*. The Note summarizes best practices in information and document sharing processes, including in the context of missions. On this basis, Risk and Resilience Assessments (RRAs) carried out by the World Bank are expected to be shared with the Fund to inform CES, while specific modalities are being finalized. Other relevant Bank analytics include the Systematic Country Diagnostic (SCD), which delves into political economy issues; poverty and social impact analysis; PERs and Public Expenditure and Financial Accountability (PEFA) analyses; Country Economic Memorandums; Country Private Sector Diagnostics (CPSD); or thematic diagnostics on climate change, inequality, forced displacement, governance and anti-corruption, statistical capacity, financial sector stability, AML/CFT, and other macro-critical issues.
- **Enhanced coordination at the country-level:** The Fund will strengthen operational dialogue with the Bank in FCS, especially leveraging the sharing of core diagnostics, collaborating on economic policy reforms, and consultations on CES, in line with the *Guidance Note on Information Sharing between IMF and World Bank Staff*. This will ensure greater complementarity of financial and non-financial engagement, including to strengthen coordination of CD planning and delivery, where flexibility and synergies are essential to react to changing local circumstances. Coordination will build on lessons learned from joint support to countries such as Somalia and Sudan through the HIPC process or the enhanced cooperation in pandemic-related joint initiatives such as the DSSI and Common Framework. Collaboration on debt issues will continue, in particular, as per the joint Bank-Fund LICs Debt Sustainability Framework

(DSF),⁸² which has become a critical tool to assess the sustainability of macroeconomic policies and inform country authorities on policy actions that can be taken to minimize risks that public debt becomes unsustainable, and more broadly through the close cooperation the two institutions have on debt issues, as described in the *Multi-Pronged Approach to Address Debt Vulnerabilities*.

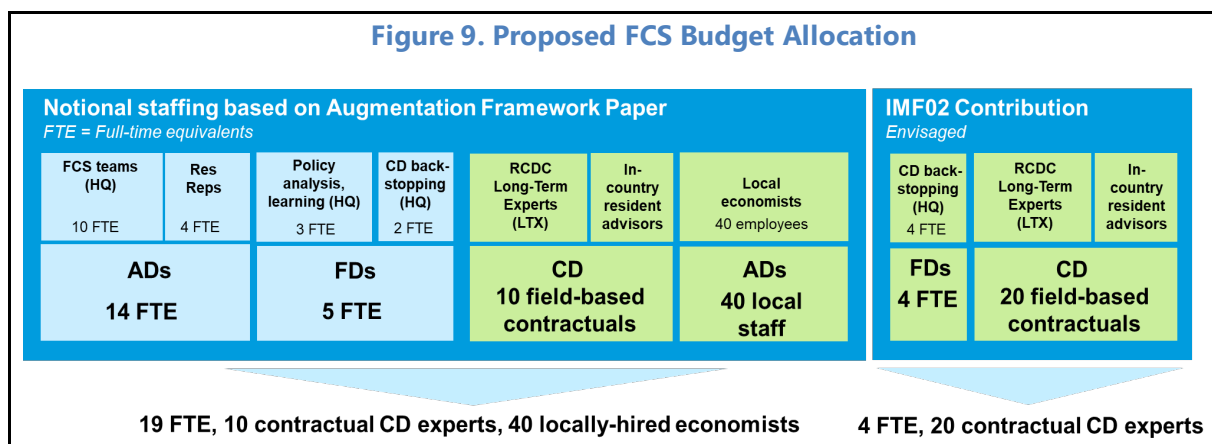
ORGANIZATIONAL IMPLICATIONS

To achieve its objectives and key measures, the Strategy proposes increasing the cohort of IMF staff dedicated to FCS by 12 percent to fund a notional steady-state level of 212 full-time equivalent (FTE) positions. The Strategy also proposes a cost-effective increase in the number of field-based contractual employees and local economists, from 70 to 140 positions. About four fifths of the additional dollar resources will be targeted towards an affordable increase of IMF presence in the field, and a significant push to scale-up CD provision. A modest and focused increase at HQ will complement this growth to ensure adequate guidance and support. The Fund will also support its staff through the implementation of the new career development framework featuring stronger incentives and recognition for FCS work. A new FCS learning curriculum for staff will be set up, emphasizing key elements of the FCS Strategy. As additional personnel will be deployed to FCS, their health and safety will continue to be a top priority. Given the inherent risks in FCS engagement, the Strategy will be phased in starting in FY22, with implementation gradually accelerating between FY23-FY25. This will allow for course corrections and effective risk management, recognizing the inherent volatility of the fragility and conflict landscape. Progress will be carefully monitored through specific indicators, with Staff updating the Board annually.

A. Engagement Model and Resources

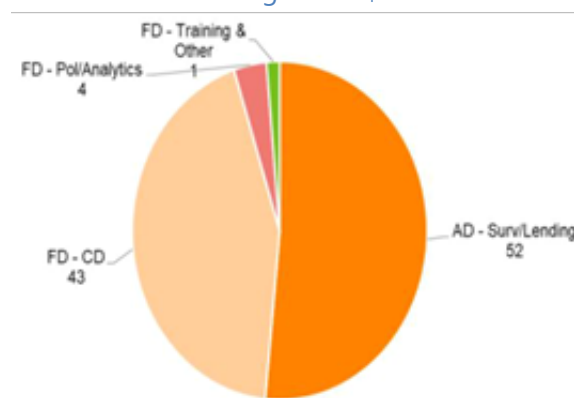
100. The Strategy is grounded in the view that enhanced support to country authorities is the most important lever for the Fund. This will help FCS improve economic outcomes, strengthen their resilience, and support their exit from fragility. This entails intensifying dialogue with authorities and stakeholders on the implementation of policies and reforms necessary to (i) sustain inclusive growth; (ii) progressively build strong and well-governed institutions; and (iii) sequence reforms in line with the capacity to implement change. The Fund's enhanced engagement model thus envisages a gradual increase in resources over FY23-25, with 80 percent of the resource build-up going towards the strengthened field presence of Area Departments and for CD delivery. A modest resource increase will support HQ operations (**Figure 9**). Decisions on the specific deployment of the additional resources across regions and countries, including for CD, will be taken in the context of departments' annual budget discussions based on an assessment of priorities.

⁸² The 2018 Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries emphasizes the importance of early consultation and review within each institution to prepare well-articulated economic projections and minimize risks of last-minute disagreements and requests for changes.

Figure 9. Proposed FCS Budget Allocation

101. In the steady state, the Fund's full-time dedicated to FCS workforce would be 12 percent larger than today (Table 3). Recognizing FCS as a priority area, a budget increase of about US\$17 million, as well as more IMF02 funding for CD activities will enable the Fund to enhance its capacity to support FCS. Almost all the resources will directly benefit country operations (**Figure 10**). This brings the steady-state notional level of FTEs to 212 positions, up from the current 189. The cohort of field-based employees would double from 70 to 140 positions—40 of which will be local economists needed to strengthen FCS country offices. These resources will be distributed as follows:

- Stepped-up Area Department engagement.** A strong and continuous dialogue with country authorities and partners will be critical for the Fund's traction in FCS. Opening four additional Resident Representative posts—thereby increasing the total number of such posts from the current 22 to 26 (out of 42 current FCS)—will enable the Fund to flexibly respond to opportunities for enhanced engagement in countries where the authorities are ready for a stronger dialogue that would often lead to a Fund arrangement. Resident Representatives will play a significant role in leveraging partnerships, but also should convey the challenges faced by country authorities on the ground to HQ and help shape Fund policies and practices. The recruitment of 40 additional local economists into country offices is a cost-effective way of strengthening our field presence. The existing cohort of local economists would more than double to an average of almost 2 per country.
- Increased CD delivery to FCS.** The Fund will enhance the provision of CD to FCS, in line with absorptive capacity and country demand. The Strategy allows for the deployment of up to 30 CD experts serving as long-term experts in RCDCs and resident advisors within FCS. One-third of

Figure 10. Resources under the FCS Strategy by Output Type & Department
Percentage of US\$ value

Source: IMF Staff Analysis.

these, together with 2 out of 6 backstopping resources at HQ to ensure quality control, will be financed by the Fund's own resources. The remainder will be funded from contributions that must be secured from donors and channeled through the IMF02 budget. This CD scale-up in FCS will increase the Fund's ability to provide regional and in-country support by about 70 percent compared with the current level—from 42 to 72 long-term experts (LTX) and resident advisors based in FCS.

- **More resources for FCS work at headquarters (HQ) for Area Department teams supporting heavy CD users.** The Fund's success in FCS country operations will continue to rely on effective and efficient HQ teams, which retain the main responsibility for surveillance and lending operations, as well as close CD integration. To account for the expansion in CD, staffing in Area Departments will receive additional allocations to country teams (10 FTEs). In addition, 2 new positions will be created to strengthen policy and analytical support to monitor the implementation of the FCS Strategy, the analysis of fragility and conflict drivers, support the work of country teams, and enhance an effective dialogue with partners. One additional economist position in ICD would facilitate the creation of a fully-fledged FCS training curriculum for staff and other training materials.

102. In addition to enhanced staffing for FCS, the strategy would allow the Fund budget to cover a part of RCDC administrative expenses. To position CD delivery in the field on a more stable financial footing, the FCS Strategy envisages an envelope of US\$3.0 million per annum (in the steady state) to strengthen funding for RCDC administrative expenses. This financial support is expected to re-channel donor funding towards CD delivery, for instance additional experts deployed to RCDCs covering FCS or directly in-country, as discussed in the previous paragraph.

103. The Strategy has built-in flexibility that will allow for course corrections and adjustments over a three-year implementation period. Recruitment for field-based positions and HQ-based country teams would be initiated in parallel through the Economist Program and the mid-career pipeline. Local economist recruitment will tap into the available pools of local talent. In terms of security risk management, phased implementation and the option of alternative locations for staffing in the field will allow for proactive and flexible management amid evolving conditions.

Table 3. Proposed FCS Staffing Changes (FY23–FY25)

Full-Time Equivalents (FTEs) - FCS Country Teams			
	<i>Current headcount*</i>	<i>Notional staffing based on Augmentation Framework Paper</i>	
Area Departments (AD)	122		10
Resident Representatives (Res Reps)	22		4
Functional Department support (FD)	18		3
Full-Time Equivalent (FTEs) - Capacity Development (CD)			
	<i>Current headcount*</i>	<i>Notional staffing based on Augmentation Framework Paper</i>	<i>Envisaged IMF02 contribution</i>
HQ-based CD experts supporting FCS	27	2	4
Notional Steady-State FTE Cohort for FCS			
Current headcount*	189		
Notional staffing based on Augmentation Framework Paper	19		
Envisaged IMF02 contribution	4		
Estimated Total FTEs	212		
% change from current staffing levels expected during the FY23-FY25 Medium Term Budget	12%		
Non-FTE Staff			
	<i>Current headcount*</i>	<i>Notional staffing based on Augmentation Framework Paper</i>	<i>Envisaged IMF02 contribution</i>
Local Economists in FCS	28		40
LTX in RCDCs and Resident Advisors in FCS	42		10
			20
Notional Steady-State non-FTE Cohort for FCS			
Current non-FTE headcount*	70		
Notional staffing based on Augmentation Framework Paper	50		
Envisaged IMF02 contribution	20		
Estimated total non-FTEs	140		
% change from current staffing levels expected during the FY23-Fy25 Medium Term Budget	100%		

*Current headcount determined as of May 2021 FCS Staff Survey

Sources: IMF Staff Analysis using TIMS and TRACES. May 2021 Staff Survey

B. Human Resources and Support for Staff

104. The Fund’s engagement in FCS poses specific challenges to staff. These include the need to (i) work with countries that are more vulnerable to political, social, and economic instability; (ii) help members with limited capacity address a more complex range of macroeconomic challenges (iii) develop policy advice despite limited data availability and quality; and (iv) support reforms within a constrained policy space that impedes rapid progress and requires more experience.

105. The 2018 IEO report identified significant HR constraints in the Fund’s FCS work.⁸³ Fund FCS teams tended to lack experience and were subject to high turnover. Performance ratings were generally lower and promotion prospects were fewer than for staff assigned to non-FCS. The Report also noted that despite its labor-intensive nature, FCS work had not received additional

⁸³ IMF (2018c).

resources, thus diminishing its attractiveness as a country assignment. It concluded that a fundamental change in staff incentives was needed to encourage staff work on FCS.

106. Despite some improvements in talent allocation since 2018, challenges persist. FCS teams rely more on new hires from the mid-career pipeline and in some cases the Economist Program, resulting in overall lower levels of IMF-specific country experience. Incentivizing experienced Fund staff to work on FCS, monitoring performance ratings systematically at the corporate level, and ensuring adequate visibility and recognition continue to be relevant issues.

107. The Strategy thus aims to enhance staff incentives and recognition for FCS work, as well as to step up training, skills development, and support to teams. Given the Strategy's gradual implementation (FY22-FY25), the process will be iterative: identified gaps in staffing will be closed through institutional reforms that are being closely monitored, regularly evaluated, and adjusted as needed. The long-term aim is to fundamentally shift the perception of FCS work within the Fund, nurture and attract the right skills mix, and provide adequate support for staff health and safety.

108. First, the Fund adopted a new HR policy in 2020 requiring FCS or LIC work as a criterion for promotion to A15 positions starting in 2023. Under this policy, fungible macroeconomists must demonstrate two years (or equivalent) of operational experience on FCS or LICs to be eligible for promotion to the A15 level. This will increase the number of experienced internal candidates that apply for FCS and LIC vacancies. This requirement will become effective in July 2023 and implementation efforts are underway. To operationalize the policy, comprehensive guidance has been developed to specify qualifying experiences that meet the promotion criterion. Staff who presently do not meet the requirement will have an incentive to seek FCS and LIC experience, particularly the most experienced applicant pool (A14s). Metrics will be established to assess results two years after implementation.

109. The FCS Strategy will also provide for adjustments to ensure adequate transitions as experienced staff move to FCS positions. Candidates from the Mid-Career Pipeline and the Economist Program will backfill vacancies that arise from experienced economists moving to LIC and FCS roles (including Resident Representative positions). The Mid-Career Program can also be used as a supplemental mechanism to help fill positions, as it provides a vetted mix of experienced macroeconomists who are ready for hire to meet the current and emerging skills needs. Additional supporting initiatives are being explored that would specifically benefit staff working on FCS and LICs, including processes to accelerate mid-career hiring.

110. Second, to support career development and strengthen staff capacity to implement the FCS Strategy, the Fund will develop a fully-fledged FCS learning curriculum in FY23. The curriculum will take a hands-on, practical approach, geared towards improving the skillsets needed for surveillance, CD delivery, and program work. It will be targeted to staff working in or on FCS, including those involved in the review process. Specific areas of focus will include (i) diagnosis of fragility and conflict drivers as part of the CES rollout; (ii) tailoring policy advice, lending facilities, and conditionality to the specific manifestations of fragility and conflict; (iii) integrating CD support

into Fund surveillance and lending programs and adapting delivery to FCS conditions; and (iv) designing partnerships, especially scaling up collaboration with the World Bank.

111. Third, departments will strengthen accountability for adequately recognizing staff work on FCS. Departments will publish annually aggregated metrics related to staff ratings and promotions for FCS versus non-FCS (starting in FY24). These metrics will be part of broader efforts to increase transparency around the annual performance management exercise. The metrics will be used to monitor implementation efforts and to help assess the promotions policy two years after it has been implemented. The metrics will be designed and utilized for the FY23 performance cycle, to account for, inter alia, the policy effective date of July 2023.

112. In addition, a Fund-wide special recognition scheme will be explored. The goal is to highlight contributions to key organizational priorities, including outstanding work on FCS acknowledging the more difficult work environment for economists on FCS. Individuals and teams could be recognized for exceptional contributions, collaborative behaviors, knowledge sharing, and innovative thinking that have helped achieve significant milestones for high impact initiatives or projects in FCS. Recognition to be explored could include financial (e.g., one-time, non-pensionable payments) and/or non-financial awards (e.g., management recognition ceremonies).

113. A range of ongoing and new IMF-wide and departmental initiatives will help increase visibility of staff working on FCS. Concrete proposals will be specified and assessed during the FCS Strategy implementation. These include:

- **Activating a new FCS Community of Practice.** This will serve as a platform for the regular exchanges of best practices and lessons learned, including by Resident Representatives who are in a position to convey to HQ the challenges faced by country authorities; holding seminars to explore the multifaceted links between fragility, conflict, and macro-structural reforms; just-in-time advice; as well as sharing institutional best practices that successfully incentivized FCS work.
- **Highlighting analytical work:** Staff's FCS analyses will be included in core IMF products (e.g., flagship reports, regional economic outlooks) showcased through increased internal and external communication. Staff will be encouraged and supported to present regularly on analytical and operational issues related to work in FCS (e.g., in a joint IMF-WB seminar series).

114. Lastly, the Fund will strengthen the institutional culture around FCS. Fund communications will continue to emphasize the importance and benefits of FCS assignments to staff members' development, including the acquisition of new experience working on IMF-supported programs, knowledge of Fund procedures, program negotiation skills, heightened exposure to the work of CD departments, coordination with the World Bank, and ultimately the potential for large impact when programs are successful.

115. Progress on implementing these measures will be tracked through the following indicators:

- A **new promotions policy** to attract experienced fungible macroeconomist staff to work on FCS and LICs—effective in July 2023.

- An **FCS learning curriculum** to support the implementation of the Strategy—due in FY23.
- Activation of an **FCS Community of Practice**—due in FY23.
- **Increased transparency on ratings and promotion decisions at an aggregate level for FCS vs non-FCS staff**—due in FY24.

Security and Field Support for Staff

116. The Fund prioritizes the safety, security, and well-being of all personnel, in line with its duty of care as an employer. As part of the enhanced engagement in FCS, effective support for staff will be provided within the existing risk mitigation structure. Recognizing the heightened risk of working in FCS, security support will be strengthened according to the following measures:

- **Policy and guidance:** The existing Security and Business Continuity Accountability Framework (SAF) guides the decision-making on field presence and modalities for security support. The SAF covers requirements for all country security risk levels and establishes adequate risk mitigation measures in each FCS. For FCS that are Medium to High-Risk Locations (levels 2 and 3 indicating medium and high levels of residual risk) a Country Engagement Plan (CEP) is required, which is informed by up-to-date country security assessments.
- **In-country support:** Local Security Coordinators will be recruited to be present in every FCS duty station. Visiting missions to FCS can be supported by adding Mission Security Consultants as needed. Existing Emergency Action Plans and the Crisis Management Plan guide the Fund's emergency response, supported by a HQ-based 24/7 Global Security Operations Center. The specific needs of FCS offices and resources for staff will be incorporated through current security and real estate planning mechanisms. Funding for the additional local security coordinators would be accommodated within the overhead allocation of the augmentation framework. If security risks exceed IMF risk tolerance, the Fund will explore options to place staff in neighboring countries. The forthcoming *Staff Guidance Note on the Implementation of the FCS Strategy* will include an emphasis on integrated and timely coordination across departments to allow for effective planning and staff deployment.
- **Cooperation with partners in the field:** As a member of the UN Security Management System, the Fund can leverage security support from the UN. Support includes local emergency response, building security standards and inspections, logistical support, including evacuation transportation, and medical assistance. A similar, informal agreement exists with the World Bank, according to which mutual support can be provided, subject to case-by-case assessment and the availability of resources. Where beneficial and appropriate, the Fund seeks and will continue to explore co-location opportunities with other institutions' country offices.
- **Security training:** The existing security training suite meets the current and anticipated needs of FCS work. As part of the enhanced engagement in FCS, the required security training for HQ-based and internationally recruited FCS personnel will be increased from one course to a minimum standard of four courses before taking up their posts. These four security courses include: (i) the HRL online training course; (ii) the Safe and Secure Environments in the Field

(SSAFE) course; (iii) the first aid certification course offered at HQ; and (iv) the already mandatory IMF BSAFE course.⁸⁴

C. Monitoring Progress

The implementation of the proposed FCS Strategy will begin in FY22 and accelerate gradually between FY23-FY25. Progress on the specific measures will be monitored through relevant outcome and output indicators listed in **Table 4**, which will inform the annual update to the Board. These indicators are clustered in three categories focused on: (i) a more tailored Fund engagement to FCS; (ii) strengthened IMF core functions; and (iii) resources and staffing.

Table 4. FCS Strategy Key Progress Indicators	
<i>Outcome 1: Enhanced Tailoring of IMF Engagement to FCS</i>	
1. New Staff Guidance Note on FCS	
1.1. <i>Staff Guidance Note on the Implementation of the FCS Strategy</i> to update and supersede the 2012 <i>Staff Guidance Note on the Fund's Engagement with Countries in Fragile Situations</i> —with operational recommendations on all FCS Strategy proposals, including tailoring across the fragility and conflict spectrum, program design and conditionality, Country Engagement Strategies, and partnerships.	October 2022
2. Identification and classification of FCS	
2.1. Adopting the methodology, thresholds, and criteria of the World Bank's FCS list while retaining autonomy and ownership in its application.	October 2022
2.2. New FCS list methodology effectively informing IMF approaches to FCS, with adequate transitional arrangements developed to support Fund staff and operations.	FY23-FY25
3. Rolling out Country Engagement Strategies (CES) to FCS	
3.1. CES guidance included as part of revised Staff Guidance Note on FCS.	October 2022
3.2. One half of FCS will have completed a CES within 18 months of the issuance of the new Staff Guidance Note on FCS.	April 2024
3.3. Survey of FCS Mission Chiefs launched to take stock of lessons learned on the successes and possible areas for improvement of CES.	October 2024
<i>Outcome 2: Strengthening the Effectiveness of IMF Core Functions in FCS</i>	
4. Surveillance	
4.1. Article IV reports in FCS systematically address fragility and conflict issues that are macro-critical (e.g., governance, inclusion, gender, food insecurity, forced displacement, fiscal impact of security crises, climate change risks).	FY22-FY25
4.2. FCS topics are featured in flagship reports and regional economic outlooks.	FY22-FY25
Table 4. FCS Strategy Key Progress Indicators (concluded)	

⁸⁴ Local staff will be required to complete security courses (i) and (iv), while options are being explored to enhance in-country training access through partner organizations. Availability of courses (ii) and (iii) are subject to potential resource constraints and COVID-19 restrictions.

5. Capacity Development	
5.1. Improved effectiveness and ratings of sustainability of Fund CD in FCS, as measured by relevant RCDC evaluations from the present baseline of 2.5 (moderate)."	FY23-onwards
5.2. Year-to-year aggregate increase in CD delivery (from the baseline of US\$48.2 million), in response to demand.	FY23-onwards
5.3. The increase in the number of long-term experts to equivalent of 2 per FCS from the present baseline of 1.5 in relevant RTACs (METAC, key AFRITACs, PFTAC).	FY22-FY25
5.4. RCDCs to highlight increased coverage of FCS in work programs and annual reports.	FY23-onwards
5.5. All FCS will have clearly articulated CD priorities in CES.	FY22-FY25
6. Lending Toolkit	
6.1. Tailored program design and conditionality incorporated into the revised Staff Guidance Note on the Implementation of the FCS Strategy.	October 2022
6.2. Increased concurrent use SMPs and repeated RCF/RFI, based on demand.	FY23-onwards
7. Mission-Driven Partnerships	
7.1. Enhanced collaboration with the World Bank on key topics, e.g., FCS list, shared Risk and Resilience Assessments (RRAs) and other analytics, macro-structural cooperation in FCS.	FY23-FY25
7.2. The annual update to the Board on the implementation of the FCS Strategy will take stock of the progress made to improve strategic collaboration between the Fund and other organizations at the country level across FCS.	FY23-FY25
<i>IMF Resources and Staffing fit for FCS</i>	
8. Engagement Model	
8.1. Hiring 40 additional local economists to strengthen FCS country offices.	FY22-FY25
8.2. Deploying 4 additional Resident Representatives to FCS, thereby increasing Fund coverage to 64 percent.	FY23
8.3. Deploying 30 additional experts in RCDCs and in-country to enhance CD delivery in FCS, subject to demand and country absorption capacity.	FY22-FY25
8.4. Strengthening HQ support with 10 additional staff for Area Departments focusing on support for integration of CD activities into core country work, 2 additional staff for non-CD providing Functional Departments for policy analysis, and 1 additional staff to develop the learning curriculum.	FY23
9. Human Resources and Support to Staff	
9.1. Implementation of A15 Promotions Framework and establishing assessment metrics.	July 2023-FY25
9.2. FCS Community of Practice activated.	FY23
9.3. FCS Learning Curriculum developed.	FY23

D. Risks

117. Engaging in FCS is a high-risk endeavor. Political instability, high uncertainty, and a greater vulnerability to external shocks can undermine authorities' efforts to build a credible track-record of reform. Governance challenges may further weaken institutional capacity to carry out effective macroeconomic policies. These circumstances put a premium on the Fund's ability to effectively manage risks while delivering on its mandate to assist the most vulnerable members.

118. Enhanced efforts to support FCS in response to the IEO 2018 report on *The IMF and Fragile States*, and in line with the proposed Strategy, will help address existing risks to the Fund's engagement. With regards to strategic risks, greater tailoring to fragility and conflict contexts will enable the IMF to better assist over 20 percent of its membership classified as FCS. This will strengthen the position of the Fund as a reliable source of support for fragile states, while reducing reputational risks. Recognizing the cross-border spillovers originating in fragile states, including the impact on regional trade and investment, the Strategy will also benefit Fund members beyond those presently classified as FCS.

119. This proposed Strategy addresses factors that presently limit the Fund's impact in FCS. Key proposals such as rolling out Country Engagement Strategies (CES) will enrich the Fund's understanding of fragility and conflict drivers. Optimizing the FCS footprint will strengthen policy dialogue and enhance the Fund's ability to adapt to political economy dynamics. These measures will help address business risks identified in the IEO 2018 report such as differences in program completion rates, improving the agility and traction of IMF policy advice.

120. At the same time, Fund engagement with FCS will continue to carry greater financial risks, given their circumstances. Ensuring that adequate safeguards are in place—including through tailored program design and conditionality, appropriate debt sustainability analysis (DSA) and capacity to repay (CTR) assessment—is thus of utmost importance for the Fund and our FCS members.

121. Implementing the Strategy could entail additional operational risks related to the potential difficulty of attracting talent and qualified staff with professional knowledge and keen interest in FCS. This risk—also flagged by the IEO 2018 report—will be managed by the range of HR-related measures to enhance staff incentives, recognition, and visibility of FCS work, as well as build an adequate skillset suited for staff work on FCS.

122. An enhanced Fund's footprint in FCS will also require managing global real estate and security risks. To this end, the Strategy provides for effective support, which will be provided within the existing risk mitigation structure. This will include: (i) expanded and enhanced mandatory security training; (ii) increased security staffing; and (iii) supporting the field presence through appropriate and safe field offices in collaboration with local partners.

123. In addition to strategic and reputational risks, ineffective implementation of the Strategy may magnify business risks related to the quality, agility, and traction of IMF policy advice. The principles of engagement and measures proposed by the Strategy will help the Fund

manage some, but not all of these risks. The rollout of CES across FCS will foster a deeper understanding of fragility and conflict contexts. Strengthening partnerships provides the Fund with a deeper understanding of political economy and governance-related challenges. A more extensive footprint should also help manage unforeseen developments caused by changes in governments and other forms of instability. However, operating in FCS will always entail residual risks which will have to be accepted if the Fund is to effectively support its most vulnerable members.

CONCLUSIONS

124. The worsening global fragility and conflict landscape poses critical macroeconomic policy challenges that affect about a fifth of IMF members. Fragility and conflict can undermine macroeconomic stability and the development of productive resources, creating or exacerbating BOP needs. Interconnected social, political, economic, and security crises severely constrain the policy space for reforms and increase trade-offs between short and long-run policy objectives. Fragility and conflict spillovers emanating in FCS threaten the economic stability in neighboring countries and regions. These challenges are persistent over time and sometimes require decades of progress to reverse losses. Fragility and conflict are also linked to other global trends such as climate change, food insecurity, and gender disparities. As such, the challenges associated with fragility and conflict are critical for a significant subset of IMF members.

125. For the Fund to fulfill its mandate, it needs to help its FCS members achieve macroeconomic stability, promote inclusive economic growth, and to strengthen resilience. Strong institutions that effectively implement macro-fiscal and monetary policies can play an essential role in preventing countries from becoming fragile and supporting them to undertake a sustainable post-crisis recovery. This is especially important as the economic impact of the COVID-19 pandemic has put FCS at an even greater risk of falling behind other countries. The Fund has a unique and critical role to play in the array of global efforts to support FCS.

126. This proposed Strategy thus aims to enhance the Fund's effectiveness and impact in FCS, in accordance with its mandate, and in cooperation with partners. The principles of engagement and measures presented above will ensure that the Fund is equipped to do its part in FCS in three broad directions. First, enhance its understanding of FCS conditions, especially through the rollout of CES that identify fragility and conflict drivers, and inform the integration of Fund instruments. Second, strengthen the tailoring of surveillance, scaled-up CD delivery, and the lending toolkit to the challenging situations of FCS countries and the case specific manifestations of fragility and conflict. Third, deploy more and better skilled staff in FCS to enhance dialogue with authorities, adapt IMF support to local absorptive capacity, and strengthen partnerships that amplify the Fund's impact.

127. The Strategy will gradually be implemented starting in FY22 and continuing between FY23-FY25. It will also incorporate lessons learned from the implementation of Fund-wide initiatives such as the *Comprehensive Surveillance Review*, the *Capacity Development Strategy*, and the reviews of various lending facilities. The FCS Strategy will be supported by increased resources outlined in the context of the budget augmentation framework discussed by the Board in December 2021 and reflected in the FY23-FY25 Medium Term Budget.

ISSUES FOR DISCUSSION

- Do Directors support the proposed Strategy and its measures to strengthen the Fund's support to its FCS membership?
- Do Directors see any further areas that could be considered to better serve the membership?

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Annex I. Summary of Consultations with Country Authorities and Partners

1. Extensive consultations on the FCS Strategy Concept Note were held with country authorities and partners between July 30- September 30, 2021. The Fund received written inputs from 55 counterparts including members (FCS and non-FCS); UN agencies, funds, and programs; the World Bank and MDBs; CSOs, think tanks, and academia. The IMF also held 17 one-on-one virtual consultation meetings with stakeholders.

2. FCS members emphasized the critical role the Fund can play in helping countries to exit fragility. They expressed clear support for the various proposals of the Strategy, especially the enhanced field presence, scaling up capacity development provided in-country, and greater tailoring of IMF support to local conditions. More specifically:

- **FCS members underscored the impact and volatility of cross-border effects of fragility on neighboring countries.** FCS country authorities emphasized that difficult tradeoffs, political realities, and constraints require a high degree of adaptation. They stressed that Fund activities should be country-specific, and that country leadership is essential to achieve progress. FCS members also emphasized the need to strengthen public outreach on their activities.
- **Members offered a range of views on the lending toolkit.** While FCS members stressed the need for longer maturities that are better fit for the complex challenges they face, non-FCS some member states emphasized concerns on the volume of financing that may be increased in the context of countries' debt vulnerabilities.

3. Partners voiced strong support for the FCS Strategy. The proposed approach was "strongly welcomed," perceived as a priority of the Fund, and recognized as "tremendously important." The common position across all partners was that the IMF needs a longer-term engagement in FCS based on better tailored approaches to effectively enhance its impact. There was an almost unanimous agreement that this objective requires greater in-country presence. CSOs and think tanks wanted to see more IMF sensitivity to the risk of authorities perpetuating underlying fragilities, as well as to the potential implications of IMF engagement on social grievances in the context of volatile political economy conditions.

4. Partners also provided specific feedback on key FCS Strategy proposals:

- **Country Engagement Strategy (CES):** Partners strongly welcomed the proposed rollout of CES and perceive it as a key instrument to help tailor the Fund's longer-term engagement in FCS, which was assessed to be critical for progress.
- **Capacity Development (CD):** Several partners emphasized that CD is one of the core elements of the Strategy necessary to ensure a more effective IMF engagement with a focus on longer term institution building. Ensuring country ownership, appropriately considering the limitations of absorptive capacities, and the countries' political economy were widely seen as vital for effective CD delivery,

- **Partnerships:** Consultations underscored the need for the Fund to strengthen cooperation with relevant actors in FCS, particularly World Bank. Many external partners (e.g., MDBs, UN agencies and CSOs) offered to leverage their field presence and cooperate on analytics to support IMF's FCS core activities.
- **Lending toolkit:** Several partners underscored that FCS require higher and more concessional and longer-term financing, as well as the need to adjust conditionalities to country needs and context specificities.
- **Support to IMF Staff:** Building on their experience in the field, many partners strongly emphasized that staff incentives—including career development, local recruitment, and skills development—were essential to equip personnel for effective FCS work.
- **Areas requiring special focus in FCS:** Partners asked that the Strategy emphasize the interlinkages between FCS and climate change, social inclusion, gender, governance, and security. Some partners also welcomed a clear recognition of the importance of prevention, forced displacement, and conflict-sensitive program design.