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STAFF GUIDANCE NOTE ON THE FUND'S ENGAGEMENT WITH COUNTRIES IN FRAGILE SITUATIONS

EXECUTIVE SUMMARY

This note aims to provide country teams with broad guidance on engagement with countries in fragile situations. The aim of the guidance note is to help staff maintain focus on issues specific to countries in fragile situations. While engagement should focus on the issues and principles laid out in the note, there is, of course, scope for staff to tailor engagement to country specific circumstances beyond proposed practices.

Approved By
Siddharth Tiwari

Prepared by the Strategy, Policy, and Review Department
In consultation with the African, Middle East and Central Asia, Legal,
and Other Departments

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LIST OF ACRONYMS

| | |
|-----------|--|
| ANDS | Afghanistan National Development Strategy |
| ADB | Asian Development Bank |
| ARTF | Afghanistan Reconstruction Trust Fund |
| BSG | Budget Support Group |
| CPIA | Country Policy and Institutional Assessment |
| CSA | Country Social Analysis |
| DAC | Development Assistance Committee |
| DDR | Disarmament, Demobilization and Reintegration Program |
| DfID | Department of International Developments |
| ECF | Extended Credit Facility |
| EFF | Extended Fund Facility |
| GEMAP | Governance and Economic Management Assistance Program |
| HIPC/MDRI | Heavily Indebted Poor Countries/Multilateral Debt Relief Initiatives |
| IDB | Islamic Development Bank |
| IFIs | International Financial Institutions |
| JMAP | Joint Management Action Plan |
| LICs | Low-Income Countries |
| LOI | Letter of Intent |
| MC | Management Committee |
| MEFP | Memorandum on Economic and Financial Policies |
| MICs | Middle-Income Countries |
| MDTFs | Multi-Donor Trust Funds |
| NTGL | National Transitional Government |
| PA | Palestinian Authority |
| PFM | Public Financial Management |
| PMA | Palestinian Monetary Authority |
| PNDP | Palestinian National Development Plan |
| PRDP | Palestinian Reform and Development Plan |
| PRGF | Poverty Reduction and Growth Facility |
| PRGT | Poverty Reduction Growth and Trust |
| PRS | Poverty Reduction Strategy |
| PRSP | Poverty Reduction Strategy Paper |
| RAP | Rights Accumulation Program |
| RCF | Rapid Credit Facility |
| RFI | Rapid Financing Instrument |
| RTACs | Regional Technical Assistance Centers |
| SMP | Staff-Monitored Program |
| TA | Technical Assistance |
| UCT | Upper Credit Tranche |
| WBG | West Bank and Gaza |

INTRODUCTION¹

1. **This note provides operational guidance to staff on the Fund's engagement with low- and middle-income countries in fragile situations.** It reflects the Executive Board discussion of [Macroeconomic and Operational Challenges in Countries in Fragile Situations](#). The Guidance Note aims to help Fund country teams better tailor engagement with countries in fragile situations to country-specific circumstances, including as regards policy design, the choice of financing facility or instrument, technical assistance and training, and donor coordination.²
2. **The Fund is well placed to support member countries as they seek to transition out of fragility.** Engagement may take multiple forms: surveillance only, staff-monitored programs (SMPs), emergency financing, or arrangements meeting the upper credit tranche (UCT) standard (hereafter UCT arrangements), all combined with technical assistance (TA) and training. Surveillance³ and programs support macroeconomic stability, which is key to a sustainable transition out of fragility. TA in the core areas of Fund expertise—e.g., public financial management (PFM), revenue mobilization, central banking and payment systems, and basic macroeconomic statistics—helps build capacity that is critical to state building and transition efforts. TA can also be a critical component of efforts to foster macroeconomic stability. As in other countries, Fund financial assistance can help countries meet balance of payments needs and can also catalyze donor assistance, including debt relief.⁴
3. **Over the years, the Fund has engaged extensively in countries in fragile situations.** The evidence indicates that, in general, Fund engagement is associated with improved macroeconomic outcomes and increased capacity. However, in some low- and middle- income countries, the experience indicates a greater risk of programs going off-track or failing to meet UCT-standard objectives. In these cases, most of the weak policy performance was linked to policy slippages rather than shocks. At times, this resulted in a “stop-and-go” relationship with countries in fragile situations and, due to frequent delays in reviews, greater volatility of Fund financing.

¹ Prepared by Nisreen Farhan under the guidance of Dominique Desruelle and Bhaswar Mukhopadhyay (all SPR). SPR gratefully acknowledges inputs from, and helpful exchanges with, Sean Nolan, Enrique Gelbard, Chris Lane, and Jean Le Dem (all AFR), Ron van Rooden and Todd Schneider (both MCD), and Meron Makonnen (LEG). Country examples were also provided by respective country teams in AFR, MCD, and WHD.

² This note provides guidance on engagement with countries in fragile situations that are members of the Fund and have authorities that are recognized by the international community. Other cases—i.e., non-members and members without recognized authorities—are not covered here.

³ Under the Fund's Articles of Agreement, the Fund has an obligation to conduct surveillance and all member countries have an obligation to collaborate with Fund in its surveillance activities. In general terms, country surveillance focuses on assessing whether countries' policies promote domestic and external stability and the associated risks and vulnerabilities. See [The New Decision on Bilateral Surveillance over Member Policies, June 2007](#).

⁴ The use of Fund resources for budgetary support needs to be consistent with the Fund's legal framework and the Fund's mandate to provide balance of payments financing.

4. **Identifying fragility in countries and tailoring Fund engagement to their specific characteristics is crucial to enhancing the Fund's effectiveness in these countries.** In particular, Fund activities in these countries should be guided by: (i) attention to political economy; (ii) content and pace of reforms that reflect the need for security and social cohesion as well as capacity constraints; (iii) promotion of approaches conducive to sustained engagement; and (iv) close coordination with donors.
5. **The guidance note is organized as follows:** First, it discusses common features of countries in fragile situations. It then provides guidance on policy design and the choice of form of engagement. Finally, it discusses the political context in countries in fragile situations, specific aspects of TA and training, and donor coordination. Appendix I seeks to clarify how to reflect these various elements in the drafting of Policy Notes and Staff Reports, and the remaining appendices provide country examples and good practices.

CHARACTERISTICS AND IDENTIFICATION OF FRAGILE SITUATIONS

6. **While there is no universally accepted definition of “fragility” (see Box 1) and each country case is unique, countries in fragile situations typically share some common characteristics.** Countries in fragile situations exhibit a preponderance of characteristics, including: (i) significant institutional and policy implementation weaknesses assessed using the World Bank's Country Policy and Institutional Assessment (CPIA) or other relevant information;⁵ (ii) a fractious political context evidenced by a greater tendency to political stress and civil unrest; (iii) severe domestic resource constraints; and (iv) vulnerability to shocks. These characteristics may often translate into limited external assistance (often compounding the domestic resource constraint) and/or high degree of volatility in such assistance. Some countries may also experience domestic conflict, insecurity, and absence of government control, which may present spillover risks to neighboring countries.
7. **Notwithstanding these commonalities, there is significant heterogeneity between fragile situations, and fragilities in a given country tend to change over time.** The factors driving countries into fragility are case specific, as are the eventual transition out of fragility. Changing resource conditions, uncertain political transitions, shifting demographics, or lack of institutional capacity to deal with sudden and severe shocks can shift states from relative stability to political or economic fragility. In situations of fragility, the above-mentioned characteristics are combined in different ways in different countries at different times. A return to stability can vary

⁵ While the World Bank uses an average CPIA score of 3.2 and below to classify a state as fragile, teams can make a case for a more flexible approach to assessing institutional and policy implementation capacity based on other tangible information. Where a CPIA score is not available, such as in MICs, the assessment of institutional and policy implementation capacity would have to be made on a case-by-case basis.

from months to years (Somalia, for example, has been a failed state for over two decades, whereas the Kyrgyz Republic went in and out of two major political transitions within the course of one year each).

Box 1. Definitions of Fragility

World Bank World Development Report, 2011

Fragile states is the term used for countries facing particularly severe development challenges: weak institutional capacity, poor governance, and political instability. Often these countries experience ongoing violence as the residue of past severe conflict.

Fragility and fragile situations—Periods when states or institutions lack the capacity, accountability, or legitimacy to mediate relations between citizen groups and between citizens and the state, making them vulnerable to violence.

OECD Development Assistance Committee (DAC)

Fragility—Situations when state structures lack political will and/or capacity to provide the basic functions needed for poverty reduction and development, and to safeguard the security and human rights of their populations.

European Commission

Fragility refers to weak or failing structures and to situations where the social contract is broken due to the state's incapacity or unwillingness to deal with its basic functions, meet its obligations and responsibilities regarding service delivery, management of resources, rule of law, equitable access to power, security and safety of the populace, and protection and promotion of citizens' rights and freedoms.

8. **Effective Fund engagement requires, in the first instance, identification and regular updates of the country's main fragilities and of the authorities' policy capacity and commitment.** These can help country teams tailor engagement through the complex process of emerging from fragility. The multiple dimensions of fragility can be assessed by drawing on analysis from donors, academics, and other relevant sources.⁶ In particular, a (possibly lagged) snapshot of institutional and policy implementation capacity can be obtained using the World Bank's CPIA or other relevant information. These inputs can help country teams conduct needed regular assessments of: (i) the authorities' willingness and ability to implement policy reforms and build institutional capacity; (ii) progress made in building peace, security, and political and social cohesion; and (iii) the level of engagement and the durability of support from the international community (see Appendix I on requirements for Policy Notes and Staff Reports).

⁶ For example, available fragility indicators are discussed in the [German Development Institute/UNDP User's Guide on Measuring Fragility](#) (2009).

POLICY DESIGN

9. **In line with its central objective, Fund engagement with countries in fragile situations, should be aimed at achieving or ensuring macroeconomic stability and promoting sustainable growth.** While this is not different from engagement in non-fragile situations, sustaining a relatively stable economic environment is itself a key ingredient of transition from fragility. Near-term objectives will differ significantly between country cases depending on the individual context, but generally the medium-term objective is to make progress toward a stable and sustainable macroeconomic environment that is consistent with strong and durable poverty reduction and growth.

10. **With this overarching objective in mind, policy design in countries in fragile situations (both low and middle income) should ideally capture the following principles, while remaining consistent with the Fund's Conditionality Guidelines when policies are to be supported by a Fund arrangement.**⁷ These principles broadly apply across the whole Fund membership but are of particular importance in fragile situations (see Appendix V for experiences and good practices):

- *Explicit consideration of the political context:* A closer and more realistic assessment of the socio-political constraints to reform and adjustment is a highly valuable input into program design. Staff needs to be in a position to understand what policies and reforms can contribute to social cohesion (e.g., a fall in inflation from very high levels that gives consumers of staple goods a sense of stability); conversely, what policies and reforms can put significant stress on the political and social fabric (e.g., a large fall in public sector employment, including in the military); and whether and how such stress can be managed. An understanding of the political and social context should, to the extent needed or possible, be factored in the implementation of all of the remaining principles below.
- *A well-tailored pace of macroeconomic adjustment:*⁸ Quantitative objectives should take account of weak institutional capacity, uncertainties about domestic policy needs, and exposure to shocks. This principle is particularly important in situations involving peace-related spending, demobilization, or reconstruction, where policy and program design will need to reflect the costs of essential cohesion-building initiatives.
- *Opportunities for "quick wins":* At an early stage of engagement, it is important to focus on achievable, short-term objectives that can deliver early successes in order to build support

⁷ See [Conditionality Guidelines](#).

⁸ As evidenced by delays in completing reviews and programs going off track (see [Macroeconomic and Operational Challenges in Countries in Fragile Situations](#)), the authorities' commitment to an ambitious macroeconomic program that they do not have the capacity or the political commitment to deliver on, does not necessarily help mitigate risks to Fund financing.

for the process of reform. The delivery of quick wins in countries in fragile situations may have a more dramatic impact on building public support to reform compared to other low- and middle-income countries.

- *Inclusive growth and social protection:* Explicit attention to inclusive growth, job creation, and basic social safety nets would likely be a central component of the country's and international community's medium-term strategy. For instance, to enhance peace and security, providing employment opportunities for low-skilled, idle youth may be of utmost importance. While keeping with the Fund's central mandate, collaboration with donors and IFIs may help identify specific measures to include in Fund-supported programs that would offer the population the prospect of improving income and welfare, thus increasing buy-in to the reform process. The financial implications of these measures should be fully incorporated in the fiscal program.
- *Well-tailored structural reforms.* Low capacity would typically suggest the need for a strictly prioritized, gradual agenda of key structural reforms. Consideration should also be given to the timing of socially critical measures. Such approaches could help foster realistic expectations that could enhance the legitimacy of state institutions—an issue of particular relevance for countries in fragile situations. That said, in some but likely rare cases where sufficient external financial support, TA, and government ownership exist, a “window of opportunity” for a more comprehensive structural reform agenda may be considered.
- *Integrated TA:* Very close integration between policy advice and program design, on the one hand, and, on the other hand, TA is essential. In many if not most situations of fragility, adoption and effective implementation of key structural or institutional measures will not happen if the Fund or another international partner does not provide targeted and timely TA. Where applicable and beneficial, this approach can be reinforced with structural benchmarks and a TA matrix matching these benchmarks.
- *Contingency planning:* Explicit and candid recognition of both political and economic risks should lead to an associated emphasis in program design on contingency plans. In countries in fragile situations, contingency planning may be all the more needed given the often fluid political situation that can affect policy decisions. Contingency planning can take a variety of forms, depending on circumstances, from explicit consideration of approaches to maintain continuous engagement in the face of difficulties (e.g., how to maintain the policy dialogue and delivery of TA when a Fund-supported program has veered off-track) to the design of specific contingency measures.

11. **Program design will naturally differ between LIC and MIC cases, both in terms of capacity and financing needs.** For instance, middle-income countries (MICs) at risk of, or emerging from, fragility may well have significantly higher financing needs given greater integration with world financial markets and/or heavier debt obligations. However, with these particular concerns in mind, program design in MICs would still need to encompass the principles noted above.

MODALITIES OF FUND ENGAGEMENT

12. **Modalities of engagement.** The Fund has had an intensive engagement in most countries in fragile situations.⁹ Sustained engagement is considered key to real progress in institution building and solid improvements in macroeconomic and social indicators. For the Fund, this may well require repeated use of available facilities and instruments (in a manner consistent with the terms of the relevant policies), as well as long-term TA and training, in coordination with the donor community. Given the protracted balance of payments needs typically faced by countries in fragile situations, Extended Credit Facility (ECF) arrangements are expected to remain the main vehicle of Fund engagement across the set of countries in fragile situations and over the long haul. However, what form of engagement is most appropriate at any specific point in time for a specific country? More specifically, what should be considered when choosing between close engagement in a surveillance-only context, an SMP, use of the Rapid Credit Facility (RCF) or Rapid Financing Instrument (RFI), or a UCT arrangement? The following paragraphs should guide decisions on the form of engagement with countries in fragile situations, coupled with adequate consideration to country-specific circumstances, case-specific characteristics of fragility, and the need to promote approaches conducive to sustained engagement (see Appendix II for examples). Given heterogeneity among fragile situations, these paragraphs should not be taken to suggest that there is a “normal” or “standard” progression in forms of Fund engagement with countries experiencing fragility.

- **Close non-financial engagement:** There are some middle- and low- income countries in fragile situations that could benefit significantly from frequent policy dialogue with Fund staff and targeted TA, but where a financial arrangement is precluded because of protracted arrears to the Fund, insufficient commitment to implement reforms (for example, due to strong political impediments), or lack of a potential, actual (present or prospective), or protracted balance of payments need. In these instances, close non-financial engagement may be the most effective form of engagement (see Appendix III for examples).¹⁰
 - The Fund can have frequent interactions with the country to discuss and monitor macroeconomic developments and provide policy advice, including through elaboration of a quantified macroeconomic framework. This can be achieved using a combination of Article IV consultation missions and staff visits.

⁹ There are a few cases where Fund engagement was not immediately possible, or was minimal, due to security concerns. Some examples include Somalia, Democratic Republic of Congo in 1997, Liberia in 2000–03, and Cote d'Ivoire in 2003. Fund staff has sought to overcome security obstacles through discussions with the authorities in third-party countries or special security measures. Some recent examples include Afghanistan, Yemen, Pakistan, and Iraq.

¹⁰ See also footnote three on member obligations under the Surveillance Decision. This option is available for all members. In practice, the extent of its use by Fund departments reflects, on the supply side, priorities and budget constraints and is subject to Management approval.

- Extensive TA can also be provided as needed to build capacity.
- *The Fund can, and should, remain closely engaged with the country's development partners to help countries design and implement a well-coordinated set of policies and to coordinate responses to TA needs. Where useful, and where requested by the member, staff could produce regular reports on macroeconomic developments and policies and related capacity building for the benefit of the international community.*
- **Staff-Monitored Program:** An SMP can be used to help member countries, including middle- and low-income countries, establish, or re-establish a track record of policy implementation ahead of a Fund financial arrangement. In particular, where needed, an SMP can help provide assurances that the authorities have the capacity and commitment to implement a UCT-quality economic program (see Appendix IV for country examples).
 - The use of an SMP would be more appropriate than an RCF in cases where (i) significant capacity constraints exist and there are no adequate safeguards to Fund resources; and (ii) there is no urgent need to draw on the Fund's financial resources. In some cases, an SMP and a drawing under the RCF may be used concurrently if an urgent financing need arises.
 - SMPs can also be the preferred modality of engagement with countries that have overdue obligations to the Fund or have arrears to official or external private creditors. In these cases, careful examination of a country's financing situation will be needed in light of a probable subsequent request for a Fund arrangement or for the resumption of an arrangement that has gone off track.¹¹
- **Rapid Credit Facility (for PRGT-eligible countries):** The RCF is the preferred choice of engagement in low-income countries (LICs) that cannot yet implement UCT policies due to a variety of factors (e.g., inability to make credible commitments beyond the short term, inability to absorb stress from large policy adjustment, severe capacity constraints) but where Fund financing is needed to address an urgent balance of payments need.¹² The RCF was designed, inter alia, for circumstances where UCT conditionality is "not feasible, for instance in cases where institutional and policy capacity is highly constrained" or is not needed.¹³

¹¹ See [The Handbook of IMF Facilities for LICs](#) (The Handbook) for more information on track records under the RCF and SMPs.

¹² The terms and conditions of use of the RCF are set in the [PRGT Instrument \(see Decision No. 8759-\(87/176\)\)](#).

¹³ See [A New Architecture of Facilities for Low-Income Countries](#) and [The Handbook](#) for more information and for the criteria for approving RCF financing.

- In addition to providing some financial support,¹⁴ the RCF can provide a framework for policy support and TA, and also play a catalytic role in mobilizing donor financing.
- Support under the RCF can facilitate an improvement in policies and outcomes needed to meet the requirements for an ECF arrangement. In some cases, as part of a well-paced progression out of fragility, repeated use of the RCF can help countries build a track record toward a UCT arrangement in a way tailored to country-specific characteristics.¹⁵ Support under the RCF can facilitate a build-up in institutional capacity and a gradual improvement in economic policies needed to meet requirements for an ECF arrangement. In these cases, the RCF would facilitate sustained engagement, avoiding a “stop-and-go” pattern that might result from targeting over-ambitious policies under a UCT arrangement. It would best be framed within a medium-term strategy, which would highlight the Fund's intention to have such a sustained engagement with the concerned member country. Financing under the RCF can also be underpinned by a track-record SMP.¹⁶
- Flexibility can be practiced under certain circumstances for countries that have arrears to official or external private creditors, making RCF disbursements possible without meeting all the conditions of the Fund's policies on non-tolerance of sovereign arrears or lending into arrears.^{17 18} For instance, in the wake of a conflict or natural catastrophe, use of the RCF can be part of a concerted plan of action by the international community that is expected to lead to the normalization of relations with official creditors and a program supported by a Fund financial arrangement. In all cases where external arrears exist, staff reports for RCF requests should provide detailed information on such arrears and discuss prospects for arrears clearance.
- The RCF should not be used if a UCT-quality program is feasible and more appropriate.

¹⁴ Access norms and limits differ for each Fund financial facility and is largely determined by balance of payments needs, the strength of the program, and capacity to repay the Fund (see paragraph below on Access).

¹⁵ Repeated use must be consistent with the rules set in the PRGT Instrument and would be subject to access limits under the policy.

¹⁶ See [The Handbook](#) for eligibility and qualification under the RCF.

¹⁷ The treatment of external arrears in Fund arrangements is governed by four inter-related policies: financing assurances, the non-tolerance of sovereign arrears to official creditors, the lending into arrears, and disputed claims. See [The Handbook](#) and the [Review of Fund Policy on Arrears to Private Creditors](#). In cases where use of the RCF is envisaged in the presence of external arrears, area department staff should contact SPR and LEG to discuss requirements stemming from these policies.

¹⁸ In principle, the Paris Club only offers rescheduling to countries with a UCT arrangement in place. However, there have been very few exceptions to this rule (e.g., Iraq 2004), where an agreement was reached on the basis of an EPCA.

- **Rapid Financing Instrument (GRA financing):**¹⁹ The RFI is designed to provide rapid, low-access financing to address urgent balance of payments needs arising from a variety of circumstances, including fragile or post-conflict situations or other disruptive events. Like the RCF, the RFI was designed for situations where UCT-quality conditionality is either not feasible, for example due to current institutional and policy implementation constraints, or not necessary.
 - In addition to providing financial support, the RFI can provide a framework for policy support and TA, and play a catalytic financing role for both official and market sources.
 - Like the RCF, in some cases, repeated use of the RFI, consistent with the rules, can be part of a well-paced progression out of fragility. Policy support under the RFI can also be tailored to help countries build a track record toward UCT arrangements. Financing under the RFI can also be underpinned by a track-record building SMP. Use of the RFI, with or without an SMP, would provide an opportunity to assess the member's commitment and progress toward building commitment to reform and the ability to implement an UCT-quality economic program.
 - Like the RCF, there is flexibility in applying the Fund's policies on non-tolerance of sovereign arrears and lending into arrears in the context of RFI disbursements.²⁰
- **UCT Arrangements (for PRGT-eligible countries and GRA financing):** As any other Fund members, countries in fragile situations are eligible to use Fund financing facilities requiring the implementation of a UCT-quality economic program. In some circumstances, moving quickly to a UCT arrangement may have large payoffs, but in others, moving too early could be counter-productive and may result in ineffective implementation of the UCT arrangement. An example of the former type of circumstances would be the presence of new governments with strong reform credentials backed by strong TA and policy support from the international community. Therefore, adoption of a UCT arrangement in a fragile situation requires a careful assessment of the strength of the program and the prospects for its implementation, taking note of relevant institutional, social, and political risks and constraints; these arrangements should be deployed only in support of programs that have good prospects for success.

13. **Re-evaluation of modes of engagement.** As precise judgments on the credibility of policy commitments and on implementation capacity are difficult to make, staff needs to remain open to re-evaluate modes of engagement. This is particularly true for the choice between RCF/RFI and UCT arrangements. For instance, in circumstances where the initial strategy

¹⁹ See [The Fund's Financing Role: Reform Proposals on Liquidity and Emergency Assistance](#) and [Executive Board Decision No. 15015-\(11/112\) of November 21, 2011](#) for more information and for the criteria for approving RFI financing.

²⁰ See footnote 18.

envisaged several RCF or RFI purchases but progress under these purchases has been faster than expected, a quicker switch to a UCT arrangement may be advisable. Similarly, when the initial strategy envisaged early use of a UCT arrangement but that arrangement has been marked by severe and repeated slippages, it could be beneficial to all parties to switch to a different mode of engagement (e.g., use of the RCF/RFI or SMP before a new UCT arrangement).

14. **Access:** Determination of access should be considered for each RCF/RFI disbursement and UCT arrangement in the context of the needed length of engagement and the access norms, limits, and caps established for each individual facility. As with all Fund financing arrangements, access depends on three standard criteria: (i) the member's balance of payments need; (ii) the strength of its program and capacity to repay the Fund, taking into account the member's policy plans, adjustment effort, commitment to implement the program, institutional capacity, track record of policy implementation, and country circumstances, such as vulnerabilities, imbalances, and debt sustainability; and (iii) the amount of outstanding Fund credit and the member's record of past use.²¹

CONSIDERING THE POLITICAL CONTEXT

15. **A deeper understanding of the political context in countries in fragile situations is needed to improve the design of Fund-supported policies, particularly the pace of adjustment and reform, and to have a more informed judgment of the risks of engagement.** A deeper knowledge and understanding of specific country contexts, including the political and institutional environment, and the constraints and opportunities they create can help support a more effective and feasible reform strategy. In fact, in the UFR context, the Fund's Guidelines on Conditionality provide that "the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems and their administrative capacity to implement reforms". Moreover, the Fund's Guidance Note on The Role of the Fund in Governance Issues notes that seeking information about the political situation in member countries can be an essential element in judging the prospect for policy implementation.²² Paying attention to countries' political circumstances can also help improve the prospects for successful and sustained engagement with countries in fragile situations, as it can inform more realistic expectations of what can be achieved, including the adoption of second best reforms, and shed light on the risks involved. Having said that, however, understanding the political context may not be straightforward, especially given the complexity and volatility of political and social developments in countries in fragile situations.

²¹ See [The Handbook](#).

²² See [The Role of the Fund in Governance Issues](#) and the Fund's [Conditionality Guidelines](#).

16. Fund staff should coordinate closely with donors and other IFIs to share information on (subject to confidentiality procedures), and understand, the political economy in countries in fragile situations. Fund staff, especially resident representatives, should also conduct their own evaluation of the political situation and social context, to the extent possible. By doing so, the extent and pace of policy measures set under a Fund-supported program, including macroeconomic adjustment and structural reforms, may also be consistent with socio-political factors. The main areas to consider when analyzing the main drivers of political decisions in countries can include: (i) political process in the country; (ii) the role of formal and informal norms; (iii) social risks and access to public goods; and (iv) the main fault lines in society. Alongside such understandings, strong outreach by mission teams and resident representatives with local civil society, parliamentarians, and academics can also help build support to the reform program and increase understanding of the role of the Fund in the reform process (see Appendix VI for fuller details and good practices in understanding the political context).

TECHNICAL ASSISTANCE AND TRAINING

17. Capacity building, which includes TA and training, should be an integral part of the Fund's engagement with countries in fragile situations, regardless of the mode of such engagement. Key principles include the following:

- Paying closer attention to a country's absorption capacity, including the availability of staff and other resources in the country.
- Developing well-tailored TA programs, with discrete objectives and deliverables that are clearly aligned with the objectives of the program, the authorities' capacity, commitment to implement reforms, and quick wins if identified.
- Focusing on a programmatic approach to TA. This will typically involve preparation with country authorities of a plan that spells out how the Fund's TA will support their reform objectives over the medium term. This approach provides greater predictability for the recipient country and continuity in the provision of TA, which in turn facilitates improved coordination among TA providers.
- Using results-based management to both improve the design of TA projects and programs. This means focusing on clear outcomes and appropriate and well-designed indicators and milestones, as well as tracking and reporting on TA performance.
- Increasing reliance on resident macroeconomic advisors—utilizing new financing facilities and instruments where necessary.²³ Given significantly more constrained capacity in countries

²³ For example, DFID is providing financing under a three-year program to station resident advisors in six countries in fragile situations in the Middle East and Central Asia region, to help with building capacity in key economic institutions.

in fragile situations, boots on the ground may be a more effective and lasting form of delivering TA, particularly at an early stage, when efficient communication and coordination with the authorities are crucial to kick-start capacity building.

- Enhancing ongoing donor coordination, including the use of trust funds supported by donor financing—without overwhelming country officials and creating competing TA initiatives. The Steering Committees of RTACs would be a natural platform for this, in particular against the background of plans to better integrate them into the Resource Allocation Plans/Regional Strategy Note processes. IMF participation in country-specific donor groups would also be desirable, as appropriate and feasible. See below for more details on donor coordination.

18. **Training of country officials, including through increased emphasis on training in home country and greater use of RTACs.**²⁴ A regional approach has the advantage of offering opportunities for peer-to-peer learning, while maintaining a focus on the specific needs of the region. Again here, the principle of boots on the ground may be more beneficial in the context of fragility.

COORDINATING WITH DONORS

19. **The Fund can play an important role in coordination efforts between the authorities and donors, including development agencies, in countries in fragile situations.** While the Fund may not always assume the role of lead coordinator, it is often expected to play a catalytic role through its financing and the establishment of a consistent macroeconomic framework. To improve the Fund's performance in this area, country teams, particularly resident representatives, would be expected to pay more attention to the following:

- Remain closely engaged with donors on their *financing commitments* and discuss countries' financing needs.
- Help keep donor engagement focused via prioritization of key program objectives within the resource envelope, while working closely with the country authorities to avoid overwhelming their capacity. In some instances, this can be achieved through the use of common conditionality matrices, which target a limited set of complementary reforms supported by the country's development partners (see Appendix VII for an example).
- Work closely with country authorities and donors to identify quick wins, taking into consideration financing implications. Where possible, quick win reforms should be embedded into Fund macroeconomic frameworks. Missions should work with country authorities, donors, and IFIs on the ground to help quantify financing implications of the

²⁴ The IMF institute works with a large number of regional training organizations and with the RTACs when deciding on course topics, which are highly demand driven.

identified reforms and, wherever possible, incorporate them into the authorities' budget and the Fund's macroeconomic framework.

- Discuss with donors their understanding of the political and social situations to provide context to the reform strategy and to better tailor the pace and type of reforms.
- Be engaged on use of budget support as an important and flexible mode of delivery of donor assistance, including through country-specific trust funds with links to performance under Fund-supported programs.²⁵ In countries that already have multi-donor trust funds (MDTFs) in place or where the establishment of MDTFs is under consideration (at the World Bank, other IFI, or bilateral donors), Fund staff should strive to remain fully informed of the process, in order to study the opportunity for a donor budget support window that would be linked to a Fund-supported program.

²⁵ The intention is not to have the Fund manage MDTFs, but rather that any such MDTFs are linked to Fund-supported programs, in order to help donors channel budget support to governments through MDTFs. A good example would be the [Afghanistan Reconstruction Trust Fund](#), which is administered by the World Bank (see Appendix VIII for details).

APPENDIX I. DOCUMENTATION AND REVIEW PROCESS

This appendix summarizes documentation requirements and procedures for a typical mission cycle to a middle- or low-income country in a fragile situation. The basic requirements vis-à-vis Policy Notes, Briefing Memorandums, and Staff Reports, the review process, Management clearance, and other requirements are the same as those for non-fragile states. This appendix highlights any additional issues of relevance to countries in fragile situations. The guidance below should be interpreted flexibly and sensibly. In particular, one would expect discussions of issues pertaining to the overall approach to Fund engagement—e.g., characteristics of fragility, political and social context, capacity, and willingness to implement reforms—to be extensive at the initiation of a new program or when unexpected developments call for a re-evaluation of important elements of Fund engagement or policy design. While treatment of such matters would likely be lighter when recent developments were broadly in line with expectations.

A. Identification of Fragilities

1. **Mission teams should explicitly identify characteristics of fragility in a country as the first step in the design of Fund engagement.** Common characteristics are discussed in the second section of the guidance note. Mission teams should indicate whether a country displays some or all of these characteristics and link such information to the choice and modality for Fund engagement.
2. **Country teams need to be able to continuously tailor the level and nature of Fund engagement during the complex process of emerging from fragility.** The following procedures should help maintain focus of teams working on countries in fragile situations on the principles laid out in this guidance note.

B. Pre-Mission Work

3. **Early consultation:** Area departments should informally consult with SPR, FIN, LEG, and relevant TA departments at an early stage when recognizing fragility in countries. In cases where new financing or program support is envisaged, early consultation should focus on the choice of instrument and access. Early consultation is also encouraged where a Fund-supported program is already in place but area departments deem it necessary to rethink the approach to better suit the country.
4. **Policy Note:** For new programs, Article IV consultations, or when unexpected developments call for a re-evaluation of elements of Fund engagement or policy design, Policy Notes should explicitly address the nature of fragility, including, as needed, sufficient exposition of (i) characteristics of fragility in the country, including recent events or changes to the status quo (as described in the second section of the guidance note); (ii) political and social context, including source of information (i.e., donors and/or other IFIs) if applicable (see fifth section of

the guidance note);¹ (iii) information on capacity constraints and governance, including capacity and willingness to implement reforms; and (iv) aspects of donor coordination (see seventh section of the guidance note). These issues should supplement the usual requirements for Policy Notes as per existing guidance.² In addition to this, the following would apply:

- If the Policy Note pertains to a **request for a new UCT arrangement or initial RCF/RFI disbursement**, a brief discussion of the overall strategy that would help the country transition out of fragility, in terms of the choice of facility or instrument and elements of program design that reflect the pillars discussed in this Guidance Note.
- Similarly, for **existing program reviews or repeated RCF/RFI disbursements**, the Policy Note should identify any changes in program design in accordance with this Guidance Note, also referring back to the overall strategy that would help the country transition out of fragility.
- Policy Notes for **Article IV consultation missions** should lay out the characteristics of fragility, the political and social context, capacity and governance issues, and coordination with donors. Policy advice on the medium-term approach should focus on helping the authorities build capacity and achieve macroeconomic sustainability in a way that helps the country transition out of fragility.

C. On Mission

5. **While in the field**, missions should coordinate closely with other multilaterals, donors, and experts on the ground, both to understand the political and social context, and to formulate an aligned reform agenda that better considers the financial implications of reforms.

6. **Letter of Intent/Memorandum on Economic and Financial Policies (LOI/MEFP)**: For new financing/program requests and for program reviews, the authorities of the member country will need to discuss in their LOI/MEFP the overall strategy to improve institutional capacity and governance, along with the objective of achieving medium-term macroeconomic sustainability. The LOI/MEFP should set out the policies and measures they intend to pursue in line with their Fund-supported program. In cases of repeated use of an RCF (LICs) or RFI (MICs), which are intended for building a track record, the LOI/MEFP could usefully present a non-UCT program with explicit targets. It could also discuss any expectation that there may be repeated disbursements, ahead of which program implementation would be reviewed and program targets updated. Such a set up would provide the structure for evaluating progress made toward an UCT-standard program (i.e., the track record).

¹ In complex situations, teams can include a political diagnostic as an attachment to the Policy Note and refer to that diagnostic as needed to justify specific policy design features.

² For further details, see [The Handbook](#) and [GRA lending toolkit and conditionality](#).

D. Post-Mission Work

7. **Back-to-Office Report (BTO):** The BTO should highlight any developments with respect to the strategy based on this guidance note, including program design and issues related to fragility, political developments, and coordination with donors.
8. **Staff Report:** Staff reports for countries in fragile situations should include sufficient exposition of the requirements noted above for Policy Notes as needed, in addition to the usual requirements for Staff Reports as per existing guidance.

E. Other Documents

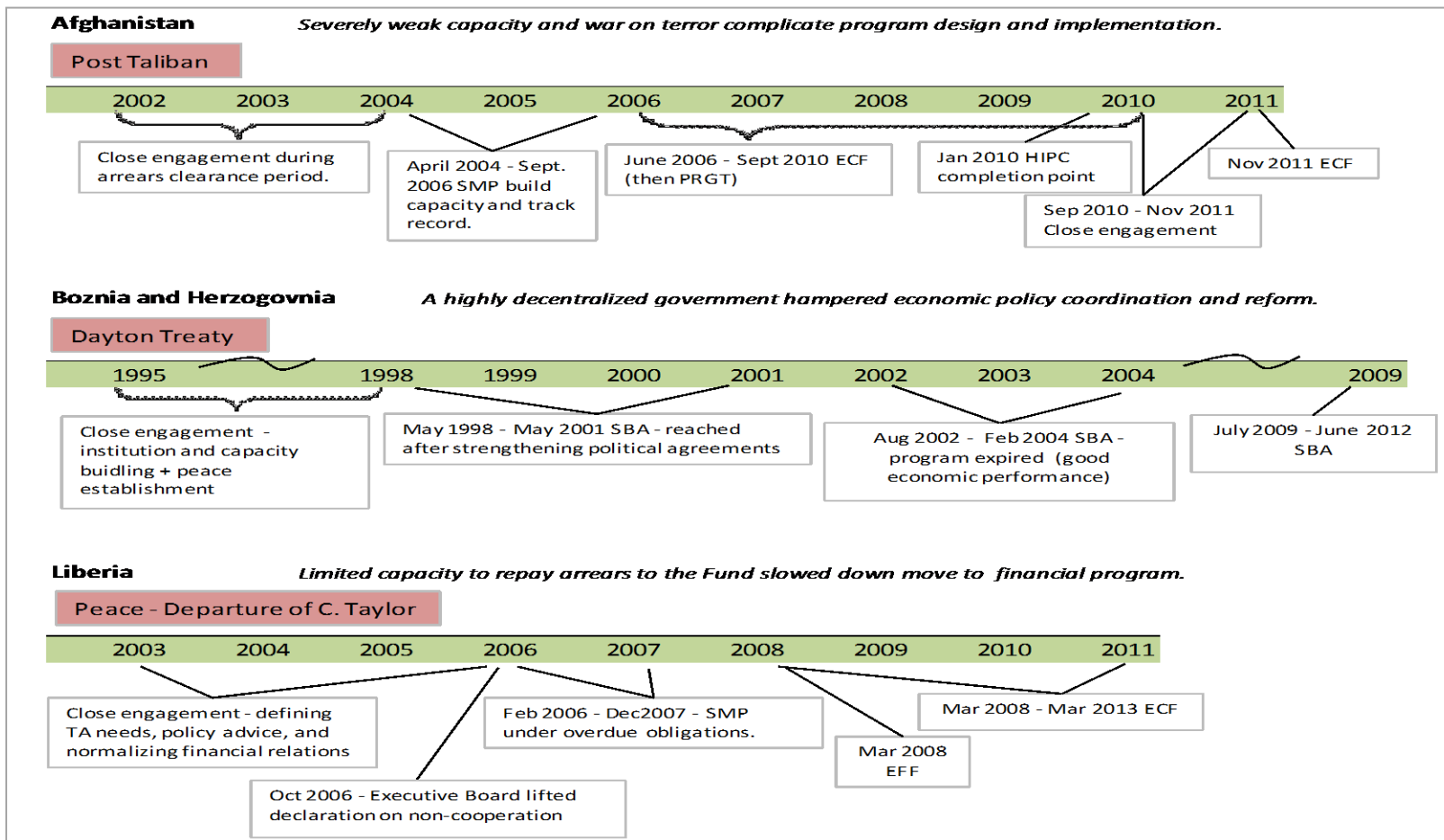
9. **The Joint Management Action Plan (JMAP) for LICs:**³ In addition to the standard requirements under the JMAP process,⁴ Fund staff should discuss with the World Bank the overall strategy to help the country transition out of fragility, including program design and TA needs. Furthermore, as noted in this Guidance Note, Fund staff should work closely with the World Bank, through the JMAP process and on the ground, to prioritize reforms and identify quick wins that can be integrated into Fund-supported programs, where possible. The joint memorandum for files should document such discussions.

³ The usual requirements for a PRSP and the PRS process apply as per the [Updated Staff Guidance on Poverty Reduction Strategy Documents](#).

⁴ See [The Handbook](#) and [Implementation of the Joint Management Action Plan on Fund-Bank Collaboration](#).

APPENDIX II. EXAMPLES OF FUND ENGAGEMENT IN COUNTRIES IN FRAGILE SITUATIONS

This appendix provides country examples of Fund engagement, highlighting the form of engagement at different stages.



APPENDIX III. EXPERIENCE WITH CLOSE NON-FINANCIAL ENGAGEMENT IN COUNTRIES IN FRAGILE SITUATIONS

This appendix provides examples where non-financial engagement in countries in fragile situations was closer, given that a financial arrangement was precluded either because of protracted arrears, lack of sufficient policy commitment, or absence of financing needs that could be met by the Fund.

A. Zimbabwe

Arrears to the Fund and a declaration on non-cooperation preclude a financial arrangement with Zimbabwe. Close non-financial engagement became the best form of engagement. It includes policy advice, regular updates of the macroeconomic framework, and targeted TA.

1. **After the inauguration of the new government in February 2009, the collaboration between the authorities and Fund staff became more intensive.** The 2008 presidential and parliamentary elections took place against a background of mass unemployment, hyperinflation, and an acute humanitarian crisis. Following mediation by South Africa, the ruling ZANU-PF Party and the political opposition agreed to form a coalition government and share power. The first Fund mission, following the inauguration of the new government, visited Harare in March 2009.
2. **Fund engagement since 2009 has focused on supporting the short-term economic recovery.** Fund staff has prepared regular updates of the macroeconomic framework, including detailed revenue projections, and made recommendations to strengthen the macroeconomic stabilization, introduce structural measures, and improve the credibility of the new dollarized monetary system. Following decisions by the Executive Board in 2009 to lift the suspension of TA in targeted areas, functional departments started to provide TA in (i) tax policy and administration; (ii) payments system; (iii) lender-of-last resort and banking supervision; and (iv) central banking governance and accounting.¹

B. Liberia 2003

Given arrears to the Fund and the need to normalize relations between Liberia and the international community, close non-financing engagement was the most effective mode of

¹ The suspension of TA has subsequently been lifted also in (i) macroeconomic statistics; (ii) PFM; and (iii) anti-money laundering and combating the financing of terrorism.

engagement. The initial focus was on capacity building in policy-making and implementation in preparation for an SMP (see Appendix III).

3. **Fund re-engagement began quickly after the signature of the 2003 Peace Treaty leading up to the successful elections.**

Following the signature of a peace treaty and the departure of President Taylor in August 2003, the UN Security Council established the UN Mission in Liberia (UNMIL). In October 2003, a National Transitional Government (NTGL) was established as a power-sharing arrangement to prepare for elections in October 2005. The Fund sent a mission to report on the post-conflict situation in December 2003 in parallel with TA needs missions from FAD, MCM (the then MFD), and STA.²

4. **The immediate post-conflict engagement focused on defining TA needs, policy advice, and normalizing financial relations with the Fund, with an SMP unlikely for mid-2004.**

Staff outlined a TA program and assisted the authorities in crafting fiscal policies for January–June 2004. To de-escalate the remedial measures in place, a record of token payments to the Fund was requested as well as the implementation of sound policies including a balanced budget in recognition of the weak financing situation. Token payments to the Fund started in January 2004. The prospects for an SMP were seen by Fund staff to depend on policy performance in the first half of 2004, the 2004/05 budget, and improving the provision of data. With the help of external partners, the NTGL elaborated a two-year reform program for 2004–05. In discussions on the post-conflict situation by the Executive Board in February 2004, some Directors favored an early SMP while others cautioned against moving too quickly.

5. **Subsequent missions concluded that, despite continued and close support, a mixed record of cooperation with the Fund and slow progress meant that the authorities were not yet ready to adopt and implement an SMP.**

The economic program through June 2004 was successfully implemented but slippages were reported on fiscal and monetary policies and governance in subsequent months. The April 2005 review of overdue obligations to the Fund and Article IV consultation concluded that there was a lack of unified support in the transitional government and many new governance issues had arisen. In light of the difficult post-conflict circumstances staff proposed no further remedial actions in April 2005 and implicitly waited for the October 2005 elections and a new administration.

² Country Report 04/84: [Liberia-Report on Post-Conflict Economic Conditions and Economic Program for 2004/05](#).

C. West Bank and Gaza

As West Bank and Gaza (WBG) is considered an entity (not a member of the Fund), Fund support can only take the form of close engagement. Over the years, this focused on policy advice, TA, and regular reporting to inform the donor community. The Fund's role in coordinating donor support was also important.

6. **Because the WBG Strip is not a member of the IMF, Fund support is limited to providing TA.** The Fund cannot provide financial support to WBG because it is not a member state, but Fund staff has taken a leading role among international agencies in the work related to economic, fiscal, and financial issues.
7. **Fund staff worked with the Palestinian Authority (PA) to develop the Palestinian Reform and Development Plan (PRDP) presented at the Paris Donors' Conference in 2007 and, more recently, its successor Palestinian National Development Plan, published in 2011.** Fund staff reports reviewing progress in implementing the plans have been taken into account by donors in their disbursement decisions (see <http://www.imf.org/wbg> for recent reports). The bi-annual staff reports are timed with the donors' meetings and have been used for informal Board briefings on the WBG.
8. **The public finance management system had been severely degraded by mismanagement and financial sanctions.** Fund staff provided policy advice and TA to restore financial controls, enhance fiscal transparency and accountability in line with international standards, and ensure detailed monthly reporting of budget execution on the Ministry of Finance's website.
9. **The Fund has been the primary provider of policy advice and TA to the Palestinian Monetary Authority (PMA).** The PMA has over time gained the trust of the Central Bank of Israel and international banks, and is now able to regulate and supervise the Palestinian financial system fully, with rigorous implementation of regulations against money laundering and the financing of terrorism.
10. **Fund staff worked with the authorities to develop a macroeconomic framework to enable a continual appraisal of economic conditions and outlook in the Palestinian territories.** In parallel, intensive TA has been provided to raise the quality of official economic statistics.

11. **After the preparation of the PRDP, and its endorsement by the Fund's Executive Board, the Fund began close monitoring of implementation.** IMF Executive Directors endorsed the Plan at an informal Board meeting held in December 2007. The achievement of the Plan's objectives required close cooperation among the PA, the government of Israel, and the donors. The IMF staff was mandated to review the Plan's implementation in the fiscal and macroeconomic areas, and assess the corresponding performance of the WBG's economy. In 2010, the staff assisted the PA in the preparation of the 2011–13 Palestinian National Development Plan (PNDP)—a successor plan to the 2008–2010 PRDP. The PNDP was published in 2011. The staff has been reviewing the new Plan's implementation through bi-annual reviews.

12. **The staff has monitored the Plan's implementation through bi-annual staff visits reflected in staff reports.** The reports, together with the reports prepared by the World Bank and the UN, are discussed at bi-annual donors' meetings. The Fund and Bank staff reports are taken into consideration by donors in their aid disbursement decisions.

13. **During the missions staff discusses the economic situation and progress in economic reforms, with the PA, Government of Israel officials, and donor representatives.** The discussions with the Israeli authorities have centered on conveying the staff's analysis of the economic consequences of Israeli measures that have an impact on the WBG's development and growth. The Israeli authorities have considered the Fund's analysis helpful in informing their decisions aimed at helping the PA's development efforts. In their discussions with donors, Fund staff has worked to strengthen the donor community's engagement in the WBG, with a focus on encouraging the provision of adequate and predictable support to the PA budget.

14. **Fund staff has worked to strengthen the donor community's engagement in WBG, with a focus on encouraging the provision of adequate and predictable support to the PA budget.** At the local level, in Jerusalem and Ramallah, Fund staff has been supporting donor aid coordination through co-chairing, with the PA, of a local forum. Through the forum the staff and the PA apprise key donor representatives of the latest developments in the areas covered by the staff reports.

APPENDIX IV. EXPERIENCE WITH STAFF-MONITORED PROGRAMS (SMP) IN COUNTRIES IN FRAGILE SITUATIONS

This appendix provides examples where SMPs proved the most effective mode of Fund engagement in some countries in fragile situations.

A. Liberia 2006–07

Given arrears to the Fund, after initial progress was made on capacity building, an SMP was the most appropriate modality after re-engagement with Liberia. The SMP helped improve cooperation with the Fund and good performance helped to rapidly bring back donor support.

1. **Immediately after a new government took office in January 2006, a Fund SMP was put in place, covering February to September 2006.** The SMP envisaged a balanced cash-based budget (maintained through the SMP and through the subsequent ECF arrangement) and structural measures to strengthen fiscal and monetary management and improve governance.¹
2. **Staff soon reported much improved cooperation from the new administration on both policies and payments to the Fund and support from other partners rapidly increased during 2006.**² Staff suggested that SMP performance together with the accumulation of sufficient resources for debt relief could form the basis for a rights accumulation program, a comprehensive arrears clearance operation, and HIPC/MDRI-like debt relief. In June 2006, IDA approved a pre-arrears clearance grant in the amount of US\$30 million, and gross donor assistance rose to approximately US\$300 million in 2006 (excluding any arrears accumulation). The SMP was broadly on track at the time of the first review (September 2006) and de-escalation of remedial measures began. Fiscal management improved, and international experts were deployed to monitor transactions and strengthen capacity in revenue collecting agencies and other public institutions under the GEMAP.
3. **The SMP was extended to June 2007 with parallel efforts to raise the necessary funds for financing Fund debt relief.** In October 2006, the Executive Board lifted the

¹ After extensive negotiations with donors, the Fund, the World Bank, and the transitional government set up the GEMAP in 2005. The program invited external financial controllers into key revenue collecting agencies (including the central bank). This was seen as a critical early foundation for the successful SMP and subsequent ECF (see Appendix III)

² The token monthly payment to the Fund was increased from \$50,000 to \$60,000.

declaration of non-cooperation.³ The review of overdue obligations also noted that proceeding to a RAP would be difficult, not least because the RAP policy would likely need to be modified to allow an increase in arrears as Liberia had insufficient resources to meet Fund payments falling due.⁴ Various options for funding the debt relief were presented to the Board in November 2006.

4. **The SMP was extended again to December 2007 while efforts continued to raise debt relief financing.** Performance was mixed for the second review (January 2007), particularly related to structural reform implementation, but judged broadly satisfactory for the third review (June 2007). Liberia could not move to a RAP because payment capacity was limited and it was still accumulating arrears, while financing assurances for debt relief had not been obtained. At the time of the second SMP review, staff and the Board considered the SMP to be of upper credit tranche conditionality standard, apart from financing assurances.

5. **In June 2007, a comprehensive financing package was proposed which eventually was supported by the Board.** It involved a distribution of SCA-1 resources and Liberia-related burden-shared deferred charges adjustments that would be returned to members and then voluntarily pledged to a Liberia trust fund; and new cash contributions, including an SDR 45 million commitment from the G-8. This package would enable an arrears clearance operation as well as eventual debt relief and facilitate a move from the SMP to a Fund arrangement, without a need to engage in a RAP.

B. Afghanistan 2004–11

Given arrears to the Fund, modalities of re-engagement with Afghanistan started with intensive cooperation (close engagement) that focused on policy advice and capacity building. An SMP was approved after two years of progress to build capacity toward a UCT arrangement.

6. **The Fund's program engagement with the post-Taliban government of Afghanistan began in 2004 with a one-year SMP.** The SMP followed a period of intensive cooperation with the new government since January 2002 that focused on policy advice and TA

³ The de-escalation policy applies a case-by-case approach. The guideline for the length of the evaluation period that would lead to the restoration of voting and related rights is about two years while that for lifting the declaration of non-cooperation is about one year.

⁴ See [Review of the Fund's Policy on Overdue Financial Obligations](#).

for institutional capacity building in the fiscal, monetary, and statistical areas, but also clearance of Afghanistan's arrears to the IMF, the World Bank, and the Asian Development Bank. The first post-2001 Article IV consultation took place in 2003. Subsequently, an SMP was agreed for the period April 2004 to March 2005 that aimed at maintaining financial stability and preparing the groundwork for a more comprehensive Fund-supported loan arrangement. Key measures included strengthening the economic and financial databases to reinforcing the government's capacity to monitor economic developments and conduct macroeconomic policies.

7. Program implementation under the 2004 SMP was broadly on track amid a difficult security situation and the challenges of rebuilding the political and economic institutions.

The SMP was set against a background of poor infrastructure, a large informal/illicit economy (including the opium sector), as well as weak institutions and governance structures. Despite this challenging environment, the authorities established a record of sound fiscal and monetary policies, which contributed to economic growth, declining inflation, the build-up of international reserves, a relatively stable exchange rate, and sizable revenue gains.

8. The SMP was extended twice—first to end-September 2005 and then to end-September 2006. This allowed the authorities to improve their capacity to be able to implement a formal arrangement with the Fund, and prepare an interim Afghanistan National Development Strategy (ANDS) that formed the basis of an economic program supported by the IMF's Poverty Reduction and Growth Facility (PRGF).

9. The SMP was succeeded by a three-year PRGF arrangement in June 2006. The program continued capacity building, consolidated macroeconomic stability gains, aimed at poverty reduction and creating an investment climate conducive to private sector investment and sustained growth and sought to strengthen supervisory and enforcement capacity at the central bank. In January 2010, Afghanistan reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative, which brought a debt relief of \$1.6 billion. Notwithstanding the accomplishments in macroeconomic management, limited progress was achieved in improving governance and strengthening institutions in line with the fast-developing private sector. The most compelling example is the collapse of the largest bank in the country, Kabul Bank, in September 2010. Taking advantage of the poor institutions and using political influence, the shareholders of Kabul Bank committed large-scale fraud that endangered the financial stability of the country and imposed a large fiscal cost (about 6 percent of 2010 GDP).

Due to capacity limitations and vested interests, managing the crisis has been slow. As a result, discussions for an ECF to succeed the 2006–10 PRGF were drawn out until November 2011, after the authorities had taken some critical measures to deal with Kabul Bank.

10. **A new three-year ECF arrangement was approved in November 2011.** The program addresses the near-term problems that emerged from the collapse of Kabul Bank and, more generally, seeks to strengthen the banking system. Moreover, the program will provide the macroeconomic framework to help the authorities manage economic challenges posed by the scheduled departure of foreign troops in 2014 and an expected gradual decline in donor support. To this end, the authorities intend to raise domestic revenue collection, improve PFM, and move Afghanistan toward fiscal sustainability. The success of the program will depend critically on the progress in improving governance, safeguarding the rule of law, reducing the role of the illicit sector, and limiting the influence of vested interests.

APPENDIX V. GOOD PRACTICES IN PROGRAM DESIGN IN COUNTRIES IN FRAGILE SITUATIONS

This appendix provides examples of good practices pertaining to program design, broadly based on the pillars discussed in the third section of the guidance note.

A. Sierra Leone: A well-tailored adjustment program

1. **Fund engagement.** The stated rationale for financial involvement was the uncertainty in external conditions, an underlying balance of payments need, and the role of Fund-supported policies in catalyzing international support. The size of PRGF arrangements (120 percent of quota) exceeded the normal 90 percent of quota, a reflection of generally sizable financing requirements following periods of conflict or other emergencies. In addition to a relatively large PRGF allocation, the disbursements in Sierra Leone's program were heavily front-loaded. The approach was validated as the appropriate policy mix was implemented and it succeeded in mobilizing international assistance. As it turned out, a flexible policy approach was critical for simultaneously cementing the peace and improving the economic situation. The Interim PRSP (2001) provided an appropriate platform for collaboration by establishing a two-stage approach that recognized both the immediate post-conflict needs and the long-term development objectives. The first stage (2001–02) was linked to the National Recovery Strategy (2002) which aimed to consolidate civil authority, improve service delivery, facilitate settlement and reintegration, and stimulate economic recovery. The second stage (2003–05) was not fully developed at the time but was further elaborated by the government in the PRSP Status Report (2003) and the full PRSP (2005).
2. **The Disarmament, Demobilization, and Reintegration (DDR) Program.** Although the DDR was not officially completed until 2004, the bulk of the work was done by the time the PRGF started in 2001. Disarmament took place in the key diamond field areas at a fast pace and by October 2001 about 60 percent of an estimated 25,000 RUF fighters had passed through the UN-sponsored DDR process. At the onset of the program, the annual cost of the DDR was \$21.5 million of which donors contributed \$20 million. The domestic component was equivalent to 0.8 percent of recurrent spending or 0.2 percent of GDP. In order to account for potential shortfalls in donor support, the floor on the domestic primary budget balance of the central government was defined as domestic revenue minus total expenditure and net lending, excluding interest payments, externally financed capital expenditure, and the DDR program.

3. **Conditionality.** Success under the PRGF was achieved against the background of a relatively high degree of conditionality. The number of performance criteria and prior actions under the program was four times and five times, respectively, the average number for PRGF countries as a whole. Although the high level of conditionality was contrary to the trend to streamline conditionality, it may have helped in compensating for the conflict-related damage to capacity in Sierra Leone and ensuring step-by-step policy implementation.

4. **Donor collaboration.** Coordination among the international community was critical for restoring and sustaining the peace, through both the direct intervention of peacekeepers (UN and the United Kingdom) and support for reforms. The Bank was closely involved in developing the key structural reforms, including budget and expenditure management reform, civil service restructuring, debt sustainability analysis, and institutional and governance reform. In addition, successive Fund programs were coordinated with the EU, which provided budget support and TA, Paris Club creditors (debt relief), and DFID (TA and budget support).

B. Liberia: Well-Tailored Structural Reforms

5. **The initial stages of structural reforms under Fund engagement focused on financial oversight and governance issues, in an effort to regain donor support.** The new government implemented the GEMAP agreement of financial oversight, which strengthened governance and provided assurances to donors. The new government set comprehensive debt relief and macroeconomic stability as primary policy objectives, and this, in turn, supported generally good implementation of the SMP from 2006, the PRGF/EFF from 2008, and implementation of the HIPC triggers. While structural reforms often lagged, it was primarily as a result of capacity weaknesses rather than reluctance to advance on reforms or a lack of political commitment.

APPENDIX VI. GOOD PRACTICES IN UNDERSTANDING THE POLITICAL CONTEXT

This appendix provides a summary of existing material from the Fund, the World Bank, and development agencies on political and socio-economic issues.¹ It provides general good practices in understanding the political and social context in countries.

1. **A deeper understanding of the political context in countries in fragile situations is important to improve the design of Fund-supported policies, particularly the pace of adjustment and reform, and to have a more informed judgment of the risks of engagement.** According to the World Bank, development practitioners are increasingly aware of the role that social and political structures play in shaping countries' development paths and results. Failure to anticipate political and institutional challenges is a chief cause of unsuccessful policy reform processes. Recognition of these relationships has prompted the donor community to explicitly address how social and political factors shape economic development and vice versa. In this context, various donor agencies have developed and piloted individual approaches to macro-level social and political analysis. The World Bank has developed and piloted Country Social Analysis (CSA). CSAs examine relevant social, political, and institutional factors to identify significant opportunities, constraints, and risks to development. Based on this analysis of a country's social and political context, they provide policy recommendations for achieving more inclusive and accountable institutions and for mitigating country-level social and political risks.
2. **Fund staff should collaborate with donors and other IFIs to share information on (subject to confidentiality procedures), and understand, the political economy in countries in fragile situations.** Fund staff, especially resident representatives, should also conduct their own evaluation of the political situation and social context, where and when possible. According to the Fund's guidance, it is legitimate for Management to seek information about the political situation in member countries as an essential element in judging the prospects for policy implementation. It may also be helpful for staff to be aware that, according to the World Bank and DfID, the main areas to consider when analyzing the main drivers of political decisions in countries can include:

¹ See the Fund's [The Role of the Fund in Governance Issues](#) and the Fund's [Conditionality Guidelines](#). For a detailed guide on political economy analysis, see [The World Bank Understanding Socio-Economic and Political Factors to Impact Policy Change](#) for a summary of the approaches of major donor agencies to political economy analysis. See also the [DfID How To Note on Political Economy Analysis, June 2009](#).

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- Political process in the country concerned, including the distribution of power, interest groups, and incentive structures and how these generate particular policy outcomes that may encourage or hinder development;
- The role that formal institutions (e.g., rule of law, elections) and informal social, political, and cultural norms play in shaping political and economic competition.
- The effect of existing social and cultural groups on access to assets, services, and public goods, in order to better determine sources of growth. This can also help assess the social risks that may have a bearing on economic policy.
- Broad social expectations and the capacity of the state that may impact economic policy-making and the capacity or ability to implement policies under Fund-supported programs. Where possible, studying the main fault lines in society may help in better understanding political behavior and public policy. This could include the impact and strength of values and ideas, including political ideologies, religion, and cultural beliefs.

3. **Strengthening the Fund's outreach is also key to improving the general understanding of Fund involvement in the reform process.** Mission chiefs and resident representatives can familiarize themselves with the Fund's communication toolkit and draw on the experience of Media Relations at the External Relations' Department.

APPENDIX VII. GOOD PRACTICES IN DONOR COORDINATION ON REFORMS

This appendix provides an example of good practices pertaining to donor engagement and prioritized program reforms, broadly based on the discussion in the seventh section of the guidance note.

A. Haiti: Cooperation with Donors

Coordination with the World Bank has been effective in advancing Haiti's reform agenda. Cooperation with donors has also been generally good on structural reforms. Further efforts would be worthwhile to improve coordination on budget support, including for capital spending.

1. **The Fund has a history of engagement in Haiti.** During the past decade, there were two consecutive SMPs from April 2003 to September 2004 and during April–September 2004, followed by two consecutive Emergency Post Conflict Assistance (from October 2004 to September 2005; and during September 2005–2006). These modalities of Fund engagement provided a framework for economic stabilization and a track record that led to two programs supported by arrangements under the PRGF (October 2006–September 2009), and its successor, the ECF (July 2010–July 2013).
2. **The international community is also involved in Haiti through provision of significant financial and TA.** Donors include international financial and regional institutions and a significant number of bilateral donors from Europe and the Western Hemisphere. Therefore, cooperation and coordination among donors is critical to (i) ensure timely disbursement of aid and TA provision; (ii) use resources efficiently and avoid cross conditionality and overlaps; (iii) tailor the reforms to fit existing capacity; and (iv) create the conditions for a successful implementation of the program. From the Fund standpoint, this cooperation covers three key areas: budget support, the structural reform agenda, and TA provision.
3. **Regarding budget support, past experience has led donors to put in place an ad hoc budget support group (BSG) that designed a budget support matrix.** The BSG tries to meet as often as possible to take stock of progress under the program, review aid projections, and facilitate disbursement. The existence of the BSG has helped alleviate the volatility of aid disbursement observed in the past, which hindered program execution. While the BSG is a welcome progress, there is still a need for more coordination in this area, in view of (i) the various forms of budget support provided in Haiti, including line item support, unrestricted support, and reimbursement of expenditures covered by the government; and (ii) most importantly the different budget cycles and constraints of donors.

4. **Cooperation in the structural area is more effective.** The Fund led the dialogue on revenue enhancing measures and tax policy; at the same time, there was close coordination, in the context of the various programs implemented during the past decade with the Bank, the Islamic Development Bank (IDB), the EU, and some bilateral donors. This covered public expenditure management (budget formulation and execution, medium-term expenditure frameworks); accounting procedures; financial sector reform (mainly through the FSAP); the business environment; and poverty analysis. Reform measures were discussed and agreed between teams. Bank staff participated in Fund review missions and progress assessments are discussed regularly. Furthermore, coordination was reflected in the annual Progress Reports and updated Joint Staff Assessments Notes. In addition, both institutions worked closely with the authorities on the elaboration of the poverty reduction strategies (2006 and 2010) and preparations for HIPC and MDRI eligibility. At the request of IDB, the Fund provided macro inputs and assessment letters on several occasions which allowed this institution to move forward with its lending operations. Consultations with staff from the World Bank, IDB, and Fund staff continue to take place on a regular basis at headquarters and in the field.

5. **On TA, the Fund takes the lead to improve macroeconomic data, enhance tax and revenue administration capacity, and strengthen monetary and foreign exchange frameworks.** With support from the EU, Fund staff is assisting the authorities in reforming accounting procedures and treasury management, and putting together a macro-fiscal unit at the ministry of economy and finance. Close coordination takes place with World Bank staff in the financial sector. Also, discussions are held on as-needed-basis with other donors that express an intention to provide TA in the public finance area. While progress is being made, there is room for improving and strengthening coordination in this area, including the establishment of a TA matrix that would involve all donors and the authorities. This work is in progress.

APPENDIX VIII. EXAMPLE OF A MULTI-DONOR TRUST FUND (MDTF)

This appendix gives an overview of the Afghanistan Reconstruction Trust Fund.¹

1. **The Afghanistan Reconstruction Trust Fund (ARTF) is a partnership between the international community and the Afghan government to improve the effectiveness of the reconstruction effort.** The ARTF was established in 2002 to support the government's national priority programs and to contribute to the achievement of the Afghanistan National Development Strategy (ANDS) goals. The ARTF has developed into the main multilateral funding mechanism for the government's core budget and is positioned to be the key funding source for the ANDS implementation. Its main national-level impact is therefore its contribution toward greater coherence of the delivery of development assistance in Afghanistan.

2. **The main role of the ARTF is to provide a coordinated financing mechanism for the government's budget for spending on priority sectors and investment projects.** The specific objectives of ARTF are to:
 - Position the national budget as the key vehicle to align the reconstruction program with national development objectives;
 - Promote transparency and accountability of reconstruction assistance;
 - Reduce the burden on limited government capacity while promoting capacity-building;
 - Enhance donor coordination for financing and policy dialogue.

3. **The ARTF's fiduciary framework has contributed to the strengthening of the government's PFM systems.** Disbursements are based on eligibility criteria agreed with the government in line with the broader fiduciary framework for public expenditures. Overall, the ARTF also contributes to broader coherence of operations by:
 - Channeling resources in line with Afghan priorities—thereby strengthening the ownership and accountability of the Afghan government for the resources deployed.
 - Channeling resources through the Afghan budget—thereby strengthening the budget as the main policy tool for directing and allocating resources for priority needs.

¹ See the [World Bank Afghanistan Reconstruction Trust Fund website](#).

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- Offering a collective platform for donor funding—thereby reducing the transaction costs of government dealing with 30 plus donors bilaterally.
- Offering a collective platform for donor/government dialogue—thereby creating leverage on the government on critical reform points.
- Offering an efficient channel for funding scale up of national priority programs—which are considered to be more effective mechanisms for development than individual projects.

4. **The ARTF is managed by the Management Committee** (MC) consisting of the World Bank (as the administrator), the IDB, the Asian Development Bank (ADB), and the UN (UNAMA and UNDP). The Management Committee meets regularly in Kabul, with the Ministry of Finance as an observer, to carry out the day-to-day business of the fund. Once a quarter, ARTF Donors meet to discuss broader strategy with the government and ARTF Management.

5. **Donors contribute funds into a single account, held by the World Bank.** The MC makes decisions on proposed allocations at its monthly meeting, and those decisions are translated into funds through Grant Agreements signed between the World Bank and the Government of Afghanistan. ARTF allocations are made through two windows: the Recurrent Cost Window and the Investment Window. The Recurrent Cost Window reimburses the government for a certain portion of eligible and non-security related operating expenditure every year. The Investment Window provides grant financing for national development programs in the development budget. Since early 2002, 30 donors have contributed over \$3 billion, making ARTF the largest contributor to the Afghan budget.

6. **The Recurrent Cost Window:** Domestic revenues continue to be insufficient to cover the costs of government. The ARTF Recurrent Cost Window has therefore ensured the basic functioning of government including the payment of salaries and the delivery of services such as healthcare and education. ARTF financing of recurrent budget expenditures would be based on the government of Afghanistan's macroeconomic and budget framework that would be reviewed by the Fund and the World Bank, and there would be close coordination with bilateral and multilateral donors who are also providing budgetary support for recurrent expenditures.

7. **The Investment Window:** The Investment Window has in the last two years increased significantly in volume and in scope, thanks to increased levels of donor contributions. Decentralized and national rural development programs, such as the National Solidarity Program,

the National Rural Access Program, and microfinance programs, have been strongly supported by the ARTF. Other expanding areas that are attracting donor funding include the education sector, capacity building, justice sector reform, power, and urban development (roads, water, and sanitation). A three-year financing strategy was recently developed and agreed by the donors and the government to better align ARTF support with longer-term government priorities and to move the ARTF away from annual allocations toward more predictable multiyear financing.

8. **Donor contributions:** Donors generally make annual pledges which are paid in during the Afghan Solar Year (March to March). The ARTF has developed a system of "preferences". A preference is not an earmark. It is a formal recognition by the Administrator of the donor's preference to allocate a certain portion of a contribution toward a particular project. There are some key rules that guide this system, as follows:

- The ARTF will not accept preferencing in excess of 50 percent of a donor's contribution in a solar year.
- This rule is lifted for all donors once sufficient un-preferenced funds have been paid in to cover the Recurrent Cost Window obligation.
- Geographic preferencing is not accepted by the ARTF.
- Preferences must be for ongoing, on-budget, national priority programs, that have a clear funding gap.

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