

# STATEMENT BY THE MANAGING DIRECTOR

## ON THE INDEPENDENT EVALUATION OFFICE REPORT ON THE IMF AND FRAGILE STATES

### EXECUTIVE BOARD MEETING MARCH 22, 2018

*I welcome the report of the Independent Evaluation Office (IEO) on the IMF and Fragile States. The report recognizes that the Fund has made important contributions in restoring macroeconomic stability, building core institutions, and catalyzing donor support across a diverse range of countries in fragile and conflict situations. The IEO's analysis and findings provide a thorough stock-taking and resonate with staff. Accordingly, I broadly support the IEO's recommendations to make the Fund's engagement with countries in fragile and conflict situations more impactful.*

As noted in the IEO report, helping countries in fragile and conflict situations has been deemed an international priority, meriting close engagement by the Fund in its bilateral surveillance, program design and lending, and capacity development (CD). The growing attention given to the dangerous implications of persistent fragility for regional and global stability, underline the key role of the Fund in international efforts to help countries in fragile and conflict situations. The Fund is in a unique position in this effort, particularly in its proven ability to respond quickly and effectively to assist such countries.

I am pleased that the IEO report finds important contributions that the IMF has made in countries in fragile and conflict situations, including helping to restore macroeconomic stability, build core macroeconomic policy institutions, and catalyze donor support. It is also welcome that the IEO shows that the IMF is broadly acknowledged to have high impact, particularly in years soon after countries emerged from periods of violence and isolation. The findings of the IEO report confirm many identified in the June 2015 policy paper on “*IMF Engagement with Countries in Post-Conflict and Fragile Situations—Stocktaking*.” The paper concluded that the Fund's engagement with countries in fragile and conflict situations is often impactful and well appreciated by country authorities, and that this vulnerable group of the membership particularly benefits from the Fund's expertise in capacity building, financial support, and policy advice.

At the same time, I agree that there remains room to do better, while considering that engagement with countries in fragile and conflict situations is inherently challenging, given their generally limited capacity, weak governance, and often unstable political and security environment. In particular, the IEO report concludes that more could be achieved by making bolder efforts, including to: build on ongoing initiatives to develop forward-looking, holistic country strategies; provide more sustained financial support; strengthen the impact of CD; and incentivize staff work in countries in fragile and conflict situations. In making these recommendations, the IEO report recognizes that some efforts would require an increased allocation of the Fund's financial and human resources.

In broadly supporting the findings of the IEO, I wish to highlight relevant actions that are in train or are in the work program agreed by the Executive Board. Specifically, staff are piloting a

multi-year CD framework for selected countries in fragile and conflict situations that better integrates CD with surveillance and improves coordination with other assistance providers. The ongoing 2018 PRGT facilities review will provide an opportunity to assess the finding that there is a gap in the toolkit between emergency and medium-term support. The new HR strategy, currently under development, aims to strengthen incentives for staff to work on countries in fragile and conflict situations by ensuring that career development is linked to experience in working with a broad range of the membership, including in countries in fragile and conflict situations. In this context, I acknowledge and recognize the finding that the lack of field presence of staff in high-risk locations could be a limitation on effective engagement. But I believe we need to weigh this finding against the paramount objective of ensuring staff safety as set out in our 2015 security policy for missions to high-risk locations.

## RESPONSE TO IEO RECOMMENDATIONS

The IEO makes six recommendations in its report. Below is my proposed response to each of these.

**Recommendation 1.** Management and the Executive Board should reinforce that work on fragile states is a top priority for the IMF by issuing a statement of its importance, for IMFC endorsement, to guide the Fund's fragile state work going forward.

I broadly support this recommendation as laid out in my responses to recommendations 2-6.

**Recommendation 2.** Management should give the IMF's work on fragile states greater continuity and prominence by establishing an effective institutional mechanism with the mandate and authority to coordinate and champion such work.

I agree there is scope to better coordinate and discuss countries in fragile and conflict situations within the Fund and with a broad range of stakeholders through establishing an effective institutional mechanism. We will consider how best to structure an interdepartmental mechanism in a manner that is not duplicative and not unduly resource-intensive. This mechanism could, as proposed, review the implementation of the *Staff Guidance Note on the Fund's Engagements with Countries in Fragile Situations* including whether program design has adequately taken into account the fragile

characteristics of a country; and prepare broad guidance on country strategies proposed in Recommendation 3. The institutional mechanism could also provide a platform for revisiting our engagement with key international players in countries in fragile and conflict situations.

**Recommendation 3.** For work on individual fragile states, the IMF should build on ongoing area department initiatives to develop forward-looking, holistic country strategies that integrate the roles of policy advice, financial support, and capacity building as part of the Article IV surveillance process. These strategies would provide a platform for more actively involving concerned Executive Directors and a more robust framework for collaborating with development partners.

I concur with the usefulness of country strategies that integrate Fund activities across our various roles into the Article IV process. However, the resource costs of developing holistic long-term country strategies could be significant, and their useful lifespan limited by uncertainties inherent to countries in fragile and conflict situations. Therefore, requirements for such strategies will need to be flexible and adaptive, to avoid creating a "box-checking" exercise, and will need to be lean so as not to overburden the Article IV process.

**Recommendation 4.** The IMF should adapt its lending toolkit in ways that could deliver more sustained financial support to fragile states, including for those challenged to meet the requirements of upper-credit-tranche conditionality, and should proactively engage with stakeholders to mobilize broad creditor support for FCS with outstanding external arrears to official creditors, including the IMF.

I support this recommendation insofar as I see definite merit in reassessing the IMF's lending toolkit from the perspective of the needs of countries in fragile and conflict situations. But we should be clear from the outset on the constraints imposed by the IMF's funding model: we borrow money from some member countries to lend to other member countries. Even with the interest rate at zero percent, IMF funding today adds to countries' debt burden in the medium term. Countries in fragile and conflict situations typically already carry significant debt burdens and face elevated economic uncertainty; they need grant

aid from development partners, rather than rely heavily on external loans to help meet immediate financing needs.

This is not an argument against the provision of any Fund financing. As the IEO report underscores, IMF financing in fragile situations has been catalytic, playing a critical signaling role in providing the donor community with a degree of assurance “that donor financial assistance would be used in a transparent and sustainable macroeconomic framework.” Countries in fragile and conflict situations benefit from entering into arrangements with the IMF not primarily because of the volume of IMF funding, but rather the volume of donor funding that is catalyzed by IMF loans.

IMF staff are examining whether/how the Fund should modify its toolkit to accommodate the needs of countries in fragile and conflict situations in the context of the 2018 Review of Facilities for Low-Income Countries (the conclusions of this examination could also be relevant for the support of middle-income countries in fragile and conflict situations). The IEO’s suggestion that the Fund consider the case for shorter (say one-year) arrangements is an interesting proposal that warrants careful examination in the facilities review: we will also look at the case for raising access limits for the rapid financing facilities (RFI/RCF). However, I do not see a convincing case for extending the repayment period for loans under the PRGT (which currently extends out to 10 years); our mandate is to provide short-to-medium-term finance to countries to tackle balance of payments needs, not longer-term financing (the space filled by the development banks). Absent some new trust funding targeted explicitly at countries in fragile and conflict situations, an extension of the term of PRGT loans would have to cover all low-income countries—a move that would threaten the current financing model for PRGT lending.

As noted in the report, establishing a facility specially tailored to the needs of countries in fragile and conflict situations for grant funding and long-term loans would require the establishment of a large trust fund dedicated to this purpose. The proposal has appeal, providing that we can ensure maintaining uniformity of treatment of the Fund’s membership. But I cannot see it obtaining the levels of financial support from our membership that would make it viable over time, and it would also involve fundraising efforts in the same space as IDA, with the risk that it would simply shift grant funding between the Bretton Woods Institutions rather than generate additional resources.

Finally, I agree that the Fund should respond speedily to windows of opportunity to achieve a comprehensive clearance of arrears with members that have long been in arrears to the international community. That said, comprehensive debt settlements require the consent of all external bilateral creditors, which may not be easy to achieve.

**Recommendation 5.** The IMF should take practical steps to increase the impact of its capacity development support to fragile states, including increasing the use of on-the ground experts, employing realistic impact assessment tools, and making efforts to ensure that adequate financial resources are available for capacity development work in these countries.

I support most elements of this multi-pronged recommendation while also stressing the critical issue of absorption capacity that can critically limit the impact of CD in countries in fragile and conflict situations, particularly in small states, which face a unique set of challenges. I agree that the Fund should find ways to make more flexible use of CD funding contributed by donors—efforts are already underway and will continue to enhance flexibility, though the degree of existing inflexibility should not be overstated. In addition to the pilot initiatives for the CD Framework mentioned above, efforts include: (i) additional technical advisors deployed during FY17-18 in several countries in fragile and conflict situations, and; (ii) additional responsibilities for some regional technical assistance centers to cater to countries in fragile and conflict situations through long-term advisors hired specifically for that purpose.

I share the view that the impact of CD can also be enhanced through the implementation of results-based assessments. I concur that there may be scope for a multi-donor trust fund dedicated to CD for use by countries in fragile and conflict situations, provided that we can make a business case to donors and ensure that this would not undercut funding for RTACs. On charging for CD, a 2015 change in the Fund’s charging policy envisaged that “use of internal Fund resources for technical assistance to high-income countries be limited to critical needs (e.g., crisis cases) where no external funding can be found,” establishing an expectation that such countries would pay for their own technical assistance in most cases. However, recent staff work on cost-recovery for externally-financed activities has found such charges would not raise much

additional finance, while introducing cumbersome administrative procedures including for procurement, and possibly reducing broader traction of policy advice.

As regards the recommendation for formal coordination mechanisms with other providers, they have proved to be cumbersome and not flexible enough in responding quickly to emerging needs. While the Platform for Collaboration on Tax provides a good example of interagency cooperation, it is a labor-intensive exercise and it is too early to assess whether it should be replicated in other areas. In this context, Executive Directors’ support on coordination with their respective aid agencies is welcome.

**Recommendation 6.** The IMF should take steps to incentivize high-quality and experienced staff to work on individual fragile states, ensure that adequate resources are allocated to support their work, and find pragmatic ways of increasing field presence in High-Risk Locations while taking necessary security arrangements even at high cost.

I recognize the human resources challenges involved in staffing fragile and conflict situation country teams, and I concur with the need to offer more robust incentives for staff working on these countries in the context of the ongoing HR strategy. However, as regards increasing field presence, our paramount objective is staff safety as set out in our security policy for missions to high-risk locations.

**TABLE 1. THE MANAGING DIRECTOR’S POSITION ON IEO RECOMMENDATIONS**

RECOMMENDATION	POSITION
(i) Management and the Executive Board should reinforce that work on fragile states is a top priority for the IMF by issuing a statement of its importance, for IMFC endorsement, to guide the Fund’s fragile state work going forward.	SUPPORT
(ii) Management should give the IMF’s work on fragile states greater continuity and prominence by establishing an effective institutional mechanism with the mandate and authority to coordinate and champion such work.	SUPPORT
(iii) For work on individual fragile states, the IMF should build on ongoing area department initiatives to develop forward-looking, holistic country strategies that integrate the roles of policy advice, financial support, and capacity building as part of the Article IV surveillance process.	SUPPORT
(iv) The IMF should adapt its lending toolkit in ways that could deliver more sustained financial support to fragile states, including for those challenged to meet the requirements of upper credit-tranche conditionality, and should proactively engage with stakeholders to mobilize broad creditor support for FCS with outstanding external arrears to official creditors, including the IMF.	SUPPORT
(v) The IMF should take practical steps to increase the impact of its capacity development support to fragile states, including increasing the use of on-the ground experts, employing realistic impact assessment tools, and making efforts to ensure that adequate financial resources are available for capacity development work in these countries.	SUPPORT
(vi) The IMF should take steps to incentivize high-quality and experienced staff to work on individual fragile states, ensure that adequate resources are allocated to support their work, and find pragmatic ways of increasing field presence in high risk locations while taking necessary security arrangements even at high cost.	QUALIFIED SUPPORT