FINANCING IN CONTEXTS FACING EXTREME TO HIGH FRAGILITY

Key messages

Contexts exposed to extreme and high fragility are often seen through a humanitarian lens. This view is no longer borne out by the evidence, is at odds with the Financing for Development agenda, and risks leaving behind a significant portion of the planet's population.

The OECD fragility framework includes dimensions of economic, environmental, human, security, social and political fragility and resilience. It is important to bring a fragility and resilience lens to Financing for Development to better manage risks and realise opportunities, including and beyond those contexts on an FCV list or in open conflict.

There are opportunities to help address fragility challenges through financing that is:

- **Tailored** – contextual knowledge is needed to support prioritization, sequencing, and coordination, and to help address specific issues - for example displacement, food security, political polarization, corruption, supporting minimum state functioning etc.
- **Targeted** – goals must be realistic and targeted to address the underlying sources of fragility; funding and financing should be of a size and nature that can be absorbed, with political awareness of partners and the need to reinforce inclusion.
- **Timed** – funding and financing can play a role in prevention, in readiness for peace, and in supporting positive transitions. The right financing can support peace processes and very fragile political or economic transition periods.
- **Conflict sensitive** – the emphasis is on the *right* funding and financing, which is sometimes, but not necessarily, more funding and financing. Additional resources can bring additional strain or themselves become contested if not well-managed.

Problem statement

Contexts experiencing extreme to high fragility have growing populations, growing consumption needs, and the same legitimate aspirations as contexts experiencing medium to low fragility .. Fragility is not limited to a certain

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ABOUT THIS SERIES

The Financing Policy Brief Series has been prepared by the Inter-agency Task Force on Financing for Development to inform the substantive preparations for the Fourth International Conference on Financing for Development (FfD4), to be held in Sevilla, Spain, from 30 June to 3 July 2025.

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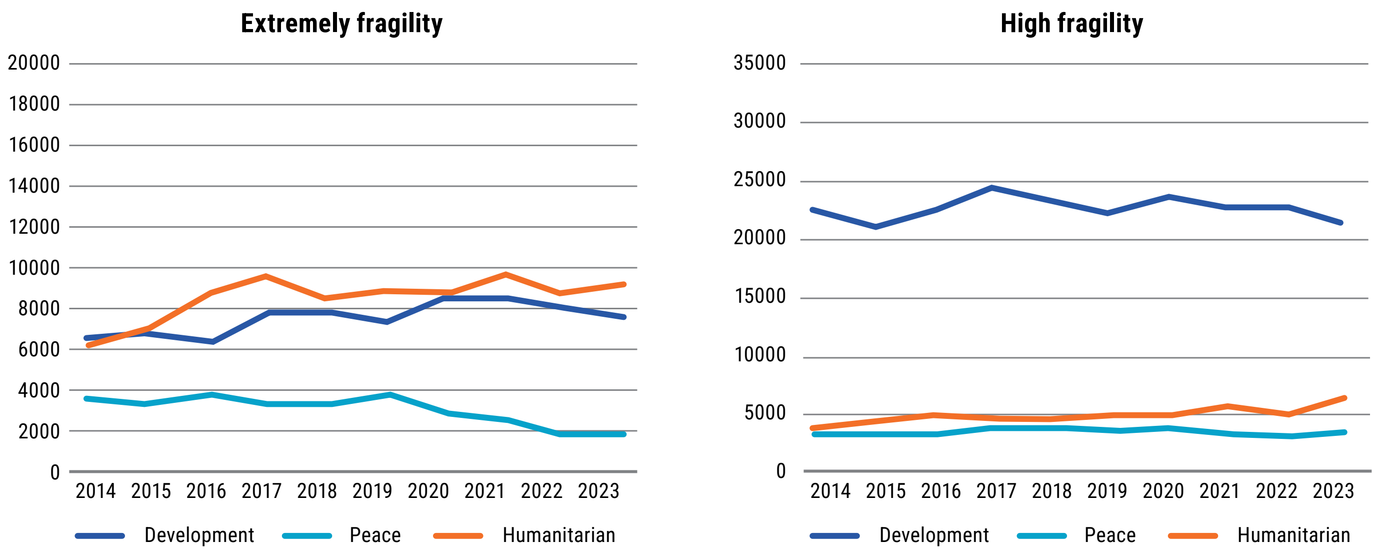
geography or income level - there are currently more middle-income than low-income contexts exposed to extreme and high fragility, with social contracts fraying in many contexts irrespective of income level. By 2030 contexts affected by extreme to high fragility are expected to home at least 26% of the world's population and 86 % of the world's extreme poor[1]. They lag behind reaching SDG targets, and fragility is a known destroyer of human potential and opportunity. Yet fragility has not played a significant role in FFD discussions outside of humanitarian assistance.

The Financing for Development agenda is just as relevant in contexts exposed to extreme and high fragility as elsewhere, but it needs to be delivered differently, and needs investment in enabling environments to be effective. The volume, quality, and political economy of financing – where, how and to whom resources flow – can impact significantly on socio-economic opportunities and incentives towards stability or conflict. Financing choices can have knock-on impacts in the economic, environmental, human, political, security and societal dimensions of fragility through investments in social safety nets and human capital; the ability to respond to climate change, disasters and other climactic events; the growth of inequality; and the ability of elites to sustain power structures.

In terms of aid, the Humanitarian-Development-Peace nexus is an effort to deliver aid in a more strategic way, that should also recognise the importance of other private and public sources of finance. EEach context requires a different mix of approaches and resources spent on humanitarian, development and peace. Nevertheless, the concern about rising humanitarian needs and funding appeals has perhaps been exacerbated by reductions in the recent past of the proportion of ODA to contexts exposed to extreme fragility that has gone towards development and peace. Nevertheless, development finance remains a critical resource in contexts facing extreme to high fragility and can be used strategically.

Figure 1.
ODA across the humanitarian-development-peace nexus[2] *(USD Million, 2022 constant prices)*



Source: OECD (2024), "Creditor Reporting System: Aid activities", https://doi.org/10.1787/data-00061-en

1. States of Fragility 2022 | OECD
2. States of Fragility Platform and Creditor Reporting System | OECD iLibrary

Moving from states of fragility to states of resilience means responding to fragility before it becomes a crisis. It is important to invest in state capacity and societal resilience over time. Most of today's crises and conflicts are the result of unaddressed fragilities, disputes and tensions from the past. **And even in a crisis, humanitarian aid cannot work alone.** Debt relief, macro-economic stability, provision of basic services, or political engagement can be urgent. Addressing the drivers of crisis and fragility is an inter-generational endeavour that needs to include consideration of Financing for Sustainable Development.

Striving to protect ODA is necessary but will not be sufficient in the face of chronic fragility and multiple crises. The difference in financing risks and opportunities is stark between contexts experiencing the most extreme fragility and contexts experiencing high fragility. Some contexts in the extreme to high fragility space have succeeded in attracting private investment and remittances and/or increasing tax revenues. Yet others, especially contexts exposed to extreme fragility, remain heavily reliant on humanitarian and development finance. Among those able to access different types of finance, debt levels are increasing and are increasingly unsustainable for many.

Expanding the diversity of financing is a difficult but important transition to manage. It requires significant capacity and political will, and increases both opportunities and obligations. Increasing diverse sources of finance involves navigating risks that are now acute – for example, concurrent debt and food security risks, and increasing risk of climate shocks.

As well as development, peace comes with a price tag to ensure it is sustainable. Yet, ensuring the right financing for peace, and ensuring that other types of finance are conflict-sensitive and promote peace - has often been an afterthought. Without peace, humanitarian needs will not decrease, development objectives cannot be reached, and the very real costs of violence grow. There must be the right amount of finance, using the right financial tools, for the right length of time, to address underlying fragilities and support the right incentives for sustained peace. Conflict sensitivity has to be assured – including in investment, tax, debt, trade opportunities, remittances and other policy areas.

Policy solutions

Contexts facing extreme to high fragility are highly heterogenous, and solutions will be context specific. Nevertheless, three high level recommendations are:

- **Bring a fragility lens to Financing for Development discussions, including debt, investment, and domestic resources mobilisation;**
- **Adapt and tailor FFD tools and reform efforts to the special considerations of contexts exposed to extreme and high fragility, making the tools and approaches of FFD available to help address underlying fragility issues;**
- **Bring together fragility and FFD expertise, at the technical and political levels.**

Financing and fragility impact one another: a lack of socio-economic opportunities, state capacity and inclusive governance are both results of and sources of fragility. Where there is sufficient state functioning, the government remains an important source of financial resilience. Financing can help build resilience, for example through investments in social protection and human capital. Unfortunately, debt levels in many contexts exposed to extreme and high fragility are unsustainably high and rising. While growth has stabilized since 2021, contexts exposed to extreme and high fragility are still struggling to recover from the economic fallout of the Covid-19 pandemic.[3]

Domestic resources mobilisation (DRM) is a nascent agenda in contexts exposed to extreme and high fragility and should be seen through a social contract lens as much as through a financial lens. Much remains to be learned about effective approaches, and much depends on local-level trust in institutions, governance, of use of funds.

3. States of Fragility 2025, forthcoming.

Almost all contexts in the extreme to high fragility space receive some type of support to DRM, but only around a third of the 43 contexts analysed have achieved a tax-to-GDP ratio of at least 15%, a widely considered benchmark for effective state functioning and economic development. Mobilising significant additional tax revenues is likely to only be achieved with sustained political commitment, alongside enhancements to public financial management and expenditure, governance, trade and economic performance as a whole.

The transnational and inter-agency cooperation and measures needed to address tax crimes, and combat illicit financial flows, and fully implement Financial Action Task Force (FATF) standards can be especially challenging in contexts experiencing extreme to high fragility. Institutional capacities are often severely stretched, formal financial sectors are often thin, and in some cases, elites may benefit from the status quo. Many contexts exposed to extreme and high fragility are also reliant on high-risk extractives and commodity sectors. IFFs are a direct financial loss and weaken public institutions and state capacities, reinforcing corrupt practices, reducing legitimate foreign and domestic investments, and strengthening the position of illicit actors that undermine the rule of law and stability. IFFs threaten the security, development and economic interests of contexts affected by extreme to high fragility, undermine public trust in government and compromise the performance and functioning of the financial system.[4]

Remittances are often the single largest source of external financing in contexts in the extreme to high fragility space and can provide a buffer during tough economic times. But remittances are volatile, household dependent, and can be extremely costly to send.

Domestic private sectors are often lifelines, delivering key goods and services even when the government cannot, and potentially contributing to peace. Even when conflict and shadow economies are present, the legitimate coping economy is often still highly relevant, and key for resilience[5]. Domestic private sectors are largely disconnected from large foreign investments and the private sector operations of development finance, which need to radically scale down and adopt different business models in many contexts experiencing extreme to high fragility. There is a need to develop options for inclusive and sustainable economic pathways for contexts affected by extreme to high fragility, in light of climate change impacts and shifting demand for natural resources (for example, rare earth minerals; ocean resources; shifting agricultural patterns).

When it does happen, foreign private investment needs to be conflict sensitive, and tailored to contexts exposed to extreme and high fragility. Large infrastructure investments can be very important, but tailoring also means that a higher volume and larger deals are not always better. Contexts in the extreme to high fragility space receive a tiny proportion of all developing context foreign direct investment (FDI), reflecting their smaller economies, less conducive business environments, and actual or perceived risk. When it does occur, FDI has continued to favour contexts with natural resource endowments, potentially reinforcing extractive rather than inclusive economic prospects. At the same time, there have been substantial disinvestments, for example in Angola, Iraq, South Sudan and Yemen.

Better understanding and communicating real risks, as opposed to perceived risks or stereotypes, matters. At the community level and in an experimental setting, researchers found that increased awareness of the costs of conflict shifted voting patterns to parties which were more supportive of a peace process.[6] At the global level, many countries experiencing extreme to high fragility may bear undue additional financing costs and access issues due to stereotypes and perceptions that do not always reflect risks. More nuanced sub-national and sectoral-specific risk premia may be more appropriate.[7]

4. See Convention and commentaries booklet 2024.pdf and https://www.u4.no/publications/illicit-financial-flows-fragility-and-conflict.
5. Conflict Economies in the Middle East and North Africa | Chatham House – International Affairs Think Tank
6. Valuing Peace: The Effects of Financial Market Exposure on Votes and Political Attitudes | The Econometric Society
7. Country risk premiums: What we know and why they are not working well

Financial preparedness and the development of fiscal buffers and social safety nets is particularly important in contexts experiencing extreme to high fragility where shocks are frequent, buffers are thin, and socio-economic impacts can be high. Shocks and crises provide a momentum for issues such as violent extremism, misinformation, food insecurity, and violence against women. The most effective preparedness - expanding fiscal buffers and reducing public debt, maintaining sufficient foreign reserves, and the ability to mobilize domestic resources - are most challenging in contexts affected by extreme to high fragility. Yet when managed well, they can help countries manage multiple risks at the same time.

An inclusion and conflict-sensitivity lens is needed when considering fiscal austerity, ending of subsidies, concessionality, and how to address the growing unsustainability of debt. Research suggests that the fiscal buffers are one of the most effective coping capacities for shocks in contexts in the extreme to high fragility space.[8] At the same time, measures to address unsustainable government finances have often been the precursor to instability, especially in situations where households have themselves little capacity to absorb shocks, and where there are concerns relating to the transparency, inclusion and governance of use of funds.

Where possible, partners should stay engaged in core economic systems and services, and help preserve markets and good governance, to lay the foundation for faster reconstruction and recovery. Even partial economic recovery can help improve the conditions for peace. Conflict changes the formal and informal rules that govern economic activity. Two of the aspects that appear to contribute to the long duration of fragility and conflict are impacts on core economic/governance systems and impacts on human capital. Banking and finance sector questions are usually less addressed, but they can be fundamental to human development outcomes through, for example, agricultural trade finance.

Conflict actors engage strategically with economic institutions, opportunities, resources and livelihoods. Conflict sensitivity is needed for all financing for development resources, as they can become an arena of contestation. Research into aid spending in counterinsurgency situations, for example, has indicated the potential for aid spending to reduce violence in non-contested areas, but to actually increase violence in contested areas, as insurgents respond to what they see as an attempt to win over local populations.[9] The fragility implications of financing decisions are not always well-understood. Understanding the impacts, costs and incentives created by financing choices, investing in human capital; increasing supply chain transparency, and understanding which social groups benefit from monetary or economic interventions can help to support peace-building efforts..

Fragility and crises are made of a complex web of political and economic struggle that is not always reflected in technical interventions. Cross-disciplinary approaches, partnerships and instruments between fragility and technical FFD experts are important. There is a need to mainstream discussions and expertise on fragility, and increase dialogue between fragility experts and sectoral experts, given the system-wide impact that financing choices can bring.

FFD tools can make an important contribution to addressing underlying fragility concerns, for example:

- 75% of refugees were hosted by low- and middle-income countries in 2023, the majority hosted in contexts experiencing extreme to high fragility. Considering options for investment, private sector development, social safety nets, taxation strategies, etc can contribute to strengthening / restoring the social contract, social cohesion, and bring tangible benefits to refugees and host communities.
- In contexts exposed to extreme and high fragility, security sectors face off-book spending and budget overruns, worsened by poor coordination between finance and defence ministries and

8. States of Fragility 2022 | OECD and Macroeconomic policy in fragile contexts
9. Aid as a Tool against Insurgency: Evidence from Contested and Controlled Territory in Afghanistan | American Political Science Review | Cambridge Core

senior leaders controlling resources. Tools such as public expenditure reviews and actors such as the International Financial Institutions (IFIs) help bridge financing and reform in other sectors. While the evidence for their impact in SSR/G is there, their potential has not yet been fully embraced.

- The higher the level of fragility a country is exposed to, the less climate-related development finance it currently receives. For 2020/2021, the climate-related development finance per person that DAC members provided annually on average to developing contexts in the medium to low fragility space (USD 7.5) only slightly exceeded that provided to developing contexts in the high fragility space (USD 7) but is far higher than that provided to the 15 contexts in the extreme fragility space (USD 4.3).[10]

Increasing resilience and reducing the risk of conflict is not just about spending more, but about spending more strategically. When government is not in a position to lead, there is still a responsibility on international actors to better coordinate and "lead from behind". Being strategic in financing would mean moving from reactively funding shocks and crisis responses to realistic financing strategies. The OECD and the International Network on Conflict and Fragility (INCAF) have developed financing strategies, using the fragility framework and financing data to inform key financing processes, in line with the DAC Recommendation and the Addis Ababa Action Agenda (AAAA). These aim to provide better information to collectively prioritise, sequence and align financing flows, though the process needs to be flexible and adaptable and may look different to an Integrated National Financing Framework in more stable settings.

Specific recommendations for FFD4

Explicitly acknowledge fragility and resilience as important considerations for FFD4. This could be achieved even if the 'fragile states' language is avoided and the focus is instead on 'resilience'.. Prioritise an inclusion, social contract and conflict-sensitivity considerations at the global and country level, for example, in discussions of debt issues, private investment, taxation and remittances.

Support development of approaches to shoring up resilience, to stay engaged through fragility, and to collectively support transitions out of fragility – sharing lessons learnt. It is important to look for opportunities whether nationally or sub-nationally, to preserve markets, strengthen governance and institutions, foster private investment, and enhance inclusive public financial management and tax revenues.

Work with networks of fragility experts and those working in situations of fragility, to share knowledge and lessons. These linkages should include governments, the UN system, donors, and actors expanding their work in contexts facing extreme and high fragility, such as the international financial institutions and development finance institutions.

Advocate for, and continue developing financing strategies, even when the government is not yet in a position to fully lead the process alone. Share lessons learnt across contexts. It is still important to use resources effectively and efficiently, to build effective partnerships, to lay the groundwork for current and future FFD investments, to think strategically about prevention and when/how to stay engaged through crises, and to prepare for potential windows of positive transition.

10. Development finance for climate and environment-related fragility : Cooling the hotspots | OECD Development Perspectives | OECD iLibrary