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WIDER BACKGROUND NOTE

Reforming the international financial architecture

Implications of international financial architecture reform for fragile and conflict-affected states

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Abstract: Demand for reform of the international financial architecture (IFA) has accelerated in recent years. Profound changes in the global landscape, including geopolitical shifts, economic instability, the after-effects of the pandemic, increased insecurity, and the impact of climate change, have significantly altered how governments perceive and address the international financial system. These dynamics have given rise to criticisms that the IFA has not kept pace with contemporary challenges. However, a number of countries have been relatively silent in the IFA reform debate—those affected by violent conflict and severe fragility, characterized by weak systems of governance and underdeveloped institutions. This note considers a gap in this landscape: the nexus between IFA reform and fragility. This contribution examines the specific needs of this set of countries and the evolving nature of IFA reform in fragile and conflict-affected states.

Key words: international financial architecture, fragility, fragile states, conflict-affected states

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Demand for reform of the international financial architecture (IFA) has accelerated in recent years and several initiatives took place in preparation for the UN Summit of the Future and the endorsement of the Pact of the Future during the 79th session of the UN General Assembly in September 2024. These reforms are not merely theoretical but reflect practical realities, driven by growing instability in global markets, increasing debt burdens, and concerns about the governance structures of multilateral institutions, such as the IMF and World Bank. **Proposals for an IFA reform** range from new mechanisms for debt relief, to reforms of the multilateral development banks (MDBs) and international credit systems, and national and international tax reforms (Passarelli and Justino 2024). Final commitments may be short of some of these initial demands but represent **a substantial break with the status quo** (UN 2024).

Profound changes in the global landscape, including geopolitical shifts, economic instability, the after-effects of the pandemic, increased insecurity, and the impact of climate change, **have significantly altered how governments perceive and address the international financial system** (Gwaindepi and Karimu 2024). Countries in the Global North struggle with expenditure cuts and budget restrictions caused by rising inflation and economic uncertainty. Countries in the Global South grapple with increasing levels of debt and reduced financial contributions from the international community, which has led them to conclude that **the current international financial system is unfair and unfit to address global challenges** in the era of polycrisis (Passarelli and Justino 2024). These dynamics have given rise to criticisms that the IFA has not kept pace with contemporary challenges. For example, many argue that the system still operates under rules established in the aftermath of World War II, which prioritize the interests of developed nations while marginalizing those of developing countries.

Notwithstanding these various positions, a number of countries have been relatively silent in the IFA reform debate—those affected by violent conflict and severe fragility, characterized by weak systems of governance and underdeveloped institutions. This note considers a gap in this landscape: the nexus between IFA reform and fragility. This contribution examines the specific needs of this set of countries and the evolving nature of IFA reform in fragile and conflict-affected states.

Fragile and conflict-affected states, despite representing a significant portion of the global population facing extreme poverty, remain on the fringes of these discussions, often being seen as recipients of aid rather than active participants in shaping international policy reforms. This systemic exclusion is becoming an increasingly contentious issue as global debates on inequality, climate change, and security gain traction. According to estimates by the World Bank and the OECD, **between 60–80 per cent of the world's poor will live in fragile and conflict-affected countries by 2030**, substantially shifting the nature of global poverty and vulnerability (World Bank 2024), with considerable implications for how international financial assistance will be designed and targeted. However, the ways in which the international financial system engages in these contexts does not differ much from other developing contexts, despite heightened needs around security and governance. New IFA reforms need to include a change in this off-the-shelf approach to fragile and conflict-affected countries. How those changes will happen may have profound implications for global security more generally. We urgently need to initiate a new discussion about how the IFA reform could better address the needs of fragile, conflict-affected, and post-conflict countries.

In recent discussions on the reform of the IFA, calls for a more tailored approach to fragile and conflict-affected states **have become increasingly urgent** (Gwaindepi and Karimu 2024). The Pact for the Future itself echoes this urgency, recognizing the disproportionate impact of global shocks on these states, emphasizing their need for increased financial support, and outlining a vision of a more just and sustainable world, grounded in peace, equality, and cooperation. The Pact for the Future sets out concrete actions to achieve this vision, many of which directly apply to strengthening the IFA's ability to support fragile and conflict-affected states. As stated in **Action 1 (pp. 4)**, ‘We recognize that the 2030 Agenda is universal and that all developing countries, including countries in special situations, in particular [...] countries in conflict and post-conflict situations, require assistance to implement the Agenda’ (UN 2024: 4). Nonetheless, the international donor community, including the IMF and World Bank, have been criticized for their ‘one-size-fits-all’ strategies that fail to address the political, social, and economic fragilities of these states. The pressure for reform has mounted not just from within the Global South but also from a growing coalition of international organizations, think tanks, and non-governmental organizations (NGOs), all of which argue that without specific provisions for fragile countries, **the broader goal of stabilizing the global economy will remain elusive** (UN 2023a). The Bretton Woods institutions are at the centre of this debate, with critics emphasizing the need for these bodies to adapt to an evolving world order, one where geopolitical tensions and global conflicts are more deeply intertwined with economic fragility.

Why fragile and conflict-affected countries matter in the IFA reform debate

The relevance of fragile and conflict-affected states to the broader IFA reform discourse lies in their disproportionate vulnerability to global shocks. Whether through renewed conflicts, debt crises, inflationary pressures, or climate change-induced disasters, these states are at the frontline of systemic weaknesses in the current financial architecture.

Conflict resurgence. The period between January 2020 and December 2023 was the most violent period in the last thirty years. There are **currently 59 active conflicts in 34 countries**, the highest number since the end of the Cold War (Rustad 2024). The latest projections by ACLED estimate that **1 in 7 people in the world today are exposed to violent conflict** (ACLED 2024). According to the UNHCR, almost 120 million people are forcibly displaced, the highest level on record. **Over 85 per cent of displaced persons** are hosted in developing countries (UNHCR 2024), compounding their development and financial constraints. This uptick in armed violence underscores the need for IFA to be more closely integrated with efforts to address the root causes of conflict, as well as be flexible and adaptable, allowing for rapid responses to emerging threats. Notably, the rapid escalation in violent conflict underscores a pressing need for the IFA to integrate peace and security considerations into financial policy and programming, a point strongly emphasized in the UN’s **New Agenda for Peace** (UN 2023b). Yet, despite this critical intersection between conflict and financial instability, reform discussions remain predominantly economic in focus, largely sidelining the nexus between conflict and financial fragility.

Russia’s invasion of Ukraine and the Israel-Gaza conflict, in particular, have led to political instability in Europe and the Middle East with far-reaching consequences, including rises in inflation, disruption in supply chains, and the risk of regional disruption. As a result, the cost of borrowing for low-income countries, including those affected by or emerging from conflict, has become much more expensive as such countries typically cannot access the international capital markets to borrow for the refinancing of their debt. Flows of refugees, disrupted regional markets, and challenges in accessing basic goods further aggravate this situation, increasing the risk of further conflicts spiralling.

Conflict-affected states are the proverbial ‘canary in the coal mine’ for global instability. Reforming the IFA to be more responsive to these states is not just a humanitarian necessity but as a strategic priority to prevent further global crises. Unless the IFA is designed to be more responsive to the risks of conflict, the international community may end up merely managing symptoms rather than addressing the root causes of instability in fragile states. The war in Ukraine is a case in point. It has mobilized unprecedented international financial responses, but has also demonstrated how selective the global system can be in addressing crises. While swift financial measures were rightly deployed in Ukraine, these actions stand in contrast with the slower, often inadequate, responses to conflicts in Africa and the Middle East, highlighting systemic biases within the IFA that need urgent attention.

Geopolitical shifts in international aid. International financial assistance to fragile and conflict-affected countries increased substantially over the last two decades with the aim of improving state capacity, institutional reach, and democratic values. Evaluations of the effectiveness of such interventions have been **at best mixed** (Justino 2019). As a result, and despite the increase in global security concerns, a new political reluctance is emerging with regards to channelling aid to fragile countries. This is partially a result of the aftermath of the withdrawal of US and allied troops and international community from Afghanistan, and partially due to growing economic challenges in donor countries. The post-Afghanistan landscape has, in particular, heightened debates about the effectiveness of international aid in fragile settings, with some arguing for a rethinking of aid structures to ensure that they do not reinforce authoritarianism or exacerbate corruption. These debates, however, come at a time when many donor nations face domestic political pressures to reduce foreign aid, leading to discussions about alternative mechanisms, such as leveraging private capital for development in fragile states.

Donors have always faced critical trade-offs when operating in fragile countries. On the one hand, funnelling aid through government ministries of fragile countries is an effective way of improving state capacity. On the other hand, it risks **strengthening non-democratic regimes, feeding corruption, or being captured for political and economic gains** (Hoeffler and Justino 2024). Over the last two decades, the prevailing view was that the benefits of such interventions might outweigh any risks. However, the accumulation of economic crises and uncertainty is slowly shifting that dominant view, especially as more nationalistic governments gained power in Western countries.

This ongoing debate surrounding ‘aid fatigue’ highlights a critical challenge for IFA reform. As donor countries become more inwardly focused, fragile states face increasing difficulty securing necessary resources, while new donor nations like China and India push for a more transactional and less conditional approach to international financial assistance. This shift towards a multipolar world presents both opportunities and risks for fragile states, whose dependency on international aid places them in a vulnerable position vis-à-vis changing global power dynamics.

The rise of multipolarity, characterized by the growing influence of China and India has led to a reconfiguration of international alliances and aid flows. Traditional Western donors are increasingly challenged by these emerging powers, which offer alternative sources of financing that are often less conditional and more focused on infrastructure development. These approaches are appealing to fragile countries given lower conditionalities attached to financial assistance, leading many to reassess their reliance on Western aid and explore new partnerships. The contrast between the speed of international intervention in Ukraine and in other conflicts in developing countries has further hindered the trust of fragile countries on western governments. However, this diversification of aid sources has also complicated the development landscape, leading to a more fragmented and competitive environment for the international financial system, which can potentially reinforce weak governance and heighten socio-political tensions in already fragile countries. This creates a more fragmented international financial landscape, where fragile countries are sometimes caught between competing spheres of influence, complicating the goal of cohesive, globally coordinated IFA reforms.

Disproportionate exposure of fragile and conflict-affected countries to economic uncertainty. The global economy has experienced significant turbulence in recent years, marked by events such as the COVID-19 pandemic, inflationary pressures, and disruptions in global supply chains. Fragile states find themselves at the epicentre of these global economic shocks. Due to their already weakened institutions and economies, they face disproportionate challenges in absorbing these shocks. In light of this, reforming the international financial system to make it more responsive to the specific needs of fragile states needs to become a focal point for international development institutions.

Total debt in developing countries is at the highest level in 50 years, and around 60 percent of low-income countries are at extreme risk of debt default. This trend has been further exacerbated by rising interest rates, depreciating currencies, and slowing global growth. The eruption of new conflicts has disrupted regional markets and supply chains, further adding to strained health systems in the aftermath of the pandemic, disrupted economies, and increased social tensions.

One of the most hotly debated aspects of IFA reform is how debt relief measures can be made more equitable and effective in countries which are vulnerable to multiple shocks. Proponents of a more radical approach argue for broader debt cancellation schemes, particularly for countries that have endured prolonged fragilities, as a prerequisite for rebuilding their economies. However, others caution that such measures, if not carefully calibrated, risk alienating creditor nations and institutions. In this context, international financial assistance has been critical in supporting fragile states' responses to the pandemic and to new conflicts. However, both the pandemic and the wars in Ukraine and Gaza have also highlighted the limitations of traditional aid models and international financial assistance, leading to calls for reform of debt restructuring and relief programmes, which might be re-engineered to better serve the specific vulnerabilities of fragile states. There is thus a need for greater emphasis on ensuring that the international financial system is better aligned with the specific needs of fragile states, with a focus on strengthening institutions, improving governance and security, and building resilience to future shocks, in ways that differentiate these countries from other low- or middle-income countries.

Climate change and fragility. Climate change has emerged as a critical factor influencing the international financial system, particularly in fragile states that are disproportionately affected by climate-related disasters, as highlighted in the newly released **Bridgetown Initiative 3.0**. These events have exacerbated existing vulnerabilities, leading to displacement, food insecurity, and increased conflict over scarce resources. In fragile states, the combination of conflict and climate change often creates a vicious cycle, where environmental degradation intensifies resource competition, exacerbating social tensions and triggering new conflicts. This dual vulnerability to both conflict and climate shocks is increasingly leading to a growing recognition of the need for the IFA to be more responsive to the challenges posed by climate change in conflict-affected and post-conflict settings. This has led to a shift in focus towards funding for climate adaptation and mitigation, as well as disaster risk reduction, within the broader framework of the IFA.

Moving forward: two pitfalls to avoid

The focus on national tax reforms. National tax reforms have been part of IFA reform debates. Critics argue that without a stronger focus on international cooperation and wealth redistribution, fragile states will struggle to build effective tax systems, often becoming reliant on regressive taxation that exacerbates social inequalities. Calls for global tax reform, including measures to curtail tax havens and illicit financial flows, have gained traction as part of broader IFA reforms. There has also been a growing debate on the role of domestic resource mobilization (DRM) and taxation in IFA reform in fragile states. International financial institutions, such as the International Monetary Fund (IMF) and the World Bank, have been actively promoting DRM as a key component of their engagement with fragile states. However, these countries often have low levels of tax revenue, which limits their ability to finance development and reduces their dependence on external aid. They are also typically characterized by fragmentation of authority, which **opens the space for non-state actors to control territory, collect revenue and provide governance in parallel or in competition with the state** (Justino 2022).

The challenges of DRM in fragile states are significant. Weak institutions, corruption, and limited administrative capacity make it difficult to collect taxes effectively. Additionally, the informal nature of many economies in fragile states means that large segments of the population are outside the reach of tax authorities. The increase in conflicts, and the challenges and consequences of that, are global problems that require global solutions. While the IMF and World Bank push for stronger DRM strategies across developing countries, critics argue that fragile states cannot rely on taxation alone, especially when they face ongoing conflicts, fragmented authority, and informal economies. This has sparked calls for broader global tax reforms, such as wealth redistribution and the elimination of tax havens, to better support fragile states. Reforming national tax systems in fragile and conflict-affected countries may offer some way forward but such approaches are likely to offer only limited solutions.

A shift to humanitarian focus. The delivery of international financial assistance during times of violent conflict and in contexts of extreme fragility presents unique challenges. Conflicts disrupt the flow of aid, make it difficult to reach vulnerable populations, and increase the risk of aid being diverted or misused. However, such financial assistance remains critical in supporting fragile states during times of conflict. In recent years, there has been a growing call to limit international financial assistance to conflict-affected countries to addressing humanitarian needs and providing immediate relief to affected populations. This includes the provision of food, water, shelter, and medical care.

This humanitarian imperative is undoubtedly important, but increasingly, voices within the development community argue that focusing exclusively on short-term relief risks undermining longer-term development goals. As part of the IFA reform agenda, it is vital to strike a balance between addressing immediate needs and ensuring the sustainability of peacebuilding and state-building efforts. While humanitarian financial assistance is valuable – and perhaps more palatable to citizens in donor countries facing their own economic challenges – humanitarian assistance represents short-term relief that sometimes undermines longer-term development efforts by delaying the transition to recovery and reconstruction. A focus on humanitarian assistance alone may perpetuate cycles of dependency and instability, leaving fragile states without the necessary investments in governance, infrastructure, and economic resilience. Reforming the IFA should thus prioritize creating a more robust, long-term framework for financial assistance that links emergency relief with sustainable development outcomes.

There is also growing evidence that international financial assistance plays a critical role in supporting peacebuilding and statebuilding efforts in fragile states, including funding for programmes aimed at promoting reconciliation, strengthening institutions, and building the capacity of the state to provide basic services. **Not all efforts have been successful** (Justino 2022). However, that does not necessarily imply a reversal of the IFA to the 1990s whereby international donors engaged with conflict-affected and post-conflict countries largely by providing only emergency recovery assistance. The continued success of international financial assistance to fragile and conflict-affected countries requires not less assistance but rather *better* assistance, with more effective coordination and a clearer mandate to support peacebuilding and statebuilding strategies, in line with the UN's New Agenda for Peace. There is also a need for the IFA to be more flexible and adaptive in these contexts, allowing for a rapid response to changing circumstances on the ground. This includes the use of innovative financing mechanisms, such as blended finance and impact investing, to leverage additional resources for development.

Political decision-makers in fragile states are also advocating for greater ownership of the development process. This includes a stronger emphasis on aligning the IFA with national development priorities and ensuring that aid is used to support long-term development goals rather than short-term needs. There is also a growing recognition of the importance of involving local communities in the design and implementation of aid programmes, to ensure that they are responsive to local needs and priorities. Overall, the reform of the IFA must balance immediate relief with long-term strategies that address the unique vulnerabilities of fragile states. As discussions move forward, these states cannot remain on the periphery of the conversation. The current global financial architecture must evolve to prevent fragility from spiralling into crises that destabilize entire regions.

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