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## **Financing for development: A progress report on the implementation of the Monterrey Consensus**



## **I. Introduction**

1. The Monterrey Consensus on Financing for Development, adopted at the International Conference on Financing for Development in 2002, represented the first global attempt to comprehensively address the challenges of financing development, especially in the context of meeting the Millennium Development Goals (MDGs). The Consensus called for a new partnership between developed and developing countries covering six main areas of action: mobilizing domestic financial resources; attracting international capital flows; promoting international trade as an engine for development; increasing international financial and technical cooperation of development; sustainable debt financing and external debt relief; and enhancing the coherence and consistency of international monetary, financial and trading systems for development. Despite these commitments, progress in terms of compliance and implementation has been largely inadequate since the Consensus was adopted in 2002.

2. This report assesses the progress that Africa and its development partners have made towards achieving the targets under the Monterrey Consensus in 2012. The report reviews Africa's performance in the context of the current regional and global economic environment. It monitors trends in key macroeconomic and financial variables since Monterrey, comparing African countries' performance over the last decade against targets set under the Monterrey Consensus and subsequent related international commitments.

3. The key message of the report is that progress has been mixed in realizing the objectives of the Monterrey Consensus. Some progress has been made in mobilizing domestic revenue; however, more needs to be done in several countries to close the gap between tax potential and actual tax revenue. Whereas substantial progress has been recorded in the areas of foreign aid and remittances, performance in international trade has been disappointing. Global economic uncertainties threaten to reverse the progress that has been made to date, as African countries may experience weaker international financial flows that constrain their capacity to meet the Monterrey commitments.

4. The policy challenge is therefore how to deploy adequate financial resources for advancing Africa's socio-economic development agenda. One strand in meeting this challenge would be to concentrate efforts on deepening financial markets and strengthening institutional capacity so that mobilized funds are effectively intermediated and used for productive investment and socio-economic development.

## **II. Assessment of progress**

### **A. Mobilizing domestic resources**

5. African countries have made significant efforts to mobilize both public and private savings, but these still fall below expected thresholds. This is reflected in the low levels of domestic savings, which have consistently been insufficient to meet most countries' investment needs. After reaching a decade-high level of 24.4 per cent of gross domestic product (GDP) in 2008, Africa's average gross domestic savings declined to 20.67 per cent by 2010 (table 1), which is much lower than in other developing regions like developing Asia (46.1 per cent). It is also low relative to the region's investment requirements for the achievement of the MDGs. The low level of domestic savings is due to both public-sector and private-sector constraints on the mobilization of adequate financial resources.

**Table 1**  
**Gross domestic savings, 2003-2010**

	2003	2004	2005	2008	2009	2010
Africa	21.02	21.11	22.12	24.37	19.31	20.67
East Asia and the Pacific (developing countries)	39.33	40.78	42.38	45.30	46.04	46.14
Latin America and the Caribbean (developing countries)	20.77	22.72	22.63	23.34	20.79	21.83
High income	19.66	20.13	20.11	19.72	17.37	17.81
Low income	10.35	10.66	9.56	7.86	8.51	9.78
Middle income	27.28	29.11	29.70	30.87	29.14	30.05

*Source:* World Bank (2011a).

6. On the public sector side, despite government revenue standing at 27 per cent of GDP for the continent as a whole in 2011, tax collection abilities vary greatly, and this figure still stands at less than 15 per cent of GDP for a quarter of African economies. Some of the factors responsible for this performance include low income levels that impact on revenue from direct taxation; cross-cutting structural bottlenecks, including high levels of informality; a lack of fiscal discipline and legitimacy and huge administrative capacity constraints, as well as the excessive granting of tax preferences; inefficient taxation of extractive activities; inability to fight abuses of transfer pricing by multinational enterprises; and excessive reliance on a narrow set of taxes for revenue (AfDB and others, 2010).

7. Financial intermediation in Africa also remains shallow and too underdeveloped to attract adequate private savings. It is estimated that between 2005 and 2010, domestic credit to the private sector among African countries averaged 52.7 per cent of GDP, while the money supply (M2) averaged 48.4 per cent of GDP. However, these figures are heavily influenced by the performance of South Africa and North Africa (UNECA, 2012). When recomputed without South Africa and North Africa, the average of the two indicators drops slightly below the average for low-income economies (22 per cent for domestic credit to the private sector, 35 per cent for M2).

8. Similarly, African capital markets are constrained by several structural weaknesses, including small market size, illiquidity and low levels of technology. For example, out of the 29 stock markets currently operating on the continent, only 3 (in Egypt, Nigeria and South Africa) have a listing of more than 100 companies, while at least 6 have a listing of less than 10 companies. The total value of stocks traded on these markets equalled on average 51 per cent of GDP in the period 2005-2010. This compares to an average of 60 per cent in middle income economies, 124 per cent in the developing economies of East Asia and the Pacific and only 20 per cent in the developing economies of Latin America and the Caribbean.

## **B. Mobilizing international resources for development**

9. Over the last three years, developments around the world have significantly impacted on Africa's efforts to mobilize resources for development. Growth in flows of foreign direct investment (FDI) has declined. Since reaching a historic high of about \$58 billion in 2008, FDI inflows to Africa have been on the decline, reaching a three-year low of \$42.7 billion in 2011 (table 2). Three key factors have led to this downward trend: weak global economic performance emanating from the 2007 global economic crisis; continued weak performance in developed countries, especially in the euro zone; and political and social developments since early 2010 in North Africa, where FDI flows fell from \$17.4 billion in 2009 to \$7.4 billion by 2011. Moreover,

FDI flows are largely targeted on the natural resources sector, and are therefore of limited impact in accelerating economic transformation and development.

10. On the other hand, remittances have picked up significantly over the past decade. The World Bank estimates that they will reach \$60 billion by 2014 from \$11.4 billion in 2000. However, more serious policy efforts are needed if African countries are to maximize their gains from this potential. The establishment of the African Institute for Remittances by the African Union is expected to enhance remittance inflows, for example, by lowering the associated transaction costs.

**Table 2**  
**FDI flows to Africa, 2000-2011**

	FDI flows to Africa (of billions of US dollars)					
	2000	2005	2008	2009	2010	2011
<b>Africa</b>	<b>9.7</b>	<b>30.5</b>	<b>57.8</b>	<b>52.6</b>	<b>43.1</b>	<b>42.7</b>
Central Africa	0.6	2.7	2.3	5.4	6.5	6.7
Eastern Africa	0.8	1.5	4.9	3.5	5.8	4.7
Northern Africa	2.7	12.6	21.4	17.4	14.9	7.4
Southern Africa	2.7	6.6	14.1	11.2	2.8	6.6
West Africa	2.9	7.0	15.0	15.1	13.1	17.1

*Source:* United Nations Conference on Trade and Development, online statistical database (<http://unctadstat.unctad.org>).

*International financial and technical cooperation*

11. Whilst the quantity and effectiveness of official development assistance (ODA) has improved over the past decade, downside risks remain elevated amidst the current global economic uncertainty. Total ODA inflows, excluding debt relief, increased in nominal terms from \$17.4 billion in 2002 to \$50.0 billion in 2011. However, the total quantity remains below international commitments under both the Monterrey Consensus and the 2005 Paris Declaration on Aid Effectiveness. Under the Monterrey Consensus, developed countries committed to increase ODA to 0.7 per cent of GDP, with an additional 0.15-0.2 per cent to support the least developed countries. By 2011, ODA from most of the developed countries had not yet reached this level. Similarly, the authors of the Paris Declaration estimated that ODA flows to Africa would increase to \$64 billion by 2010. In practice, Africa received only around half of the estimated increase, partly as a result of lower global ODA contributions compared with commitments and partly owing to Africa's lower than anticipated share of the global increase. The continued global economic uncertainty has raised legitimate concerns over the ability of donor countries to deliver on their commitments on aid.

12. By 2011, it was clear that progress in delivering the Paris and Monterrey commitments on aid effectiveness had been slower than anticipated, signalling that significant changes in the aid delivery system were necessary. In cognizance of this, the Fourth High Level Forum on Aid Effectiveness, held in Busan, Republic of Korea, in November/December 2011, instituted a Busan Partnership for Effective Development Cooperation, establishing a key shift from "aid effectiveness" to wider "development effectiveness". The main argument is that, although ODA is one of the sources for financing Africa's development, it should be placed in the broader context of development to support capacity development and domestic resource mobilization for productive sector growth and economic transformation.

13. Although there are several issues that need to be addressed in order to maximize the impact of aid on Africa's development, three are critical to progress and require an immediate focus on the part of African countries and their development partners. First, stakeholders should take practical steps to shift the focus from aid effectiveness to "actual" development. As reflected in both the Paris Declaration and the Busan Partnership agreement, it is now widely acknowledged by development practitioners that aid is useful largely to the extent that it helps recipient countries achieve their broader development objectives.

14. Key in this is to ensure that development partners continue to align their aid delivery modes (e.g. reforms that they are supporting, monitoring and evaluation mechanisms, and sectoral support) to the recipient country's development strategy. While some countries such as Mozambique, Uganda and Zambia have taken significant steps in this direction, there remains a lot of room to improve this alignment. Secondly, and as a related issue, aid should be geared towards promoting structural transformation. While technological progress, industrialization and investment in infrastructure are key to Africa's transformation, statistics have shown that aid allocation to economic and production sectors remains insufficient.

15. Development partners should therefore make deliberate efforts to support economic and productive sectors that have been identified by the recipient countries as important for their economic transformation. Lastly, African countries should develop clear and time-bound strategies to exit aid dependence. Apart from its unpredictability and volatility, aid also makes it challenging for recipient countries to have complete ownership of their programmes and ensure that governments are accountable to their citizens. There is therefore a need for countries to design medium-to-long-term development financing strategies that minimize their dependence on aid for implementing their development programmes.

### **C. International trade as an engine of growth**

16. While international trade is promoted as an engine of development, there has been slow progress in improving Africa's trade with the rest of the world. The continent's exports rebounded in 2011, surpassing pre-crisis levels. A notable trend over the past decade is the growing trade between Africa and other emerging economies, which helped to propel Africa's exports and imports in value terms by 28.3 per cent and 18.6 per cent respectively in 2010, and by 14.5 per cent and 19.5 per cent respectively in 2011. But estimates suggest that these figures may have fallen by at least half in 2012, owing to the global economic slowdown (World Bank, 2012). It is also worth noting that Africa's exports continue to be driven by an increase in demand for commodities by the emerging economies of China and India, which is likely to be unsustainable in the long term.

17. The key challenge for African countries in optimizing their trade potential for growth is how to sustain this increase in exports and exploit the potential of trade for growth and poverty reduction. In this regard, African countries have a great stake in the conclusion of the World Trade Organization's Doha Round, which has so far not delivered the gains promised in key areas such as agriculture, non-agricultural market access and development issues. Further, regional integration remains critical for African countries to attain economic diversification and structural transformation. In this respect, the endorsement of the Action Plan for Boosting Intra-African Trade and the establishment of a continental free trade area by the African Union Heads of State and Government in January 2012 will go a long way in harnessing Africa's integration agenda.

#### D. External debt

18. Regarding sustainable debt financing and external debt relief, positive steps have been taken towards reducing Africa's external debt since 2002, especially following the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). Indeed, \$109.8 billion (net present value) in debt relief had been extended in total to HIPC countries by the end of 2011 (UNECA and OECD 2012). As a result, the total stock of external debt as a share of gross national income declined from 53.5 per cent in 2000 to 20.6 per cent in 2011, well below the 50 per cent sustainability threshold. This performance is reflected across all five subregions of the continent (table 3). Improved macroeconomic management in many African countries, the HIPC initiative, MDRI, and the Paris Club's Evian Approach to debt relief initiatives for non-HIPC countries largely contributed to this decline. Total external debt as a share of both GDP and total exports is forecast to increase to 23.6 per cent and 63.8 per cent respectively in 2012.

**Table 3**  
**Trends in external debt stock 2000-2011 (percentage of gross national income)**

	2000	2005	2008	2009	2010	2011
<b>Africa</b>	<b>53.5</b>	<b>33.9</b>	<b>20.4</b>	<b>23.7</b>	<b>23.1</b>	<b>20.6</b>
Central Africa	112.8	54.3	21.3	24.5	17.0	14.3
Eastern Africa	88.0	62.6	33.2	35.7	31.4	32.3
Northern Africa	41.8	29.0	16.9	20.0	20.8	15.6
Southern Africa	34.5	25.9	24.4	27.4	27.9	26.7
West Africa	94.3	41.3	16.7	19.9	16.9	16.2

*Source:* ECA calculations based on World Bank data on world development finance.

#### E. Systemic issues

19. In addition to the specific areas raised above, the Monterrey Consensus also recognizes the importance of enhancing the coherence, governance and consistency of the international monetary, financial and trading systems. During recent years, there have been a number of multilateral dialogues on key systemic issues for improving the governance structure of international financial institutions.

20. With respect to this area of the Consensus, the 2007-2009 global financial and economic crisis revealed weaknesses in the current international financial architecture and prompted increased calls for reforms in the system. A key weakness in the system has been the fact that although developing countries in general, and African countries in particular, are increasingly affected by the global financial and economic shocks, they remain highly underrepresented in the global economic and financial policymaking structures and institutions.

21. Specifically, Africa has been insufficiently represented in international organizations such as the International Monetary Fund, the World Bank, the World Trade Organization, the Bank for International Settlements and the G-20, which make decisions on issues that have serious economic and financial implications for the region. Although there have been recent attempts (through the G-20) to improve the governance of international monetary and financial systems, there is a need to increase efforts to improve the participation of African countries in the decision-making organs of international organizations.

### **III. Conclusion**

22. This report highlights several challenges and constraints inhibiting the implementation of the Monterrey Consensus. Firstly, though African governments have been making some efforts to mobilize domestic resources, savings rates remain inadequate relative to investment requirements. The underdeveloped state of financial institutions (banks and capital markets) makes it difficult to mobilize savings adequately, increasing country risk premiums and mitigating against efforts to mobilize external resources. There is therefore a need to improve banking infrastructure and governance as well as exploit the potential of capital markets and microfinance institutions for resource mobilization.

23. Secondly, FDI inflows have increased, but are still insufficient to help accelerate economic growth and development. ODA flows to Africa are on the increase, but donors are still not on track to meet their commitments. There is a need to increase allocations to the productive sectors and also to scale up efforts to improve aid effectiveness.

24. Thirdly, the transformation of African countries from producers of commodities to exporters of dynamic products has remained a key challenge in the realization of the ultimate objective of the Monterrey Consensus to reduce poverty through sustained economic growth. These problems are compounded by the persistent market access barriers facing African countries in the markets of developed countries. In order to reduce these barriers, it is important to boost donor support for trade capacity development and to ensure adequate access and representation in forums where international trade agreements are made.



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