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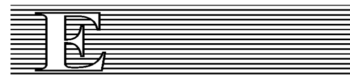

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Progress Report on Implementation of the Monterrey Consensus on Financing for Development

Acronyms

AfDB	African Development Bank
AU	African Union
AUC	African Union Commission
CAMEF	Conference of African Ministers of Economy and Finance
DDR	Doha Development Round
ECA	Economic Commission for Africa
ECOWAS	Economic Community of West African States
EDF	European Development Fund
EPAPD	ECOWAS EPA Development Programme
EPA	Economic Partnership Agreement
ERA	Economic Report on Africa
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
HIPC	Highly-Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LDC	Least Developed Country
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

I. INTRODUCTION

1. The Monterrey Consensus on Financing for Development covers six core areas, namely, (a) mobilization of domestic resources; (b) mobilization of international resources for development; (c) international trade; (d) international financial and technical cooperation; (e) external debt; and (f) enhancement of the coherence and consistency of the international monetary, financial and trading systems in the context of addressing systemic issues.

2. The present report is being undertaken in an international context where various external events are jeopardizing the global community's attempts at inclusive economic development. These events include international conflicts, natural disasters and a global economic crisis in which key financial markets have lost value and stability. These elements combined will tend to reverse the progress that has been made in the area of development finance, as African countries are experiencing weaker export revenues, lower investment rates as well as shrinking remittances and foreign direct investment (FDI) flows.

3. The key message emanating from the report is that progress remains limited in realizing the objectives of the Monterrey Consensus. Whereas substantial progress was recorded in the area of debt relief, and official development assistance (ODA) to a lesser extent, performance in domestic resource mobilization, foreign capital inflows and international trade has been disappointing. African countries are experiencing weaker export revenues, lower investment and growth rates, and shrinking remittances and FDI flows, which constrain their capacity to meet the Monterrey commitments.

4. Accordingly, there is an urgent need for African governments and their regional and international development partners to take more proactive steps towards:

(a) Strengthening the institutional framework including development of domestic stock and bond markets as an important avenue to diversify savings and investment funds;

(b) Exploring innovative financing at the national and regional levels to complement external sources; and

(c) Advancing agreed reforms of the international financial architecture to correct existing imbalances in global flow of resources as well as enhance the participation of African countries in economic decision-making at the global level.

5. In this regard, this report is prepared for presentation and discussion at the 4th Joint Annual Meetings of the AU Conference of Ministers of Economy and Finance and ECA Conference of African Ministers of Finance, Planning and Economic Development, and its Committee of Experts, to be held in Addis Ababa, Ethiopia, 28 – 29 March 2011. Clear guidelines and strategies on the way forward are expected from Conference deliberations.

II. ASSESSMENT OF PROGRESS

Limited taxable capacity hampers domestic resource mobilization

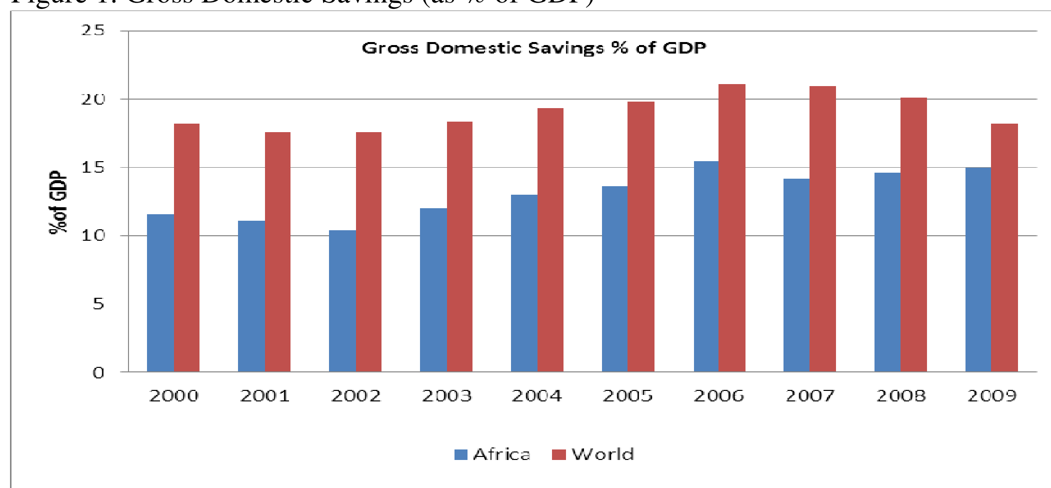
6. Although the African financial system may have largely escaped significant direct damages from the recent financial crisis given that it is not closely integrated into the global financial system, the slowdown in the global economy, especially the decrease in demand, has already had negative effects on the real economy of Africa. This makes the need for mobilization of additional domestic resources more urgent and crucial in order to stabilize the economy and maintain long-term growth.

7. The Monterrey Consensus also reaffirmed the importance of mobilizing domestic resources through taxation, the main domestic financial resource for most African countries. However, this has been hampered by the limitations of taxable capacity for each individual country, which depends on fundamental economic factors such as per capita income, trade levels, and the shares of agriculture and mining in the economy. Figure 1 shows a slight increase of gross domestic savings in Africa from 14.5 per cent of GDP in 2008 to 15 per cent in 2009. This increasing trend is expected to continue by about 1 percentage point of GDP to reach 16 per cent in 2010.

8. However, the level of domestic savings is still low relative to Africa's investment requirements and is thus a serious constraint to growth. Studies have shown that countries with high growth performance tend to have high saving ratios (Rodrik, 2000). Consequently, one of the key challenges of African governments is how to increase domestic savings and channel them into socially-productive investments.

9. As income levels increase, tax revenues are also expected to increase. However, this relationship may not be very strong in many African countries because a sizable part of the growth in many of these economies comes from the informal sector which is outside of the formal tax net. This is translated in the low level of government revenues which average only 27.9 per cent of GDP in 2010 from 26.8 per cent in 2009.

Figure 1: Gross Domestic Savings (as % of GDP)



Source: World Bank National Accounts, and OECD National Accounts data files (2010)

10. Generally, existing tax bases in Africa are often eroded by excessive granting of tax preferences, inefficient taxation of extractive activities and an inability to fight abuses of transfer pricing by multinational enterprises (African Economic Outlook, 2010). The tax mix of many African countries is unbalanced with countries relying excessively on a narrow set of taxes. In particular, the lack of urban cadastres and population censuses makes collecting urban property taxes particularly challenging for local administrations in addition to the difficulty of collecting taxes from higher-income groups.

11. Strategies towards more effective, efficient, and fair taxation in Africa typically lie with deepening the tax base in ways that are administratively feasible. The policy options here include removing tax preferences, dealing with abuses of transfer pricing techniques by multinationals and taxing extractive industries more fairly and transparently. The international community has a key role to play in enhancing administrative capacity, while African partners should provide peer-learning opportunities. In the longer term, effort should be made to remove the capacity constraints of African tax administrations in order to open up more policy options as well as enable the generation of tax revenues through a more balanced tax mix.

Global economic slowdown constrains international resources mobilization

12. The important role of international capital flows as a source of investment, technology and economic growth in African countries is well recognized. FDI has become one of the most important sources of development financing in Africa. Given the budgetary constraints and low saving rates facing most African governments and the need to bring in the necessary knowledge, technology and skills, FDI is likely to remain a strategically important source of financing in Africa. Migrants' remittances to Africa are also set to become one of the most important private flows of financing. Hence, this section focuses on trends in FDI and remittances given their stated importance.

13. As foreseen during the early stages of the financial crises, net FDI inflows to Africa drew back from $US72 billion in 2008 to $58.6 billion in 2009, recording a decrease of 18.9 per cent. The decrease is particularly significant when reported as a share of GDP. For Southern Africa, for instance, the inflow of FDI decreased from about 3.5 per cent in 2008 to about 2.1 per cent in 2009 (table 1). Although there has been an increase for Central Africa from 16.9 to 17.7 per cent of GDP over the period, the drop recorded for Africa reached 0.7 per cent of GDP.

Table 1: Foreign Direct Investment Flows (% of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009
East Africa	2.43	2.68	2.50	2.16	3.21	4.63	3.62	3.15
Central Africa	12.92	16.96	13.24	12.99	14.34	15.84	16.93	17.66
North Africa	1.56	1.96	2.06	3.32	5.45	4.94	3.87	3.13
Southern Africa	1.87	0.70	0.65	2.76	0.20	2.28	3.45	2.12
West Africa	2.84	2.82	2.44	4.01	7.37	3.80	3.50	3.59
Africa	4.32	5.02	4.18	5.05	6.11	6.30	6.27	5.93

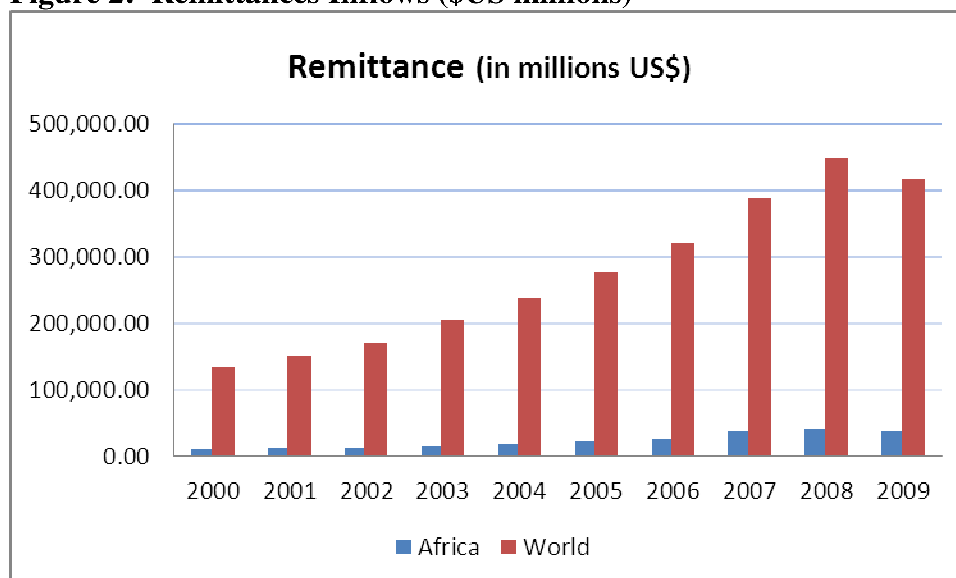
Source: UNCTADStat, 2010

14. Most FDI flows to Africa remain largely concentrated in the extractive industries. Thus, the broader development impact of FDI is often limited. It is therefore desirable for African countries to adopt a selective approach to ensure coherence between increasing FDI and pursuing the national

development strategy. Particularly, Africa should strive to attract investments that are linked to the rest of the economy, that generate employment and that lead to transfer of knowledge and local capacity-building.

15. Remittances also constitute a major contributor to finance for development in Africa. The value of remittances increased considerably globally and is presently among the three most important financial flows to developing countries, alongside FDI and ODA. Figure 2 indicates a decrease in total inflow of remittances in Africa, from US$41 billion in 2008 to US$38 billion in 2009, indicating a downward trend of 6.8 per cent. The preliminary estimate for 2010 is about 21.5 billion. This decrease is due largely to the more difficult working conditions in the destination countries of migrants and the possible job losses resulting from the global economic crisis.

Figure 2: Remittances Inflows ($US millions)



Source: UNCTAD, UNCTADstat 2010

16. Similar to foreign direct investments, the flow of remittances is distributed unevenly across countries with six African countries (Egypt, Nigeria, Morocco, the Sudan, Algeria and Tunisia) accounting for over 75 per cent of total remittances received. However, due to the global crises, there was a drop in remittances in these countries, with Egypt most severely affected with a 17.8 per cent decrease.

Export diversification is vital for Africa to increase trade performance

17. Among the external sources of financing, international trade is recognized as a key engine of Africa's growth and development. Trade is also the key channel through which Africa suffered most from the global economic slowdown (ERA, 2011). Many countries experienced a sharp decline in both the international prices as well as the volume of their key primary exports. Consequently, the region's merchandise exports contracted drastically, in nominal terms, by 31 per cent while the value of merchandise imports dropped by 15 per cent in 2009 as shown in table 2. The table also indicates that exports of Africa's commercial services declined by 9 per cent in 2009 while imports declined even more by 16 per cent in the same period. This poor performance partly relates to trade protection outside

Africa against African products and the drying up of trade finance, but it also stems from constraints that inhibit trade within Africa.

18. Whereas export earnings rebounded strongly in 2010, owing to increased commodity demand and prices, current account deficits have widened for many non-oil exporting African countries, and especially African LDCs.

Table 2: Africa's Trade in Merchandise and Commercial Services, 2007-2009 (Annual Percentage Change)

	Exports			Imports		
	2007	**2008**	**2009**	**2007**	**2008**	**2009**
Merchandise trade	17	28	-31	23	28	-15
Commercial services trade	18	16	-9	27	27	-16

Source: WTO, 2010

19. A critical factor behind Africa’s relatively poor trade performance is the weak diversification of African trade in terms of structure and destination. Reduced demand in the USA and EU (accentuated by the depreciation of the dollar) contributed to squeezing export volumes, underlining the advantages of diversifying export markets. Half of African exports go to American and European markets, a share declining steadily from 60 per cent at the turn of the century. China and India, meanwhile, continue to enjoy a growing share of Africa’s exports, 11.2 per cent and 4.4 per cent respectively. The proportion of exports destined to African countries grew from 9 per cent in 2008 to more than 11 per cent in 2009 as Africa capitalized on falling demand elsewhere.

20. As traditional markets in advanced countries are expected to grow less than those in emerging Asian and Middle East countries as well as markets in Africa, trade relations with these more dynamic markets must be enhanced.

Increased uncertainties about ODA flows to African countries

21. ODA is still an important source of external financing. Available data for 2009 showed that global ODA reached US$127 billion, or 0.7 per cent increase from 2008. The share of ODA in donor gross national income (GNI) was 0.31 per cent, well below the United Nations target of 0.7 per cent, which has been reached and exceeded by only five donor countries. If this target were to be met by all donors by 2015, it would raise over US$300 billion per annum for development (in 2009 prices and exchange rates).

22. From table 3, ODA to Africa increased from US$43 billion in 2008 to US$47 billion in 2009. In 2010, the continent is expected to receive only about US$45 billion, leaving a gap relative to the Gleneagles commitments. Sub-Saharan Africa, however, continued to be the largest recipient of ODA flows allocated to the poorer countries.

Table 3: All Donors: Total Current Prices (US$ million); ODA: Total Gross Disbursements

	2002	2003	2004	2005	2006	2007	2008	2009
Developing Countries, Total	61716.5	71029.9	79817.8	108441.0	106548.5	106774.8	126655.8	127526.6
Africa, Total	21299.6	27347.4	29865.6	35703.6	43962.8	39305.3	43926.4	47609.4
Africa's Share of Total ODA to developing countries	0.35	0.39	0.37	0.33	0.41	0.37	0.35	0.37

Source: Data extracted from OECD.Stat, 2010

23. In response to the financing needs of developing countries in the face of the global financial and economic crisis, the international community substantially increased funding and reform of concessional financial facilities at the International Monetary Fund (IMF) and the multilateral development banks. However, the economic downturn has raised legitimate concerns over the ability of donor countries to maintain their commitments on aid. To date, only a few countries have decreased their previous commitments. The extent to which the current pressure on the budgets of advanced economies will reduce aid flows is still uncertain and remains a concern. It is in this context that there is need to give increased attention to ODA from countries such as China, among others 2.

Debt sustainability remains a challenge for many countries

24. Recognizing debt financing as an important element for mobilizing resources for economic development, the Monterrey Consensus stresses that the national strategies to monitor and manage external liabilities should include sound macroeconomic policies and public resource management in order to reduce the vulnerability that has risen with rapid globalization in recent years.

25. Available data reported in table 4 show that Africa had accumulated over US$300 billion in external debt in 2009, and this amount was expected to increase to US$324 billion in 2010. As a proportion of GDP, Africa's total external debt fell slightly from 22.3 per cent in 2008 to 25.4 per cent in 2009 and then to 24.9 per cent in 2010. For sub-Saharan Africa, the total external debt was over US$256 billion in 2009, with this amount expected to increase to US$278 billion in 2010. It rose steadily from a low level of US$213.1 billion in 2006, following the 2004 historical peak of US$263 billion. Relative to GDP, the total external debt of sub-Saharan Africa increased from 24.5 per cent in 2008 to 27.8 and 27.6 per cent respectively in 2009 and 2010. North Africa had a relatively lower level of external debt. Total debt for the subregion stood at US$44.4 billion in 2009 rising slightly to US$46.2 billion in 2010. Its highest value of US$57.9 billion was recorded in the 2003/2004 period.

26. Debt sustainability in sub-Saharan Africa has generally improved. Table 4 shows that in the past decade, the overall debt-to-export ratio dropped persistently from 180.0 per cent in 2000 to around 53.4 per cent in 2008, before rising significantly to 80.3 per cent in 2009 partly as a result of the recent economic crisis. During the same period, the overall debt-service-to-export ratio also dropped from 26.9 per cent in 2000 to 12.1 per cent in 2008 before increasing to 15.9 per cent in 2009. It is likely to decrease in 2010 to around 14 per cent.

27. A major reason behind this debt sustainability improvement is the various debt relief initiatives by the international community. Of the forty (40) countries globally eligible or potentially eligible for Highly-Indebted Poor Country (HIPC) Initiative assistance, 33 of them are in Africa. As of end-July 2010, 30 African countries are past decision point and committed a total debt relief of US$102.6 billion representing, on average, 46.4 per cent of these countries' 2009 GDP. However, debt relief under Multilateral Debt Relief Initiative (MDRI) accounts for 37.8 per cent of the total committed to 24 post-completion-point African countries. Overall, as presented in table 4, a total of 30 out of 33 HIPC African countries were past their decision point and 24 past their completion point as of end-July 2010.

Table 4: Africa's External Debt (2000 - 2010)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010e
External debt, total $US billion	**284.3**	**274.6**	**280.4**	**304.6**	**321**	**291**	**253**	**283.3**	**286.8**	**300.6**	**324.7**
Sub-Saharan Africa	229.7	222.9	226.9	246.7	263.0	241.3	213.1	240.2	243.5	256.2	278.5
North Africa	54.6	51.6	53.5	57.9	57.9	49.7	39.8	43.0	43.3	44.4	46.2
External debt, total per cent of GDP	**62.8**	**62.6**	**60.6**	**52.3**	**44.5**	**34.7**	**26.3**	**25.6**	**22.3**	**25.4**	**24.9**
Sub-Saharan Africa	67.3	68.4	65.9	56.1	47.7	37.3	28.5	27.9	24.5	27.8	27.6
External debt, total per cent of exports	**180.0**	**182.9**	**180.1**	**155.9**	**128.8**	**92.7**	**68.5**	**64.8**	**53.4**	**80.3**	**73.7**
Sub-Saharan Africa	197.4	203.6	199.1	171.1	142.0	104.1	77.7	73.5	61.3	91.9	84.5
External debt, total debt service US$ billion	**42.4**	**41.5**	**39.5**	**44.8**	**47.1**	**66.0**	**87.7**	**59.7**	**64.9**	**59.3**	**62.9**
Sub-Saharan Africa	29.7	29.9	25.3	29.4	29.6	48.5	62.6	46.4	50.8	45.2	49.1
North Africa	12.7	11.6	14.2	15.4	17.5	17.5	25.2	13.3	14.2	14.2	13.8
External debt, total debt service, per cent of exports	**26.9**	**27.7**	**25.4**	**23.0**	**18.9**	**21.1**	**23.8**	**13.6**	**12.1**	**15.9**	**14.3**
Sub-Saharan Africa	25.5	27.3	22.2	20.4	16.0	20.9	22.8	14.2	12.8	16.2	14.9
External debt, total debt service, interest per cent of exports	**8.46**	**8.80**	**8.28**	**7.10**	**5.65**	**4.90**	**3.71**	**2.90**	**2.69**	**4.19**	**3.72**
Sub-Saharan Africa	6.30	7.01	5.84	5.32	4.11	3.97	2.60	2.45	2.21	3.49	3.21
External debt, total debt service, interest per cent of GDP	**6.43**	**6.46**	**5.76**	**5.33**	**4.59**	**6.05**	**7.70**	**4.24**	**3.94**	**3.68**	**3.57**
Sub-Saharan Africa	6.56	6.83	5.41	4.95	4.00	6.09	7.41	4.46	4.23	3.85	3.82

International Monetary Fund, World Economic Outlook Database, October 2009
Note: e – estimate.

Enhancing Africa's representation and legitimacy in the international decision-making process

28. The Monterrey Consensus recognizes the urgent need to enhance the coherence and consistency of the international monetary, financial and trading systems in order to stabilize exchange rates and trade flows. The Consensus also advocates comprehensive and sustained reform of the international financial architecture with the participation of developing countries, to ensure that it better serves their needs.

29. With regard to trade issues, a lack of progress is noted in the Doha Development Round (DDR) negotiations. The 2010 negotiations barely progressed beyond informal meetings focusing on the "cocktail approach", leading to postponement of cross-sectoral negotiations based on schedules of

commitments. Nevertheless, the year saw some highlights such as the "banana deal", progress on cotton trade and non-tariff barriers negotiations, and notable engagement of the Africa Group.

30. Similar to the WTO negotiations, little progress was made in negotiations on Economic Partnership Agreements (EPAs) in 2010. Discussions were held across all EPA configurations; however, negotiations appeared stuck on the same contentious issues of the previous year. Concerning market access, no development-friendly rules of origin which allow for cumulation beyond those countries that are signatory to the interim EPAs have been negotiated. The development component of EPAs also remains contentious as the EU refuses to commit additional funds beyond the European Development Fund (EDF). The ECOWAS EPA Development Programme (EPAPD), for instance, has attracted less than required amounts for implementation of the EPAs.

31. Furthermore, the growing instability of the world financial system, highlighted by recurrent crises, has exposed weaknesses in the existing international financial architecture. The need for a new international financial architecture has become more evident in the wake of the 2008-2009 international financial crises and the consequent global recession from which most countries are still recovering. These issues have been voiced in the wake of the global financial crisis and the subsequent G-20 Summits that committed to reform the global architecture to meet the needs of the 21st century.

32. Some positive signs could be seen with the number of recent governance reforms undertaken by the World Bank Group, the most important of which is the reaffirmation of the Development Committee to an increase of at least 3 per cent of voting power for developing and transition countries in the International Bank for Reconstruction and Development (IBRD), in addition to the 1.46 per cent increase under the first phase of this important adjustment, to the benefit of underrepresented countries. The IMF has also initiated a process designed to realign members' voting power in a manner that will enhance its effectiveness and legitimacy. Moreover, the Declaration adopted in Seoul at the G-20 Summit, called for further reforms by January 2013, "aimed at enhancing the voice and representation of emerging markets and developing countries, including the poorest".

III. CONCLUSIONS AND RECOMMENDATIONS

33. Significant obstacles have prevented African countries from achieving some of the objectives and goals set in the Monterrey Consensus, including (a) limitation of taxable capacity combined with inefficient tax administration which have hampered domestic resource mobilization; (b) increased uncertainty with regard to access to international flows due to existing global economic and financial conditions; (c) stalemate of the WTO Doha Round negotiations – whose initial objective was to promote a multilateral system that allowed these countries to enjoy the advantages resulting from international trade; (d) the levels of ODA provided by developed countries with respect to their GDP which are still below the goal mutually set earlier; (e) limitations of the current debt sustainability framework, and the legitimate concerns that ODA flows seem to have been undermined by the financial resources granted for debt relief; and (f) lack of inter-institutional coordination at the global level to ensure a stable international financial system that can promote development.

34. Concrete actions are required to address these issues.

35. In particular, on the mobilization of domestic resources for development, African countries should increasingly focus on promoting an effective, efficient, and fair taxation system tied to deepening tax

administration. Generally, the capacity of African economies to mobilize domestic resources through taxation is not only hampered by widespread poverty, but is also largely a consequence of institutional failures that need to be addressed. Thus, the primary objective of tax revenue enhancement should be pursued with a criterion compatible with efficiency and equity. Potential policy measures include broadening the effective tax base by eliminating economic distortions and encouraging investment; streamlining tax policy and tax administration procedures to reduce compliance costs and encourage formality; rationalizing the rate structure; and providing incentive schemes to improve tax collection.

36. Improving the ability and efficiency of the financial system in generating as well as in allocating funds to boost productivity growth and employment creation is equally important as tax revenue enhancements. The first task is to create incentives for people to hold financial assets. Second, the rate of interest should also be competitive since it defines the expected return of holding financial assets, although in Africa, reducing related risk and transaction costs would be more crucial.

37. Regarding the transformation of FDI into a major source of growth, there is need to re-orient inflows to more diversified and higher-value-added sectors. Strengthening of the regional integration processes in Africa must become a key element in national and regional strategies in order to increase the capacity of Africa to attract FDI.

38. For ODA, many donor countries are reforming their development systems to make aid more effective, in particular by orienting ODA towards maximizing poverty reduction and achieving the other Millennium Development Goals (MDGs). To ensure transparency and accountability, there must be high-quality evaluation based on solid evidence for measuring the impact on development goals. On their side, African countries should commit to more efficient management of ODA flows, while promoting South-South cooperation. This would result in additional aid from emerging economies.

39. On international trade, a successful conclusion of the DDR, within the WTO framework, is a basic requirement for African countries to take advantage of the benefits of trade as an engine of development. Strengthened debt management would enable highly-indebted African countries to face the new global situation characterized by an increase in the prices of raw materials but also higher costs of energy and food products. Finally, it is necessary to make progress with reform of the international financial architecture. This will assist in correcting existing imbalances in global flow of resources as well as enhance the participation of African countries in economic decision-making at the global level.

40. Finally, there is a great need for Africa to speak with one voice in the international economic arena. Individual countries will not be able to have much impact at a global level whereas Africa as a continent can have a stronger position in the bargaining process with other nations and groups of nations. In that regard, it is necessary to strengthen Pan-African institutions that are already pursuing this objective, namely UNECA, AUC, and African Development Bank (AfDB), among others. Due recognition should be made of recent initiatives with a regional scope, such as the African Central Bank, the African Monetary Fund and the African Investment Bank– all of which are instruments for monetary and financial cooperation among African countries that could be effective as both an alternative and a complementary framework to already existing mechanisms on the continent.

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