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Abstract: The Monterrey Consensus agreed at the UN summit on Financing for Development in 2002 promised a breakthrough in terms of donor generosity, aid effectiveness and new means of financing. However, the development orientation of world leaders proved to be short-lived. This is even though our evaluation reveals progress since Monterrey in some areas, notably debt relief and private (FDI) flows. Calls for substantially scaling up regular aid had little effect, and financial innovations contributed only marginally to overall development financing so far. There is not much progress either from the perspective of critics focusing on the quality of aid. In particular, we find that the targeting of aid according to need and merit leaves much to be desired. The gap between words and deeds continues to be wide with regard to aid proliferation and donor coordination, too.

Keywords: official development assistance, debt relief, aid for trade, donor coordination, financial innovations, foreign direct investment, corruption

JEL classification: F35; F53

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1. Introduction

According to the former UN Secretary-General Kofi Annan, the International Conference on Financing for Development in Monterrey, Mexico, in March 2002 was "a turning point in the quest for economic and social progress. … It produced a breakthrough on the question of official development assistance, with substantial new pledges, and a major change in attitude."[1] The conference was the first UN summit-level meeting, attended by more than 50 Heads of State and Government, to address key financial issues pertaining to global development. While important elements of the Monterrey Consensus had been worked out over the previous four years, the summit convened just six months after the terrorist attacks of September 11th, 2001. As stressed by the Heads of State and Government, "it has now become all the more urgent to enhance collaboration among all stakeholders to … address the long-term challenges of financing for development."

Indeed, major initiatives such as the Millennium Challenge Corporation, an innovative performance-based aid scheme announced by the Bush administration, arose out of the UN summit in Monterrey (Fleck and Kilby 2010).[2] Likewise, European donors promised considerable increases in their aid budgets. All the same, sceptics such as Woods (2005) were concerned that the War on Terror would rather weaken the international development cooperation by diverting funds and donors prioritizing strategic self-interest. Similar ambiguity still prevailed after the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus in Doha, Qatar, in November/December 2008. The Doha Declaration reaffirmed the goals and commitments of the Monterrey Consensus.[3] Critics noted advances in some areas, but complained about missed opportunities in many respects.[4]

The Monterrey Consensus as well as the Doha Declaration addresses six major areas (so-called leading actions), ranging from the mobilization of *domestic* financial resources to systemic issues such as the coherence of the international monetary, financial and trading systems. The subsequent evaluation of the progress achieved since Monterrey focuses on *foreign* financing for development and leaves systemic issues out of account. In other words, we concentrate on transfers of capital from advanced (donor) countries to less advanced (recipient) countries. Specifically, we assess whether advanced countries became more

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[1] This and the subsequent quote are from: http://www.un.org/esa/ffd/documents/Building%20on%20Monterrey.pdf (accessed: March 2011).

[2] See also the additional references given there.

[3] The full declaration is available from: http://www.un.org/Docs/journal/asp/ws.asp?m=A/CONF.212/L.1/Rev.1 (accessed: March 2011).

[4] See, e.g., the reaction of civil society organizations, available from: http://www.un.org/esa/ffd/doha/press/ngopressconf.pdf (accessed: March 2011).

generous in granting official development assistance (ODA) (Section 3), alleviated the debt situation of heavily indebted poor countries (Section 4), supported the integration of recipient countries into the international division of labour by providing "aid for trade" (Section 5), introduced financial innovations to mobilize additional resources for development (Section 6), improved the effectiveness of ODA by less aid fragmentation and more donor coordination (Section 7), and channelled private flows, notably foreign direct investment (FDI), to an increasing number of developing economies (Section 8). However, the quality of local governance is widely perceived to be critical for sustainable development, irrespective of the source of (foreign or domestic) financing. Fighting corruption figures prominently in the Monterrey Consensus, too, as is evident from the short excerpt at the beginning of Section 2. We start with this overarching issue before turning to specific aspects of foreign financing for development.

2. Fighting corruption

Good governance is essential for sustainable development. ... Fighting corruption at all levels is a priority. Corruption is a serious barrier to effective resource mobilization and allocation, and diverts resources away from activities that are vital for poverty eradication and economic and sustainable development (page 7, paragraphs 11 and 13).[5]

The former World Bank President James Wolfensohn highlighted corruption as a major impediment to effective aid and economic development in 1996 already: "Let's not mince words: we need to deal with the cancer of corruption".[6] Nevertheless, little has changed (see also Easterly 2007). Transparency International's Corruption Perceptions Index (CPI) clearly reveals that corruption remains pervasive.[7] The most recent CPI of 2010 has in common with the CPI of 2002, i.e., at the time of agreeing on the Monterrey Consensus, that more than two thirds of all listed countries scored below an index value of five, on a scale from ten (=highly clean) to zero (=highly corrupt).[8] Just five out of the 70 countries scoring below five in 2002 surpassed this threshold until 2010.

Responsibility for reducing corruption and, thereby, removing an obstacle to economic development rests primarily with national governments and local authorities. However, international financial institutions such as the World Bank and various bilateral donor countries claim to allocate ODA in a way to promote better governance in the aid recipient

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[5] At the beginning of each section, we insert a relevant quote (*in italics*) from the Monterrey Consensus (United Nations 2003).

[6] http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/EXTPRESIDENT2007/EXTPASTPRESIDENTS/PRESIDENTEXTERNAL/0,,contentMDK:20025269~menuPK:232083~pagePK:159837~piPK:159808~theSitePK:227585,00.html (accessed: March 2011).

[7] For details, see: http://www.transparency.org/policy_research/surveys_indices/cpi (accessed: March 2011).

[8] Note that country coverage of the CPI increased from 102 in 2002 to 178 in 2010.

countries, including by containing corruption. As noted by Alesina and Weder (2002: 1126), "the rhetoric that accompanies these [aid] programs is that they serve not only of reducing poverty, but also of rewarding good policies and efficient and honest governments."

In striking contrast to the donors' rhetoric, the empirical findings of Alesina and Weder (2002) pointed to a vicious circle of donors granting aid indiscriminately to inefficient and dishonest governments and continuous aid inflows breeding further corruption. For the largest bilateral donor, the United States, aid was even shown to be positively correlated with corruption in recipient countries during the 1975-1995 period covered by Alesina and Weder. The German government responded to a parliamentary inquiry in 1997 that "no development cooperation contracts were annulled due to proof of corruption" (as quoted by Cremer 2008: 122).

Assessing the correlation between corruption and aid with more recent data suggests that donors have hardly become more selective by redirecting aid to better governed recipient countries and, thereby, improving the chances for an effective use of aid.[9] In Figure 1, we show this correlation for the three-year period preceding the Monterrey Summit (1999-2001) and the most recent three-year period for which complete aid data are available from the OECD's Creditor Reporting System (2007-2009).[10] The partial correlations in panels (a) and (b) are based on regressions with aid commitments from all member countries of the Development Assistance Committee (DAC) as the dependent variable. We control for the recipient countries' size (population in 1998 and 2006, respectively) and their per-capita income (PPP in 1998 and 2006, respectively). The corruption measure is taken from the World Bank's Worldwide Governance Indicators.[11] More precisely, this indicator reflects control of corruption in 1998 and 2006, respectively; the range is from -2.5 to 2.5 with higher values indicating better control of corruption so that we would expect a significantly positive correlation with aid if donors granted more aid to better governed recipient countries. In contrast to panel (a) of Figure 1, the coefficient of control of corruption appears to be weakly positive in panel (b). All the same, there is no significant evidence that DAC countries preferred recipients with better control of corruption in the most recent past.

[9] See also recent empirical analyses of aid allocation (e.g. Dreher et al. 2010; Hoeffler and Outram 2011). Schudel (2008) finds that corruption levels in the donor countries determine their reaction to corruption in the recipient countries. According to Claessens et al. (2009), bilateral aid responded more favourably to a better institutional environment in the recipient countries in 1999-2004 than before. However, this study employs a broadly defined institutional measure, the World Bank's Country Policy and Institutional Assessment (CPIA), rather than specifically corruption.

[10] For details, see: http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW (accessed: March 2011).

[11] For details, see: http://info.worldbank.org/governance/wgi/index.asp (accessed: March 2011).

Figure 1 invites the conclusion that the Monterrey Consensus did not generally strengthen the merit-based allocation of aid through which donors could have provided stronger incentives for recipient countries to fight corruption more effectively. This could be because donors did not even try to close the gap between their rhetoric and actual allocation behaviour; but part of the explanation may also rest with failed donor attempts to condition aid on reform promises of recipient countries. Critics such as Collier (1997) have stressed that traditional forms of (ex-ante) conditionality suffer from time inconsistency problems: Breaches of reform promises are rarely sanctioned by donors so that recipients are tempted to renege on earlier commitments such as fighting corruption.

Replacing ex-ante conditions by ex-post rewards may offer a way out of this dilemma. Donors would then base their aid allocation on retrospective performance appraisals, e.g. with respect to improved control of corruption. The Millennium Challenge Corporation (MCC), announced by the Bush administration at the Monterrey summit in 2002, represents an innovative aid scheme designed along these lines. To receive MCC aid it is mandatory for countries to score higher than the median of all candidate countries in terms of controlling corruption. The empirical assessment of Öhler et al. (2010) indeed suggests that this approach was more successful than traditional forms of conditional aid in encouraging recipient countries to fight corruption. However, the incentive effects seem to have weakened more recently when it became increasingly uncertain how MCC operations and its funding would develop.

3. Scaling up official aid

We recognize that a substantial increase in ODA and other resources will be required if developing countries are to achieve the internationally agreed development goals and objectives, including those contained in the Millennium Declaration. … In that context, we urge developed countries that have not done so to make concrete efforts towards the target of 0.7 per cent of gross national product (GNP) as ODA to developing countries (page 14, paragraphs 41 and 42).

Donor reliability and aid predictability are questionable not only with regard to specific aid schemes such as the MCC. The same applies to the international goal for industrialized countries to devote a specific proportion of their income to development assistance, which is almost as old as modern development cooperation itself. The 0.7 percent figure was first mentioned in the report of the Pearson Commission, which states that "we therefore recommend that each aid-giver increase commitments of official development assistance for net disbursements to reach 0.70 percent of its gross national product by 1975 or shortly

thereafter, but in no case later than 1980" (Pearson et al. 1969: 148-149).[12] It was loosely based on back-of-the-envelope calculations using the two-gap approach (e.g. Chenery and Strout 1966), which in the tradition of the Harrod-Domar growth model assumes a fixed relationship between capital use and economic growth. Accordingly, any gap between domestic savings and overall capital needed to achieve a desired growth rate was to be filled by foreign aid.[13]

Despite the fact that there was almost no progress towards attaining it in the decades following its inception, the 0.7 percent aid target has remained on the political agenda (Clemens and Moss 2007). After it was again confirmed in the Monterrey Consensus, reports published by the UN Millennium Project, directed by Jeffrey Sachs (UNDP 2005), and the Commission for Africa, set up by the then Prime Minister Tony Blair (CFA 2005), called for a massive increase in official development assistance to Sub-Saharan Africa in particular. At the Gleneagles G8 meeting in November 2005, governments followed these calls and promised to double aid to the region by 2010.

Aid disbursed by all DAC donors indeed increased somewhat in 2005 compared to previous years (Figure 2), but this solely reflected a steep but temporary increase in debt relief measures. Net of actions related to debt, the average aid share started to rise only in 2009. Yet, with slightly above 0.3 percent it was still way below the UN target. During the Gleneagles summit, the EU-DAC member countries explicitly committed themselves to raise their collective aid share from 0.35 percent in 2004 to 0.56 percent in 2010, aiming to finally hit the 0.7 percent target in 2015 (Gleneagles Communiqué 2005). Judged against the average of 0.42 percent realized in 2009, the EU most likely missed the 2010 interim target.[14] Still, unlike the other two big donors, Japan and the United States, whose aid share stagnates at around 0.2 percent, the EU countries have at least taken steps towards becoming more generous donors.

Even if the scaling up of aid succeeds, though later than envisaged by the Monterrey Consensus, there remains the question of how effective aid can be. Several recent empirical studies (e.g. Doucouliagos and Paldam 2009; Rajan and Subramanian 2008) have raised doubts as to whether more aid translates into higher growth, but there are also some more favourable assessments (e.g. Dalgaard et al. 2004), preventing any firm conclusion on the aid-growth relationship.

[12] See Clemens et al. (2007) for a detailed account of the developments that led to the formulation of the 0.7 percent goal.
[13] The two-gap approach has been criticized for its unrealistic assumptions (e.g. Easterly 1999), but is nonetheless widely used as a tool for identifying external financing gaps (e.g. Devarajan et al. 2002).
[14] Average EU aid has been projected to rise to 0.48 percent in 2010 (OECD 2010).

4. Debt relief

External debt relief can play a key role in liberating resources that can then be directed towards activities consistent with attaining sustainable growth and development, and therefore, debt relief measures should, where appropriate, be pursued vigorously and expeditiously, including within the Paris and London Clubs (page 17, paragraph 48).

As indicated before, the cancellation of ODA-related debt must not be confused with longer-term trends of regular ODA. Yet even critics credit the Monterrey Consensus for having contributed to "considerable progress" (VENRO 2008: 9) in removing over-indebtedness as an obstacle to sustainable development. In 2005, the previous HIPC initiative which aimed at reducing the external debt burden of Highly Indebted Poor Countries was supplemented by the Multilateral Debt Relief Initiative (MDRI). The MDRI offers relief on debt owed multilateral lenders, notably the IMF and the World Bank, by countries completing the fairly complex process of the HIPC initiative. As of December 2010, debt reduction packages under these initiatives had been approved for 36 countries (32 of them in Africa) providing an overall sum of US$ 72 billion in debt-service relief.[15] Large-scale debt relief has also been granted to non-HIPC countries, in particular Nigeria and Iraq in 2005-2006.

Specific schemes such as the Debt2Health program, launched by the Global Fund to Fight AIDS, Tuberculosis and Malaria in 2007, explicitly link the cancellation of debt to increases in health spending. Debt2Health calls on creditors to write off debt on the condition that the debtor country invests an agreed-upon amount in local health programs approved by the Global Fund. This enables poor countries to devote more of their own resources to fighting infectious diseases (http://www.globalaidsalliance.org/index.php/29; accessed: March 2011). For instance, Germany agreed on debt conversion with Pakistan in the context of the Debt2Health program during the Follow-up International Conference on Financing for Development in Doha in November/December 2008; the conversion involved €40 million of Pakistani debt, cancelled on the condition that Pakistan would invest half of this amount in local health programs.[16]

Nevertheless, it is open to question to which extent debt relief operations have actually released additional resources that the borrowing countries could have used to spend more on poverty eradication. Arguably, at least part of the cancelled debt would not have been serviced even if it had remained in the books. In other words, eliminating a debt overhang

[15] More detailed information is available from: http://www.imf.org/external/np/exr/facts/pdf/hipc.pdf (accessed: March 2011).

[16] http://www.epo.de/index.php?option=com_content&view=article&id=4428:debt2health-deutschland-erlaesst-pakistan-40-millionen-euro-schulden&catid=49:schuldenkrise&Itemid=97 (accessed: March 2011).

does not necessarily provide the debtor country with more public resources to invest. Furthermore, the (dis-)incentive effects of debt relief are debated controversially. Clearing the books may tempt borrowers to enter a new debt spiral, hoping to be bailed out once again. At the same time, new lenders – including new global players such as China and India – might be the true beneficiaries of the previous relief by free-riding on the concessions made by traditional creditors.

Reisen and Ndoye (2008) assess the empirical relevance of renewed 'imprudent' lending to African countries that had been granted debt relief before. They find "very little evidence" of free-riding by emerging lenders such as China and of imprudent lending to beneficiaries of debt relief. The latter finding is in contrast to an earlier evaluation of the HIPC initiative by the Independent Evaluation Group (IEG) of the World Bank. The IEG evaluation summarizes: "In 11 of 13 post-completion point countries for which data are available, the key indicator of external debt sustainability has deteriorated since completion point. In eight of these countries, the ratios have come to once again exceed HIPC thresholds."[17] Even though the empirical evidence continues to be ambiguous, it is probably safe to conclude that debt reduction granted ad-hoc is not sufficient to ensure debt sustainability. Orderly debt resolution mechanisms should thus remain on the international agenda to meet the Monterrey Consensus' call for "clear principles for the management and resolution of financial crises that provide for fair burden-sharing" (United Nations 2003: 17).

5. Aid for trade

We further invite bilateral donors and the international and regional financial institutions,…, to reinforce the support for trade-related training, capacity and institution building and trade-supporting services. Special consideration should be given to least developed countries, landlocked developing countries, small island developing states, African development, transit developing countries and countries with economies in transition (page 13, paragraph 36).

Trade is one specific area in which donors have pledged to commit additional resources (e.g. Higgins and Prowse 2010), especially since the aid-for-trade initiative was launched at the Hong Kong Ministerial Meeting of the WTO in 2005. The reason why this area has received particular attention is that trade and trade liberalization can make a substantial contribution to economic growth and poverty reduction. However, a range of factors may prevent low-income countries in particular from taking advantage of trade opportunities (Rodrik 2007; Winters et al. 2004). Among the obstacles are trade restrictions adopted by industrialized countries and the developing countries themselves as well as structural weaknesses such as

[17] http://siteresources.worldbank.org/INTDEBTDEPT/Resources/ieghipcupdatereview2006.pdf (accessed: March 2011).

low levels of human capital and an insufficiently developed infrastructure. This is where aid for trade comes in as a means of reinforcing the positive impact of trade on poverty.[18] A decisive characteristic of the aid-for-trade agenda is that it takes a very broad perspective, going well beyond directly trade-related measures such as developing the skills of trade negotiators or assisting countries in dealing with international trade standards (OECD 2009).[19] It aims, among other things, to provide support for the productive capacities of the poor, to help connect the poor to markets through a set of marketing policies, institutions and investments in rural infrastructure, and to facilitate adjustment to trade-induced structural change.

While such a broad definition may be justified on conceptual grounds due to the complex nature of the trade-poverty nexus (e.g. Mc Culloch et al. 2001), the numerous potential entry points of donor support render it extremely difficult to delineate aid for trade from other forms of assistance. Five broad aid categories (trade policy and regulations, trade-related infrastructure, productive capacity building including trade development, trade-related adjustment, and other trade-related needs) have been identified as being potentially conducive to the integration of developing countries into the world economy (OECD and WTO 2009).[20] For monitoring purposes, however, the WTO and OECD Working Group on Statistics has taken the pragmatic decision to consider all aid to productive sectors and economic infrastructure reported under the Creditor Reporting System (CRS) as aid for trade. Since these two categorizations do not fully align - aid for trade-related infrastructure, for instance, constitutes only a part of overall aid for economic infrastructure - evaluations based on CRS data have to be interpreted cautiously and would ideally be complemented by in-depth country studies.[21]

According to CRS data for the period 2002-2009 reported in Figure 3, over 60 percent of overall aid for trade is spent on economic infrastructure. Measured in constant US Dollars, aid for economic infrastructure and aid for productive sectors both exhibit a slight upward trend, which suggests that donors at least partly kept their promises of committing additional

[18] It has to be noted that the lingering Doha Round of trade negotiations imposes severe limits on the possible contribution the aid-for-trade agenda can make.

[19] The previous concept of "Trade-Related Assistance" had a much narrower focus on issues directly related to trade (e.g. Voionmaa and Brüntrup 2009).

[20] For a description of the components that make up these five aid categories and a discussion of how each of them might help raise the benefits from trade, see Higgins and Prowse (2010) or Bird and Vandemoortele's (2009) background paper to this study. In an econometric analysis for a sample of 120 countries, Cali and te Velde (2011) find (i) that aid for economic infrastructure as well as aid for productive capacities promote export activity and (ii) that aid for trade policy and regulations reduces the costs of trading across borders as measured by the trade-related components of the World Bank's doing business database.

[21] See Voionmaa and Brüntrup (2009) for a detailed account of German aid for trade. HWWI and PWC (2009) provide a comprehensive evaluation of the local implementation of the aid-for-trade agenda in the three founding members of the East African Community (Kenya, Tanzania, and Uganda).

resources. By contrast, the US Dollar value of more specifically trade-related measures in the category "trade policy and regulations" remained roughly constant over time, and these measures accounted for less than five percent of total aid for trade throughout. This is even though they have been shown to lower trading costs substantially (Cali and te Velde 2011).

Figure 4 shows the distribution of funds across countries. It turns out that aid for trade is clearly not targeted towards needy recipients as stipulated in the Monterrey Consensus. Rather, 55 percent of the total budget over the period 2002-2009 was allocated to middle-income countries, whereas the group of least developed countries received less than 20 percent. The concentration of aid for trade on more advanced recipients with higher commercial potential could well reflect trade-related self interest of donors, which has previously been shown to affect aid allocation in general (e.g. Hoeffler and Outram 2011).

6. Introducing innovative instruments

We recognize the value of exploring innovative sources of finance…. In that regard, we agree to study, in the appropriate forums, the results of the analysis requested from the Secretary-General on possible innovative sources of finance (page 16, paragraph 44).

The widely perceived failure of the donor community to raise sufficient ODA for meeting the Millennium Development Goals provides a major motive for the search of innovative funding mechanisms. For instance, the North-South Institute (2008: 1) posits: "In the face of this development emergency, there is an urgent need for new ideas and initiatives."[22] Critics such as the Association of German Development NGOs complain that the Monterrey Consensus is "particularly week" with respect to innovative development financing (VENRO 2008: 8). However, "a bewildering variety" (Atkinson 2005: 4) of proposals have been made since then. This is even true when focusing on attempts to raise additional concessionary funds, though not necessarily within the narrow confines of standard ODA.[23]

Some specific financing schemes are in operation already.[24] New instruments have been implemented in particular to help achieve health-related objectives. The International Finance Facility for Immunization (IFFIm), initiated by the UK government and launched in 2006, raises finance by issuing bonds in the capital markets - backed by long-term ODA

[22] See also Girishankar (2009: 7).

[23] Note that broader definitions of innovative development financing extend beyond the generation of new official funds. For instance, Girishankar (2009) and the World Bank (2010) argue that more effective financial solutions on the ground, including guarantees, risk-reducing instruments and results-based financing, provide an important complement to new fundraising. Furthermore, various initiatives for raising development finance rely on market-based mechanisms, rather than official transfer mechanisms; see, e.g., the collection of proposals in Ketkar and Ratha 2009).

[24] For informative overviews, see Reisen (2004) and OECD (2011). The following innovative schemes are just examples.

pledges of several donor countries.[25] In this way, IFFIm accelerates the purchase and delivery of vaccines (frontloading) by the GAVI Alliance, a public-private partnership, and improves the predictability of funds for immunization in poor recipient countries. Similarly, UNITAID (a drug purchasing facility administered by the World Health Organization) draws on innovative financing to scale up and accelerate access to treatment for HIV/AIDS, malaria and tuberculosis in low-income countries.[26] About half of UNITAID's budget is financed by a tax on airline tickets levied in France and some other countries since 2006. Private funds are raised by various multinational companies through the sale of so-called Product Red items (http://www.joinred.com/aboutred) in order to support the Global Fund to Fight AIDS, Tuberculosis and Malaria.

Carbon-based funding provides another set of innovative mechanisms that have gained some prominence recently.[27] In the context of the Kyoto Protocol, developing countries may benefit from the Clean Development Mechanism (CDM) by attracting resources for climate-change mitigation. At the same time, a two percent share of proceeds of Certified Emission Reductions issued by the CDM is used to finance the so-called Adaptation Fund, which is designed to support climate-change adaptation programs submitted by developing countries that are parties to the Kyoto Protocol (http://adaptation-fund.org; accessed: March 2011). According to Girishankar (2009: 14), the financing of the Adaptation Fund is "a precedent-setting international 'tax' with a global base arising from an international treaty." The World Bank (2010) expected that the Adaptation Fund could raise US$ 100-200 million annually by 2012.

More generally, the quantitative importance of fundraising through innovative instruments is "as yet very small" (World Bank 2010: 3), compared to traditional ODA. Girishankar (2009) estimates that alternative sources of concessional financing, including from "new" non-DAC donors, totalled about US$ 12 billion in 2000-2008, i.e., just 1.3 percent of gross ODA during the same period. The contribution of innovative instruments could increase tremendously, however, if advanced donor countries agreed on the long debated financial (or: currency) transaction tax (FTT).[28] Meanwhile the FTT commands considerable political support in Europe, including from the French President Sarkozy and the German Chancellor Merkel. Introducing the FTT in the European Union could raise about

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[25] For details, see http://www.iff-immunisation.org (accessed: March 2011).
[26] For details, see http://www.unitaid.eu (accessed: March 2011).
[27] In addition to the sources given in footnotes 21 and 22 above, see Brown et al. (2008) for a more detailed discussion of innovative carbon-based funding proposals to help developing countries adapt to climate change.
[28] Raffer (1998) called for reviving the Tobin tax in the late 1990s already.

€200 billion per annum according to a resolution adopted by a large majority in the European Parliament in March 2011.[29]

The proponents of raising development funds through international taxation stress the 'double dividend' that instruments such as the FTT and carbon taxes could yield. In addition to their large fundraising potential, international taxes could also have positive steering effects, notably by reducing financial instability and containing global warming (e.g., VENRO 2008).[30] All the same, it typically involves trade-offs if one (tax) instrument shall achieve two objectives. On the one hand, critics of the FTT maintain that even low tax rates may impair the functioning of international capital markets. The FTT discourages not only destabilizing speculation but also short-term hedging against risk; by reducing the liquidity of money markets the FTT may even amplify price disturbances and market volatility (Grahl and Lysandrou 2003).[31] On the other hand, the tax rates required for effectively steering economic activities may be considerably higher than the low rates currently discussed with respect to fundraising: "The taxes are not, therefore, guaranteed to have the major behavioural impact, discouraging pollution and speculation, which has been sought" (Atkinson 2005: 242).

Focusing on fundraising and leaving steering functions to specific instruments, the introduction of new taxes may be inferior to raising the rate of an existing tax.[32] For instance, it tends to be more cost effective to mobilize additional MDG-related financing through higher rates of income and value-added taxes, compared to a new special tax. For the latter to generate the same net revenue, the gross tax burden tends to be higher because of additional costs of tax administration (Atkinson 2005: 24). The frequently made assumption that new innovative instruments, including international taxes, will mobilize *additional* development funds is also open to debate. Scepticism is warranted particularly at times when the need for fiscal consolidation is pressing. Global programs such as the IFFIm that rely on ODA funding at least partly may lead donors to reduce bilateral aid projects in the health sector (Girishankar 2009). More generally, new sources of development finance may crowd out traditional forms of ODA so that the net effect is hard to predict.

[29] http://www.europarl.europa.eu/en/pressroom/content/20110308IPR15028/html/MEPs-call-for-the-introduction-of-a-tax-on-financial-transactions (accessed: March 2011). This sum considerably exceeds previous estimates. However, the tax rate underlying the resolution is not specified in the press release.

[30] For a more detailed discussion, see Atkinson (2005).

[31] For a similar line of reasoning, see Reisen (2002). However, the majority view after the recent financial crisis appears to be that "financial markets are characterized by excessive liquidity" (Schulmeister 2009: 7).

[32] Reisen (2004: 27) concludes from his review of innovative approaches to funding the MDGs: "The most straightforward way to avoid underfunding of the Goals is to raise ODA."

7. Coordinating development cooperation

Recipient and donor countries, as well as international institutions, should strive to make ODA more effective. In particular, there is a need for the multilateral and bilateral financial and development institutions to intensify efforts to:

- *Harmonize their operational procedures at the highest standard so as to reduce transaction costs….*
- *… …*
- *Improve ODA targeting to the poor, coordination of aid and measurement of results* (page 15, paragraph 43).

Rather than stressing the need for additional resources, efforts to enhance donor coordination focus on the quality of the aid given. This element of the Monterrey Consensus has gained further prominence with the Paris Declaration on Aid Effectiveness in March 2005. It is now widely accepted that the effectiveness of aid could be enhanced if donors specialized and coordinated more than they have done in the past.[33] Specialization might counteract aid proliferation and donor fragmentation which impose high transaction costs on the recipient countries, especially the poorest among them, with multiple donor missions, different sets of policy conditions and inconsistent reporting requirements absorbing scarce administrative resources (Acharya et al. 2006). At the same time, donors are often "poaching" qualified local labour. The theoretical case for donor coordination rests on the public good character of poverty alleviation in aid recipient countries (Torsvik 2005). Assuming altruistic donors, the common goods problem would still imply an under-provision of aid unless donors cooperated and took into account that an extra amount of aid not only affects the welfare of the particular donor but also the welfare of all other donors.

We follow Aldasoro et al. (2010) and adopt a two-step approach of assessing whether donors have improved aid effectiveness by increasing specialization and coordination. In the first step, we employ Theil indices to evaluate whether major donors, viewed as independent actors, have reduced aid proliferation and fragmentation by concentrating in selected recipient countries and specializing in selected aid sectors, for example aid for education. The Theil index (FrTh) is calculated as:

$$\text{FrTh}_{j,t} = -\sum_{i=1}^{n} \sum_{s=1}^{m} \left(\text{aid}_{i,s} * \ln(\text{aid}_{i,s})\right),$$

with $\text{aid}_{i,s}$ representing the share of aid in sector s to recipient i in donor country j's overall aid budget at time t. The index takes the minimum value $\ln(1) = 0$ if donor j is completely

[33] This is not to deny that there may also be instances of too much specialization and thus too little competition among donors (Frot and Santiso 2010). As in any other market, a lack of competition might raise the "price" of aid, e.g. if implementing agencies hire well-paid external consultants.

specialized (all aid goes to sector *s* in country *i*); it rises with the extent of dispersion and reaches its maximum ln($n*m$) when aid is evenly distributed among countries and sectors.

In the second step, we refer to the earlier literature on the measurement of intra-industry trade (Grubel and Lloyd 1971). So-called trade overlaps have often been used to assess the empirical relevance of intra-industry trade. Analogously, we employ overlap indices to analyze to which extent donors coordinate their aid efforts. Combining the two dimensions of recipient countries and aid sectors, the index of aid overlap (I) or, respectively, the degree of donor coordination (C) between donors *j1* and *j2* at time *t* can be calculated as follows:

$$I^{j1,j2,t} = (1\text{-}C^{j1,j2,t}) = \sum_{i=1}^{n} \sum_{s=1}^{m} \text{Min}(aid_{i,s}^{j1,t}; aid_{i,s}^{j2,t}), \text{ with } aid_{i,s} \text{ defined as before.}$$

This index varies from 0 in the case of no overlap to 1 in the case of complete overlap. It should be declining over time for donors who increasingly avoided a duplication of aid activities and engaged in coordinated aid allocation.

Our calculations are based on aid commitment data from the CRS. We compare the period just before the Monterrey Consensus (1999-2001) with the most recent period for which data are available (2006-2009). The Theil indices for 11 major donors shown in Figure 5 do not reveal an overall trend towards more concentrated and less proliferated aid.[34] Index values declined over the period under consideration for four donors (France, Germany, the Netherlands, and the United Kingdom). They went up for Japan and hardly changed for the remaining six donors (Denmark, EU, Sweden, IDA, Norway and the United States). Comparing aid proliferation across donors, the ranking differs markedly from rankings based on indicators relating to altruistic or selfish aid motivations of donors (e.g. Dollar and Levin 2006; Thiele and Nunnenkamp 2006). Though often berated as selfish donors, France and Japan turn out to be relatively modest proliferators in the most recent period 2006-2009. By contrast, Norway is a strong proliferator, even though it belongs to the group of like-minded, and widely believed to be superior, donors.

Even less favourable conclusions than for the Theil indices emerge from the analysis of aid overlaps. In stark contrast to the provisions of the Monterrey Consensus, our calculations point to a falling degree of coordination for all major donors (Figure 6).[35] The change is particularly pronounced among donors with low initial overlap indices (Denmark,

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[34] Note that our analysis does not include non-DAC donors such as Brazil, China and India. The emergence of these new donors could further complicate the problem of aid fragmentation (Paolo and Reisen 2010).

[35] As shown by Aldasoro et al (2010), the *level* of the overlaps mainly depends on the degree to which the underlying aid data are disaggregated. Using sector-specific aid to individual recipient countries, the overlaps rarely exceed 0.5 even if the distribution of aid by one particular donor is compared at different points in time.

France, and Japan). These three bilateral donors and IDA retain their leading position with regard to coordinated aid allocation in the period 2006-2009, but the distinction between better and worse performers gets increasingly blurred among bilateral donors.

8. Attracting FDI

Private international capital flows, particularly foreign direct investment, …, are vital complements to national and international development efforts. Foreign direct investment … is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship, and ultimately eradicate poverty through economic growth and development. A central challenge, therefore, is to create the necessary domestic and international conditions to facilitate direct investment flows (page 9, paragraph 20).

In contrast to aid which stagnated until recently (Section 3), foreign direct investment (FDI) boomed throughout the last three decades.[36] Furthermore, the above noted scepticism concerning the effectiveness of aid in promoting growth and alleviating poverty contrasts markedly with the favourable view held on FDI. Proponents of globalization as well as prominent critics largely agree that FDI could bring various benefits to developing host countries. The OECD (2002: 13) reckons that FDI promotes productivity and income growth more strongly than domestic investment. Stiglitz (2000) calls for restrictions on other types of capital flows, but finds the case for FDI convincing. Hence, it is hardly surprising that policymakers around the world paid heed and entered into the global competition for FDI by relaxing previous restrictions and offering incentives such as tax exemptions. UNCTAD registered almost 2,500 measures taken by host countries to liberalize and promote FDI inflows since the early 1990s, compared to just 300 measures to restrict and regulate FDI (Figure 7).

FDI liberalization and promotion could have helped a "distinct shift in the pattern of FDI" (Kekic 2009). Kekic concludes that "practice may be catching up to theory" according to which FDI should flow from capital abundant, rich countries to capital scarce, poor countries. UNCTAD reports that the year 2010 was the first in which rich developed countries received less than half of global FDI inflows (*The Economist*, January 20th, 2011).

All the same, there is at best limited progress in meeting the challenge of spreading the benefits of FDI across developing countries. First of all, various disadvantaged groups of potential host countries have hardly participated in the boom of FDI. FDI stocks remain strongly concentrated in a few large and relatively advanced developing countries; the 20 top

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[36] Annual average net inflows of FDI to all low and middle-income countries soared from US$ 12 billion in the 1980s to US$ 93 billion in the 1990s and US$ 291 billion since 2000 (World Bank, World Development Indicators Online).

performers persistently accounted for more than 80 percent of FDI stocks in all developing countries.[37] The Monterrey Consensus explicitly refers to the least developed countries, small island states as well as landlocked developing countries as those groups most in need of FDI to achieve national development priorities. Table 1 shows that the shares of these groups in worldwide FDI stocks continue to be extremely low. The same applies to the group of highly indebted poor countries. All low-income countries hosted just slightly more than three percent of worldwide FDI stocks in 2009 once China is excluded.

Furthermore, the challenge to promote economic growth and alleviate poverty by drawing on FDI extends far beyond the call from Monterrey to attract FDI flows to a larger number of countries. It appears to be particularly difficult to derive macroeconomic benefits from FDI where such benefits would be needed most. Local firms in poor countries are often too far behind the technological frontier to absorb superior technologies transferred by foreign investors (Aghion et al. 2005). According to Borensztein et al. (1998), FDI-related technology transfers translate into higher growth only when the host country is equipped with sufficiently qualified human capital. Alfaro et al. (2004) find that local financial markets need to be well developed for FDI to promote growth in the host countries. The convergence regressions reported in Mayer-Foulkes and Nunnenkamp (2009) suggest that FDI tends to narrow income gaps relative to the United States only for host countries classified as high-income countries by the World Bank. In sharp contrast to the above mentioned OECD study (OECD 2002), Alfaro et al. (2010) conclude from the recent empirical literature that the macroeconomic evidence for positive growth effects of FDI in developing countries is weak, and most microeconomic studies using firm-level data have found positive spill over effects only for developed host countries.[38]

This may explain why UNCTAD argues that host countries "should perhaps pay more attention to the quality of FDI they receive, and take steps to enhance the developmental impact of FDI."[39] Indeed, Alfaro and Charlton (2007) find that the growth effects strengthen when accounting for the quality of FDI. This study relies on the subjective preferences of the host countries, as revealed by industry-level targeting by investment promotion agencies, to identify the quality of FDI. However, the findings of Alfaro and Charlton (2007) do not imply

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[37] For details see: http://unctadstat.unctad.org/.

[38] For a similar conclusion, see Nunnenkamp (2004). The poverty-alleviating effects of FDI may also be limited because FDI benefits more skilled workers in developing countries, and worsens the relative income position of then poor; for an overview of the relevant literature, see ODI (2002).

[39] The quote is from an earlier assessment of the performance and potential of FDI in Africa; for details see: http://www.fdi.net/unctad/5given.htm (accessed: March 2011); see also VENRO (2008: 5). Pradhan (2006) proposes a composite index according to which the quality of FDI increases with the export orientation of foreign investors, R&D intensity, the localization of production (i.e., value added created in the host country), the demand for local inputs, and the extent to which (greenfield) engagements add to productive capacity.

that the developmental impact of FDI could be enhanced if only policymakers in less advanced host countries pursued selective FDI policies and provided targeted incentives. Attempts at picking high-quality FDI may involve considerable costs in terms of effective screening and targeted incentives. The poorer the potential host country, the more likely it is that selective FDI policies suffer from lacking administrative capabilities.[40] Furthermore, previous experience with selective approval procedures and foreign ownership restrictions points to a serious trade-off: For instance, India's strict regulations until the early 1990s ensured that still realized FDI projects corresponded to the host country's preferences; however, they substantially reduced the number of realized projects – including those with the preferred high-quality characteristics (Görg et al. 2010). In other words, the overall objective of the Monterrey Consensus to spread the benefits of FDI more widely could hardly be achieved more easily if policymakers in developing host countries targeted high-quality FDI.

9. Summary

Only six months after the terrorist attacks of September 2010, more than 50 Heads of State and Government attended the International Conference on Financing for Development and agreed on the Monterrey Consensus. Participants praised the UN summit as a turning point in the quest for economic and social progress and a breakthrough on the question of official development assistance. However, their resolve to confront the challenges of financing for development was not "stronger than ever" – in contrast to claims in the Monterrey Consensus (United Nations 2003: paragraph 5).

The sceptics were essentially proven right in suspecting that the development orientation of world leaders would turn out to be short-lived and soon be dominated by strategic motives in the ongoing War on Terror and economic self-interest once the United States and Europe were threatened by the financial crisis. This is even though some progress has been made since Monterrey with respect to specific aspects of financing for development, notably debt relief and FDI flows. However, debt relief under the HIPC initiative dated further back into the late 1990s, and was clearly politically motivated in quantitatively important cases such as Iraq. By contrast, the boom in FDI flows was market driven which also explains why various poor countries continue to be sidelined. Specific initiatives such as aid for trade can help integrate more developing countries into the global division of labour;

[40] In this context, it should be stressed that the analysis of Alfaro and Charlton (2007) is restricted to the small group of OECD countries. There is thus a serious sample selection bias so that a generalization of their findings is clearly unwarranted.

but better targeting would be required in order to support the neediest recipients, rather than those with relatively well established trade links with donor countries.

Critics have little to celebrate after Monterrey, no matter which of the two major camps they belong to. Those pinning their hope mainly on substantially increased amounts of aid in order to promote growth and alleviate poverty are concerned about broken promises and insufficient scaling up. The chances appear to be remote that the situation will improve and major donors will become more generous in the near future. The United States, Europe and Japan all confront huge fiscal consolidation needs in the aftermath of bank failures, sovereign debt crises and natural disasters. Innovative financial instruments have contributed little so far to ease the budgetary constraints of official donors. This is unlikely to change unless revived initiatives of international taxation, notably the financial transaction tax, move beyond the stage of receiving support in official communiqués and are implemented at least in Europe.

The second and larger camp of critics focuses on the quality and effectiveness of aid. For them there is not much progress since Monterrey either. Donors persistently stress the crucial role of good governance in general, and better control of corruption in particular, for rendering aid more effective. All the same, this rhetoric rings hollow as long as the correlation between corruption and aid remains weak and merit does not appear to shape the allocation of aid. More specifically, the concentration of aid for trade on middle-income countries is in conflict with a needs-based allocation. Finally, the gap between words and deeds continues to be wide when it comes to improving the effectiveness of aid through less proliferation and better coordination among donors.

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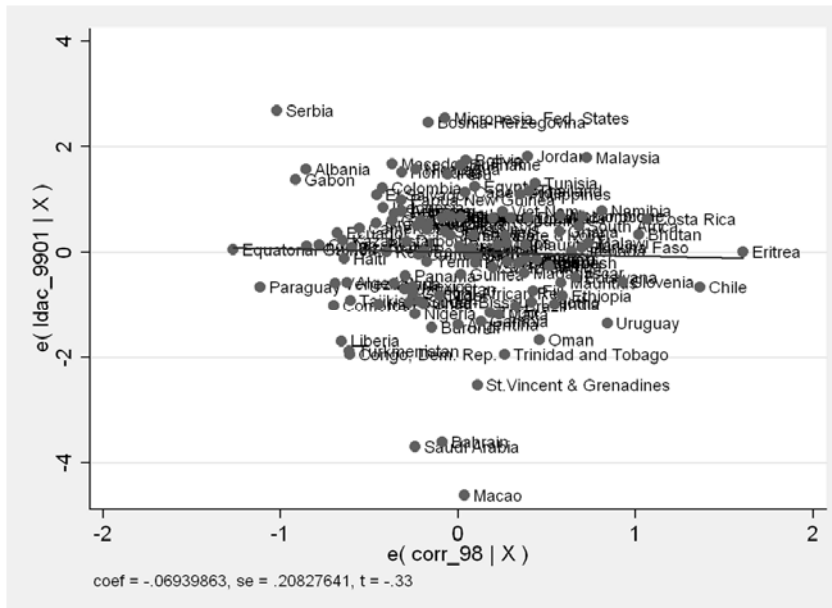
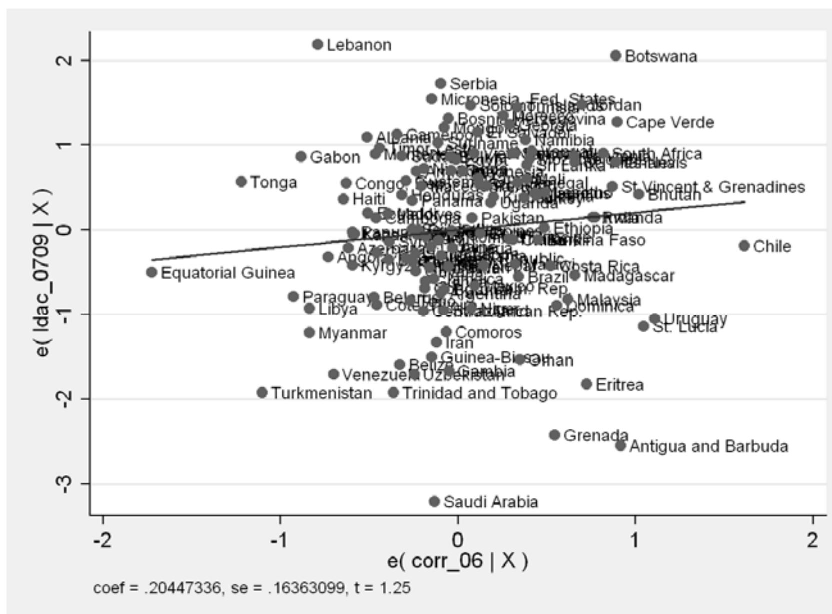
Figure 1: Control of corruption and ODA from all DAC countries

(a) 1999-2001



Notes: partial correlation between control of corruption in 1998, e(corr_98/X), and ODA in 1999-2001, e(ldac_9901/X); controlled for the per-capita income and population of recipient countries in 1998. The correlation is statistically insignificant at conventional confidence levels.

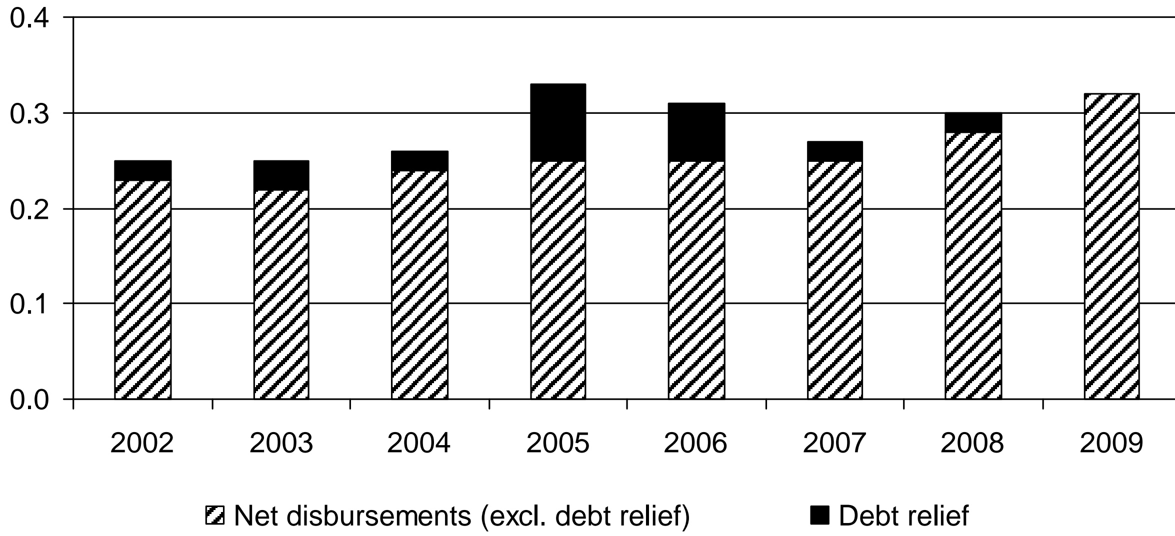
(b) 2007-2009



Notes: partial correlation between control of corruption in 2006, e(corr_06/X), and ODA in 2007-2009, e(ldac_0709/X); controlled for the per-capita income and population of recipient countries in 2006. The correlation is statistically insignificant at conventional confidence levels.

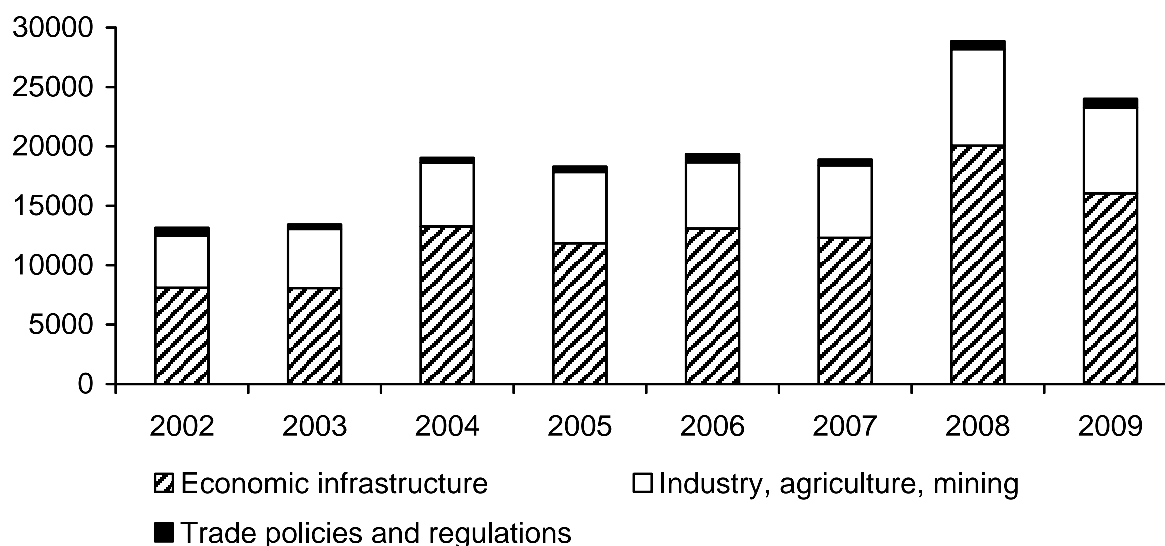
Source: OECD (http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW); Kaufmann et al. (2009).

Figure 2: Net ODA disbursements 2002-2009: All DAC countries, percent of GNP



Source: OECD (http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW).

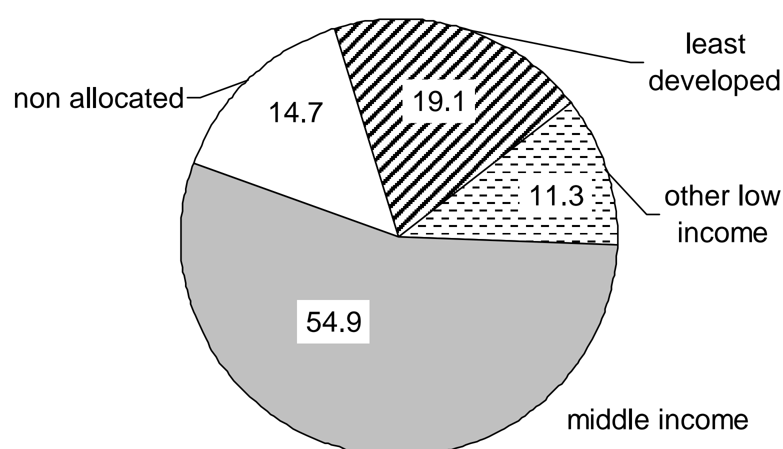
Figure 3: “Aid for Trade”, 2002-2009: All DAC countries ($ million in constant prices)



Note: data still appear to be preliminary and incomplete for some donors in 2009.

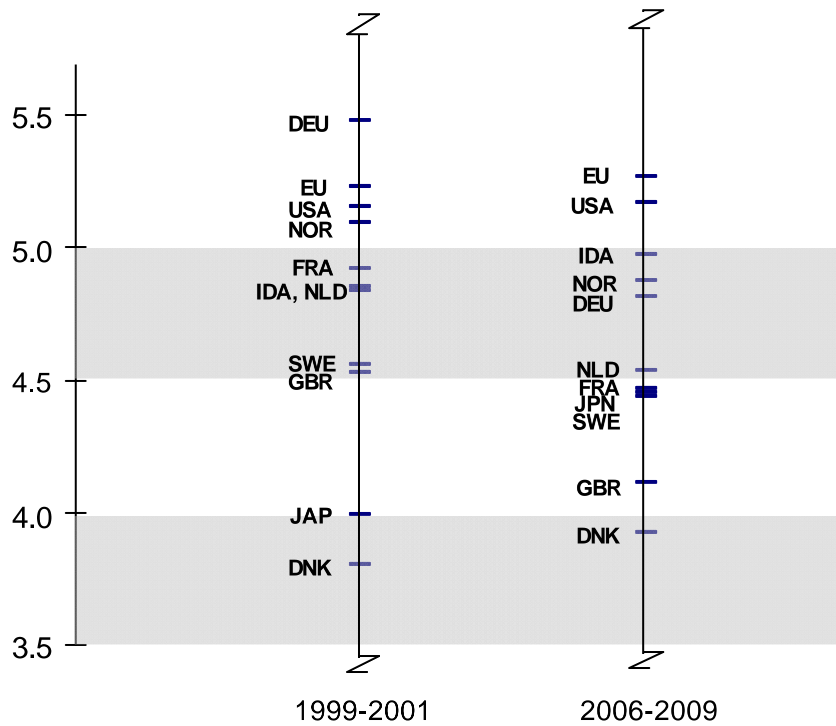
Source: OECD (http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW).

Figure 4: “Aid for Trade” by all DAC countries in 2002-2009: Allocation across income groups of recipient countries (percent)



Source: OECD (http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW).

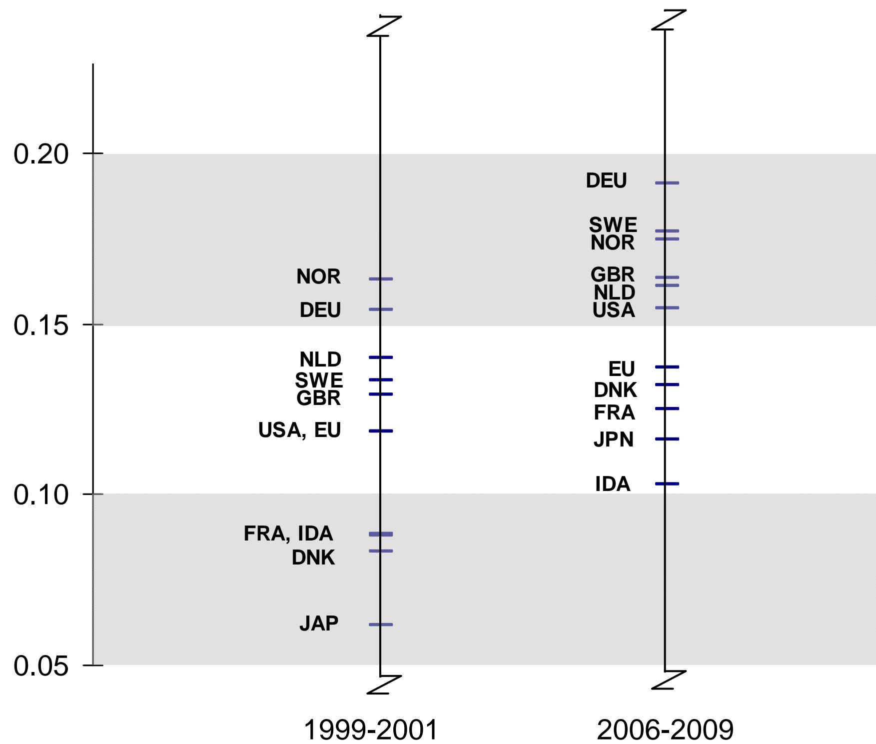
Figure 5: Aid fragmentation across recipient countries and sectors: major donors, 1999-2001 and 2006-2009



Notes: period average of annual Theil index values (see text for details of calculation); index values range from a minimum of zero (one sector in one recipient country accounts for total annual ODA) to a maximum of 8.13 (annual ODA is distributed equally across 3,408 sector-country combinations).
DEU=Germany; DNK=Denmark; EU=European Union; FRA=France; GBR=United Kingdom; IDA=International Development Agency; JPN=Japan; NLD=Netherlands; NOR=Norway; SWE=Sweden; USA=United States.

Source: OECD (http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW).

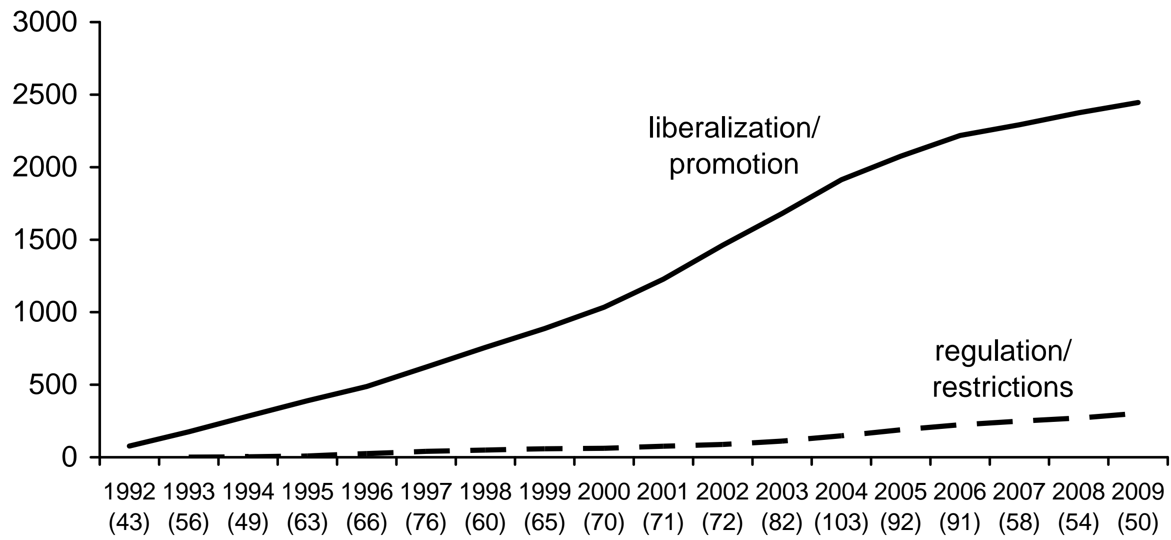
Figure 6: Average aid overlaps with other donors: major donors, 1999-2001 and 2006-2009



Notes: period average of annual overlaps of aid by a particular donor with all other donors in the sample (see text for details of calculation); in addition to donors shown, the sample includes Australia, Austria, Belgium, Canada, Finland, Italy, Spain, and Switzerland.
DEU=Germany; DNK=Denmark; EU=European Union; FRA=France; GBR=United Kingdom; IDA=International Development Agency; JPN=Japan; NLD=Netherlands; NOR=Norway; SWE=Sweden; USA=United States.

Source: OECD (http://stats.oecd.org/Index.aspx?DatasetCode=CRSNEW).

Figure 7: National measures to promote and regulate FDI, 1992-2009 (cumulated number)



Note: number of countries with measures in corresponding year in brackets.

Source: UNCTAD (2010).

Table 1: Inward FDI stocks in selected groups of developing host countries (percentage of worldwide stocks) in 1990, 2000 and 2009

	1990	2000	2009
All developing countries	25.2	23.2	27.6
Low income countries	3.14	4.79	5.85
Low income countries, excluding China	2.14	2.19	3.19
Least developed countries	0.56	0.52	0.74
Landlocked countries	0.36	0.48	0.84
Small island states	0.37	0.29	0.34
Highly indebted poor countries	0.64	0.48	0.73
Sub-Saharan Africa, excluding Rep. of South Africa	1.32	0.89	1.23

Note: definition of country groups as in the source.

Source: UNCTAD (http://unctadstat.unctad.org/).