



# **In whose benefit?**

The case for untying aid

**April 1998**

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# In Whose Benefit? The case for untying aid

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In whose benefit? The case for untying aid – April 1998

Written by Jeffery Chinnock and edited by Sarah Collinson. Additional input from Dr. O. Morrissey and J. Hanlon.

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Northern Affairs Unit

Action Affairs Unit

ActionAid

Hamlyn House

Archway

LONDON N19 5PG

Tel: 0171 561 7561 Fax: 0171 263 7599

## In whose benefit?: the case for untying aid

*"If used inappropriately, tied aid credits may substitute for financing on market terms and may also fund projects of dubious development benefit. In an era of very tight aid budgets, there is also concern that the use of tied aid credits diverts aid away from countries ... most in need of aid"*

(OECD Development Assistance Committee (DAC), 1996)<sup>1</sup>

*The donor community, including the UK, should now undertake to seek a complete multilateral untying of development assistance by the year 2000 and ensure that procurement<sup>2</sup> policies help to promote pro-poor development in recipient countries.*

### a. Introduction

Over a third of the total amount of aid to developing countries - around £13 billion<sup>3</sup> is given on the condition that it is tied to the purchase of products and services from donor countries. The principle of mutual benefit or *quid pro quo* between donor and recipient countries might seem, at first glance, to be a fair reciprocal arrangement: developing countries receive aid or the equivalent in goods and services while the donor country gets a welcome boost to its economy and the promise of new markets.

*Yet this is not a situation in which everyone involved is a winner. Tied aid brings some limited commercial benefits to a small number of companies but it would be wrong to equate these with economic benefits for the wider donor economy. As argued by the DAC, "The basic subsidy involved in... [aid] may be captured by the exporter rather than the recipient for whom it is intended".<sup>4</sup> Moreover, there is no conclusive evidence that it creates net exports.<sup>5</sup>*

*More importantly, tied aid distorts and devalues aid programmes and thereby reduces the net benefit of aid to recipient countries. Aid should not be used to subsidise the private sector in donor countries at the expense of development objectives in the recipient countries.*

The principal arguments against the practice of tying aid are recognised by aid donors. A 1996 report by the UK's Overseas Development Administration's (ODA)(the forerunner of the Department for International Development) - 'Review of UK Aid Tying Policy' concluded that "The UK would benefit from untying its aid programme, even on a unilateral basis" (ODA, 1996b). And in 1994, the OECD's Development Assistance Committee (DAC) noted that "the interest in the provision of goods and services may give impetus to project designs that do not correspond well with recipients' priorities for sustainable development and inputs may be priced well above prevailing market levels".<sup>6</sup>

This recognition, together with a recent redefinition of tied aid and a new emphasis on social sector support, has helped over recent years to reduce the proportion of aid that is reported as tied. What progress had been made towards the untying of aid is to be welcomed. Yet donor-wide progress on untying aid remains slow and the amount of aid that is tied remains significant.

<sup>1</sup>Development Assistance Committee, 1996, p.74

<sup>2</sup>Procurement refers to the purchase of goods and services for aid funded projects -1

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<sup>3</sup>This figure includes technical co-operation. Excluding TC the figure falls to £6.5 billion

<sup>4</sup>O Morrissey, 1998 (unpublished report)

<sup>5</sup>O. Morrissey et al., 1992

<sup>6</sup>Development Assistance Committee, 1994, p.27

If all OECD donors were to untie their aid programmes tomorrow, this would help to improve the quality of up to £13 billion of overseas development aid and increase the value of this aid by over £2.5 billion.<sup>7</sup> In a context of rising global poverty and failing levels of official aid (16 per cent reduction since 1992 across the OECD), increasing the quality, impact and value of official aid programmes is more vital than ever. Improving the quality of over a third of aid to developing countries is an essential pre-requisite for reaching the DAC's 21st century goals on poverty reduction.

### **The case against tied aid<sup>8</sup>**

- tied aid is inefficient: it increases the costs of many goods and services by between 15-30 per cent; it places additional administrative burdens on both recipients and donors through the associated procurement rules; it decreases donor co-ordination by encouraging a culture of competition rather than partnership among fellow donors; and it represents an ineffective and costly means of subsidising jobs in the donor countries.
- tied aid represents a form of distorting protectionism: it supports domestic industry by non-competitive means, and therefore goes against global moves to reduce protectionism; and it prevents firms and consultants in developing countries from competing on an equal basis for aid contracts.
- tied aid devalues and undermines overseas development programmes: it decreases the development impact of overseas aid spending by skewing project objectives towards commercial considerations; it reduces the concessionality of aid; it favours capital-intensive (e.g. high-tech and/or infrastructure) over smaller and more effective poverty-focused projects; it can lead to the provision of inappropriate goods, technology and advice and result in developing countries becoming over-reliant on donor-country exports.

### **ActionAid believes that:**

- donor countries should improve the quality of development assistance by ensuring that it is used to meet the needs of developing countries. The DAC should therefore seek to commit donors to untie aid to the least developed countries (LLDCs) by the end of 1998 and seek to untie all official aid by the year 2000.
- those aid donors, including the UK and the Netherlands, that are firmly committed to seeking wider multilateral untying should embark immediately on a programme of wholesale reciprocal untying with like-minded partners. This strategy should be pursued through formal agreements embodying ambitious and transparent objectives to untie aid. ActionAid urges the UK and partner governments to seek the conclusion of such agreements by the end of 1998. This will help to accelerate moves to untie aid across OECD members and place pressure on those countries who are currently unsupportive of unilateral or multilateral untying.
- if, by the end of 1998, there has been no substantial and effective progress towards reciprocal untying among at least ten OECD governments, the UK Government should announce its intention to untie all its aid on a unilateral basis by the end of 1999 to show leadership in the continuing DAC discussions on untying aid.<sup>9</sup>
- the DAC should ensure that donors do not untie aid simply to allow multinationals and other companies in the richer countries to compete for aid contracts. ActionAid believes that the current DAC discussions on multilateral untying should seek to establish positive pro-poor development criteria for development aid. Preferential treatment should be given to developing country producers, manufacturers and consultants rather than to OECD-based companies.

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<sup>7</sup>See p.6 / paragraph 2 below

<sup>8</sup>This overview is examined in more detail in section C

<sup>9</sup>See section D

## b. Aid tying: an overview

Tying aid to the purchase of goods and services from donor countries has always been and remains today a subject of controversy. In the UK, attention has focused largely on the now discredited 'Aid and Trade Provision' (ATP), a source of mixed credit subsidy for British industry which supported the notorious Pergau Dam project in Malaysia. The ATP, a form of tied aid that was used to explicitly subsidise British exporters to win overseas aid contracts, was abolished by the Labour Government at the end of 1997 (see Box 1).<sup>10</sup>

### *Debates surrounding tied aid*

Two related but separate debates have taken place in relation to tied aid. During the 1970s and 1980s, the main donor governments, backed up by the business sector, maintained the use of their aid programmes to provide financial support for domestic industry. The grounds for protecting the competitive position of domestic companies rested on the argument that other donor governments would continue to support their own domestic industries to their own commercial advantage. In the UK, the Confederation of British Industry (CBI) and the Export Group for the Construction Industries (ECC1)<sup>12</sup> continue to argue against any move to untie British aid on a unilateral basis because of fears that British companies will lose out.

*"The majority of DAC Members continue to shield substantial elements of their aid programmes from international competition and the normal processes of the international market. DAC, 1996"<sup>11</sup>*

Over recent years, growing pressure for untying multilateral aid has transformed this debate into concerns about unfair practices. Systems need to be put into place to ensure that all competitors are subject to the same rules, and to ensure that formal tying is not simply replaced by "informal" aid tying (see Box 7, p.12).

### **Box 1: Aid and Trade Provision**

The Aid and Trade Provision (ATP) was introduced by the Labour Government in 1978 to assist British companies to obtain orders for aid funded projects in developing countries. ATP was developed partly in response to the use of mixed credit facilities by other donors and made up between 5-10 per cent of total aid during the 1980s and early 1990s and was directed to the wealthier poorest countries. ATP projects were 'developed and promoted by British companies and the proposed projects were then appraised on development criteria by the ODA. ATP was abolished by the Labour Government in November 1997 following revelations in 1994 on how ATP was "abused" to fund the Pergau Dam in Malaysia. A relatively small number of British companies benefited from ATP including GEC, NEI, Davy McKee, Balfour Beatty, Biwater, Boving, Babcock, Wimpey, Rolls Royce, BAe, British Shipbuilders.

<sup>10</sup> See Her Majesty's Government, 1997, paragraph 2.35



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<sup>11</sup> Development Assistance Committee, 1996, p. 113

<sup>12</sup> Representing British-based civil engineering contractors working overseas

*"Reductions in tied aid are a result of 'the growth in untied components of bilateral programmes rather than the reduction of tied project aid'"*  
DAC, 1993<sup>13</sup>

More recently tied aid has been included in the debates on the increasing liberalisation of the global economy. Many companies and donor governments now view tied aid as an anachronistic throwback to the times when state support for national companies was seen as a legitimate use of public funds. The use of tied aid as

a subsidy to uncompetitive companies in donor countries is seen as going against the spirit of global trade liberalisation. As the DAC notes, tied aid "is out of line with OECD countries' economic philosophies and policies in many spheres, including trade and investment".<sup>14</sup> This contrasts with provisions to reduce domestic subsidies in developing countries. Yet, tied aid was specifically excluded from the results of the Uruguay Round of the GATT negotiations.

Moreover, for many larger companies and transnational corporations (TNCs), the idea of "home-grown" goods and services is no longer relevant within the globalised economy given that parts can be manufactured anywhere in the world.

### **Box 2: Tied aid definitions**

There are a number of definitions of tied aid. The DAC definition of tied aid is: "official or officially supported loans, credits or associated financing packages where procurement of the goods and services involved is limited to the donor country or to a group of countries which does not substantially include all developing countries." This definition changed in November 1997 to exclude all technical co-operation and administrative costs. This has had the effect of significantly lowering the published figures on tied aid as reported to the DAC.

One of the OECD officials involved in the Helsinki Agreement, Ray (1995), defines tie aid thus: "aid where procurement is limited to the donor country, or to the donor country and to a limited number of other countries."

The development economist, Oliver Morrissey, defines aid as: "tied if there are conditions attached which prevent the recipient procuring goods and services financed by the aid from any global source." (O. Morrissey, 1998 (unpublished))

According to Catrinus Jepma, an academic who has written extensively on tied aid, "while these definitions may seem quite straightforward, in practice they are weak when it comes to precisely assessing the nature of tied aid relationships ... [because] tying is not only determined by formal arrangements, but also informal understanding, or even as a secondary consequence of an arrangement already in effect (C. Jepma, 1991, p.20). Official statistics on tied aid give an incomplete picture of the extent to which aid is tied in reality (Box 7 examines informal tying in greater detail, p. 12).

The other salient feature of aid tying statistics is how difficult reliable and up-to-date figures are to obtain. The DAC reports do not allow comparison of aid tying for donors across different years. The DAC also relies on reporting from donors themselves, which can lead to inconsistencies across countries. The British Government's *'British Aid Statistics'* no longer reports aid tying (Department for International Development, various years).

<sup>13</sup> Development Assistance Committee, 1993, p.94

<sup>14</sup> Development Assistance Committee, 1994, p.29

### c. The case for untying aid

The case against tied aid is convincing though not without debate. In a recent report commissioned by ActionAid, Oliver Morrissey concludes that “there is convincing evidence and argument that untied aid would be of greater benefit to recipients than tied aid”<sup>15</sup>. Meanwhile, Catrinus Jepma highlights why the debate continues: “the case for tying is essentially political rather than macro-economic”<sup>16</sup>. While many of the key stakeholders involved in tied aid recognise that there are not sufficient reasons to continue the practice, the *realpolitik* of the debate means that progress towards untying remains painfully slow.

Donor governments have argued that untying aid may further weaken public and business support for aid programmes, and that this, in turn, would further jeopardise already hard-squeezed aid budgets. Yet opinion polls regularly highlight widespread support for aid programmes and the majority view is that aid should be directed to meeting basic needs, poverty reduction and emergencies. Jepma<sup>17</sup> cites a Government of Canada poll from 1985 which showed that 72 per cent of the population felt that aid should not be tied to Canadian goods and services and only 18 per cent who said aid should be given for economic self-interest. A review of public surveys leads Jepma to conclude “that there is no conclusive empirical evidence to support the contention that aid programmes generally would be in jeopardy of losing domestic political support if aid were untied from its export function”. Moreover, as the DAC argues: “if the public at large, or even government officials, were to reach the conclusion that aid money should essentially be spent at home, or at least targeted to support domestic employment and exports, this would represent a basic distortion of the real issues, options and implications involved in the contemporary challenge of development.”<sup>18</sup>

The principal arguments against tied aid are:

- **tied aid is inefficient:** it increases the costs of many goods and services by between 15-30 per cent; it places additional administrative burdens on both recipients and donors through the associated procurement rules; it decreases donor co-ordination by encouraging a culture of competition rather than partnership among fellow donors; and it represents an ineffective and costly means of subsidising jobs in the donor countries.

#### **Box 3: Case study of tied aid power projects**

An evaluation of World Bank supported diesel electric power projects carried out in 1992 examined a UK-aided power generating plant in Indonesia. This concluded that the tied aid funded power projects were of very low quality and characterised by “low production, low revenues, high costs and short engine lifetimes”. In addition, the quality of the electricity generated was poor, resulting in voltage fluctuations and forcing industrial users to provide their own electricity sources. Aid tying “resulted in non-standardisation in many plants....resulting in efficiencies”. It continues, “fuel and lubricant consumption was often high, partly because of poor maintenance in turn partly the result of non-standardisation.” (Overseas Development Administration, Evsurn ‘Energy EV 457/A: 1992’)

<sup>15</sup> O. Morrissey, 1998, (unpublished)

<sup>16</sup> C. Jepma, 1991, p.42

<sup>17</sup> C. Jepma, 1996, p.255 in O. Stokke et al

<sup>18</sup> Development Assistance Committee, 1994, p.29

A number of studies on tied aid over the past 15 years show that it can lead to overpricing. According to Morrissey, ---there are *a priori* reasons to believe that procurement prices under tied aid, where competition for contracts is limited to a few donor firms, will be higher than prices under fully untied aid which can, in principle, be sourced on the world market where competition is more intense".<sup>19</sup> Despite measures taken by donors to restrict overpricing, evidence suggests that prices can be inflated. Morrissey suggests that prices for tied aid goods and services are between 10-15 per cent higher than competitive world prices; Jepma suggests that the figure varies between 10-15 per cent.<sup>20</sup> On the assumption that tied aid increases costs by around 20%, then the value of international aid could be increased by over £2.5 billion.

Aid tying can be viewed as a form of export subsidy for donor companies. Consequently, there is often fierce inter-donor rivalry to fund specific aid projects, particularly those requiring imports of capital-intensive goods in telecommunications and infrastructure. Competition between donors makes donor co-ordination more difficult. As the DAC notes, "Co-ordination has received considerable attention over the past three decades...Nevertheless, real progress on the ground is limited and too often depends on the individual personalities of key actors".<sup>21</sup> To illustrate the problems that such competition can produce, Jepma cites the example of the provision of water pumps to Kenya: "nine per cent of aid to Kenya from several donors was allocated to water projects resulting in 18 different types of water pumps' eventually being used, many of which never worked".<sup>22</sup> In Bangladesh, one donor country sends an excessive 80 missions annually to carry out evaluations and inspections of development; and in 1989, the Tanzanian authorities received over 10,000 missions from different donor countries.<sup>23</sup>

- tied aid represents a form of distorting protectionism: it supports domestic industry by non-competitive means, and therefore goes against global moves to reduce protectionism; and it prevents firms and consultants in developing countries from competing on an equal basis for aid contracts.

Donor benefits from tied aid are frequently over-emphasised by a failure to account for the absence of net trade creation; there is no clear evidence that British aid, for example, has created exports. Moreover, the net benefit to the donor is reduced to the extent that the demand for domestic inputs to meet aided exports displaces domestic demand. In other words, if industries were not producing aided exports, they could be devoting their productive capacity to other markets, either domestically or overseas. More generally, if firms could not rely on aided exports they might devote more energy to winning orders in open competition.

Even in the absence of tied aid, exports to developing countries would remain substantial. In fact, if untied aid promoted growth in LLDCs, exports could actually increase. It would be wrong to assume that the commercial benefits from tied aid are economic benefits; rather, they represent a subsidy paid by taxpayers to exporters in the donor countries.

<sup>19</sup> O. Morrissey, 1996, p.2

<sup>20</sup> C. Jepma, 1991, p.15

<sup>21</sup> Development Assistance Committee, 1997, p.30

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<sup>22</sup> C. Jepma, 1991, p.61 cited from Duncan and Mosley, 1985, Aid Effectiveness: Kenya Case Study

<sup>23</sup> C. Jepma, 1996, p.253 in O. Stokke et al

**Box 4: Case study of UK tied aid water supply project in Nepal**

Tied aid, using British contractors, was used in 1992 to provide water supplies to 16 communities in Nepal. An evaluation of the projects was carried out in 1996 by the Overseas Development Administration in 1992. It found that the project was only "partially successful" partly because the implementing agency - UK consultants - gave insufficient attention to social issues and concentrated too much on ensuring a high quality standard of infrastructure. In addition, the evaluation found that the Nepalese water department lacked the capacity, maintenance budget and necessary spare parts and tools to keep the taps in working order. The project was left unfinished with three of the largest schemes uncompleted due to "significant time and cost overruns," and five schemes were dropped altogether. There was a "46 per cent escalation in costs" for the implementation of the project. The evaluation concluded that "construction of relatively large centralised schemes may not be the best solution to the provision of much needed water supplies". (Overseas Development Administration,

If aid contributes to the economic growth of recipients it will, in time, provide new export markets for donor economics. Few developing countries have adequate capital industries, thus a large share of aid currently finances capital exports from donors to recipients. In the absence of tying, donor industries should win a share of global aid contracts according to their relative competitiveness.

- tied aid devalues and undermines overseas development programmes: it decreases the development impact of overseas aid spending by skewing project objectives towards commercial considerations; it reduces the concessionality of aid; it favours capital-intensive (e.g. high-tech and/or infrastructure) over smaller and more effective poverty-focused projects; it can lead to the provision of inappropriate goods, technology and advice and result in developing countries becoming over-reliant on donor-country exports.

The existence of trade and commercial interests within the framework of aid-giving suggests that donors tend to support projects which will result in imports best suited to the type of products produced by the donor. As Oliver Morrissey suggests, "aid policy is determined within a policy-making process where development interests are weak relative to donor self-interests, government interests, and domestic economic interests"<sup>24</sup>. According to Jepma, there is, therefore, "a corresponding bias against projects and programmes with low import content, such as rural development projects, and in particular those involving local-cost financing".<sup>25</sup>

For example, the UK Government's 1996 review of tied aid policy suggested that, within the framework of the 1980 Overseas Development and Co-operation Act (which by law means that aid must have development as its primary objective), "it is acceptable for aid also to strengthen the UK's relations with developing countries and promote British exports...as long as this preference does not impose excess costs".<sup>26</sup> Apart from a few exceptional cases (see Box 9, p.18), donors do not usually design aid projects with the explicit purpose of promoting orders for goods and services which they are best placed to meet; but the existence of commercial pressures means that donors tend to fund projects which fit with "what they do best".

<sup>24</sup>O. Morrissey, 1992, p. 165

<sup>25</sup>C. Jepma, 1991, p.62

<sup>26</sup>Overseas Development Administration, 1996, p.5



According to the DAC, tied aid projects are concentrated on certain sectors, particularly transport, power, and telecommunications.<sup>27</sup> Aid projects which rely on importing capital goods in sectors such as power and transport are less focused on poverty reduction than those designed to meet the basic needs of poor, rural communities (see Box 11, p.20), or those supporting wider social sectors, such as health and education. Jepma notes that there is "a bias towards tangible projects... projects which can enhance the prestige of the donor and/or recipient, but are not necessarily indispensable for long-term economic growth."<sup>28</sup>

Aid-tying also limits the choice of goods and services open to recipients by restricting them to using products and technologies from donor country companies. This results in procuring goods which are not always the most appropriate for the needs of the recipient. Almost all technical co-operation, in the form of advice, consultancy and expertise, is tied to companies and personnel from donor countries although, as noted above, it is now excluded from official DAC statistics. This practice is less undesirable than aid tied to goods, but, as some of the case studies demonstrate, the tying of technical 'co-operation can lead to increased costs and to advice which is unsuited to local conditions. Moreover, the assumption that developing countries lack the necessary expertise or skilled personnel is increasingly questionable.

Because tied aid tends to fund projects that require importing (donor-produced) capital goods or donor-based expertise, the "spin-off" effects for developing country economics can be limited. The danger is that developing countries will remain reliant on importing donor goods, services and technologies rather than building up the capacity of their own consultants and manufacturers. The result is that capital which could help to create employment and local economic benefits within recipient or other developing countries is transferred to donor countries. Thus tied aid helps to create a continuing dependency of recipients on donors. As John Ray notes, this problem is often compounded by a lack of transparency in the procurement process:

"It is often difficult for potential suppliers, other than those from the donor country, to get timely and complete information on proposals for untied aid... It is often very difficult to find out from whom and in what country procurement for untied and partially untied aid has taken place, either for individual projects or for national aid programs."<sup>29</sup>

**Box 5: Case study of tied aid solar panels project in Brazil**

In 1992 the US Department of Energy developed a project to install nearly 800 households in two states in Brazil with solar panels and to train local personnel to service them. While the project succeeded in establishing two utilities to provide off-grid electricity, it failed to promote the development of any local production because Brazilian solar panel manufacturers were completely bypassed. No consideration was given in the project design to consider the long-term benefits of stimulating indigenous production even if shorter-term costs may have been higher. Complicating the matter further is that international lenders are unwilling to fund further electrification projects because of difficulties in repaying existing loans. (source: *'Environment'*. Vol. 37. No. 9. Heldref Publications. Washington)

<sup>27</sup>Development Assistance Committee, 1993

<sup>28</sup>Jepma, 1991, p.63

<sup>29</sup>J. Ray, 1995, p.109

Despite the desire of local governments to increase the percentage of local consultants involved in aid projects, their participation remains rather modest.<sup>30</sup> Contracting and procurement procedures can also discriminate against local producers, manufacturers and consultants because of informal tying practices and the use of tried and tested existing domestic contractors.

While many developing countries will not have the capacity to provide all the necessary goods and services required for aid projects, there would be positive development benefits if the private sector in recipient countries could compete on at least an equal basis with donor companies. This would require the introduction of procurement systems which give equal access (or an agreed preference) to developing country producers and consultants (see section 1, p.20) and incentives, other than costs, to enable local and regional producers to compete.

#### d. Towards multilateral untying: progress or stalemate?

This section briefly considers the multilateral progress on untying and the most recent attempts to secure untying for all development assistance to LLDCs. It also considers some of the inconsistencies that are apparent in the debate on tied aid, particularly in relation to EU procurement directives and international trade rules.

**Box 6: Percentage tying status of total oda (1995) for selected DAC donors (1995- excluding technical co-operation and admin. costs) (1994 - excluding admin. costs but including technical co-operation)**

DAC Member	Total untied		Partially tied		Tied		Tied (including TC) <sup>q</sup>
	1995	1994	1995	1994	1995	1995	
1994							
Austria		25.0	..	..		75.0	55.5
Canada	27.3	31.5	7.9		26.7	68.5	52.9
Finland	24.6	75.8	10.3	8.3	17.5	15.9	22.9
France <sup>7</sup>	40.7	58.4	8.7	16.5	30.5	25.1	41.5
Germany <sup>9</sup>	29.7	60.3	..	..	37.4	39.7	57.5
Italy	35.9	59.8	..	..	18.2	40.2	35.7
Japan <sup>u</sup>	65.3	96.3	1.0	3.6	13.9	0.2	16.7
Netherlands	80.0	78.9	2.2	14.6	2.2	6.5	37.8
Norway	56.7	77.0	0.0		10.0	23.0	26.2
Portugal	63.6	98.1	1.3		3.3	1.9	0.0
Spain						100.0	42.3
Sweden	19.2	93.9	..		14.8	6.1	12.0
Switzerland	71.3	91.3	1.4		1.7	8.7	22.8
UK <sup>z</sup>	22.5	86.2	..		26.6	13.8	24.7
United States	..	..	..		..	..	--
Total DAC	47.3	77.7	2.4	4.6	22.1	17.7	

From Table 31 (A50), 'Development Cooperation', DAC 1996

1995 Figures from Table 31 (A50), 'Development Cooperation', DAC 1997

Not available

<sup>q</sup> bilateral tied aid plus technical co-operation as a proportion of total development assistance

<sup>7</sup> 97.8 % of bilateral aid reported (95)

<sup>9</sup> 99.9% of bilateral aid reported (95)

<sup>u</sup> 75.1 % of bilateral aid reported (95)

<sup>z</sup> 8.6% of bilateral aid reported (95)

<sup>30</sup> M C. Jepma, 1991, p.62

The donor community has made some moves to address the issue of tied aid, principally through the DAC. Most notably, the "Helsinki Package" of 1991 was agreed in an attempt to regulate the use of mixed credit schemes through peer scrutiny of the commercial viability and development quality of selected projects (see Appendix 1). The measures sought both to improve the development quality of tied aid projects and to limit the use of tied aid funds to projects that were otherwise less commercially viable.

*What progress?*

Recent changes in how aid donors report to the DAC (most importantly, the exclusion of technical co-operation from the latest 1996 figures on tied aid) make it difficult to compare the data across different years, and make it more difficult to ascertain the real level of aid tying (see Box 2, p.4). It is clear, nevertheless, that the growing (and welcome) emphasis by donors on support to social sector projects has helped to reduce the proportion of aid that is tied. In addition, many donors are making some moves to open up procurement, as is also reflected in the continuing downward trend in tied aid as a proportion of total aid.

*"The fact remains that [tied aid] ... is one of the areas that lags behind wider thrusts of OECD countries in promoting deregulation and more open competition both domestically and in developing countries."*  
DAC, 1996<sup>31</sup>

However, many donors still maintain relatively high levels of aid tying. These donors include Italy, Spain, Austria, Canada, France, Germany, and Belgium. Others, most notably Japan, Norway, Switzerland, the United States and the Netherlands have low levels of (formal) aid tying. Japan's aid loans, for example, are now almost completely untied and substantial steps have been taken to make its procurement practices more open and transparent. Some of the donors with poor tied aid

records are now making significant moves to untie aid. The Simons Report in Australia recommended untying aid to the poorest countries and partially untying elsewhere. This has led to a reduction in the proportion of Australian aid that is tied. The Netherlands, concerned about the slow movement on the issue, has moved towards a policy that seeks to secure reciprocal untying with other donors. The Swiss have introduced greater competition in their procurement procedures.

*Towards multilateral untying to all Least Developed Countries (LLDCs)?*

In December 1997, a DAC working group on tied aid sent a range of proposals to donor countries putting forward a case for untying aid to LLDCs and made further proposals on guidelines to prevent informal tying practices. Most donor countries have responded to the consultation note in a positive way, although some donors, most notably Canada, Denmark and France, have reacted with greater caution.

The proposals are based on developing systems to check on aid tying to LLDCs. These involve random sampling and listing projects on an electronic bulletin board accessible to all donor countries and held centrally by the DAC. Systems of verification and dispute resolution as well as procedures for developing open and transparent project procurement have also been put forward by the DAC.

The DAC's efforts to untie aid to LLDCs have been broadly backed by the Business and Industry Advisory Council (which includes the CBI) - which advises the OECD from a business perspective. The main blocks to progress at this stage appear to be based on the concerns, expressed by some countries, that their domestic companies may lose out from such a deal and how this may harm public opinion. However, as shown elsewhere in this report, both arguments are increasingly open to debate (see section C, p.5).

<sup>31</sup> Development Assistance Committee, 1996, p. 113.

### *Danger of stalemate*

Despite the welcome progress that has been made by the DAC in pushing this latest attempt to untie aid to LLDCs, it is apparent that some donor governments (the Japanese and the Dutch) with progressive policies on tied aid, may consider the need to increase the use of aid tying. This will demonstrate their dissatisfaction over the speed of the process and may thereby influence those within the donor community who are less willing to move towards an untied aid regime.

Warnings of backsliding on moves to untie aid are clearly part of the negotiation process, but it does demonstrate that there are dangers that progress could be reversed unless donors demonstrate a willingness and determination to achieve multilateral untying.

### *Aid tying and competition*

Using aid budgets to provide subsidies for domestic companies goes against the spirit, if not the letter, of the GATT. The GATT prohibits export subsidies, defined as including any form of income or price support which operates directly or indirectly to increase exports of any product from its territory.

Tied aid avoids the strictures of GATT because an exception was specifically negotiated. Export credits, with which tied aid and mixed credits<sup>32</sup> are associated, are allowed provided the loans are above cost but below market rates. In the context of World Trade Organisation (WTO) trade rules, tied aid should be prohibited but is permitted by exception.

Aid-tying also falls foul of EU procurement procedures. In principle, following rules on public procurement and competition policy, EU Governments must allow firms from across all Member States to compete for procurement orders. To date, these directives have not yet been tested in court. Legal opinion appears to be divided as to whether a court case could be brought against Member States on tied aid and a number of donors are known to be taking urgent legal advice on this matter.

### *Making further progress?*

Any moves to untie aid are welcome, but given that the matter has been on the agenda of the DAC for over twenty years, much greater progress should have been made already by the donor community towards multilateral untying.

Commercial pressures remain the central stumbling-block to further progress towards untying although these are often cited when the real issue concerns wider political considerations. For some donors, the central issue remains a lack of confidence that domestic companies will be competitive enough to win orders on the open market. Yet, as the DAC notes, "when procurement is awarded without competition or only limited competition, the quality and effectiveness of aid and its contribution to the development objectives of the recipient are in question."<sup>33</sup>

Given the evidence that aid tying does not bring economic benefits and that development can be enhanced by untying, aid donors should aim to untie all aid to developing countries by the end of 2000.

## In whose benefit? the case for untying aid

<sup>32</sup>Mixed credits are defined by P. Mosley, 1987, p. 62 as "the provision of aid to a recipient government which is designed to persuade that government to place a contract with a firm from the donor government's country rather than competing firms from other countries."

<sup>33</sup>Development Assistance Committee, 1994, p.28

### Box 7: Informal aid tying

Uncovering the extent to which aid flows to developing countries are tied in reality is extremely difficult. This is because the practice of donor/recipient dialogue on specific aid projects can lead to tying on an informal rather than a formal basis. This can affect the type of projects and/or the type of commodities and services provided by donors where deliveries correspond to the comparative advantages of the donor. A study of five European donors conducted by Jepma and Bartels (1986) showed that particular activities supported by donors were closely linked to the donors' comparative specialisation. Although difficult to pin down, there are often "silent understandings" or "mutual interests" at play which may go beyond the donor-recipient relationship. In addition, aid tying can take place as a matter of convenience combined with tradition or history: "shopping around" is not even considered because information costs are too high; Thus, traditional patterns of procurement tend to be reinforced." (Jepma, 1991, p.20)

Clearly any moves to untie aid must ensure that mechanisms are put in place to enable real competition for contracts. The DAC can play a "watchdog" role here to ensure that informal tying is minimised. This is likely to become the subject of significant debate in the current DAC moves to untie aid to LLDCs.

In 1984, the Overseas Development Administration (ODA) evaluated a range of appropriate technology projects in Kenya, India, and Sri Lanka such as windmills, smallscale mining, tricycle production, fishing boats and charcoal production. The evaluation found that many of the projects generated "considerable local employment and income in local manufacturing and in end-user applications". It also found that locally produced, appropriate technologies were highly efficient. For example, "costs of producing charcoal in Sri Lanka were economically much lower than alternative energy production". The projects also resulted in introducing new skills through training and disseminating appropriate technologies **throughout developing** countries. "A good example are the windmills produced in Kenya and sold in Uganda, Tanzania, Sudan, Nigeria and the UK." (Overseas Development Administration, 'EV 325 1985 (other studies)')

### e. UK tied aid

*"The UK would benefit from untying its aid programme, even on a unilateral basis. Unilateral untying would promote efficiency in the aid programme and the wider economy."*

ODA, 'A Review of UK Aid Tying Policy', 1996, p.31

The UK Government has traditionally tied a significant proportion of its bilateral programme to the purchase of goods and services from Britain. In an internal ODA review of aid tying ('A Review of UK Aid Tying Policy', 1996), it was stated that, "the formal aid tying rules... ensure that a large proportion of British bilateral aid is tied to UK procurement". Over the last five years, the level of formally tied aid has declined as both the current and previous Governments have gradually accepted the case that tied aid is inefficient, that it distorts development programmes, and that it reduces the development impact of aid projects. The recent exclusion of the technical co-operation element from tied aid statistics also significantly reduces the headline figures.



The reduction in aid tying can be attributed, in part, to changes made to the internal Department for International Development (DFID) rules governing the use of tied aid. These changes have allowed for exemptions or waivers for:

- certain categories of goods (such as food aid or condoms)
- certain multilateral programmes (the UK component of the Special Programme of Assistance to Africa (SPA) is untied<sup>34</sup>)
- certain categories of countries (LLDCs can procure from any IDA eligible country)
- goods which are clearly uncompetitive from British sources
- goods valued at under £2,500 which can be bought at lower cost than from the UK.

Waivers on the use of tied aid take place automatically on items less than £25,000, with DFID approval on items between £25,000 and £100,000 and with Department of Trade and Industry (DTI) approval on items costing more than £100,000.

*"Tied aid is all about doing things for the wrong reasons with Western economies. Instead of looking for the best possible development, they are looking for what they can get in return for aid. We believe that should be ended and is undesirable. Aid should be untied. Clare Short<sup>35</sup>*

The proportion of aid that is tied remains high, particularly if technical co-operation is included (at 55 per cent of bilateral aid in 1996) although the proportion of tied aid as a percentage of total aid as reported to the DAC now stands at just over 13 per cent. In 1994, technical co-operation made up around 80 per cent of total UK tied aid; in 1995, technical co-operation has been excluded from the tied aid figures reported to the DAC. This helps to explain the

apparent increase in untied aid from 22.5 per cent in 1994 to 86.2 per cent in 1995. Almost all technical co-operation, in the form of advice, consultancy and expertise, is tied to companies and personnel from donor countries. Clearly, this practice is less undesirable than aid tied to goods, but as some of the case studies show, this can lead to inappropriate advice which is not well suited to local conditions.

In 1995, the then ODA carried out three separate studies on tied aid which were published in August 1996 (*A Review of UK Aid Tying Policy*). These studies concluded that UK aid tying could add between 14-18 per cent to the costs of some goods for aid projects, although consultancies and technical co-operation were found to be reasonably competitive. The report concluded that Britain would achieve some small economic benefits if the UK were to untie on a unilateral basis and would gain additional exports through multilateral untying in excess of what may be lost due to untying.

Although the 1996 Tied Aid Review shows that there are "strong reasons to believe that unilateral untying would have a positive impact on the UK economy", the Conservative Government decided not to proceed on this basis. The Review concluded that the reasons for the Government deciding not to go ahead with unilateral untying at that point included a concern that "aid tying helps to maintain popular support for the aid programme". In July 1996, Jeremy Hanley, then a junior Minister at the Foreign and Commonwealth Office, gave a fuller explanation when he stated in a Parliamentary Answer that "unilateral untying would yield few efficiency gains for the aid programme, would bring little commercial benefit, and would be unpopular with individual firms and businesses competing for aid funded contracts".

Thus popular support for the aid programme was equated here with the specific interests of those companies that benefit from aid funded contracts.

<sup>34</sup>UK aid to the Special Programme of Assistance to Africa is, in principle, untied. Yet Morrissey notes "the volume of aid granted is determined by the imports by the recipient from Britain in the previous year." (*Research Consultancy Report on Tied Aid*, March 1998, Dr Oliver Morrissey)

<sup>35</sup>Clare Short talking to pupils at Edinburgh's Tynecastle High School, Raymond Duncan, *The Herald*, 13.03.98

**Box 8: UK tied aid figures**

Year	% tied of total ODA	% tied <sup>i</sup> of bilateral ODA	% untied of total ODA	% untied <sup>i</sup> of bilateral ODA	Tied DAC (average)
1987	42.3	76.4	13.1	23.6	26.7
1988	46.4	82.5	9.8	17.5	30.5
1991	41.4	71.8	16.3	28.2	24.0
1992	35.5	66.7	17.7	33.3	25.4
1993	34.6	64.8	18.8	35.2	24.8
1994	26.6	54.2	22.5	45.8	22.1
1995*		13.8		86.2	17.7

\* 1995 Figures exclude technical co-operation and administrative costs and are not given percentage of total ODA. Including technical co-operation in the 1995 figures will change the figures to untied aid - 44%; tied aid - 56%.

<sup>i</sup>Figures for tied and untied percentages of bilateral aid are estimated proportions based on figures contained in successive DAC reports

While ruling out unilateral untying, the previous Government did conclude that it would be in Britain's interests to untie aid on a multilateral basis: "The Government remains convinced that multilateral untying would be in the best interests of donors and developing countries. They will continue their efforts to encourage other donors to agree jointly to untie aid".<sup>36</sup>

Yet, given that the ODA Tied Aid Review explicitly states the difficulties in persuading other donors to untie aid on a multilateral basis (there would be "strong opposition" against multilateral untying) and net benefits that would accrue to the British economy from unilateral untying, the present Government's decision to pursue multilateral untying instead of untying itself is highly questionable.

One of the highlights of the new Labour Government's White Paper, trailed heavily before its official release, was the scrapping of the widely discredited Aid and Trade Provision (see Box 1, p.3). This new policy was welcomed by most commentators as a further move away from the commercialisation of the British aid programme.

Despite this move, however, the new Government has largely maintained the policy on tied aid established under the previous administration, and the influence of British business over Government decisions on aid remains strong (see Box 10, p.19).

The White Paper on international Development released in November 1997 states that.

*"The Government... will pursue energetically the scope for multilateral untying of development assistance. We will also seek to develop further the use of local and regional skills and resources in assistance programmes, thus strengthening the local private sector, but will not otherwise unilaterally untie our bilateral aid. "*

The Government White Paper thus specifically rules out any moves to untie its aid programme on a unilateral basis.

<sup>36</sup> Hansard Parliamentary Question 12.7.96 col. 334 as above

The DED commitment to seek greater local procurement is welcome, as is the energy that is being devoted to multilateral negotiations to untie aid to LLDCs. But, as argued

below, the White Paper allows continuing links between aid and trade in the form of (less transparent) mixed credit arrangements within DFID Country Programmes. Moreover, despite the findings of the 1996 ODA Tied Aid Review, and the assurances that it is intent on pursuing multilateral untying with greater vigour than the previous Government, the new Labour Government has decided not to unilaterally untie its aid programme.

*Why no progress towards unilateral untying?*

There appear to be a number of reasons for the UK Government shying away from unilateral untying:

- The Whitehall discussions surrounding the drawing up of the White Paper meant that some compromises needed to be made. It seems that any move to untie aid lost out in the horse-trading between the DTI, the Treasury and DFID on the contents of the White Paper.
- The business lobby remains a potent force in any discussions about tied aid. The CBI, the EGC1 and other interested businesses met with Ministers and DFID officials prior to the release of the White Paper. While the main aim of these meetings appears to have been to secure Government support for the Aid and Trade Provision, the issue of unilateral untying was also on the agenda. The CBI's submission to the International Development Select Committee highlights its position on tied aid: "the CBI strongly welcomes the Government's commitment not to untie British bilateral aid unilaterally." (see Box 10, p.19). But there is no conclusive evidence that British aid has created exports. Moreover, the industries gaining from tied aid tend to be less competitive than average). Morrissey *et al* suggests "that tied bilateral aid appears to assist industries whose export markets are threatened rather than support expanding and internationally competitive exporters".<sup>37</sup>
- While the economic case suggests that the British economy would make secure small benefits from unilateral untying, the Labour Government is keen not to alienate the business community. The scrapping of ATP would not have found
- favour with some companies and representative groups; unilaterally untying aid could have further damaged links with specific companies benefiting from tied aid. It is highly likely that the Government decided not to proceed with unilateral untying on the pragmatic basis that the economic benefits to the economy as a whole would not be worth the loss of political support from some key companies.
- Another reason, given by DFID, is that unilateral untying could hamper Britain's ability to secure multilateral untying. Its view is that a unilateral move towards complete untying would not help to persuade other donors to take similar action and that it may undermine Britain's negotiating position. In evidence to the International Development Select Committee inquiry into the White Paper, Clare Short stated, "we could get a brownie point for complete purity -if we unilaterally untied our [aid programme], but then we would not be in the multilateral

influence business at all." However, given the strong reasons for Britain to untie on a unilateral basis, there may well be distinct advantages for the Government to take a lead in persuading other donors to do likewise, either arguing from a position of "purity" or as part of reciprocal arrangements with other donors. The assumption that the UK needs to keep tying to help influence others to untie is spurious. In addition, Britain has already taken some moves on a unilateral basis - the decision

<sup>37</sup> O. Morrissey et al, 1992, p. 152, p. 161

- to untie its aid to the Special Programme of Assistance to Africa and some unilateral moves on debt (such as the Mauritius Mandate).
- Finally, the argument that aid tying helps to broaden the constituency of support for aid and development may also have played a part in preventing the Government from unilateral untying. However, this seems to be less pertinent than under the previous administration. The best way of ensuring popular support for the aid programme is to improve its effectiveness and to show that poor people benefit; and improving effectiveness includes untying. If it is true that procurement opportunities for UK firms attract public support for aid, it follows that the public will support any measure aimed, eventually, at improving business access to international untied aid.

#### **f. Impact of untying aid in the UK**

Dr. Oliver Morrissey, an academic who has studied tied aid for a number of years, was asked by ActionAid to estimate the potential "worst-case" impact on the British economy from untying aid based on a model developed in 1992.<sup>38</sup>

"For the 1990s it is estimated that each £1m of bilateral aid generated exports worth £0.8m, total output of some £1.4m and supported about 19 jobs. This allows us to quantify the maximum loss associated with untying of (project) aid. Each £1m of aid that is untied at most costs about £0.6m in lost output and ten lost jobs."

On the basis of the worst case scenario, untying aid may lead to a potential loss of some 800 jobs (excluding technical co-operation). "This assumes however that the loss of tied aid is fully translated into a loss of exports. Furthermore, it assumes that the loss of exports is fully translated into a loss of production and jobs. These are extremely pessimistic assumptions. If firms could not avail [themselves] of aided exports they may devote more energy to winning orders in open competition. Similarly, if domestic producers of intermediate goods or services providers did not have to supply producers of aided exports, they may still supply other industries. Finally, even in the absence of tied aid exports to developing countries would remain substantial. In fact, if untied aid promoted growth in LLDCs more effectively than tied aid, exports could actually increase. It would be wrong to assume that the commercial benefits from tied aid are economic benefits; rather, they are a transfer from taxpayers to exporters. The transfer would be different under untied aid, but the net economic effect may be the same or even greater (as untying promotes efficiency in both donor and recipient).... However, the method of impact analysis cannot claim that employment or exports were *created* by aided exports; tied aid is not an efficient policy if employment or export creation is the specific objective. While the commercial benefits from tied aid appear great, tying itself is not an optimum means to achieve these gains". The subsidy required for each of these jobs from the aid programme is equivalent to approximately £100,000 each.

Moreover, "If aid contributes to the economic growth of recipients it will, in time, provide new export markets for donor economics. As few developing countries have adequate capital industries, a large share of present aid finances capital exports from donors to recipients. Depending on their international competitiveness, donor industries will win a share of global orders which, in the absence of tying, should reflect their market shares; tying is not essential to ensure donor benefits."

"Donor benefits from tied aid are frequently over-emphasised by failure to account for the absence of net export, and output, creation. There is no conclusive evidence that

<sup>38</sup> op. cit.

British aid has created exports, while the industries gaining from tied aid tend to be less competitive than average. Furthermore, while the business lobby emphasises the employment potential of aided exports, this may impose a resource burden on the economy; wages are pushed up in inefficient industries supported by aid, and this will have an inflationary wage pressure on other industries thereby reducing their international competitiveness."

In summary, it is clear that even on the most optimistic projection, the numbers of jobs created from UK tied aid is, at best, minimal. In reality It is highly likely that these jobs would exist anyway, and if the UK were to untie aid, more jobs would be created. It is also questionable whether public money on this scale, particularly from the aid budget, should be used to subsidise jobs.

#### **g. UK untying: how to proceed?**

The Government White Paper included a number of welcome developments towards redefining Britain's relations with developing countries. The approach has been warmly welcomed by other international donors. Britain is now increasingly viewed by its DAC partners as a key stakeholder in helping the international community meet the development challenges it now faces.

The crucial question is how Britain should use its new-found influence to encourage other donors to untie their aid programmes. The Government suggests that this is best done by retaining tied aid and using this to gain a "place at the table" to argue for multilateral untying. In ActionAid's view, this is not the best approach. Given the need to increase the quality and impact of aid and the findings that the British economy could benefit from unilateral untying, the Government should reconsider its position. The Government has two other options which it should pursue as an alternative to its current strategy:

- to identify a "like minded" donor group with whom it can arrange a progressive and reciprocal phasing-out of tied aid by the end of 1998. This would ensure that the Government maximises its leverage over other donors to speed up the process towards multilateral untying by 2000. A reciprocal-based strategy should include all aid flows to developing countries and not just to LLDCs.
- if, at the end of 1998, there has not been substantive progress on securing reciprocal arrangements with other donors, Britain should demonstrate strong leadership on the issue of tied aid by opting to completely untie aid by the end of 1999. Although such a move would have less immediate impact, it could help to marginalise those countries within the current negotiations who are less enthusiastic about untying their aid programmes. Given the regard afforded to the UK, this may influence other donors to follow suit. Britain would retain its seat in

the multilateral discussions and may be better placed to influence the negotiations from the "high ground" of having taken the action that others should follow. Britain's example would also highlight the benefits of tied aid both for poverty reduction and the British economy.

The British Government should use the next six months to develop reciprocal arrangements with other donors, with the option to announce unilateral untying in 1999 if progress is too slow. ActionAid believes this would be the most effective strategy for pushing for full multilateral untying by 2000.

**Box 9: Tied aid and Westland Helicopters**

In November 1983, the Indian Government requested £50m of aid from the bilateral programme to be tied to the purchase of 21 Westland Helicopters to provide transport to offshore oil rigs. Despite the fact that the ODA considered that the project would bring no direct benefit to the poorest groups in India, the proposal was accepted by Ministers in March 1984 in part because of the strong support given by the DTI. In the meantime the cost of the project rose to £65m (although once the UK Government confirmed their decision the final price dropped to £55m). The decision was taken, according to the National Audit Office, because, "the contract had become crucial to Westland's existence as the United Kingdom's sole indigenous source of helicopter design, development and manufacture".

The ODA Country Review for 1985 described the project as "develop mentally unattractive" and the 1987 Review stated that "there is little that can be said positively about this from a development point of view".

Following the delivery of the helicopters in 1986, technical problems began to emerge: there was a high rate of engine failure; high rates of oil consumption and a high incidence of foreign object damage. Following two crashes causing 10 deaths, the helicopters were grounded in 1989. The subsequent investigation attributed the blame equally between design and production faults and inadequate maintenance. Although the helicopters were cleared to fly in 1990, continuing operational problems resulted in the Government taking them out of service in 1991. By this stage no individual aircraft had flown more than six per cent of its certified life. In 1993 the then owners of the helicopters decided to sell. A 1993 tender resulted in no bids and it was not until AES Aerospace made a firm offer that the helicopters were sold for spare parts. The price paid was £0.9m.

The use of tied aid for Westland Helicopters was investigated by the Comptroller and

**h UK mixed credits: tying by the back door?**

The UK Government's decision to end the Aid and Trade Provision (ATP) in November 1997 received widespread acclaim from aid commentators and academics. In the wake of the Pergau Dam investigation in 1994 by the Foreign Affairs Committee, the move to abolish ATP (a form of mixed credit support for domestic

companies, see Box 1, p.3) was seen as a welcome reorientation of the aid programme away from the

*"Donor self interests rather than recipient interests are the principal determinants of bilateral aid policy for most of the major donors"*

commercialisation that had been apparent under the previous administration. The business lobby were less pleased. The ECCI were "concerned that the decision to abolish ATP may in practice mean that the UK will have no means of providing competitive financing in future for such projects, thereby abandoning the sector to foreign companies still legally enjoying tied aid support from their own Governments".<sup>40</sup> The CBI also regretted the demise of ATP.

<sup>39</sup>Morrissey, 1996, p.5

<sup>40</sup>International Development Select Committee, 1997, p. 74

**Box 10: British aid and the business sector**

The UK business lobby has a significant influence over UK decision makers, particularly the DTI, through the British Trade Board (BTB) and the Overseas Projects Board (OPB). These boards are made up of representatives of large companies, financial institutions and government departments and help to shape UK trade and aid policy towards developing countries. The principal business stakeholders within this system are the CBI, the EGCI and the British Consultants Bureau (BCB). Large firms with "insider" clout also seek to influence policy and specific decisions in meetings with Ministers and officials across Whitehall. Soon after the general election in May 1997, the Labour Government invited the Export Forum (a group made up of civil servants, business lobbyists, companies and Trades Unions - though not DFID) to undertake "a candid assessment of the strengths and weaknesses of current export promotion programmes and activities". Its report, released in November 1997, concludes that "any unilateral decisions to untie British aid... should be avoided" (*Towards an Export Initiative*<sup>41</sup>). According to Morrissey (1996, p.6), "the core business demand is that the aid budget should be guided by commercial considerations so that it has an export orientation... [and] should be directed to capital projects in the richer developing countries."

The White Paper states that "The Aid and Trade Provision lacks poverty elimination as its central focus; no more applications will be accepted for ATP assistance, and the scheme will be closed". The abolition of ATP, however, "does not preclude deploying development assistance in association with private finance, including in the form of mixed credits". Mixed credit schemes will be managed within DFID Country Programmes and will be subject to "the primary aim of helping to reduce poverty not of subsidising exports; [and] the same procedures for quality control as all other projects".<sup>42</sup>

Clearly the business community welcomes this Government decision: as the CBI commented to Building Magazine, "[we] welcome the maintenance of mixed credit arrangements within agreed country programmes".

While the conditions over the use of these schemes are welcome, ActionAid would have preferred the Government to abolish all forms of mixed credit schemes because of the difficulties in ensuring that commercial considerations do not outweigh developmental criteria in practice. ActionAid is concerned that the potential to use mixed credit schemes at a country level will make monitoring their use in the future

very hard. While it may be possible in retrospect to highlight bad practice (if such a situation arises), ensuring that the current use of mixed credit schemes does not distort country aid programmes will be almost impossible because of the relative lack of transparency and access to open project reviews. As Morrissey comments on the termination of ATP: 'there is no obvious policy change'.<sup>43</sup>

<sup>41</sup> This initiative included companies such as Aston Fittings Ltd, Dragon International Consulting, Cable and Wireless, British Invisibles

<sup>42</sup> Department for International Development, 1997, p. 45

<sup>43</sup> O.Morrissey, 1998 (unpublished report)

One further concern is that the White Paper commits the Government to develop a new relationship with business based on "a broader sharing of approaches to the eradication of poverty, drawing on the extensive skills of the British private sector - consultants and contractors, investors, exporters and importers, business organisations, large companies and small firms".<sup>44</sup> ActionAid is concerned that this approach may open up the possibilities of much greater informal tying of aid in the future. ActionAid urges the Government to do all it can to prevent this happening by reviewing the mechanisms and institutions through which development procurement takes place with an aim of ensuring maximum accountability and transparency. In addition, extending procurement procedures should be reviewed to encourage developing country contractors, consultants and business to play a full part in the implementation of the UK aid programme.

**Box 11: Case study of World Bank roads project in Mozambique**

Joseph Hanlon, cites a controversial \$1 billion World Bank Roads and Coastal Shipping (ROCS) project in Mozambique. A Government evaluation (*'Revisao da Carteira de Projectos do Banco Mundial'* April 1997) was highly critical of the project describing it as "unrealistic". The former World Bank Resident Representative pointed out that ROCS would increase foreign debt by 10%; most of the contracts would go to foreign suppliers and "only a tiny part will stay in the cashboxes of local companies and the pockets of workers here". The project was designed by a donor-based consultancy with little experience of Africa. More than half of the project was designed to fit well with the expertise and technology of foreign contractors and local contractors were largely excluded. The project placed the emphasis on roads which were of direct benefit to the international community (roads to South Africa, for example) rather than on roads important to the local population. (J. Hanlon, 1996 *'Deeds Without Deeds'* p. 20, 40)

**i. Pro-poor procurement**

The current multilateral negotiations at the DAC which are considering untying donor aid to LLDCs are concerned primarily with opening up competition among OECD companies to provide the goods and services necessary for aid projects. The DAC states that commercial pressures are not necessarily a problem "as long as contracts are won on the basis of competitive procedures".<sup>45</sup> The driving force of these negotiations are the economic principles of open trade and liberalisation and the associated cost savings which result from open tendering. These moves to untie aid for



this category of countries are welcome, but they remain small steps in the right direction.

<sup>44</sup> Department for International Development, 1997, p.43-45

<sup>45</sup> Development Assistance Committee, 1994, p.28

In addition to opening up procurement among the donor community, a subsidiary argument put forward by the DAC to untie aid to LLDCs is to help increase the capacity of the private sector in developing countries. Yet, in reality, this has received minimal attention with the emphasis firmly on competition among OECD donors to provide the goods and services for aid projects, no matter where the project is funded.

Pro-poor procurement would seek to add value to aid programmes by giving preferential treatment to developing country producers, manufacturers and consultants

*"To say the least, it is unfair to expect a poor country to give away US\$60 million each year as a subsidy to the exporters of certain developed countries and then have to repay this amount with interest in later years." Muhammad AI Haq, former Foreign Minister of Pakistan<sup>46</sup>*

(from local or regional sources) instead of OECD-based companies. The aim of procurement policies which encourage or favour the involvement of developing country companies is to promote sustainable capacity, know-how and knowledge of producers and consultants and ensure that the financial benefits of winning contracts resulted in a positive spin-off in terms of domestic employment.

Clearly, any new criteria governing donor procurement will need to be flexible and take into account quality issues, value for money and other economic considerations. Procurement agencies will have to be actively engaged in investigating existing and emerging developing country capacities. Donors will need to develop appropriate rules and mechanisms to maximise pro-poor outcomes and minimise any additional short-term costs due to potentially higher prices of developing country producers; potentially lower quality standards; and the provision of appropriate training/capacity building for developing-country companies and consultants. This process could also encompass consideration of how to develop appropriate ethical standards from procurement to help protect workers rights and environmental considerations.

Given the problems with aid tying highlighted in this report, it is clear that many project failures can be attributed, at least in part, to the tied aid component of specific aid projects. However, accessing this information from official sources is extremely difficult. The distorting effects of tied aid and commercial pressures on aid projects is well known, but there is very little written in publicly available documents which highlights this linkage. There is clearly a need to increase transparency, accountability and access to information on tied aid. In addition, it appears that evaluations of specific aid projects rarely address the issue of whether aid is tied - and how this

impacts on project effectiveness - and are much more concerned about economic rates of return.

The ODA Tied Aid Review, examines the economic case for untying aid. However, little attention was given in the study to the negative effects of aid tying on development and poverty reduction. ActionAid believes that the British Government should fund a study looking at the impact of tied aid on specific projects and sectors from a development perspective as part of the process of influencing other donors to untie their aid programmes.

In considering how to achieve maximum value for money and developmental impact for its aid programme, the Government should also move to open up procurement opportunities for recipient countries and third (developing) countries in order to build local/regional capacities and seek to utilise local/regional knowledge and expertise.

<sup>46</sup>Quoted in F. Colaco, 1973, p.73

#### **j. In whose benefit? Recommendations**

**'In whose benefit? the case for untying aid'** makes the following recommendations:

- donor countries should improve the quality of development assistance by ensuring that it is used to meet the needs of developing countries. The DAC should therefore seek to commit donors to untie aid to the least developed countries (LLDCs) by the end of 1998 and seek to untie all official aid by the year 2000.
- those aid donors, including the UK and the Netherlands, which are firmly committed to seeking wider multilateral untying should embark immediately on a programme of wholesale reciprocal untying with like-minded partners. This strategy should be pursued through formal agreements embodying ambitious and transparent objectives to untie aid. ActionAid urges the UK and partner governments to seek the conclusion of such agreements by the end of 1998. This will help to-accelerate moves to untie aid across OECD members and place pressure on those countries who are currently unsupportive of unilateral or multilateral untying.
- if, by the end of 1998, there has been no substantial and effective progress towards reciprocal untying among at least ten OECD governments, the UK government should announce its intention to untie all its aid on a unilateral basis by the end of 1999 to show leadership in the continuing DAC discussions on untying aid.
- the DAC should ensure that donors do not untie aid simply to allow multinationals and other companies in the richer countries to compete for aid contracts. ActionAid believes that the current DAC discussions on multilateral untying should seek to establish positive pro-poor development criteria for development aid. Preferential treatment should be given to developing country producers, manufacturers and consultants rather than to OECD-based companies.
- the British Government should extend its policy on ATP by ruling out the use of mixed credit facilities throughout the aid programme. The Government should also do all it can to prevent "Informal tying" by reviewing the mechanisms and institutions through which development procurement takes place with an aim of ensuring maximum accountability and transparency.

- the British Government should fund a study looking at the impact of tied aid on specific projects and sectors from a development perspective as part of the process of influencing other donors to untie their aid programmes.

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### ***Appendix 1: The 1991 Helsinki Agreement***

The OECD's so-called 'Helsinki Package' (Arrangement on Officially Supported Export Credits) sought to overcome a number of problems connected with tied aid, including overpricing, the funding of projects which did not correspond to development priorities and the obstacles to the development of procurement capacities in recipient countries (DAC, 1992, p.10).

John Ray, an OECD senior official closely involved in the negotiations, provides a detailed account of the emergence and aftermath of the Helsinki Package (Ray, 1995). Donors were aware that the use of low-concessionality aid and mixed credits increased in the late 1980s, such that the average concessionality of aid was failing and aid-induced trade distortions were increasing. The intention of the Helsinki Package was to avert the continuation of this trend.

Participants in the Helsinki Package initially considered new rules of concessionality based on the quality of aid projects, but soon abandoned this as it "proved Impossible to develop a simple and easily usable list of indicators of aid quality" U. Ray, 1995, p.89). Phased untying was also considered, but rejected since "there were no clear 'rules by which to tell whether an offer was truly untied... In short, the various participants did not trust each other to comply fully and in good faith with an untying commitment" (J. Ray, 1995, p.90).

After much negotiation, the agreement included the following new rules on tied aid credits (J. Ray, 1995, p.97-8):

Relatively wealthy developing countries (GNP per capita exceeding \$2465 in 1990) should not be extended tied aid credits, except for certain grants and very soft credits. Tied aid credits should not be extended to middle-income countries for projects that would normally be commercially viable. Eligibility for tied aid requires that a project would generate insufficient cash flow to cover operating costs and/or donors agree it cannot be financed on commercial market terms.

There would be no restrictions on eligibility of the poorest countries to (tied) aid (credits).

An important feature of the 'Helsinki Package' was that there should be prior notification to the DAC of any trade-related concessional or aid credits. Such notification would be required for all offers of credits with a value of SDR47.2 million (Special Drawing Rights) or over; a stronger requirement for consultation applied to projects worth SDR 50 million or over. Notification implies negotiation with other donors. Whilst a donor could proceed with a credit if others disagreed, the new procedures render this more difficult and more transparent, hence less likely. The Participants also agreed "that work on both a target for the untying of aid and a more precise definition of the circumstances in which aid can be considered to be untied would continue in co-operation with the DW (Ray, 1995, p.99).

The Helsinki Package does not appear to have had an enormous impact, although fewer tied aid contracts are extended to upper middle-income developing countries. The criteria for 'commercial viability' are vague and opaque, and unlikely to prove a barrier to a donor that wishes to extend tied aid credits to a middle-income country. A

number of measures would increase the effective implementation of restrictions on the

<sup>47</sup> Special Drawing Rights are an international reserve asset created by the International Monetary Fund (IMF) and allocated to its members to supplement existing reserves for balance of payments support. SDRs can be exchanged by central banks into national currencies and its value is determined daily on a basket of currencies

use of tied aid credits: "the DAC should tighten up definitions and procedures for tied aid, and get members to report procurement according to standard criteria; DAC members should make public the winners of bids for untied and partially tied aid; and procurement for untied aid could be implemented by agencies that are independent of both donor and recipient governments." (Ray, 1995, p. 112)

According to *'Development Today'* (Nordic Outlook on Development Assistance, Business and the Environment) 60 per cent of mixed credits are slipping through the loopholes of the Helsinki Agreement.

***List of Abbreviations***

ATP	Aid and Trade Provision
ISCB	British Consultants Bureau
BTB	British Trade Board
CBI	Confederation of British Industry
DAC	Development Assistance Committee
DFID	Department for International Development
DTI	Department of Trade and Industry
EGCI	Export Group for the Construction Industry
FCO	Foreign and Commonwealth Office
GATT	General Agreement on Tariffs and Trade
GNP	Gross National Product
IDA	International Development Association
LLDCs	Least Developed Countries
NAO	National Audit Office
ODA	Overseas Development Administration
Oda	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OPB	Overseas Projects Board
SDR	Special Drawing Right
SPA	Special Programme of Assistance to Africa
TC	Technical Co-operation
TNC	Trans National Corporation
WTO	World Trade Organisation