Untying aid: Is it working?

Summary

Evaluation of the Paris Declaration
AID UNTYING: IS IT WORKING?
THEMATIC STUDY ON THE DEVELOPMENTAL EFFECTIVENESS OF UNTIED AID:
EVALUATION OF THE IMPLEMENTATION OF THE PARIS DECLARATION AND OF THE 2001 DAC RECOMMENDATION ON UNTYING ODA TO THE LDCS:
SYNTHESIS REPORT

Summary

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List of Acronyms

AAA Accra Agenda for Action (2008)
ACP Africa, Caribbean and Pacific (Country party to Lomé Agreement with EU)
AFD French Development Agency (French Development Agency)
ANZCERTA Australia New Zealand Closer Economic Relations Trade Agreement
ANZGPA Australian and New Zealand Government Procurement Agreement
ASEAN Association of South East Asian Nations
AusAID Australian Agency for International Development
B2B Business to Business
BMZ German Federal Ministry for Economic Co-operation and Development
BOP Balance of Payments
CEA Cost Effectiveness Analysis
CHF Swiss Franc
CIDA Canadian International Development Agency
CPG Commonwealth Procurement Guidelines (Australia)
CPS Country Procurement Systems
CRS Creditor Reporting System (OECD)
DAC Development Assistance Committee
Danida Danish International Development Assistance
DBI Direct Bilateral Instruments
DFI Directly Financing Imports
DFID Department for International Development (UK)
DKK Danish Kroner
DPE Donor Partner Envelope
ECOWAS Economic Community of West African States
EEA European Economic Area
EFTA European Free Trade Association
EU European Union
FAC Food Aid Convention
FAO Food and Agriculture Organization
FDI Foreign Direct Investment
GATT General Agreement on Tariffs and Trade
GBS General Budgetary Support
GDP Gross Domestic Product
GNI Gross National Income
GST Goods and Service Tax
GTZ German Technical Cooperation
HIPC High Indebted Poor Country
HLM High Level Meeting
HQ Headquarter(s)
ICB International Competitive Bidding
ICRC International Committee of the Red Cross
ICT International Competitive Tender
IDA International Development Association (World Bank)
IDRC International Development Research Centre
JICA Japanese International Cooperation Agency
KfW German Development Bank (Germany)
LDC Least Developed Country
LIC Low Income Country
LRPs Local and Regional Purchases
MERX Canadian Public Tendering System
MCA Mixed Credits Arrangement
MCC Millennium Challenge Corporation (US)
MIC Middle Income Country
MoFA Ministry of Foreign Affairs
MFI Multilateral Financial Institution
NAFTA North American Free Trade Agreement
NCB National Competitive Bidding
NDFI Not Directly Financing Imports
NGO Non-Governmental Organisation
NMFA Norwegian Ministry of Foreign Affairs
NOK Norwegian Kroner
Norad Norwegian Agency for Development Cooperation
ODA Official Development Assistance
OECD Organisation for Economic Cooperation and Development
OICs Other Low Income Countries
O&M Operation and Maintenance
PD Paris Declaration
PDE Paris Declaration Evaluation
RTE Resource Transfer Efficiency
SADC Southern African Development Committee
SBS Sectoral Budgetary Support
SDC Swiss Agency for Development and Cooperation
SDR Special Drawing Rights (IMF)
SECO State Secretariat for Economic Affairs (Switzerland)
Sida Swedish International Development Cooperation Agency
SSA Sub-Saharan Africa
SWAP Sector-Wide Approach
TC Technical Cooperation
ToR Terms of Reference
UMIC Upper Middle Income Country
UNDB United Nations Development Business
USAID US Agency for International Development
VNG Association of Netherlands Municipalities
WFP UN World Food Programme
W&SS Water and Sanitation Sector
WTO World Trade Organisation
Background

1. The OECD DAC, in making its Recommendation in 2001 for untying of aid to least developed countries, envisaged a comprehensive evaluation of its implementation and impact by 2009. The Paris Declaration (PD) reaffirmed the Recommendation firstly by stating that untying aid generally increases aid effectiveness by reducing transaction costs for partner countries and improving country ownership and alignment, and consequently by making further steps towards aid untying Indicator 8 of progress towards increasing aid effectiveness. Accordingly OECD commissioned this study as part of the PD evaluation.

2. This study, undertaken during 2008-09, has included a re-examination of efforts towards untying as reported statistically by DAC donors to the OECD, complemented by a review of donor policies and practices through a purposive survey of five donors who had either largely untied their aid, or were actively committed to untying after 2001 (Australia, Canada, Denmark, Norway and Switzerland). The widespread perception that untying increases aid efficiency and effectiveness has been re-examined through a literature review on the economics of tying and untying practices, followed by an investigation into untying practices in six partner countries (South Africa, Zambia, Burkina Faso, Ghana, Vietnam and Lao PDR). Twenty-one development projects in these countries, supported individually or jointly by thirteen DAC members as well as the EU and the World Bank (IDA), and reported as fully untied or with untied components, were examined in detail. EC administered aid is included to ensure coverage of fully untied funding. Most projects are in the Water and Sanitation Sector (W&SS), which combines both infrastructure and social development objectives.

Key findings

3. The 2001 Recommendation and untying of aid: the overall picture is very positive in terms of progress by DAC donors in the formal untying of their aid, removing legal and regulatory impediments to the procurement of goods and services outside the donor’s own market (Synthesis Report (SR) Chapters 3 and 4). The proportion of fully untied bilateral aid rose progressively from 46% in 1999-2001 to 76% in 2007 (Figure 1 and Table 1), and for LDCs it has increased from 57% to 86%. Taking into account multilateral aid, the proportion of untied ODA has risen to 83% overall. The changes over the past 10 years indicate that the 2001 Recommendation on untying of aid, together with other international agreements such as the Paris Declaration, have had an overall positive impact on further untying aid. But there are important qualifications.

4. Free-standing technical cooperation and food aid were excluded from the Recommendation and both remain significant ‘grey areas’, with 30% and at least 50% respectively still reported as tied, and the tying status of significant proportions not being reported by some donors (Figure 2 and Table 1).

5. The study places these overall positive findings (which are based on data reported by donors to the OECD and a survey of donor views about their own actions) into the context of recipient perspectives and findings about the actual or de facto practice of aid delivery in partner countries.

6. Before considering the question of factors that enhance or impede fully untying, there is the prior issue raised by many informants in the course of this study, the genuineness of the declared formal untying of aid. Changes in policy and regulations may allow the sourcing of goods and services outside of...
the donor country but, in practice, are there such obstacles as to make this so unlikely that aid remains *de facto* tied?

7. Two forms of statistical evidence indicate a presumptive gap between the formal declaratory untying of bilateral aid and actual practice, which implies a considerable element of intended or unintended *de facto* tying. First, the high reported proportion of contracts awarded to companies registered in the donor country (SR: Chapter 3) finds further support in the donor review (SR: Chapter 4) and from partner countries (SR: Chapter 7). Second, there is, after extensive formal untying, a continuing association between the amount of bilateral aid from the individual donor and the value of its exports to the surveyed recipient countries, excepting only South Africa, for which aid is of marginal economic significance (SR: Chapter 6).

8. **Impediments to formal untying** include the effort needed to change regulatory and legislative frameworks. There is also the carry over effect of continuing projects and programmes. In the important case of the USA, legislative
restrictions on use of public funds remain in place (whilst allowing for waivers) and for food aid almost entirely, in part because of effective opposition from domestic interest groups.

9. The five donors review (SR: Chapter 4) also identified several ‘grey areas’ of tying practice. These are all outside the Recommendation and often justified on grounds of sustaining domestic support for aid of interest groups and of providing visible evidence to the public of a direct link between bilateral aid and impacts in beneficiary countries, as well as fostering aid efficiency where markets are unable to deliver. These areas include emergency and humanitarian aid provided both in-kind and through personnel, channelling of aid through NGOs, presumed to be untied, food aid (now explicitly tied only by the USA), TC, especially when delivered via framework contracts or as services-in-kind, support to governance, post-secondary education, research and Business to Business (B2B).

10. The country study evidence (SR: Chapters 6 and 7) suggests that the obstacles to untying are now for most DAC members not so much to completion of the formal process of untying, but to reducing or even removing intended and unintended tying practices.

11. Country partner stakeholders strongly affirmed that untying is about transferring responsibility for planning and managing funds from donors to recipients. Practically, untying is then a matter of contracts, modalities, use of country systems and offering local business an opportunity to compete successfully for contracts. They are less concerned about removing biases between donor partners in their trade, except where excessive inefficiencies of tying significantly reduce the resource transfer value of aid.

12. There are systematic differences in the revealed preferences of donors about aid uses in the countries surveyed, where their aid is overwhelmingly formally untied. Genuine (de facto) untying was typically found convincingly linked to evidence on the adopting of programmatic and pooling modalities, for which untying is a necessary condition, combined with efforts to use and strengthen partner capacities in financial management and procurement (Table 2).

13. Project-type aid is still the dominant modality in all surveyed countries. Many formally untied projects were found to be de facto tied or to have only some untied components. In most investment projects the primary or head contracts and most of the TC components are still procured from the donor country, even if procurement is channelled through recipient systems. This calls in question to a certain extent the genuineness of untying efforts and reflects the reality that, even where procurement is being handed over to partners, most donors try to influence project implementation, through long-term technical assistance or management consultants from their home country. Reasons for this de facto tying include: (i) donor regulations; (ii) lack of local capacity; (iii) local and regional contractors being unable to compete internationally (especially if large-scale contracts are being procured, e.g. because of weak local secondary markets for credit and professional insurance); (v) unequal access to information; (vi) potential risk aversion at donor HQ; and (v) pressure for speedy implementation.

14. The World Bank (IDA) was more successful than DAC donors in using International Competitive Bidding (ICB) and National Competitive Bidding to sourcing contracts both locally and regionally in other developing countries, again pointing to some combination of intended and unintended constraints on de facto untying of bilateral aid.

15. Value for money: the near general conclusion in economic theory and the limited evidence-based literature conclude that untied aid is likely to be cost-effective, and this is broadly confirmed by the study. In most cases procurement costs were competitive with local and international market prices. Occasionally costs were higher, reflecting small-scale tendering processes and social networks. ICB was not always cost-effective, as some bilateral donors still tend (but not necessarily intentionally) to advantage donor-based companies with associated higher costs.

16. Ownership and alignment: the country studies found that a positive approach to the use of untied funds, including using programmatic modalities such as general budgetary support, sectoral basket funding and joint pooling by donors, as well as adopting country systems for procurement, were promoting ownership and facilitating alignment with partner country priorities.

17. Developmental impacts: the country case studies are cautiously positive, finding evidence of direct employment and income stream generation. By untying, the balance of sourcing goods and services is shifted towards local suppliers, thereby promoting local business development. In addition, capacity building and knowledge transfer appear to be more likely where local and regional firms of medium capacity undertake project investment activities. However, the linkage effects are limited due to the low development of many local markets. Further expanding untying therefore must go in line with local market development.

18. Overall, successful untying emerges from the country studies as a critically important contributory factor towards achieving greater aid effectiveness and must therefore not only be justified on grounds of cost-efficiency.

The way forward: recommendations

19. Donors and their partners can do much more to complete the process of untying and to exploit the opportunities offered by untying to increase aid effectiveness and its development impacts. These actions need to be set clearly within the changing global context of aid including:
• ‘The elephant in the room’ – a better understanding is needed about the growing role of concessional and largely tied development funding provided by emerging non-DAC donors;

• New vertical funding mechanisms that could be at odds with the PD aid effectiveness principles which provide the rationale for untied aid;

• New forms of financing seem likely to be required to address the challenges posed both by the global financial crisis in the short-term and climate change in the longer term.

20. The 2008 Accra Agenda for Action (AAA) on aid effectiveness reaffirmed the commitment to continue the process of untying and calls upon DAC Members in responding to elaborate individual plans by 2010 to unite their aid to the maximum extent and to improve reporting on the 2001 Recommendation. These proposals are strongly endorsed and further specific measures are suggested to support genuine untying and reduce, if not eliminate de facto tying practices.

21. Donors should increase the transparency of their reporting to the OECD, for example by including the tying status of categories of aid exempt from the Recommendation, including all TC and food aid and expanding the role of ex ante reporting.

22. Donor untying plans should include specific measures for making greater use of country systems, and to specify the means they have adopted, or plan to adopt, for removing obstacles and encouraging local and regional firms to participate successfully in procurement.

23. Donors should consider individual or joint initiatives to strengthen local and regional capacity to compete for aid supported contracts. Broadening the sourcing of TC and management of projects should be priority areas.

24. Agencies for whom both the formal untying of aid and whose de facto untying practices are still constrained by domestic regulations should include in their plans proposals to remove or obtain general exemptions from such restrictions on the disbursement of public funds.

25. Reporting on implementation of plans for completing the untying of aid should be submitted to become part of the annual report to the DAC, and also should be made a specific item for inclusion in future DAC member peer reviews.

26. The DAC should consider adding, to the annual progress reports on untying, a country partner focused review of progress in untying, undertaken with the full cooperation of an LDC or HIPC country and also DAC members.

27. DAC members individually need to monitor and rigorously evaluate both their progress in untying and in making use of the capacities within partner countries.

28. Untying is not an end in itself but a means to increase aid effectiveness and its developmental impact. There has been much progress by most DAC members, but some have done little more than nominally untying their aid in a legal or regulatory sense. So there is much scope for further actions towards untying aid in practical ways and exploiting the opportunities that this offers for strengthening aid effectiveness through genuine partnerships between donors and aid recipients.
Table 1  DAC donor countries: tying status of bilateral ODA in 2007 (including donor administrative costs)

<table>
<thead>
<tr>
<th>Donor</th>
<th>Bilateral ODA (US$ million)</th>
<th>Untied</th>
<th>Partially tied</th>
<th>Tied</th>
<th>Not Reported</th>
<th>Untied</th>
<th>Partially tied</th>
<th>Tied</th>
<th>Not Reported</th>
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Source: Table 3.2 of Synthesis Report (original source: OECD CRS).
Table 2 Bilateral DAC donors (including EC) – Percent of aid to government using Country Procurement Systems (CPS) in 2007

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<th>Donor</th>
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<th>Lao PDR</th>
<th>Ghana</th>
<th>Vietnam</th>
<th>Burkina Faso</th>
<th>South Africa</th>
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Source: Table 6.3 of Synthesis Report (original source: OECD DAC).
Thematic Study

The Developmental Effectiveness of Untied Aid:
Evaluation of the Implementation of the Paris Declaration
and of the 2001 DAC Recommendation on Untying
ODA to the LDCs

This report presents the results of a thematic study undertaken within the
framework of the Evaluation of the Paris Declaration and in response to
the request by the DAC for an evaluation of the effects of untying of aid
to LDCs.

The report builds on extensive research carried out in a first phase, pub-
lished in October 2008 and subsequent case studies in Burkina Faso,