



## Untying Aid to the Least Developed Countries

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### Introduction

The DAC High Level Meeting in April 2001 adopted a Recommendation on untying aid to the least developed countries<sup>1</sup>. This Policy Brief sets out the background to this agreement.

Since its creation in 1961, the OECD Development Assistance Committee (DAC) has discussed ways to improve the effectiveness of its Members' aid efforts. One major issue has been whether aid should be freely available to buy goods and services from all countries (that is, "untied aid"), or whether aid should be restricted to the procurement of goods and services from the donor country (that is, "tied aid"). Over the years, the issue has been discussed in the DAC, culminating in agreement by Development Co-operation Ministers and Heads of Aid Agencies on a Recommendation to untie official development assistance to the least developed countries at the DAC High Level Meeting in April 2001. ■

1. As at 1 May 2001, the list of countries classified as "least developed" is: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cape Verde, Central African Republic, Chad, Comoros, Congo Dem. Rep., Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Laos, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Tanzania, Togo, Tuvalu, Uganda, Vanuatu, Yemen and Zambia.

## What is official development aid and how much is untied?

Donors assist developing countries in their economic development, especially in implementing poverty reduction strategies at the country level which are now the foundation for both bilateral and multilateral development cooperation. When official donor agencies give assistance with a grant element<sup>1</sup> of at least 25%, this aid is classified as Official Development Assistance (ODA). In 2000, DAC Members gave US\$ 53 billion in ODA to developing countries – approximately two-thirds was given bilaterally, the remainder was disbursed through multilateral development banks, such as the World Bank. Bilateral aid can either be tied or untied. Total bilateral aid to the least developed countries stands at around \$8 billion (some 17% of total bilateral aid); about half of this is tied. ■

## Why do donors tie their aid?

The reasons for keeping aid tied to the purchase of goods and services in the donor country are of both an economic and political nature. From a macroeconomic perspective, aid is a financial outflow from the donor country. Governments concerned with

their balance of payments may wish to offset these outflows by seeking to increase exports through aid tying. At the enterprise level, some firms in donor countries may see tied aid as a way to help them win contracts for exports to aid recipients – such tying of aid implies a subsidy to enterprises in donor countries. From a political perspective, some donor governments have argued that tying aid strengthens public and business support for the aid effort. Untying aid, in turn, could then negatively influence already squeezed aid budgets. Furthermore, development assistance extends beyond a mere economic exchange. It is seen as an expression of donors' values and willingness to cooperate on a personal level with the citizens of developing countries. To emphasise these links, many donors want their aid efforts to be clearly visible. Tying aid to the purchase of goods and services of the donor country can provide such visibility. ■

## What are the benefits of untied aid?

Proponents of untied aid emphasise that it is a more efficient way to deliver development assistance. It has been estimated that tied aid raises the cost of many goods and services by between 15 to 30%. Further, tied aid increases the administrative burdens on both recipients and donors, and also tends to favour

projects that require capital intensive imports or donor-based technical expertise rather than smaller and more poverty-focused programmes. This bias could lead to the provision of goods, technology and advice that do not conform to the priorities and specifications of the recipient country. In short, tied aid may be construed as a costly way of subsidising jobs in donor countries – a form of protectionism that runs counter to the overall OECD commitment to open markets. According to OECD Secretary-General Donald Johnston in his speech to the 1999 WTO Seattle Conference: *"Untying aid, by restoring choice to impoverished recipient countries would increase the value of aid, remove a distortion to world commerce and enhance the dignity of the aid process that has been sullied by the mercantilist attitudes of some in the developed world."* ■

## What do stakeholders think?

The practice of tying aid now appears out of line with the new thinking on development cooperation, as set out in the 1996 DAC strategy *Shaping the 21<sup>st</sup> Century: The Contribution of Development Co-operation*. This strategy commits donors to working in partnership with developing countries towards internationally agreed development goals. Aid untying figures prominently in major interna-

1. The grant element is the difference between the face value and the present value of a loan calculated at a rate of discount of 10%.

tional conferences on development issues:

- In the UNCTAD X Plan of Action, developing countries identified the issue of untying aid as a key test of the coherence and credibility of donors' policies towards them.
- The DAC agreement was welcomed as a major "deliverable" by the Third United Nations Conference on the least developed countries in May of this year;
- Preparations for the United Nations Financing for Development Conference in March 2002 emphasise the contribution of untied aid to greater aid effectiveness.

Tying practices are seen as incompatible with effective partnerships. Liberalising aid procurement is a tangible step towards increased involvement of developing countries in the selection, design and implementation of aid programmes and projects.

The business community has also expressed its interest for untying aid in a multilateral framework with credible provisions for transparency and monitoring. Competitive firms will benefit more from access to a combined pool of untied aid than from reserved access to more limited national tied aid funds. Moreover, untying

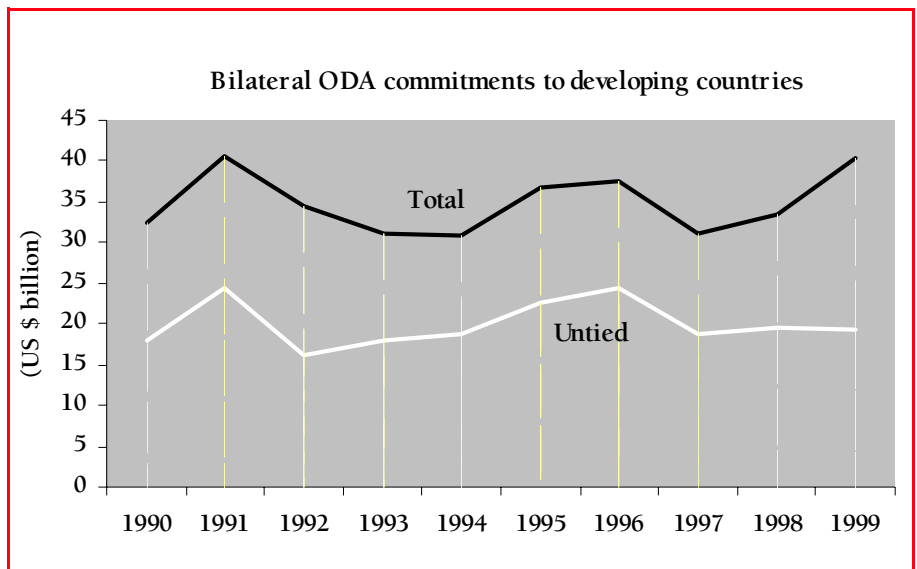
in a multilateral context will align the aid business with the free trade principles of the WTO Agreement on Government Procurement. As such, it will constitute an important step towards creating a level playing field for procurement. The Non-Governmental Organisation (NGO) community has long been an active advocate for aid untying. In fact, a coalition of over 900 NGOs based in Europe has urged the European Commission to abolish tied aid programmes. ■

### What are donors currently doing?

One cannot say that all tied aid is "bad" and that all untied aid is "good". But, in light of the argu-

ments in favour of untied aid, many donors have been increasing over time the relative importance of untied aid in their programmes.

Despite this positive trend during the 1990s, the growing share of untied aid in total bilateral aid has leveled off since 1997. This is due to the fact that some large donors gave important amounts of tied technical assistance in 1998 and 1999. Four categories of donors are identified in the table below on the basis of their ratio of untied aid to total bilateral ODA commitments to developing countries. ■



Average Untied Aid Ratio\* 1995–1999

Over 90%	50%-90%	25%-50%	Under 25%	No data
Japan Sweden Switzerland	Norway Portugal Netherlands Germany Finland Denmark	Canada Italy Australia United Kingdom <sup>a</sup> France Austria	Spain United States	Belgium Greece Ireland Luxembourg New Zealand

a. Recently, the United Kingdom has announced that it will untie all its bilateral aid, which will bring it into the group of untied aid donors together with Japan, Sweden and Switzerland.

\* Untied bilateral ODA as percentage of total bilateral ODA

Source: OECD

## Early attempts at untying aid

As far back as 1969, a first attempt did not reach agreement on untying bilateral aid. The conclusion of the discussions was reflected in the DAC Communiqué as follows: "For the first time, a large majority of Members declared themselves prepared to adhere to an agreement to untie their bilateral financial development loans. Other Members were not in a position to commit themselves on the principle or on the urgency of such a scheme. While they were prepared to participate in further discussions concerning the establishment of such an agreement, they stressed that any such scheme should take into account their special circumstances and their aid composition."

A second attempt was made in 1974, when 10 donors joined in a Memorandum of Understanding for the reciprocal untying

their bilateral development loans. But the agreement never became fully operational as the oil crises diverted attention to more pressing issues.

## The 1998 mandate to untie aid to the least developed countries

Having reached agreement in 1992 on a set of disciplines to guide the use of tied aid, the attention of the DAC subsequently returned to exploring ways to liberalise aid procurement. Following a detailed investigation of options and targets for a possible initiative, the DAC's 1998 High Level Meeting mandated work on a Recommendation to untie aid to the least developed countries. The initiative was targeted to this category of countries because of their relatively greater dependence on aid. Since the least developed coun-

tries face the greatest challenges in achieving the Millenium Development Goals, they can ill afford to bear the additional costs and inefficiencies associated with tied aid.

## The 2001 DAC Recommendation to untie aid to the least developed countries

After intensive discussions, the DAC at its High Level Meeting in May 2001 reached agreement on a Recommendation to untie ODA to the least developed countries. The objectives of the Recommendation are to:

- untie ODA to the least developed countries to the greatest extent possible;
- promote and ensure adequate ODA flows, in particular to the least developed countries;

\* The disciplines were primarily negotiated in the OECD under the auspices of the Participants to the OECD Arrangement on Officially Supported Export Credits.

- achieve balanced efforts among DAC Members in untying aid.

The Recommendation also recognises that reinforcing partner country responsibility for procurement and the ability of the private sector to compete for aid funded contracts are required in order for the Recommendation to deliver its full benefits. ■

## Coverage

By 1 January 2002, ODA to the least developed countries will be untied in the following areas: balance of payments and structural adjustment support; debt forgiveness; sector and multi-sector programmes assistance; investment project aid; import and commodity support; commercial services contracts, and ODA to NGOs for procurement related activities. In addition, the Recommendation acknowledges that different approaches are required for different categories of ODA and that actions to implement the Recommendation might vary between donors in terms of coverage and timing. Simply put, there are some activities (notably technical co-operation and food aid) where it is recognised that untying would pose more delicate problems for some donors than for others. The Recommendation therefore strikes a balance between maintaining a sense of national involvement in donor countries' development co-operation poli-

cies alongside the objective to procure more goods and services in partner countries. Thus, with respect to technical co-operation and food aid, donors can opt to keep their aid programmes tied. Overall, it is expected that approximately US\$5.5 billion or about 70% of all bilateral ODA to the least developed countries will be untied as of January 2002. ■

## Effort-sharing

Promoting a reasonable balance among Members in their efforts to implement the untying initiative is an integral part of the Recommendation. The issue of balanced effort-sharing arises from the interplay of two factors – the coverage of the Recommendation and the variations in volume, structure and geographical orientations of different aid programmes. As a result, the implementation of the Recommendation will produce important differences between individual donors both in the amount of aid that is covered by the Recommendation and the overall volume and share of aid that is untied. Therefore, the Recommendation acknowledges that achieving a balance in effort-sharing is a legitimate and important concern for governments, parliaments and the public at large. In that respect, Members have agreed to undertake their best endeavours to identify and implement supplementary actions to promote effort-sharing and to regularly

review progress towards more balanced sharing of their efforts towards the least developed countries. Furthermore, they expressed their intention that their aid to the least developed countries will not decline over time as a result of the implementation of the Recommendation. ■

## Transparency and monitoring

The Recommendation sets out strong transparency, implementation and review procedures to provide and maintain a level playing field, monitor compliance with the Recommendation and assess its effectiveness. For instance, prior to the opening of the bidding period donors will notify the OECD Secretariat of untied aid offers covered by the Recommendation. Subsequently, the notification will be made publicly available to inform companies in donor and recipient countries to the possibilities to bid for the contract. In general, bidding will take place according to the 1986 DAC Good Procurement Practices for ODA, which give guidance on effective and competitive procurement. Donors will also inform the Secretariat about the company that has been awarded the contract. In addition, an electronic information exchange system will allow Members to ask each other for additional information or to clarify ambiguities. ■

## Implementing the Recommendation

The Recommendation becomes operational on 1 January 2002. Major efforts are now underway to get in place for this and to put its provisions into practice. By the beginning of next year, Members will have to make whatever adjustments are necessary to their policies and practices to untie agreed categories of aid. Equally, the OECD Secretariat will have to put monitoring and review provisions into operation, including the creation of an

electronic bulletin board to advertise untied aid offers. Beyond these immediate tasks, implementation will require much work in other areas to check that the Recommendation is meeting its objectives. This will include, for example:

- work to strengthen procurement capacities in developing countries so that they can take greater responsibility for this;
- work to improve the completeness and comparability of Members' reporting on tied and untied aid;

- implementing the effort-sharing provisions of the Recommendation to improve the balance among Members in respect of their efforts towards the least developed countries will also be a major task. ■

## For further information

More information about the Recommendation can be obtained from Frans Lammersen (email: [frans.lammersen@oecd.org](mailto:frans.lammersen@oecd.org); tel: (33-1) 45 24 89 88). ■

## For further reading

- *Shaping the 21<sup>st</sup> Century: The Contribution of Development Co-operation*, 1996
- *DAC Recommendation on Untying Official Development Assistance to the Least Developed Countries*, May 2001 – [www.oecd.org/dac/htm/Untie.htm](http://www.oecd.org/dac/htm/Untie.htm)

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