

Untying aid: Is it working?



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

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Edward J. Clay, Matthew Geddes and Luisa Natali

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List of Acronyms

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

Summary

Background

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.

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 to the OECD as fully untied or with untied components, were examined in detail. EC administered aid is included to ensure coverage of *partial untying* and IDA aid is included as a base for comparison with *fully untied funding*. Most projects are in the Water and Sanitation Sector (W&SS), which combines both infrastructure and social development objectives.

Key findings

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. The proportion of fully untied bilateral aid rose progressively from 46% in 1999-2001 to 76% in 2007, 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. Free-standing technical cooperation (TC) 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.

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.

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.

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 strengthen partner capacities in financial management and procurement.

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 (iv) pressure for speedy implementation.

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.

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.

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.

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.

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

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.

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 untie their aid to the maximum extent and to improve reporting on the 2001 Recommendation* (OECD DAC, 2009). These proposals are strongly endorsed and further specific measures are suggested to support genuine untying and reduce, if not eliminate *de facto* tying practices.

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.

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.

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.

Agencies whose untying practice is 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.

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.

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.

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

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.

1. INTRODUCTION

1.1 Background

For several decades debates on aid effectiveness have focused on the issue of the tying status of aid (See below Chapter 2 and Table 2.1). It has been clearly documented that tied aid raises the cost of goods, services and works by 15% to 30% on average, and by as much as 40% or more for food aid.¹ This is a conservative estimate of the real costs of tying, since it does not incorporate the indirect costs. Furthermore, there have been widely discussed concerns about tying reducing effectiveness: acting as a constraint on donor cooperation and the building of partnerships with developing countries, by inhibiting the ownership and responsibility of partner countries in aid supported development, as well as hampering broader efforts to promote their integration into the global economy.²

As a result, after extended and difficult negotiations, the OECD/DAC adopted in 2001 a Recommendation to untie much Official Development Assistance (ODA) to Least Developed Countries (LDCs). The Recommendation (amended in 2006 and in 2008) also invites Development Assistance Committee (DAC) members to provide untied aid in areas not covered by the Recommendation, and to study the possibilities of extending untied aid in such areas. Basically, areas not covered are technical cooperation (TC), food aid and donor administrative costs.³ Country coverage might also be widened. Progress achieved in the proportion of ODA that is untied is tracked in the context of the Millennium Development Goals, as target

number 35. The 2005 Paris Declaration on Aid Effectiveness (PD) reiterated the 2001 DAC Recommendation and envisaged that progress in the share of aid that is untied be monitored through Indicator 8.⁴

The Working Party on Aid Effectiveness and the DAC Network on Development Evaluation asked for a study of the extent to which development partners have untied their assistance and the key factors promoting or impeding progress on fully untying development assistance. Furthermore, they have asked for the study to identify examples of benefits of fully untied aid. The 2001 DAC Recommendation to untie ODA to the LDCs had also included a request for a comprehensive evaluation of its impact, which is mandated for submission to the 2009 DAC High Level Meeting (HLM).⁵ So in the light of the close communalities between the study within the framework of the evaluation of the Paris Declaration, and the request for an evaluation in the 2001 DAC Recommendation, this study is being undertaken to assess the effectiveness of untied aid.

1.2 Purpose, scope and timetable

The purpose of the study is to provide the DAC and the 2009 HLM, as well as the wider development community, with a comprehensive assessment of current donor policies and practices regarding the tying status of aid, and an assessment of the effects of the untying status on aid effectiveness. The study's intended focus is on the *results of untied aid*, and examines if, and to what extent, the present effort for *untying aid has contributed to aid effectiveness*. The study also explores the prospects for increasing the share of untied aid, and, where

¹ The estimates of the average costs of tying were presented in a survey of research and evaluations up to c. 1990 published by the OECD (Jepma, 1991) and those for food aid in a more recent OECD (2006a) study; for further discussion see Chapter 5 below.

² See, for example, Helleiner (2000) as a statement of such broader concerns about tying practices inhibiting effective partnerships.

³ It might be thought that the tying status of donor administrative costs is irrelevant, as these are virtually by definition tied. However, as donors report more fully on the tying status of their aid, some are found to have begun to source administrative services more widely (see below Table 3.6).

⁴ "Untying aid generally increases aid effectiveness by reducing transaction costs for partner countries and improving country ownership and alignment. DAC donors will continue to make progress on untying as encouraged by the 2001 DAC Recommendation on Untying Official Development Assistance to the Least Developed Countries (Indicator 8)." OECD DAC, 2005, Para 31.

⁵ 'The comprehensive evaluation will also pay attention to the implementation of this Recommendation with respect to achieving a balance of efforts among DAC Members and promoting and sustaining ODA flows to LDCs.' OECD DAC, 2001, Para 20.

relevant, provides policy recommendations on how to achieve this objective.

The questions addressed by the study include:

- To what extent has donor behaviour changed as a result of the 2001 DAC Recommendation on Untying Aid to Least Developed Countries, i.e. to what extent have donors untied their aid further?
- What factors have enhanced or impeded fully untying development assistance?
- What is the evidence that untied aid has resulted in an increase in the effectiveness and efficiency of aid?

The evaluation study has been conducted in two stages.

- The first stage, Phase One, from May to September 2008, provided a comprehensive headquarters level overview of the current policies and practices of DAC members and non-DAC donors regarding the tying status of their aid, and the effects on aid effectiveness. During this first stage a methodology for Phase Two, including partner country case studies, was developed for presentation to DAC members in December 2008.
- Phase Two considered the effects of the tying status of aid on aid effectiveness on the basis of a representative group of six evidence-based case studies in partner countries (although originally only four were envisaged in the Terms of Reference (ToR)). The studies were organised in two stages. The ODI core team, in cooperation with local researchers, did a pilot study in Ghana during November 2008 to February 2009⁶ Five further case studies were undertaken, again in cooperation with local researchers between February and October 2009. This phase examined the extent to which untied aid has resulted in procurement from local/regional companies and its effect on aid effectiveness.⁷

The comprehensive final report covering Phases One and Two includes practical policy recommendations for increasing the share of aid that is untied.

1.3 Approach, activities and outline of report

It was envisaged that the study would be done through a consultative process with donors, partner countries and civil society, and so this intention has shaped the way Phases One and Two have been undertaken.

First, there is a statistical analysis of tying and untying practice as reported to the OECD databases, to provide an independ-

ent reassessment of progress towards untying. The preliminary findings, reported in Phase One, have been updated to include data for 2007. This analysis was undertaken after discussions with OECD statisticians about the coverage and limitations of the data as reported by member governments.

Second, there is a desk-based review of publicly available documentation, including research and evaluation studies on impacts of tying and untying practices.

Third, there is an exploratory survey, based on interviews and documentation made available by agencies, of how five donors, Australia, Canada, Denmark, Norway and Switzerland, have responded to the 2001 Recommendation. These countries are also party to different regional and bilateral trade agreements that include provisions regarding public procurement, which could be an influence on untying practices.

Fourth, there are six country partner studies, which provide through a combination of statistical information, interviews and documentation, further evidence on untying practices, including choice of aid modalities and organisational arrangements. The six partner countries were purposively selected to be representative of the range of aid recipients and also, since untying potentially has trade, including regional, implications, as pairs within economic and trading regions – West Africa (ECOWAS), Southern Africa (SADC) and SE Asia (ASEAN) (see Chapter 6, Table 6.1 for more detail).⁸

Fifth, in the case study countries, more in-depth investigations were undertaken for 21 development projects, supported largely with bilateral untied funds. The projects were purposively selected to cover many DAC members, including the largest donors, and to focus mostly on one sector to provide comparability between project components. Water and Sanitation Sector (W&SS) was chosen as it includes both infrastructure and social development aspects, and all projects were on-going in 2008-09, thus facilitating data collection and the availability for interview of personnel from the implementing agencies. The rationale for focusing on investment projects is set out below.

Project-type aid as an evaluation priority: Discussions with donor officials and reviewing the available documentation, including evaluations during Phase One, suggested four different schematic models, reflecting types of aid and associated modalities, where the potential impact of untying should be considered separately. This schema was used to determine country level evaluation priorities for Phase Two.

Model A: Discrete investments which can be compared with investments elsewhere, but have to be tailored to a specific situation. These include infrastructure projects, such as power

⁶ The Ghana study was made possible by support to ODI under a research grant from KfW for investigating the trade implications of aid instruments.

⁷ The Executive Summaries of the country studies are included in Annex D.

⁸ The ToR originally envisaged at least four country studies. The proposal for Phase Two hoped to include six, including one in Latin America, provisionally Nicaragua, subsequently Honduras. This proved impractical because of time constraints and other unforeseen difficulties.

stations, ports and dams, some industrial units e.g. fishing facilities and telecommunications systems. Multilaterally funded projects offer a standard for comparison, and so World Bank procurement was recognised as providing a counterfactual to bilateral procurement. Individual projects have been relatively little assessed from a perspective of untying practices and were made the major focus of Phase Two through a survey of 21 projects in the six countries.

Model B: Highly divisible goods that are widely traded on competitive, but not necessarily perfectly competitive markets (most obviously in the case of food aid). Extensively researched and evaluated, cost-effectiveness analysis demonstrates efficiency of unrestricted sourcing in procurement by a donor, its agent or partner. There are also effectiveness issues in terms of selection of appropriate goods and delivery times. As food aid is exempt from the Recommendation discussion of this case is confined to the statistical donor policy and literature reviews. However, highly divisible and widely traded goods such as cement and piping were recommended for cost-effectiveness analyses in the country studies.

Model C: Free standing technical cooperation between donor and recipient partner country organisations, where for example the developing country organisation is *disadvantaged in terms of information* as well as in access to funding. The partnerships are seen as a way of overcoming these obstacles. Twinning arrangements between public sector organisations and *Business to Business* (B2B) involving private sector enterprises is based on this third model.⁹ As freestanding TC is outside the Recommendation only a few TC projects have been included to ensure wider donor coverage in the project survey.

Model D: Direct bilateral instruments (DBI) where funds are made available to the recipient partner country government, usually as general budgetary (GBS) or sectoral budgetary (SBS) or programmatic support to disburse according to the partner's procedures. Sometimes these are described as 'basket' arrangements where several donors contribute to a common programmatic fund. Funds are also pooled within a project framework (Model B). Debt relief should also be considered as within this category of DBI. Programmatic support to a partner country civil society organisation according to the partner organisation's procedures follows this model and may be important in some countries where there are problems of governance. However, there might not be general agreement on this latter case, which is usually off-budget. The untying status of DBIs is relatively unambiguous and GBS and SBS have been subject to investigations. Therefore their coverage in this study is limited to statistical and literature reviews and country level surveys to determine incidence.

Methods of analysis: After a careful review of the statistical data it was decided to confine the analysis to simple tabular and

graphical presentations of actual values, proportions, distributions and trends, all broadly similar to those in the annual progress reports on untying. An econometric analysis quantifies in cross section for relationships between untying and donor and recipient characteristics and is reported more fully in Phase One Chapter 3. A more ambitious quantitative analysis of trends, as envisaged in the ToR, was precluded by data that were increasing incomplete as one goes backwards in time. Responding to the widely expressed view in both donor and recipient countries that informal tying practices are widespread, a second econometric analysis is undertaken of the relationship between the bilateral aid and export flows of individual donors during 2002-07 to each of the case study countries.

The recipient country partner studies provided an opportunity to explore, through a combination of statistical analysis and qualitative evidence from interviews with stakeholders, the extent and influence of untying on aid outcomes. Again the approach is eclectic and limited by a lack of strictly comparable statistical reporting, for example on the use of aid modalities and lack of data on procurement practices. The investigations into aid-effectiveness and developmental impacts are largely based on a combination of qualitative evidence from the 21 project case studies with selective cost-effectiveness analyses.¹⁰ Special attention was given to project reviews as a way of providing concrete, case-specific evidence. The literature review and interview evidence from Phase One had highlighted the problem of the absence of previous evaluative evidence on the impacts of untying and that investment projects were probably the most worthwhile area for detailed investigation.

The report is organised as follows. In Chapter 2 there is a brief overview of the international rules and agreements concerning the tying status of ODA. Chapter 3 provides a statistical analysis of tying and untying practices of DAC members, showing how untied aid has quickly come to predominate within bilateral aid, but how continuing data problems preclude a precise estimate of the extent of untying. In Chapter 4, the findings of a survey of changing donor policies and practices of the five donors are summarised. Chapter 5 presents the findings of a review of the research literature. This review confirms that attention in both research and evaluation has almost entirely focused on effects of tying practices and very limited attention has been given to untying practices: hence the rationale for this study.¹¹

¹⁰ A note of clarification is useful on the uses of qualitative data. When a survey is purposive, as in this case where six countries and 21 projects have been selected on grounds of representativeness, then the appropriate way to use such data is as if it were non-parametric, and so give equal weighting to each observation. We do that and draw attention to what we have done (full transparency), and so it is easy for anyone viewing the data to make an alternative calculation if they so wish. Otherwise the overall picture could be dominated or heavily biased by any country or project value that just happened to be relatively larger.

¹¹ The lack of evidence on the consequences of untying is confirmed by the 'Evaluation of the implementation of the Paris Declaration Phase One Synthesis Report' (Wood *et al.*, 2008).

⁹ The OECD study on promoting local and regional procurement identifies information and dialogue obstacles to local firms' successful participation in procurement (OECD, 2008a).

Chapter 6 provides a factual review based on country experience of how untying works in practice from recipient as well as donor perspectives in terms of modalities adopted, procurement practice and users. In response to the widespread scepticism about the genuineness of untying, an econometric analysis examines the relationship between donors and their exports to each of the case study countries. In Chapter 7, project level evidence is presented on the ways untied aid is organised, inputs are sourced and the outcomes in terms of aid efficiency, effectiveness criteria and development impacts. Finally, Chapter 8 sets out the conclusions and recommendations for increasing the share of aid that is fully untied.

2. THE INTERNATIONAL RULES AND AGREEMENTS CONCERNING THE TYING STATUS OF ODA

This chapter provides a brief overview of the main agreements and rules for determining the tying status of aid and for regulating the tying practices of donor countries.

The attempts to reach international agreement on rules covering the tying status of ODA have a long history because of two distinct but ultimately overlapping sets of concerns. First, there are the development cooperation implications of tying and untying practices for the efficiency and effectiveness of aid, as well as burden sharing amongst donor countries. Second, there are the export competition issues: the potential trade distorting implications of concessional lending and grant aid tied to the export of goods and services from donor countries. At the international level the first set of concerns has been a focus of discussion in the OECD DAC, while the second has been addressed primarily by the Participants to the Arrangement on Officially Supported Export Credits.

Definitions of tying status: The important currently operative agreements are those of the 1987 DAC Guiding Principles for Associated Financing and Tied and Partially Untied Official Development Assistance (OECD DAC, 1987) summarised in Table 2.1.

The categories of tied and untied aid are, at least formally, relatively unambiguous focusing on the key issue of whether the

sourcing of goods and services is either restricted or free from restriction and open to suppliers in other donor countries. The partially untied category is more complex. It was devised to take account of a situation in which the donor wishes to allow local procurement in the recipient country or possibly a group of developing countries, for example in the same region. Donors may also agree to permit procurement from within each other's market on a basis of reciprocity, as well as to developing countries. Conventionally such transactions are still regarded as part of tied aid. However, in this study they are both separately identified and also grouped with untied aid as a measure of movements in tying status to allow procurement within the recipient country and other developing countries.

Reporting on tying status: the Guiding Principles include an agreement to report to the OECD's DAC aggregate tables on the tying status of aid. Reporting on Technical Cooperation (TC) and administrative costs was specifically made voluntary. However, reporting to the OECD Creditor Reporting System (CRS) on a project level does contain information on the tying status of most ODA. Apart from technical problems of ensuring consistent reporting, some donors initially chose not to report on the tying status of their bilateral aid to the CRS, and even more did not report fully on their TC or administrative costs. The combination of these factors has limited the ability of the OECD DAC to monitor precisely progress on untying of

Table 2.1 DAC definitions of tying status of ODA, other official flows and officially supported credits

TYING STATUS CATEGORY	DEFINITION AND COVERAGE
UNTIED AID	Loans and grants whose proceeds are fully and freely available to finance procurement from all OECD countries and substantially all developing countries.
PARTIALLY UNTIED AID	Loans and grants which are tied, contractually or in effect, to procurement of goods and services from a restricted number of countries which must include substantially all developing countries and can include the donor country.
TIED AID	All other loans and grants are classified as tied aid, whether they are tied formally or through informal arrangements.

Source: OECD DAC (1987).

aid. The consequent data problems that hamper monitoring of tying practices are described more fully in Section 3.1.

In 2001 DAC members agreed upon a Recommendation to untie most categories of aid to LDCs (OECD DAC, 2001). The Recommendation has the usual exceptions of free-standing TC and food aid. Threshold levels on the application of the Recommendation were also initially set at SDR 700,000 (SDR 130,000 in the case of investment related TC). These thresholds were subsequently removed in 2006 (OECD DAC, 2006b). In 2008 coverage of the Recommendation was extended to include non-LDC highly indebted countries (HIPCs) and thereby provided equal treatment for the whole HIPC group (OECD DAC, 2007).¹² The DAC also urged donors to promote greater local and regional procurement in developing countries and invited non-DAC donors to respect the principles of the Recommendation.

The 2005 Paris Declaration includes a further qualitative commitment without any specific target (Indicator 8) to continue the process of untying. The 2008 Accra Agenda for Action (AAA) on aid effectiveness reaffirmed this commitment, and called upon DAC members to elaborate individual plans by 2010 to untie their aid to the maximum extent and to improve reporting on the 2001 Recommendation (OECD DAC 2009).

Table 2.2 Chronology of OECD agreements on tying status of aid including credits that qualify as ODA

WHO	WHAT	WHEN
DAC	Official flows split into: - ODA, and - Other Official Flows	1969
	Introduction of 25% Grant Element (10% discount rate)	1972
Participants	Tied Aid Disciplines - LDCs 50% concessionality - Others 35% concessionality Differentiated discount rate (cost of money)	1987
Participants/DAC	New Measures in the Field of Tied Aid - No tied aid loans for commercially viable projects	1992
DAC	Recommendation to Untie ODA to LDCs (exc. TC and Food Aid)	2001

Some specific issues for investigation arise from the stepwise process of commitment towards untying. To what extent has the Recommendation, including coverage, exemptions and thresholds, been an influence on donor policies and practices?

¹² Eight non-LDCs are part of the HIPC Initiative: Bolivia, Cameroon, Cote d'Ivoire, Ghana (case study country), Guyana, Honduras, Nicaragua, and Democratic Republic of Congo.

Incomplete reporting, as the statistical review in Chapter 3 indicates, seriously restricts any attempt to monitor donor responses to the Recommendation. Promoting local and regional performance is a key issue in assessing the impact of untying, as discussed below in Chapter 7.

Issues of tying status are also discussed in other international fora. Multilateral agencies such as the World Bank have agreed rules regarding the acceptability and eventually non-acceptability of tied aid under trust funding arrangements and so forth.

The potential for trade distortion where donors used aid to seek a competitive advantage for their exporters has been recognised and addressed in a number of ways. For officially supported export credits OECD members entered into a sequence of agreements that set out criteria for defining and restricting the use of credits as a form of export competition. These criteria include the concessionality level and notification procedures. The process culminated in the Helsinki Package of Tied Aid Disciplines in 1991 that set out principles for officially supported export credits and tied and partially untied aid, complemented in 1992 by corresponding measures agreed by the DAC. These prohibited tied and partially untied credits for richer developing countries as well as, on a case-by-case basis, projects that are commercially viable and for which commercial financing would be available.¹³ The package also reinforced monitoring procedures for tied aid credits. The criteria agreed for categorising tied credits as ODA introduced differential treatment for untied loans qualifying with 25% concessionality, tied credit to LDCs requiring a minimum of 50% and credits to other developing countries a minimum of 35%. A chronology of the main agreements within the OECD regarding the tying status of aid and official credits are summarised in Table 2.2.

Untied aid would include ODA that *directly finances imports* where the source of procurement is unrestricted. In addition, transactions that are not *directly financing imports* (NDFI) are assumed to be wholly fungible and therefore free from any trade distorting implications. These forms of aid include budgetary and balance of payments support (the provision of freely usable foreign exchange), *local cost financing* and *debt relief* (including refinancing and rescheduling). In addition, *contributions to NGOs* and *official funds in support of, or intended for, direct equity investment* are also conventionally regarded as untied or non-distorting. These are in practice 'grey areas' where there is some element of implicit tying (Chapter 4).

International concerns about potential trade distorting effects of tying practices and the introduction of regulatory practices to combat these have historically focused on two broad categories of aid with restrictive conditions. These are:

- transactions that *directly finance imports* (DFI), which specify the procurement with aid funds of specific goods and services; and

¹³ See OECD (1991), OECD (2008a) and, for an account of the process that led to the Helsinki Accord, see Ray (1995). The transparency criteria have been extended since 2005 on a voluntarily basis to untied aid credits that qualify as ODA.

- aid-in-kind where goods are purchased in the donor country and which are ready for consumption or use in arrival in the recipient country. Conventionally, a substantial part of bilateral emergency aid/humanitarian relief has been sourced in this way.

There is a potential overlap of the voluntary OECD agreements and the treaty obligations under World Trade Organisation (WTO) agreements and procedures for disputes. However, this has been in effect resolved by exempting ODA from the Agreement on Government Procurement in GATT (1979) and also in the WTO Agreement on Subsidies and Countervailing Measures (ASCM), including tied aid, which recognises the OECD arrangement as an exemption to the rules.¹⁴

Agriculture has throughout been treated separately, as reflected in the exemptions for food aid from the 2001 Recommendation on untying of ODA, and the Helsinki disciplines. There are parallel and separate procedures for avoiding, or at least minimising, commercial trade displacement through the supply of food aid through the FAO Principles on Surplus Disposal. Food aid tying practices have also been an issue in the export competition pillar of the agricultural negotiations for the Doha Development Round. The DAC definitions of tying status have been adopted in draft modalities for food aid (WTO, 2008).

¹⁴ See Annex 1, Footnote K of the WTO Agreement (WTO, 1995).

3. A STATISTICAL ANALYSIS OF THE UNTYING/TYING STATUS OF ODA

3.1 An incomplete picture of untying and tying status of ODA

This chapter includes, first, a statistical analysis of trends in the tying status of ODA of DAC donors, largely based on the reporting by donors to the OECD. This is complemented by a more detailed review of the tying status of ODA in 2007, the most recent year for which OECD CRS data are available.¹⁵ Donor performance is compared to the Recommendation and related targets agreed by the DAC. Because of the severe limitations of the available data, especially prior to the Recommendation, this statistical exploration is restricted: trends cannot be measured with any precision and caution is required in making inferences about the extent to which formal reporting of untying is associated with changes in actual practices.

The data on tying status of ODA and other official flows, as reported to the OECD, are quite incomplete, as is well known within the DAC, but perhaps less well understood outside donor circles (OECD, 2008a). Nevertheless, the reporting by DAC members on the tying status of their aid is improving, so it is possible to be more confident in describing and analysing the current status, as this conforms with OECD definitions (OECD DAC, 1987). However, trends in tying status have to be inferred with some caution, first because of the substantial reduction in non-reporting as shown in Table 3.1 (the non-reporting declined from 38% during 1999-2001 to only 7% in 2005-07). Secondly, there are examples of donors reclassifying the tying status of their aid to be more fully consistent with the practice of other donors.¹⁶ Thirdly, as discussed above,

Table 3.1 DAC donor countries: tying status of bilateral ODA to LDCs and non-LDCs in 1999-2001 and 2005-07 (percentages based on three year averages)¹

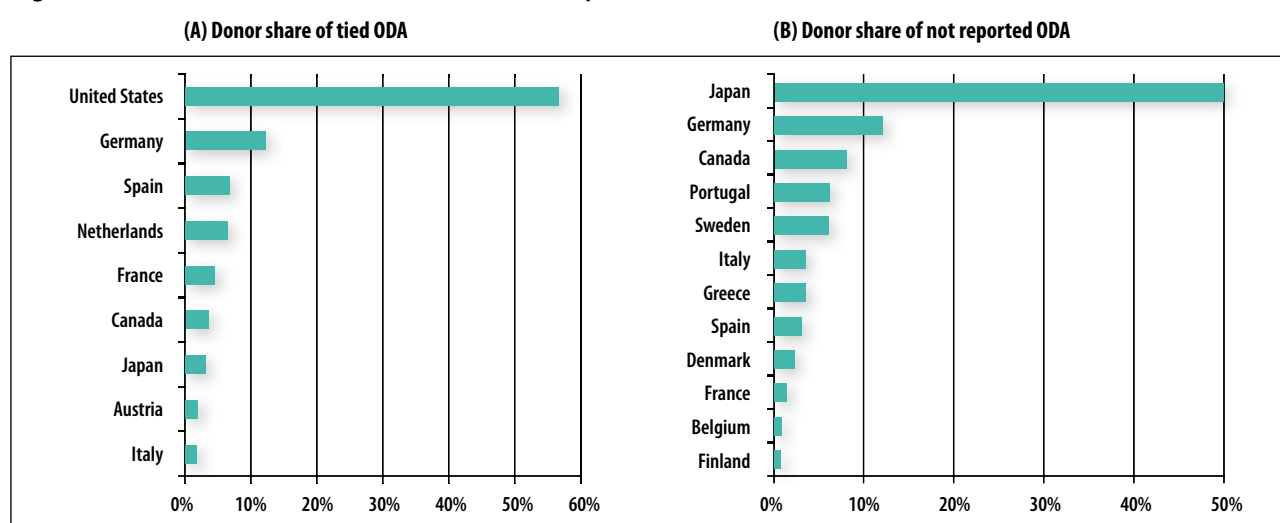
Period	Recipient country grouping	Untied (%)	Partially tied (%)	Tied (%)	Not reported (%)	Total
1999-2001	LDCs	57	3.5	8	32	100
	Non-LDCs	49	2.0	9	40	100
	All DCs	51	2.3	9	38	100
	All DCs (including EC)	46	7.5	8	39	100
2005-2007	LDCs	83	0.3	13	4	100
	Non-LDCs	70	0.8	22	7	100
	All DCs	73	0.7	20	6	100
	All DCs (including EC)	65	12.1	18	5	100

Source: OECD Creditor Reporting System (CRS) database.
Notes: 1. Data are based on commitments in current US\$.

¹⁵ The statistical information used in this chapter is based on data downloaded from the CRS database on 29 September 2009. A few modifications have been carried out to the raw data (see Annex B for details).

¹⁶ For example, CIDA used to report bilateral aid grants to Canadian based NGOs as 'tied' until 2005, when these were reclassified as 'untied' to be consistent with the usual practice of other DAC members. There is really no reason why aid to a national NGO should be treated differently from aid to a national enterprise, so should be considered as a 'grey' area in examining tying practices.

Figure 3.1 Donor share of total bilateral 'tied/not reported' ODA in 2007¹



Source: OECD Creditor Reporting System (CRS) database.

Notes: 1. Data are based on commitments in current US\$.

2. Only bilateral donors who report less than 1% (or 0%) tied or not reported ODA are not included.

there are inconsistencies in the status of aid reported as partially untied.

The current extent of the incomplete information and non-reporting of the tying status of ODA is indicated in Figure 3.1 for individual DAC donors. The most widely available annual assessment of tying status has been the annual Development Cooperation Report, which is based on aggregate commitments reported to the DAC, and excludes technical cooperation (TC), on which donor reporting is optional, and donor administrative costs. Around 76% of bilateral ODA was reported as untied for 2007, including donor administrative costs¹⁷.

This study reviews donor performance using data from the OECD Creditor Reporting System (CRS), to which donors report their commitments on an activity basis. The CRS has a more comprehensive coverage of tying status than the DAC tables, but still remains incomplete. For most DAC members the coverage is complete or close to complete. A few donors (e.g. France and Switzerland) experience difficulties in reporting aid at the activity level provided by some government departments and local governments. Even so the reporting of tying status to the CRS for 2007 is over 90% of bilateral ODA, in contrast to around 60% a decade ago. However previous under-reporting means that at the total DAC level, trends in untying can be inferred only very approximately since 1987, when current definitions of tying status were adopted (Figure 3.2).

The statistical coverage of the study includes the bilateral aid of 22 members of the DAC, as listed in Table 3.2, and also

in some instances, for purposes of comparison, European Union (EU) aid as organised by the European Commission. EU aid is multilateral, but its tying status is still with reference to the Single European Market, and stakeholders, including officials of some DAC member countries and recipient partner countries, made reference to the EU in their discussion of tying practices. As some donors report that elements of their administrative costs have been untied, so this component of bilateral aid is also included in the statistical analysis.

¹⁷ Slight differences with figures reported in the 2009 DAC Progress Report are explained by our decision to include donor administrative costs; moreover, a modification, regarding the tying status of non reported Budget Support, was applied to OECD CRS data (See Annex B for further details on data modifications).

Table 3.2 DAC donor countries: tying status of bilateral ODA in 2007¹ (including donor administrative costs)

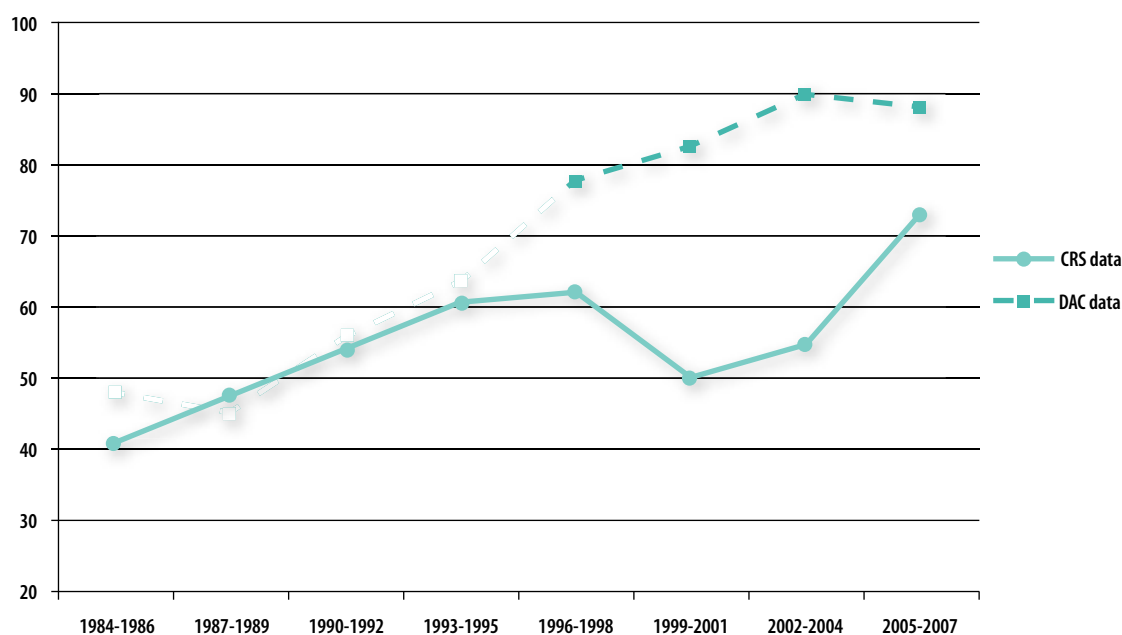
Donor	Bilateral ODA ² (US\$ million)	Tying status as % of donor ODA				Tying status as % of bilateral ODA			
		Untied	Partially tied	Tied	Not Reported	Untied	Partially tied	Tied	Not Reported
Australia	1,710	96	0	4	0	2.4	0.0	0.4	0.0
Austria	1,382	76	0	24	0	1.5	0.0	2.0	0.0
Belgium	1,587	92	0	4	4	2.1	0.0	0.4	1.1
Canada	3,338	69	1	17	13	3.4	12.8	3.6	8.2
Denmark	1,481	88	0	4	8	1.9	0.0	0.4	2.4
Finland	661	85	0	7	8	0.8	0.0	0.3	1.0
France	8,223	90	0	9	1	10.8	0.1	4.6	1.7
Germany	9,644	73	0	20	6	10.3	0.0	12.1	12.2
Greece	248	13	2	8	77	0.0	2.1	0.1	3.7
Ireland	832	95	5	0	0	1.2	14.7	0.0	0.0
Italy	1,440	52	13	21	13	1.1	68.4	1.9	3.7
Japan	12,503	75	0	4	21	13.8	0.0	3.2	50.2
Luxembourg	253	100	0	0	0	0.4	0.0	0.0	0.0
Netherlands	4,800	78	0	22	0	5.5	0.0	6.6	0.0
New Zealand	279	85	2	13	0	0.3	2.0	0.2	0.0
Norway	2,898	100	0	0	0	4.2	0.0	0.0	0.0
Portugal	605	38	0	8	54	0.3	0.0	0.3	6.4
Spain	3,778	67	0	29	4	3.7	0.0	6.8	3.2
Sweden	2,324	86	0	0	14	2.9	0.0	0.0	6.2
Switzerland	1,524	98	0	2	0	2.2	0.0	0.2	0.0
UK	5,712	100	0	0	0	8.4	0.0	0.0	0.0
USA	24,724	63	0	37	0	22.7	0.0	56.8	0.0
EC	13,373	0	100	0	0	-	-	-	-
All donors (excluding EC)	89,945	76	0	18	6	100.0	100.0	100.0	100.0
All donors (including EC)	103,318	66	13	16	5				

Source: OECD CRS database.

Notes: 1. Data are based on commitments in current US\$ millions.

2. There seems to be a misreporting problem with EC commitments: the tying status should be reported on a commitment basis however the amount of aid from the EC for which the tying status is reported exceeds the commitments reported by EC.

Figure 3.2 Share of total bilateral aid¹ that is untied, three year averages (1984-2007): DAC and CRS data comparison²



Source: OECD DAC and CRS databases.

Notes: 1. Data are based on commitments in current US\$.

2. The two figures are not strictly comparable as DAC data (Table 7b of DAC online dataset) do not include administrative costs and TC. Table DAC 7b is used to report the tying status of bilateral ODA commitments. Members have agreed that administrative costs and technical co-operation expenditure should be disregarded in assessing the percentages of tied, partially untied and untied aid. These items should therefore not be included in the data reported in this Table. (OECD, 2008g)

3.2 Tying status: trends and recent donor performance

3.2.1 The continuing trend towards the untying of ODA

The DAC donors have moved from a largely tied regime for bilateral ODA to one that is untied. ODA reported as untied rose from around 40% in the mid 80s to over 70% in 2005-07 (Figure 3.2). There is continuing progress with aid reported as untied rising to 76% in 2007.

A comparison of the three years immediately prior to the 2001 Recommendation and the most recent period for which data are available indicates that the reported increase in untying is partly 'real', partly reflects a change in donor actions and partly improved reporting (Table 3.1). The portion of ODA to LDCs reported as untied, the focus of the Recommendation, increased from 57% to 83% and from 49% to 70% for non-LDCs. There was an apparent increase in tying associated with the sharp fall in non-reporting from 32% to 4%. These trends suggest that the Recommendation has been associated with a significant increase in untied aid to LDCs and to developing countries more generally.

The full extent of the change is clearer in focusing in more detail on the overall and individual donor picture and different forms of aid for 2007. Unfortunately, such was the previous extent of non-reporting, it is not felt that meaningful detailed comparisons can be made at donor community level about types and forms of aid from the OECD data alone. Such

temporal comparisons may be possible, drawing on a range of qualitative and quantitative evidence for individual donors, as in the DAC Peer Reviews, other robust but not strictly comparable data such as WFP on food aid, and in the exploratory survey of untying policies of five donors in Chapter 4.

3.2.2 Tying status of ODA in 2007: a cross-sectional analysis

The progress towards untying is indicated in Table 3.2: three quarters of all bilateral aid was reported as untied (76%), 18% as tied and 6% not reported. Eight members reported 90% or more untied aid. Canada that had until recently provided a high proportion of tied aid and the USA that had almost entirely tied aid have both reported substantial progress. To conclude, the DAC donors have with few exceptions moved towards a largely untied framework for providing bilateral aid.

3.3 Donors responding to the 2001 Recommendation

3.3.1 Targets exceeded

In order to improve effort sharing among donors, the Recommendation set out review mechanisms that would assess members' efforts against a 60% benchmark for untying aid to LDCs. By 2007 this has been substantially exceeded by almost all members (except Italy) (Table 3.3).

Table 3.3 DAC donor countries: untied aid as percent of donor ODA in 2007¹

Donor	Untied aid			Untied aid ratio ²
	as % of donor aid to all DCs	as % of donor aid to LDCs	as % of donor aid to non-LDCs	
Luxembourg	100.0	100.0	100.0	100.0
UK	100.0	100.0	100.0	100.0
Norway	99.9	100.0	99.9	99.9
Switzerland	98.2	96.5	98.8	98.4
Australia	95.8	97.6	95.1	96.7
Ireland	95.1	100.0	89.2	96.6
Belgium	92.3	99.7	86.6	94.4
France	89.8	87.9	90.3	92.8
Denmark	87.6	94.0	83.5	92.2
Sweden	86.3	97.0	83.1	91.6
Finland	84.9	97.5	75.3	90.7
New Zealand	84.7	81.3	86.3	87.8
Netherlands	77.8	98.9	70.5	85.6
Austria	76.1	90.0	75.4	82.5
Japan	75.2	86.3	72.5	77.5
Germany	73.2	80.1	72.0	81.9
Canada	68.8	84.9	59.5	75.1
Spain	66.5	75.7	65.3	77.6
USA	62.9	74.8	58.5	66.8
Italy	52.2	52.5	52.2	83.5
Portugal	38.2	91.1	23.6	64.2
Greece	12.6	86.7	3.5	56.5
All donors (excluding EC)	76.0	86.0	72.8	82.1

Source: OECD CRS database.

Notes: 1. Data are based on commitments in current US\$ millions.

2. The untied aid ratio is the sum of: the percent of bilateral aid to LDCs reported as untied (to the CRS) multiplied by bilateral ODA (as reported to the DAC) and DAC multilateral ODA, divided by DAC total ODA.

The extent of untying of bilateral aid to LDCs (83%) is substantially greater than for non-LDCs (70%) and overall was 76% in 2007 (Table 3.2). If (untied) multilateral aid is taken into account, then 83% of all ODA was untied. The broad conclusion is that *formally* DAC members' ODA to the LDCs is overwhelmingly untied. Even donors such as Australia and Canada that had a large proportion of tied aid have moved decisively towards untying (see Chapter 4 below). The USA is the major donor that continues to formally tie, 37% in 2007. However, through developments such as the Millennium Challenge Corporation

that makes available untied bilateral grants, there has been a substantial opening of aid to international sourcing.¹⁸ There is still substantial scope for further progress on formal untying in responding to the 2001 Recommendation and more broadly, as indicated in Table 3.3. There is still a lack of transparency regarding some donors non-reporting; for instance, as Figure 3.1 shows, more than 50% of non-reported aid is by Japan.

¹⁸ For example, all Millennium Challenge Corporation compact assistance, which accounted for about 6% of total US ODA in 2006, is untied and open to competitive international bidding.

3.3.2 Aid instruments and types of aid

Differential progress towards untying might be expected for special aid instruments and types of aid. Historically, loans and non-grant forms of aid were associated with tying practices, involving elements of export promotion. The proportion of loans untied in 2007 (97%) was substantially higher than for grant aid (86%) (Table 3.4), and has increased considerably since 2006, when only 48% was untied, as noted in the Phase One report. The scale of bilateral loan aid has, however, also contracted sharply since the mid 1990s. Two explanatory factors in the contraction in loan ODA and the move to untying are concerns about indebtedness and a narrowing of commercially related lending opportunities under the Helsinki agreement. Mixed credit arrangements continue to be a limited area of tying practices for a few donors, including the USA and

Denmark, as confirmed by reports to the OECD Committee on Export Credits (OECD DAC, 2008a: Table 1). Tied food aid loans, which are excluded from the OECD reporting on export credits are still provided, but on a much reduced scale (WFP, 2008).

TC is explicitly excluded from the 2001 Recommendation and reporting to the DAC on tying status is voluntary though recommended. Even so, more than 71% of aid as TC or including a TC component was reported as untied in 2006 (Table 3.5). However, the high proportion of aid for which a possible TC component is not reported (61%) puts this figure in doubt. A more detailed review of donor practices (See Chapter 4) confirms efforts to untie many forms of TC.

Table 3.4 DAC donor countries: tying status of bilateral ODA to LDCs according to grant/non-grant status in 2007¹

	(US\$ million)	(%)					
	Bilateral ODA	Share of bilateral ODA	Untied	Partially tied	Tied	Not Reported	Share of untied bilateral ODA
ODA Grants	21,181	96.6	85.7	0.2	11.5	2.6	96.2
ODA Loans	712	3.2	96.9	0.7	2.4	0.0	3.7
Equity Investment	23	0.1	100.0	0.0	0.0	0.0	0.1
Total ODA	21,916	100.0	86.0	0.3	11.2	2.5	100.0
Total ODA (including EC)	25,454		74.1	14.1	9.6	2.2	

Source: OECD CRS database.

Notes: 1. Data are based on commitments in US\$ millions.

Table 3.5 DAC donor countries: tying status of bilateral ODA to LDCs according to technical cooperation component in 2007¹

	(US\$ million)	(%)					
	Bilateral ODA	Share of bilateral ODA	Untied	Partially tied	Tied	Not Reported	Share of untied bilateral ODA
Without TC component	4,589	20.9	96.6	0.6	2.7	0.0	23.5
With some TC component	183	0.8	91.4	3.0	5.6	0.0	0.9
Wholly TC ²	3,754	17.1	70.4	0.1	16.6	12.9	14.0
TC component not reported	13,390	61.1	86.7	0.2	12.6	0.5	61.6
Total bilateral ODA (excluding EC)	21,916	100.0	86.0	0.3	11.2	2.5	100.0
Total bilateral ODA (including EC)	25,454		74.1	14.1	9.6	2.2	

Source: OECD CRS database.

Notes: 1. Data are based on commitments in US\$ millions.

2. Projects where TC is the only component.

A sectoral classification of bilateral ODA for 2007 indicates areas where untying is more extensive, as well as types of aid in which formal tying has been retained to a greater extent (Table 3.6 and B.1).

As would be expected, the extent of untying is greatest for debt relief (100%) and general budgetary support (99.3%). In comparing 2006, as reported in Phase One, with 2007 in Table 3.6, there has been a decline from 23% of bilateral ODA in 2006 to 13% in 2007 in these forms of direct assistance to governments. Meanwhile the overall proportion of aid reported as untied has increased by 2% year on year, underlining the more general move towards untying. It is also interesting to note that 20% of donor administrative costs are reported in 2007 as untied, although this category is exempted from the Recommendation.

The high level of non-reporting in sectors in which tying of project aid might be expected, infrastructure, transport, in-

dustry and energy, indicate that caution is required in making inferences from statistical data about untying practices at an aggregate or individual donor level.

Food aid is exempt from the 2001 Recommendation. It is also difficult to determine the full extent of untying from OECD CRS for a form of aid that is reported as part of at least three sectors, including emergency assistance (21% tying), development food aid (53% tying) and commodity aid (tying status almost entirely unreported). The OECD (2006) study found widespread moves to untying, with the exception of the United States. The WFP INTERFAIS, which reports on food aid deliveries in physical terms as tonnages of commodities, provides a measure of progress on untying (Table 3.7). Total cereals food aid declined by 46% from 9.5 million tonnes in 2001 to 5.1 million tonnes in 2007. Commodities sourced in donor countries (direct transactions) also declined sharply by 65%, from 8.5 million tonnes to 2.9 million tonnes. In contrast, the share of untied and partially untied cereals aid sourced in re-

Table 3.6 DAC donor countries: bilateral ODA by consolidated sectors in 2007: tying status as percent of sector ODA¹.

Consolidated Sector	(US\$ million)	(%)					
	Bilateral ODA	Share of bilateral ODA	Untied	Partially tied	Tied	Not Reported	Share of untied bilateral ODA
Budget Support	2,769	3.1	99.3	0.0	0.7	0.0	4.0
Debt	9,010	10.0	100.0	0.0	0.0	0.0	13.2
Economic Infrastructure	11,131	12.4	76.0	0.1	21.2	2.6	12.4
Production Sectors:							
- Agriculture, Forestry & Fishing	4,266	4.7	86.1	0.4	8.2	5.3	5.4
- Other	1,337	1.5	69.0	0.0	16.7	14.2	1.3
Social Infrastructure & Services	26,850	29.9	77.6	0.2	17.5	4.7	30.5
Multisector	6,313	7.0	82.6	1.1	12.5	3.8	7.6
Government & Civil Society	11,287	12.5	71.0	0.3	25.8	2.9	11.7
NGO Support	799	0.9	84.4	3.0	1.5	11.1	1.0
Commodity Aid / Program Assistance	278	0.3	1.2	0.0	0.2	98.6	0.0
Emergency Assistance & Reconstruction	7,201	8.0	78.9	0.2	20.9	0.0	8.3
Food Aid	1,020	1.1	46.9	0.0	53.0	0.0	0.7
Refugees in Donor Countries	1,968	2.2	59.2	0.0	31.9	8.9	1.7
Donor Administrative Costs	4,357	4.8	20.4	0.9	46.3	32.4	1.3
Unspecified	1,360	1.5	44.6	0.5	8.0	47.0	0.9
Total (excluding EC)	89,945	100.0	76.0	0.3	18.0	5.7	100.0
Total (including EC)	103,318		66.2	13.2	15.6	5.0	

Source: OECD CRS database.

Notes: 1. Data are based on commitments in current US\$ millions.

Table 3.7 Global cereals food aid by source of supply in 2001 and 2007

Source	'000 tonnes in 2001 (% of total)	'000 tonnes in 2007 (% of total)	Change 2001- 2007 (%)
Developing countries ¹ (Untied/partially untied)	967 (10)	2139 (42)	+121
Direct transfers ² (Tied)	8537 (90)	2949 (58)	- 65
Total	9499 (100)	5088 (100)	- 46

Source: WFP INTERFAIS.

Notes: 1. Includes local purchases in recipient countries and triangular purchases in third countries.
2. Sourced in the donor country or in the case of the EU within the single European market.

recipient countries (local purchases) and in third, almost entirely developing countries (triangular transactions) increased from 10% to 42% and the quantity delivered also rose by 121% from under 1 million tonnes to 2.1 million tonnes.¹⁹ These developments are striking: in a period of increasingly tight global markets and rising prices, both the share and real levels of untied and partially untied food aid sourced in developing countries increased strongly.

3.3.3 Effort-sharing

There are wide differences in aid effort-sharing amongst DAC members. This is reflected, for example, in the most widely cited indicator, the percentage share of ODA in Gross National Income (GNI) in relation to the UN target of 0.7% of GNI. More specifically the implications of adopting the 2001 Recommendation can be expressed in terms of the proportion of aid directly affected. The DAC has adopted two indicators and related targets for effort-sharing. The first is the share of untied ODA in total aid to LDCs, with a straightforward target of 60%. As shown above almost all donors have reached this target within six years, including those that historically provided aid on a largely tied basis. The second indicator is the ratio of untied bilateral LDC ODA and multilateral LDC ODA with GNI. A target equivalent to 0.04% of GNI was agreed and is reported to have been exceeded (OECD DAC, 2009). However, this indicator is somewhat opaque. Donors may choose to disproportionately support parts of multilateral aid, including regional financial institutions that provide relatively more or less assistance to LDCs.

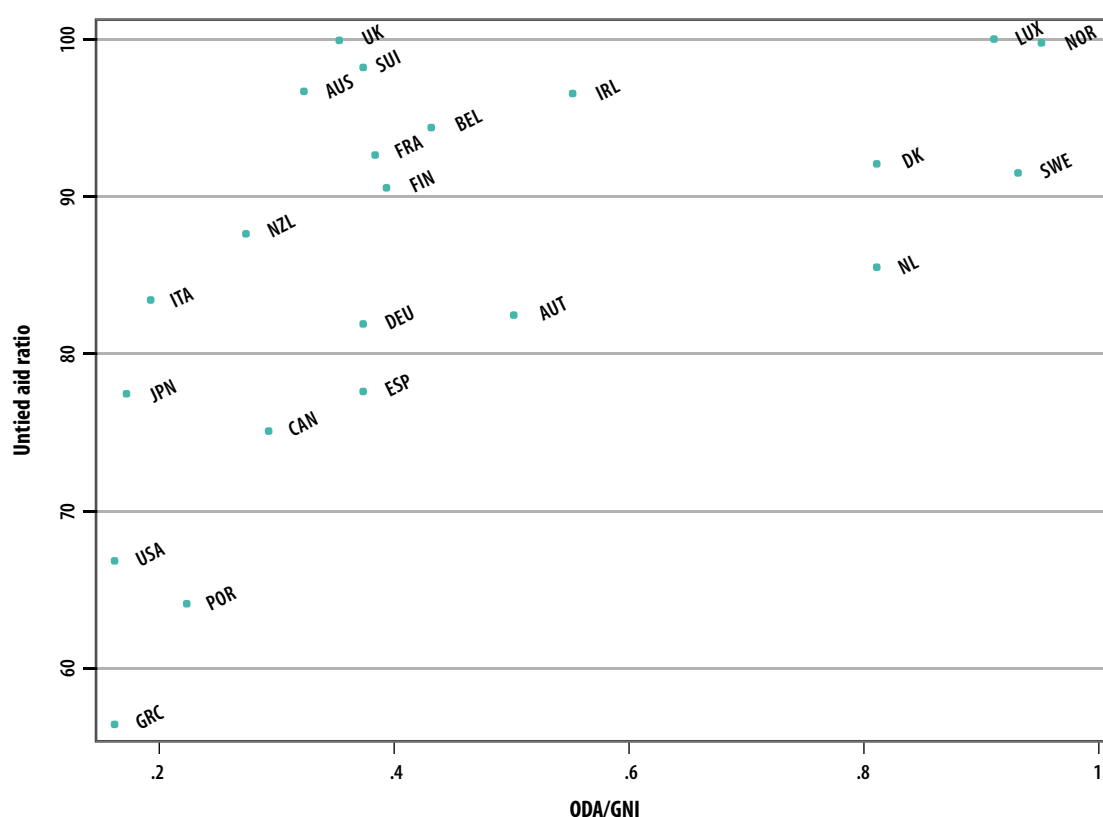
In considering overall effort sharing in the untying of ODA, and not just the aid to LDCs, the proportion of aid channelled multilaterally is a significant factor. So to provide an indicator of untying overall an 'Untied aid ratio' is estimated, which is the proportion of untied bilateral aid plus that aid channelled

multilaterally expressed as a share of total ODA (Table 3.3). The scatter plot in Figure 3.3 shows that the untied aid ratio is positively correlated with effort-sharing, the overall ODA/GNI – that is those giving relatively more aid as a percentage of GNI – appear also to provide relatively more untied aid. This conjecture that there is a positive relationship between untying and aid effort-sharing was confirmed in an econometric analysis undertaken in Phase One of this study.²⁰ However, as donors whose ODA is a relatively lower percentage of GNI, have almost fully untied their aid, for example Australia, so this relationship is becoming less pronounced.

¹⁹ WFP reports that over 90% of local and triangular purchases are in developing countries. The changes between 2001 and 2007 in 'non-cereals' food aid deliveries are broadly similar to those for cereals, but the heterogeneity of this category, which includes pulses, vegetable oils, sugar and dairy products, makes interpretation of statistical data more difficult.

²⁰ The analysis for the bilateral aid of 22 donors in 2006 found that approximately two thirds of the inter-donor variations in untying were explained statistically by the following influences in order of significance. First, the share of aid received by LDCs is highly significant, suggesting that the Recommendation is an influence on the extent to which aid is untied. Second, the share of food aid in bilateral ODA is negatively and significantly associated with untying. This confirms our expectation that a high share of bilateral food aid is associated with tying practices. Third, a higher share of TC and fourth a lower GNI per capita are associated with a lower share of untied aid. (Clay et al., 2008, Section 3.5).

Figure 3.3 Relationship between share of untied ODA (untied aid ratio) and effort-sharing (ODA/GNI) in 2007



Source: OECD CRS and DAC database.

Notes: 1. Data are based on commitments in US\$ millions.

3.3.4 Additionality of tied aid?

A concern often voiced by those defending tying practices or cautioning against change is that untying could result in a loss of domestic support for aid overall, or have diversionary effects away from LDCs to other partner countries. These possibilities have been considered in the reporting to the DAC or implementation of the 2001 Recommendation. The annual reviews suggest more positive developments and no evidence to support these concerns. Absolute levels of ODA to LDCs had almost doubled by 2007 since the base period of 1999-2001. The share of LDCs in total ODA was also 5% higher, and even higher (13%) when the somewhat temporary surges in debt relief during 2005-06 are excluded (OECD DAC, 2008a). As the historical data on untying are so weak because of the high level of non-reporting in earlier years, it is unlikely that any more sophisticated statistical investigation will be attempted that might overturn this simple refutation of the additionality argument based on trends in aid. Furthermore, the process of untying is continuing beyond the Recommendation – in terms of aid to non-LDCs, TC and food aid.

The changing pattern of sourcing within steeply declining food aid levels casts further doubt on the additionality argument for tying. The real levels of untied food aid more than doubled between 2001 and 2007 in a period of increasingly

tight markets and higher global prices. In contrast, levels of tied aid sourced in donor countries tumbled (Table 3.7). At a donor level, those who had already shifted to developing country sourcing and removed residual tying practices sustained their real levels of food aid, whilst flows from those providing domestically sourced commodities sharply contracted (WFP, 2008). If there were any additionality of tied food aid, then this phenomenon would be unstable, contingent on transient surpluses (FAO, 2006).

Taken together the findings of these statistical analyses suggest that the Recommendation has had a significant impact, and so extending the coverage of the Recommendation in terms of country and forms of aid currently exempt would lead to further untying of aid as envisaged in the Paris Declaration.

3.3.5 Formal untying and de facto tying: saying it does not make it so

The formal untying of aid does not necessarily have a developmental or trade impact, unless it is accompanied by a change in actual practice. Here there is a serious issue, the actual information, which only some donors choose to submit about some of their aid to the OECD about contracts that are open to competitive tender, indicates that 62% of contracts and 60% by value were awarded within the donor country (Table 3.8). In

the absence of contrary evidence, it would seem reasonable to infer that an even higher proportion of all contracts, including those that are not reported, are awarded within the donor country. There is thus 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. That apparent gap between declarations and outcomes implies that the investigation must seek to understand how the current untied aid regime, which donors have voluntarily agreed, works in practice within donor agencies (Chapter 4) and at a country partner level (Chapter 6) before attempting to determine its impacts.

Table 3.8 DAC donors: geographical distribution of contracts awarded in 2007

Donor	Total contracts awarded		Within donor country				Other OECD and non-DAC countries		Developing countries (excl. LDCs)		LDCs	
	No. of con-tracts	US\$ mn	No. of con-tracts	US\$ mn	as % of total contracts awarded (n)	as % total con-tracts awarded (value)	No. of con-tracts	US\$ mn	No. of con-tracts	US\$ mn	No. of con-tracts	US\$ mn
Australia	12	100.5	10	96.3	83.3	95.8	0	0.0	1	1.4	1	2.8
Austria (2)	..	..	..	..	..	..	..	..	..	..	..	..
Belgium	5	18.2	1	2.8	20.0	15.4	0	0.0	2	2.1	2	13.3
Canada	1	16.1	1	16.1	100.0	100.0	0	0.0	0	0.0	0	0.0
Denmark (3)	6	6.5	5	6.5	83.3	100.0	1	0.0	0	0.0	0	0.0
Finland	3	5.5	3	5.5	100.0	100.0	0	0.0	0	0.0	0	0.0
France	66	350.3	16	57.4	24.2	16.4	7	119.7	32	134.3	11	38.9
Germany	52	171.8	29	75.9	55.8	44.2	3	6.7	4	6.4	16	82.9
Greece (4)	0	0.0	..	..	..	..	..	..	..	..	..	..
Ireland (2)	..	..	..	..	..	..	..	..	..	..	..	..
Italy (5)	0	0.0	..	..	..	..	..	..	..	..	..	..
Japan (6)	23	..	20	..	87.0	..	2	..	0	..	1	..
Luxembourg	..	..	..	..	..	..	..	..	..	..	..	..
Netherlands	1	4.0	1	4.0	100.0	100.0	0	0.0	0	0.0	0	0.0
New Zealand	7	10.5	6	9.1	85.7	86.7	1	1.4	0	0.0	0	0.0
Norway	1	6.0	0	0.0	0.0	0.0	0	0.0	1	6.0	0	0.0
Portugal	1	1.4	0	0.0	0.0	0.0	0	0.0	1	1.4	0	0.0
Spain (4)	0	0.0	..	..	..	..	..	..	..	..	..	..
Sweden (4)	0	0.0	..	..	..	..	..	..	..	..	..	..
Switzerland (2)	..	..	..	..	..	..	..	..	..	..	..	..
UK	54	293.7	44	258.4	81.5	88.0	4	13.3	4	12.6	2	9.3
USA	95	1917.0	65	1207.4	68.4	63.0	6	20.2	20	650.2	4	39.2
Total DAC	327	2901.3	201	1739.4	61.5	60.0	24	161.2	65	814.3	37	186.4

Source: Table 5 of DCD-DAC(2009)21-REV2-ENG from Contract Awards Questionnaire, 2006. (Provisional data).

- Notes:
1. This table does not include information on small contracts (below SDR 700,000).
 2. No contract award information provided.
 3. Two contracts for Denmark did not include project amounts.
 4. No contracts from Greece, Spain and Sweden were reported above the SDR 700,000 threshold.
 5. No contracts awarded pertaining 2007 ex ante notifications.
 6. No contract amounts have been provided.

4. DONOR POLICIES AND PRACTICES: HOW DOES UNTYING WORK? A SURVEY OF FIVE DONOR EXPERIENCES OF UNTYING

4.1 Objectives and scope

The ToR calls for a 'comprehensive overview of the current policies and practices of DAC members and non-DAC members regarding the tying status of their aid and the effects on aid-effectiveness' (Para 10).

This review, undertaken in Phase One, draws largely on the annual progress reports to the DAC that monitor donor performance in relation to the 2001 Recommendation²¹. These reports provide a picture based largely on donors' own reporting on the formal tying status of their ODA, and suggest steady progress towards meeting the Recommendation. There is, however, less understanding of what this formal untying means in terms of the organisation and management of bilateral aid in relations with partner countries and its consequences – in short, how untying actually works. A comprehensive survey of current untying and tying practices was precluded by time constraints of reporting. It was therefore decided to explore this question, as well as examine the recent evolution of donor aid policies and practices, for a representative sample of five DAC members, with additional examples from other donor practices. The members surveyed are, according to their own statements, committed to the Recommendation, but are at different stages in untying their aid overall: Australia, Canada, Denmark, Norway and Switzerland.

The three European donors were already committed to untying most of their aid and reported considerable progress prior to 2002. Canada and Australia have explicitly modified their sourcing policies for LDCs in response to the Recommendation, as well as moving to untie TC and food aid, which are not covered by the Recommendation. These five countries are also party to different regional and bilateral trade agreements that include provisions regarding public procurement, which could be an influence on untying practices: Australia – bilateral agreements; Canada – NAFTA; Denmark – EU; and Norway and Switzerland – EEA and EFTA. Canada, Denmark and Norway are also part of

the informal Nordic+ grouping of donors committed to working jointly, including in some cases managing each other's aid.

This brief survey is based on a statistical analysis of ODA as reported to the OECD, plus a review of official documentation and interviews or telephone conversations with aid officials at donor HQ level undertaken during June and July 2008. It has served to highlight both common and distinctive features of donor policies and practices and to identify more precisely issues appropriate for exploration at a partner country level in Phase Two of the Study. The survey results are presented first in the form of a brief account of the evolution of policy on tying and influences for each donor, then a comparison of current practices and, third, identification of issues for further exploration – by extending the survey on a limited range of untying practice features to include all members, and investigation at partner country level.

4.2 Donor country experiences of untying

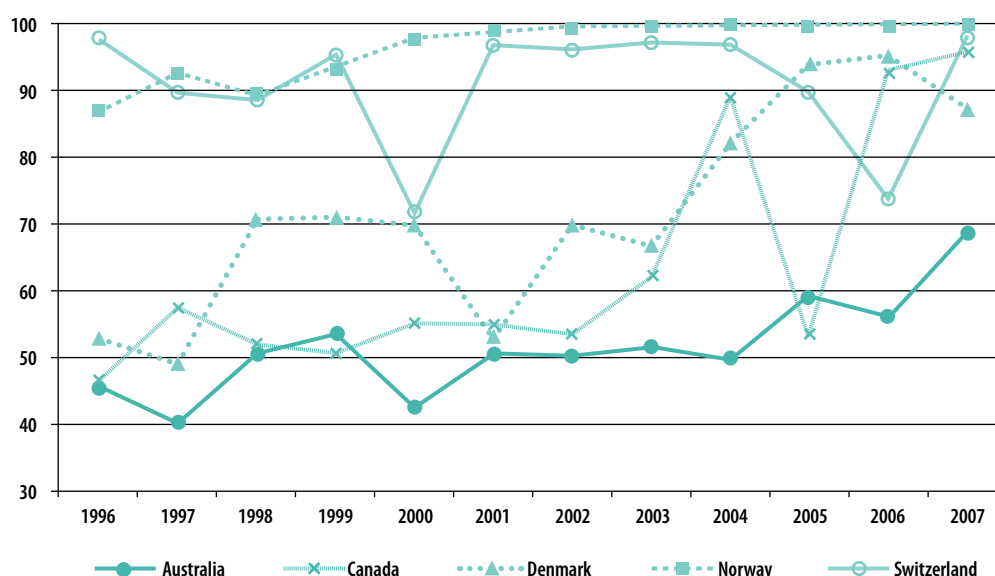
4.2.1 Norway

Untying aid began in the 1980s, and by 2002 there were only a few residual areas of tying (Figure 4.1). These included part of Norway's food aid commitment to WFP, emergency aid-in-kind (materiel and personnel) and some TC, including support for private business development or B2B²², post-secondary education and research.

²¹ The latest report is OECD DAC (2009)

²² These are called 'Matching Making Programmes' in Norway (Norwegian Ministry of Foreign Affairs (NMFA), 2004)

Figure 4.1 Five DAC Donors: bilateral aid reported as untied from 1996 to 2007 (percent)



Source: OECD CRS database.

Apart from the general economic development arguments in favour of unttying – such as resource transfer efficiency, providing greater flexibility within agency programming, as well as promoting greater responsibility and ownership for recipient partner countries – more country specific factors were influential. First, there was a concern, initially expressed in the 1970s, to avoid sectoral distortions within an export surplus oil-economy. Second, a negative experience of the ‘commercialisation of aid’ – high profile repayment difficulties over concessional loan guarantees to finance shipping construction in Norway that led to debt cancellation in 1987 – gave a discrete push towards unttying (Stokke, 1989; 2005; Abildsnes, 2007).²³ The limited pool of Norwegian expertise is a further argument to justify broader sourcing of TC, which is also formally untied. However, political concerns about sustaining public support recently led to giving special emphasis to areas where Norway is seen to have comparative strength – petroleum exploitation and environment management – which makes it more likely that Norwegian technical expertise will be funded (Norad, 2007a; 2007b).

Bilateral aid was reported as wholly untied in 2007 (Table 3.2). The last tied food aid was phased out on cost-effectiveness grounds in 2006 (NMFA, 2007). There are, however, special programmes for the provision of Norwegian sourced in-kind emergency aid and personnel; these involve assured supply and stockpiles of a limited range of materials which are *de facto* tied. A recent evaluation drew attention to the complex issues involved. There are high costs of aid-in-kind which have to be balanced against the difficulties of assuring the timely provision of supplies of highly specific goods to meet unpredictable disaster needs in the absence of a well-established market (Norad, 2008). Problems also arise in ensuring that

product innovation and changing best practice are taken into account where there is tying to specific suppliers.²⁴ This is seen as a grey area in which balancing the benefits and costs of tying practices are both less clear and significantly case specific.

Civil society, including NGOs, research institutions and universities and the private sector, has a major role in Norwegian ODA. In 2006, almost 25% of bilateral ODA was channelled through Norwegian NGOs. These agencies are free to source goods and services anywhere. However, there will be a proportion of donor country expenditure in this assistance. From a recipient country perspective such practices may also appear a grey area in the sourcing of aid. A possible issue for future investigation is the effect that channelling of aid through NGOs has on sourcing of goods and services.

The share of HQ level contracting is quite restricted, amounting to under 5% of ODA. The EEA and EFTA trade frameworks mean that Norway and also Switzerland (see below) follow EU guidelines quite closely on thresholds for competitive tendering.²⁵ This practice explains why there are severe and Europe-wide limits on donor tying possibilities.

²⁴ A similar problem of lack of incentive to innovate was found in an evaluation of US food aid support for nutritional improvement. Products developed in the 1960s were still being supplied from dedicated processing facilities three decades later, without taking into account advances in nutrition and food fortification (Marchione, 2002).

²⁵ The current thresholds (according to Norwegian Government regulations) require national tendering over NOK 500,000. Above NOK 1.2 mn an open international tendering is required. Contracts for tender are posted in English as well as Norwegian on the Norad web-site and also forwarded to Brussels to post on the EU's procurement web-site. Norad does not post contracts on the UN business web-site. Direct contracting is allowed below NOK 100,000. Between NOK 1,000,000 and NOK 500,000 Norad is expected to invite at least three proposals on the basis of a simplified invitation.

²³ There are parallels with the Pergau Dam affair that led to a political commitment to complete unttying of UK bilateral aid first by abolishing the Aid and Trade Provision in 1997 and full final unttying in 2000.

Mixed Credit Arrangements (MCAs) are an example of how untying may lead to the decline in use of aid instruments. Norway and others that have so far retained them could phase them out (Box 4.1).

Box 4.1 The Decline of Mixed Credit Arrangements

MCAs were widespread and have been contracting sharply since the adoption in 1991 of the Helsinki Accord Rules on export and aid credits. This instrument was designed to operate in a tied aid environment, funding infrastructure and power projects, for example. Currently the Norwegian MCA provide around NOK 100 mn annually, although this amount is variable. Prior to untying the level was around NOK 300 mn a year. Projects of over NOK 5 mn are considered. All contracts are internationally tendered and this has proved problematic. Tied MCA could offer a predictable package including timing, guarantees, private loans and suppliers. Untied, the MCA is not a full financing package – as the agency is unable to assure more than the interest subsidy on part of the funding with the remainder coming from a commercial source that in turn needs guarantees in place. Thus a project for Lao PDR in 2006, as part of a World Bank assisted project, was very slow to organise under international competitive tendering rules. China ended its Norwegian MCA when it became untied and China could no longer specify the exact source of supply for the equipment. Switzerland has phased out MCAs, but Denmark continues to provide them mainly for infrastructure to non-LDCs. Canada provides only grant aid and Australia has ceased to make new commitments as loans.

The residual areas of *de facto* tying and contracting practice under an untying regime raise the interesting and important issue – *when is the market the most appropriate regulator?*

4.2.2 Denmark

Development is accorded high priority in Denmark; this is reflected in a net ODA/GNI ratio of 0.8 even after a decade of little growth in real ODA. Over two thirds of all Danish bilateral aid had been untied prior to 2002 (Figure 4.1). This untying process has continued, including both TC and food aid, and in 2007 over 88% of bilateral aid was reported as untied (Table 3.2). Tying has been retained for mixed credits. Support for private sector development (B2B) is an ambiguous 'grey' area in bilateral programmes, because assistance is usually directed to building links between business in the recipient and donor countries. These two areas amounted to respectively US\$ 32 mn and US\$ 20 mn in 2006.

Historically, a high proportion of Danish aid was tied, with strong links, for example, to agriculture and agribusiness as well as high tech areas. The EU regulations on public procure-

ment, introduced following the creation of the European Single Market in 1992, provided a strong impetus for the untying of all Danish bilateral aid, including TC and contributions to multilateral food aid. The requirements for open competitive tendering within the EU for 'large' public contracts over the threshold, which is now € 125,000, weakened the links between aid and domestic exporters. The argument of cost-effectiveness was used to justify, for example, switching Denmark's share of the EU's FAC cereals aid contribution from HQ procurement to giving cash to WFP (Colding and Pinstrup-Andersen, 1998). The tied supply of dairy products as aid was also ended in 2003.

Denmark has deliberately retained some tying in support of private sector development and to fund infrastructure, accounting for around 2-3% of ODA.²⁶ The Mixed Credit Programme, largely directed to non-LDCs, is seen as sustaining domestic business support for a proportionately high level of aid. Tendering rules are increasingly flexible: contractors are allowed to source goods and services outside of Denmark, and, if there is insufficient domestic interest, non-Danish registered companies can compete.²⁷

B2B is seen to be largely demand driven. Developing country businesses are invited to seek assistance from donor country offices in finding partners. Such directed assistance is seen as responding to information problems that hamper business development in partner countries. Both the Mixed Credit Programme and B2B have been subject to recent evaluations, leading to adaptations in practice to improve performance (Danida, 2002; 2004).

The high proportion of untying is seen as associated with decentralisation of bilateral aid programming and management to country level. Enhanced procedures have been established for monitoring country office performance. Where there is strong governance and capacity in place, policy is to channel funds through partner institutions administered according to their own systems, as exemplified in South Africa (Phase One, Box 4.2). Denmark is also supporting the strengthening of recipient procurement capacity, for example in Bangladesh and Tanzania. A second route is joint funding where contracting becomes the responsibility of another lead donor. The third possibility is contracting according to Danish procedures. EU directives on public procurement govern contracting. The high transaction costs

²⁶ The government elected in 2000 was more questioning than its predecessors about the value of aid, cutting the aid budget by around a quarter; and that was a possible reason for retaining instruments that command support in the business community.

²⁷ The Danida Board, which advises the Minister for Development Cooperation on matters related to Danish development cooperation, is a distinctive institutional feature which is indicative of links between domestic stakeholders and aid strategy. The Board reviews and comments on new projects and programmes (or new phases of these) and discuss major strategy issues. It is comprised of nine members appointed by the Minister. Members come from different organisations (interest groups) in the Danish society such as NGOs working on development issues, the Danish Industry, universities and workers organisations.

and time required might explain the declining use of contracted projects that required open competitive tendering in favour of other modalities.²⁸ Danida is exemplary in being transparent about its contracting: ICT continues to award predominantly to Danish companies and their partners (Box 4.2). This outcome is consistent with other donor practice as reported to the DAC and is suggestive of a persistent, but in this case declining, advantage held by domestic organisations.

Box 4.2 Transparency: service procurement by Danida HQ

In 2006 Danida entered into 20 service contracts with a total value of DKK 254 mn. Danish companies accounted for 15 contracts with a total value of DKK 199 mn. About one third of the contracts with Danish companies were in joint venture with foreign companies. Danida received 118 applications for the 20 tenders, with 41 being from foreign companies.

In 2007 Danida entered into 14 service contracts with a total value of DKK 163 mn. Danish companies accounted for 12 contracts with a total value of DKK 157 mn. About half of the contracts with Danish companies were in joint venture with foreign companies. Danida received 68 applications for the 14 tenders with 29 being from foreign companies, which suggests an increasing interest from foreign companies.

Service contracts tendered by Danida*	2006	2007
Total number of contracts	20	14
Number of contracts with Danish companies	15	12
Total value of contracts in DKK mn	254	163
Total value of contracts Danish companies in DKK mn	199	157

*Note: * The contracts are tendered according to the rules and procedures of the EU-directive on procurement. Contracts under the threshold of the EU-directive are awarded according to Danish procurement rules. The contracts are completely untied. In 2008 Danida entered 520 such contracts to a total contract value of DKK 190 mn.*

Denmark has also engaged in efforts to untie TC, which by 2006 was free of sourcing restrictions. Research and higher

28 In 2006 procurement through HQs had fallen to around 5% of bilateral ODA (OECD DAC, 2008b). Contracts of less than DKK 500,000 can be contracted directly. Then under DKK 975,000 (€ 125,000) there is a letter of notification; and evidence is required of three offers, but not a formal tender procedure. Over DKK 975,000 Danida is required to make an international openly competitive tender (equivalent to € 125,000 under EU directives); and this typically needs seven months for full procedure, a committee established involving partners, embassy and technical advisory services.

education remain areas where funding is primarily directed to Danish institutions.²⁹

4.2.3 Switzerland

Swiss ODA has increased by 47% in the past decade. However, the share of ODA in GNI is 0.4% and Switzerland has made little progress since 2001 towards meeting the UN 0.7% of GNI target for ODA. 98% of Swiss bilateral ODA commitments in 2007 were reported as untied (Table 3.2).

Switzerland's aid was overwhelming untied prior to 2002 (Figure 4.1).³⁰ The key moment in moving on untying was 1994, when the current framework within which almost all Swiss ODA is formally untied was established in response to three developments: the Helsinki Accord in 1991, the introduction of the EU single market in 1992 and the 1994 WTO Uruguay Single Undertaking (i.e. agreement on trade) (Switzerland 1994; 1995; 2007a). Switzerland, as an EFTA country, broadly adopted EU rules on public procurement of aid, similar to the EU, enabling companies registered within the EU (15) in 1995 and the EEC to compete on an equal footing.³¹ Tying practices were gradually phased out. The State Secretariat for Economic Affairs (SECO), which is responsible for Switzerland's ODA under economic development cooperation, phased out mixed credits from the late 1990s. In meeting FAC commitments the Swiss Agency for Development and Cooperation (SDC) began to replace cereals food aid in-kind with cash from 1995 (Ferreira Duarte and Metz, 1996).

Remaining areas of *de facto* tying include dairy aid and emergency relief.³² In-kind dairy aid, costing US\$ 15 mn in 2006, was directed solely for use in nutritional programmes, thereby minimising risks of trade distortion, and justified as sustaining support for aid. In-kind emergency aid includes the high profile direct assistance provided by the Swiss Humanitarian Aid Unit.

Untying is non-controversial, with Swiss business perceiving itself as competitive in its areas of specialisation. Nevertheless, since

29 Grants are primarily awarded to research in Danish programme countries and within the yearly prioritised research themes. Priority is given to larger strategic research projects/programmes with partners in developing countries, and collaboration between several Danish institutions. Capacity building of these partners has for many years been a high priority for Denmark and so the majority of the budget is provided to them. Apart from this type of support, international research institutions are supported e.g. the Consultative Group for International Agricultural Research (CGIAR).

30 Swiss ODA is determined within a four year 'credit framework' under which annual appropriations are made. A large share of the bilateral portfolio is taken up with follow-on actions, suggesting that international commitments such as the MDG and the 2001 Recommendation have not been significant influences on the real level of ODA.

31 While a member of EFTA, Switzerland is not party to the European Economic Area Agreement. Regulations governing trade with the surrounding EEA countries tend to meet or exceed the requirements of EU Directives. http://www.euro.cauce.org/en/countries/c_ch.html

32 Switzerland did not report to the CRS the tying status of TC and administrative costs commitments in 2006 explaining the high level of non-reporting shown in Figure 4.3.1.

1994 SDC has commissioned four yearly investigations into the impact of ODA on the Swiss economy (GDP) and employment. These studies have indicated a ratio of between 1.40-1.60 of output in association with every CHF in ODA which have not been affected by progressive untying of aid (Zarin-Nejadan *et al.*, 2008).

Civil society has a major role in Swiss ODA, including NGOs, research institutions and universities, the private sector and the Geneva based ICRC, with which there are strong historic ties. In 2006, almost 21% of Swiss ODA (24% of SDC and 8% of SECO funding) was channelled through Swiss based organisations. Sourcing of goods and services was largely untied, excepting dairy food aid (Switzerland, 2007b).

The relatively high proportion of multilateral aid, NGO channelling (together 40% of ODA) and the use of direct bilateral assistance instruments limited SDC HQ's procurement of goods and services to under 11% of SDC bilateral aid in 2006. Around 85% of this funding was then directly contracted, largely because of the practice of exempting on-going projects (74%) from competitive tendering requirements.³³ International competitive tendering included only 2% of contracts. Non-Swiss organisations accounted for 9.6% of contracted funding. Consequently, the effects of untying practices are largely intermediated through the channelling of ODA, including forms of direct bilateral assistance such as sectoral and budgetary support as well as unrestricted support to NGOs and the ICRC. Untying is seen as associated with a strong policy commitment to joint funding and decentralisation of management to a country level. There is considerable interest in a better understanding of how untying has functioned and its consequences at a country level.

4.2.4 Canada

Levels of Canada's total and bilateral ODA have risen substantially during the process of untying, especially since 2004. Only food aid, a category of ODA exempt from the DAC agreements on untying, and prior to 2006 virtually all tied aid, declined in real terms. Untying and tying policies would appear to be an issue about the composition of aid and not about overall levels of aid.

Historically, Canada was a donor that gave its bilateral aid largely tied. Since 2002, significant steps have been taken to untie ODA, both in accepting the Recommendation and going beyond it; aid to non-LDCs, TC and food aid have been untied in response to evidence on effectiveness and efficiency. Prior to 2002, around 50% of bilateral ODA was untied and 6% partially untied (Figure 4.1). By 2007, at least 69% of bilateral aid was untied, 17% tied, 1% partially tied and 13% not reported (Table 3.2). The remaining areas of tying are outside the Recommendation: TC and emergency or disaster relief.

³³ The SDC categories are that procurement under CHF 50,000 can be directly contracted. Contracts up to approximately CHF 250,000 (limited to the EU directive € 125,000) are subject to an invitation procedure. Above that level a public call to tender is required. However, 'ongoing' (Folgephasen) projects are exempt (Switzerland, 2007a). In 2006, 9.5% of contracts were under CHF 50,000, 74.2% were ongoing, 14% subject to invitation and 2.2% open to competitive tender.

The Recommendation had an important influence on untying policy. Prior to 2002, the greater part of CIDA's ODA was tied to procurement in Canada, with a requirement that goods and services had a majority of Canadian content covering about 8% of total ODA. The previous 1987 policy, which coincided with the DAC determination of tying status, called for partial untying (50% in the case of LDCs and SSA). Procurement in the industrialised countries was restricted to 10% and permissible only when local or Canadian sourcing was impractical. The Recommendation was incorporated in 2002 into CIDA operational guidance, and eligibility to bid on CIDA contracts extended to LDCs and SSA. International competitive tender outside the Recommendation can be sanctioned on a case-by-case basis. Food aid was exempt, but untying of TC permitted. However, untying has been separately extended to food aid, initially to 50% of funding on a partial untying basis in 2005, and then the full untying of all food aid in 2008. Later in 2008, CIDA committed to fully untying all its bilateral aid by 2012/13.

Partial untying to allow developing country sourcing has been an important step towards full untying. The absence of reciprocity on the part of Canada's neighbour and major trading partner, the USA, was a major factor in exempting ODA from NAFTA rules that would have allowed US organisations to compete. Sourcing restrictions were initially modified to allow developing country sourcing. Full untying was seen as politically difficult as illustrated by the case of food aid (Box 4.3).

Box 4.3 Untying Canadian food aid

Canada has been a food aid donor since the 1950s, exporting cereals, oil seeds and dairy products, both as direct distribution and as budgetary/BOP support. Then, in 1998, a Performance Review highlighted resource transfer inefficiencies of Canadian programme food aid and the similar experience of other donors. At that stage untying was not considered a practical option, so the focus shifted to making targeted nutritional improvement the primary goal and programme aid for sale was phased out. There was very limited partial untying to allow local procurement. In 2005, in the context of WTO agricultural negotiations and citing further OECD evidence on resource transfer efficiency, a policy decision committed CIDA to partial untying of 50% of funding. In 2008, food aid was fully untied. These steps were made following NGOs meeting with domestic agricultural interests to emphasise the benefits of local and regional sourcing for developing country small farmers and the likely negligible effects on Canadian agricultural exports.

Presently the main areas of tying are TC, 76% untied in 2007 (as reported in 2009 DAC Progress Report), and sectorally both education and support to governance and civil society which have a high TC component, as well as emergency assistance and recon-

struction. The full extent of channelling of aid through Canadian NGOs is unclear but, in contrast to practice on the part of European donors, until recently CIDA reported such aid as tied, even where they were in fact free to source in developing countries.³⁴

The decision to untie, in accordance with the Recommendation, required the formulation of new operational guidance and an undertaking with the Treasury Board on exemptions from normal public procurement guidelines: a condition of these changes was a commitment to monitoring and evaluating the consequences of untying, so the process is well documented. In preparation for a review the evaluators formulated a logic framework to make more explicit the objectives of untying from a donor perspective. This has been of assistance to Phase Two of the OECD thematic study (see below Chapter 5).

In contrast to European donors, for whom regional trade arrangements have been an important influence on aid as a form of public procurement, aid programming lies outside of the NAFTA obligations because of a historic lack of reciprocity. Otherwise, Canadian companies would have had access to bid on US aid contracts – but they do not.³⁵

4.2.5 Australia

Prior to 2001 about 55% of Australian bilateral aid was untied. Historically, only a small share of ODA was multilateral (15%) and there was a geographical focus on neighbouring countries with around half in the form of TC. Australia then moved to untie some components of its aid to LDCs in consistency with the 2001 Recommendation, and in 2004 Australia reported 89% of its aid as untied (Figure 4.1).

In 2006, the policy of untying was extended to include virtually all ODA in recognition of its role in improving effectiveness and efficiency. Untying is seen as increasing partnerships between donors and partner governments, strengthening ownership and achieving greater value for money through competition (AusAID, 2006). In a separate decision, food aid has been wholly untied. In consequence, almost all bilateral ODA has been untied with a few specific exceptions such as TC in post-secondary education and the Australia-Indonesia Partnership for Reconstruction and Development that continues up to 2010.³⁶ In 2007 98% of commitments to LDCs and 96% of all bilateral aid were reported as untied, indicating how quickly the policy to untie aid has been implemented (Table 3.3).

³⁴ As of the beginning of 2008 all Canadian partner agreements are free of conditions on grant use and so are from the donor perspective untied. Past differences in donor reporting are another indication of the difficulty of inferring trends in tying practices.

³⁵ However if funding is from CIDA's Operation and Maintenance (O&M) budget, then there is an obligation to allow for competitive bidding by firms from NAFTA partner countries – as this represents the procurement of goods and services for CIDA's own account and not that of developing countries. There is a threshold of CND 76,500, however, for NAFTA (including GST – Goods and Service Tax) for which CIDA have to go through a competitive process through the Canadian Public Tendering System (MERX) that allows for NAFTA competition.

³⁶ Under this agreement, which predates the untying policy, Australia also provided A\$ 500 mn worth of concessional loans.

Throughout the process of untying, net aid has risen broadly in line with economic growth rates so the ODA/GNI ratio has remained stable at around 0.3%. This pattern reflects domestic public expenditure priorities which constrained the levels of aid. At the same time, an emphasis on value for money in use of the resources underpinned the commitment to untying (AusAID, 2006).

Prior to 2001, bilateral trade arrangements with New Zealand gave favoured nation status.³⁷ These agreements influenced public contracting under (national) Commonwealth Procurement Guidelines (CPG) (Australia, 2004). Since 2005, ODA has been specifically exempt from Division 2 of the CPGs (the Mandatory Procurement Procedures), which establish an A\$ 80,000 open tender threshold (AusAID, n.d.). Due to this exemption, AusAID has established its own threshold (A\$ 500,000) below which direct contracting is permissible. Again, to provide flexibility, procurement can be undertaken below the threshold by country offices. Follow-on exemptions from competitive tendering are allowed, but only as exceptions to the rule. Efforts are made to make tendering genuinely international (Box 4.4).

Box 4.4 Information about AusAID open competitive tenders

Recognising that the problem of information can restrict competition, invitations to tender for large contracts are posted not only on the government's own tender website (AusTender) but more widely. The following locations are typically used:

- DAC Untied Aid Website;
- dgMarket (<http://www.dgmarket.com/> – the tenders and consulting site attached to the US Development Gateway);
- UN Development Business (UNDB) website (recently signed up, but will now be standard);
- Newspaper advertising – usually in the Weekend Australian, and may include other Australian or overseas papers as appropriate for the tender (e.g. The Economist, The Sydney Morning Herald, The Canberra Times, The Age, Australian Financial Review, etc. as well as local papers around Asia and the Pacific.); and on occasion
- Other websites (such as the Australian Development Gateway), email newsletters and industry journals.

The immediate benefits of untying are seen from the AusAID perspective as both greater operational flexibility, allowing not only budgetary and sectoral support, but also contracting, as in Vietnam, according to partner government procedures. Untying widens the pool of international expertise and hence

³⁷ These are the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) and Australian and New Zealand Government Procurement Agreement (ANZGPA). There are post 2001 arrangements with USA (2005), Thailand (2005), Singapore (2003) and with Chile that comes into force in 2009: all are contributing to a context favouring non-discrimination as a key principle underpinning procurement.

reaps better value for money from aid delivery teams. Untying is also explicitly associated with strengthening of joint funding with other donors. For example, the effectiveness of TC, historically the major area of aid tying, has been jointly evaluated by AusAID with Danida and BMZ, providing further guidance on implementing these policies (Land, 2007).

4.3 Findings

Performance on untying

All five donors have successfully responded to the Recommendation, in four cases virtually untying all of their bilateral aid in the 'eligible categories' and the fifth, Canada, is committed to do so by 2012/13. All have extended untying beyond the categories covered by the Recommendation, both to include non-LDCs and untying of TC and food aid. Formal tying, namely sourcing in the donor country, has largely been phased out.

So far the widespread moves toward untying have not been subject to systematic monitoring or evaluation. There are a few project or sectoral evaluations that may offer insights. Rather than providing answers, discussions with officials at donor HQ lead to the question – how does untying actually work? What is the experience of other donors? So it would be premature to do more than speculate on the likely consequences of the extensive untying of aid in the past decade that has gathered pace since the 2001 Recommendation.

Additionality of tied aid?

First of all, in considering overall ODA, there is no evidence that untying has been associated with any reduction in bilateral aid or in overall ODA, and with one exception, Denmark, ODA has risen significantly in real terms since the Recommendation. In Denmark's case, domestic political considerations rather than untying of aid perhaps had a negative impact on ODA at the beginning of the decade.

The evolution of policy on untying

The experience of the five donor countries illustrates how the Recommendation has had different implications, especially significant for those DAC members that had previously taken very limited steps towards untying. Canada had to introduce legal and internal regulatory instruments and then develop procedures for the administration of untied aid. In contrast, for Australia untying required a ministerial decision to move the aid programme into line with recent government guidelines, which have non-discrimination as a key principle underpinning procurement.

Untying is widely seen as closely linked with decentralisation of responsibility for aid programming to a country office level. So many of the questions about how it works and impacts are felt to be answerable only at a partner country level. This issue is taken up in Chapters 6 and 7.

The survey suggests that untying has been associated with a shift to instruments that pass responsibility for disbursement to country partners, other joint donor partners, and civil society organisations, and so reduces the donor's role in contracting organisations to implement projects (Denmark, Norway, Switzerland). However, in the much reduced level of HQ contracting the proportion of awards to foreign organisations is very low. Two factors, policy choices in the selection of priority sub-sectors and the way contracting is organised, especially in providing TC, appear to involve a substantial element of *de facto* tying.

There are several remaining relatively small *grey areas* of tying practice. These tend to be justified on conventional grounds of sustaining domestic support for aid through the support of interest groups, and of providing visible evidence of a direct link between bilateral aid and impacts in beneficiary countries. This is a factor behind the substantial levels of emergency and humanitarian aid provided both in-kind and through personnel. A possible issue for future investigation is the effect that channelling of aid through NGOs, presumed to be untied, has on sourcing of goods and services. Although outside the Recommendation all five donors have largely removed formal tying requirements for food aid, whereas TC, support to governance, post-secondary education and research are areas of continued tying. However, there are other arguments that require careful consideration. The justification of Business to Business (B2B) cites problems of access to information about global markets that disadvantage private business development in many developing countries. Are there in fact areas in which markets alone are not necessarily able to deliver (i.e. emergency equipment) or are not the best regulators?

5. THE IMPACTS OF TYING AND UNTYING: A LITERATURE REVIEW

5.1 Introduction: objectives and scope

This chapter reviews the literature on the impact of tying and untying practices on the donor and the recipient country. The early literature has been reviewed (Jepma, 1991) and so the intention is to consider whether more recent studies confirm earlier findings, provide better explanations of what are complex relationships or are going in fresh directions. When most bilateral aid was tied the effectiveness and the impact of untied aid was at best a subject for speculation and hypothesising. So the objective here is to provide a preliminary account of a still little investigated field.

The review covers academic literature, contributions from civil society, information gathered through visits to donor agencies and internal donor reports. It focuses first on the conceptual framework underpinning the literature, then considers the contribution of more recent (since 1991) quantitative investigations into effects of tying on the recipient and the donor country, and finally considers the extremely limited literature on the impacts of untying.

5.2 The effects of tying: conceptual issues

The most significant contributions in the literature from an analytic perspective (Chilchiniski, 1983; Bhagwati *et al.*, 1983; Kemp and Kojima, 1985; Schweinberger, 1990; Hatzipanayotou and Michael, 1995; Lahiri and Raimondos, 1995; Brakman and van Marrewijk, 1995) have set out the anticipated consequences of tying and established the conceptual framework for quantitative estimates of the effects of tying practices. The broad conclusion of all these studies is that tying practices are likely to result in welfare losses for recipient economies compared with the alternative of unrestricted aid transfers made in the form of foreign exchange. Regarding the donor economy as part of a three-economy world in which the recipient, donor and 'other countries' trade, the welfare effects are unclear. The global consequence is likely to be a reduction in welfare when compared with unrestricted trade. The limitation of such modelling is the inherent

difficulty of inferring what will be a better policy in a second best world.³⁸

A degree of caution is necessary when examining the assumptions and approaches employed, as they may reduce the relevance of the findings and restrict their practical applicability. The use of these models becomes problematic when conventional assumptions do not hold. Perfect competition and information are often assumed; findings may differ depending on whether the transfer is tied to manufactured goods or primary commodities. Findings may also vary according to whether the goods are private or public, consumption or investment, tradable or non-tradable, on whether flows are considered to be temporary or permanent, on the extent to which different characteristics of the economies are taken into account, or on the existence of quantitative trade restrictions, and so forth. Finally, the methodological approach used in the analysis (comparative static versus a comparative dynamic model) may influence findings, undermining their relevance in practical analysis.

A consequence of the gulf between theory and reality is a multiplicity of possible special cases. For example, those arguing in favour of tying practices may claim that in a particular case the efficiency gains of untying are negligible and should be set against the practical reality that tying sustains higher levels of aid. A further issue is that, as circumstances change, the attempt to empirically explore the consequences of untying may change. For example, the policy literature as it relates to tying, points to the need to unpack the third 'other' economy. It may no longer be other donor industrialised economies, the implicit assumption in agreements to contain competitive tying such as the FAO Rules on Surplus Disposal for food aid (1955) and the Helsinki Rules on export credits (1991). Instead in some contexts the 'other' economy may be neighbouring developing countries or emerging economies, including non DAC donors.

³⁸ For a more detailed review of studies on foreign aid and trade policies see Suwa-Eisenmann and Verdier, 2006.

5.3 The effects of tying: evidence

Most investigations that attempt quantification have focused either on the impact of tying on the recipient countries in terms of its efficiency losses, or on its impact on the donors, mainly in terms of the assessment of potential economic benefits. So it is appropriate to consider these strands of the literature separately.

5.3.1 Effects of tying on recipient countries

The first strand of the literature on tied aid has focused on the impact of tied aid as a distortion imposed by aid policy on the recipient. Most of the empirical studies have tried to determine the extent to which tying practices represent a cost on recipients through overpricing, as aid-financed goods and services sourced in the donor country may in fact be consistently more expensive than those available to the recipient from alternative sources. Thus, tying reduces the value of aid if not necessarily wholly offsetting the benefits of concessionality. Beyond assessing direct costs of restricted sourcing, there is some exploration of the indirect costs and other factors that could reduce the potential net benefits of aid.

The attempts to quantify the costs of tying have been hampered by several practical limitations. First of all, data availability constrains the estimates; secondly, to determine with precision the likely impact of tied aid on the recipient requires a knowledge about the existence of informal tying practices (Jepma and De Haan, 1984) and the degree of fungibility, or the extent to which aid-financed imports might substitute for commercial imports which would have occurred anyway (Bhagwati, 1985). Therefore, estimates of the costs of tying to the recipients should be regarded as rough approximations (Jepma, 1991).

Resource transfer efficiency: Jepma (1991) in the most widely cited review of the early literature (1960-90) concludes that the excess cost to recipients is in the range of 15-30%. This estimate was made notwithstanding the existence of studies which report substantially higher costs, implying that the most widely cited numbers are a conservative, lower limit estimate of the costs of tying.

After 1991, there are fewer studies on the impact of tied aid on recipients. Some studies on the resource transfer efficiency model (RTE) estimate the direct excess cost of tying (Yeats, 1990; Yassin, 1991; Osei, 2004; Osei, 2003; OECD, 2006a). This approach quantifies the costs of tying by comparing procurement prices under tied aid with the cost of alternative commercial transactions that could have been procured in the absence of tying restrictions. The findings largely reconfirm Jepma's conclusion: procurement prices of tied aid are typically higher and the mark-up in prices of funded goods and services is often over 20%. A similar conclusion (overpricing in the range of 5-25%), although using a different approach, is found by Aryeetey *et al.* (2003) who interview project managers to provide estimates of the additional cost of tying with respect to open competitive bidding. Further qualitative

evidence on the direct excess cost of tying is also provided by country-based examples (Chinnock, 1998; Chinnock and Collinson, 1999; ActionAid, 2003; ActionAid International, 2005; ActionAid International, 2006; ODA, 1996).

The mark-ups may differ significantly among funded goods and services; in particular, the price differential is especially high for those products provided on a one-off basis (Osei, 2003), or characterised by a higher technology component (Osei, 2004). Moreover, the excess costs of tying aid may be systematically higher than Jepma's 15-30% band for particular types of aid, such as TC (Williams *et al.*, 2003; Riddell and Stevens, 1997) or food aid (Barrett and Maxwell, 2005; OECD, 2006a; US GAO, 2005).

Some studies have also examined the impact of excess costs on the concessionality of aid using the shadow grant element approach, which involves computing the grant element of aid, taking into account that the worth of a tied loan is actually less than its nominal value because of the effect of the excess cost of tying (Yassin, 1991; Osei, 2003; Morrissey and White, 1996). They find that the real worth of aid is severely reduced by the attached tying restrictions (Yassin, 1991; Osei, 2003), although not all the benefits of concessionality seem to be wiped out by direct excess costs (Morrissey and White, 1996). Given the harder terms on which mixed credits are offered and the related high excess costs of tying, associated finance is found to reduce the concessionality of aid more than other tied aid credits (Morrissey and White, 1996).

Many investigations highlight additional ways in which tying indirectly reduces the net value of the aid transfer. There are indirect costs such as additional recurrent costs and shipping expenses. Other non-price factors can entail actual reductions in the stream of potential developmental benefits of the transfer, such as delays in delivery, the quality of funded goods and services, the inefficient allocation of resources following from highly inappropriate or lower priority purchases or selection of projects; environmental impact of some sectoral aid flows, e.g. infrastructure; factors related to the trade impacts of tying, where it becomes a barrier to accessing markets and promoting inter-regional trade, or impacts on the local market (Jepma, 1991; Jepma, 1994; Bhagwati, 1985; Ensign, 1992; Hendra, 1987; Belfrage, 2007; Barrett, 1999; ActionAid, 2003; Chinnock, 1998; Chinnock and Collinson, 1999; ActionAid International, 2005; ActionAid International, 2006). Tied aid credits may also impact on a recipient country's external debt (Larrú, 2003; Hendra, 1987); some evidence suggests that being a recipient of tied aid increases a country's external debt, at least in the medium term (Alonso, 1999; Larrú and Gonzales, 2004; Abildsnes, 2007).

As emerging donors increase their aid to developing countries, their policies and practices become more relevant. The appearance of new (non OECD) donors who may not feel obliged to comply with voluntary DAC rules, brings for LDCs the risk of incurring once again the costs of unsustainable, unproductive capital projects (Manning, 2006; Pehnelt, 2007; Gill

and Reilly, 2007; McCormick, 2008). It should be highlighted, however, that emerging donors' tied aid (especially Chinese and Indian), with its packaged approach, is wholly unevaluated from either an efficiency or effectiveness perspective (Paulo and Reisen, 2009; Collier, 2008). Thus the argument about whether this tied aid is in fact cost-effective as compared with previous experience is inconclusive.

Finally, tying practices may also have an impact on recipients' behaviour or attitude towards aid, often characterized as a 'lack of ownership', which is outside the formal economic calculations. Recipients learn to request aid financing from donors in those specific sectors which donors are willing to finance (Hendra, 1987) and to wastefully 'cherry pick' tied aid packages. Such practices reduce the value of aid from the donor perspective. However, they also contradict the view that tying often renders recipients as passive actors in the development process with the standard example of machinery inappropriately provided by donors lying broken while recipients are left waiting for spare parts or technical assistance (examples in Hendra, 1987; ActionAid, 2003; Chinnock, 1998; Chinnock and Collinson, 1999; ActionAid International, 2005; ActionAid International, 2006).

To sum up, the recent literature on the impact of tying on the recipient country broadly reconfirms earlier findings that procurement costs of tied aid are typically over 15%-30% higher than actual and hypothetical untied alternatives. Price differentials may vary significantly among funded goods and may systematically be higher for some forms of aid. There is support too for earlier findings, using more refined evidence-based approaches, including on the reduction in the real concessionality of associated funding. The importance of indirect costs and non-price factors in assessing the impact on recipient countries is confirmed.

Overall, there is broad agreement in the literature that tied aid involves a substantial loss of value to recipients, but little systematic investigation into how different forms of tied aid may impact on recipients and on particular sectors. This greater specificity of focus and the impact of emerging donors' aid practices on recipients would seem to be priorities for further investigation.

5.3.2 Effects of tying on donor countries

The primary intention in tying an aid transaction is to favour suppliers in the donor economy relative to the rest of the world. This effect would either displace commercial exports that would have occurred without the aid transaction or, assuming a higher level of imports, entail a disproportionate increase in the donor's exports compared with competitors.

So if tying is effective, donors will derive benefits from *increased trade* that are more than proportional to their share of world export markets. More recent studies indicate that the real impact of tying on donors' exports is quite limited (Tajoli, 1999; Johansson *et al.*, 2006; Lloyd *et al.*, 2000; Lloyd *et al.*,

2001; Osei *et al.*, 2004); often when aid flows are found to have a significant positive impact on exports, this is even more so as the proportion of untied aid increases with time³⁹ (Schönherr and Vogler-Ludwig, 2002; Zarin-Nejadan *et al.*, 2008; Martínez-Zarzoso *et al.*, 2008). Sectoral studies, and in particular those on food aid, offer support for this thesis; food aid is usually found to be not fully additional.⁴⁰ Some studies, however, find a substantial positive relationship between aid flows and exports from donor countries (Nilsson, 1997; Wagner, 2003; Larrú, 2003; Larrú and González, 2004; Nowak-Lehmann *et al.*, 2008). Sectoral studies, again for food aid, offer some empirical evidence of this positive relationship. A credible sequence of impacts is that commercial food imports are reduced in the short term and there is a lagged increase in exports in the long term (Barrett, 1998; 1999). The overall impression is that 'it all depends' on the temporal specifics of goods and markets.

Similarly certain forms of aid (debt relief, budget support, technical assistance and remaining mostly project type aid) are expected to have different impacts on donors' exports; due to the lack of data availability only a few studies (Johansson *et al.*, 2006; Johansson and Pettersson, 2009) have investigated this hypothesis and it is therefore not possible to draw well-founded conclusions.

Economic literature has been largely silent on trade distorting impacts of different aid instruments. An ODI study however shows that grants and loans, and therefore the level of concessionality *per se*, do not seem to have differential trade distorting impacts beyond tying practices (Clay and Turner, 2007; Massa and Te Velde, 2009; Clay *et al.*, 2009).

Aid, and in particular tied aid, is also likely to have different impacts depending on the sector (economic infrastructure, social sector and so forth). Sectoral differences, although acknowledged, have not been thoroughly analyzed. Johansson and Pettersson (2009), in order to take into account that aid flows impact might be heterogeneous, disaggregate exports by category.

In general, disaggregated analysis has been limited, constrained by lack of data. There are further important qualifications to be made on the robustness of these findings. First, studies rarely disentangle the impact of aid on the donor country in terms of exports directly financed by tied aid and those that are not (Jepma, 1994). Secondly, fungibility is usually not taken into account; yet this could consistently affect findings. There are indications that the substitution effect is fairly large (Jepma, 1991; Khilji and Zampelli, 1991; Pack and Pack, 1993; Feyzioglu *et al.*, 1998; Devarajan *et al.*, 1999). However, there may be cases in which the recipient country

39 This is known as the goodwill effect; as a result of untied aid flows, the recipient might feel more inclined to buy goods and services directly from the donor.

40 When food aid is provided for sale on the recipient market the ratio of aid to displaced imports has been found to be around 0.6 tonnes for each tonne of aid (FAO, 2006). The displacement is lower, around 0.3 of directly distributed food.

is not able or willing to exploit such fungibility possibilities (Bhagwati, 1985). Finally, the displacement effect, the extent to which the domestic or export demand for domestic inputs is displaced by the demand to meet tied aid exports, should not be underestimated, as it could entail a reduction in the net impact of tying on the donor (Morrissey, 1989; Jepma, 1994).

Moreover, empirical investigations have usually focused on the impact of aid on donors export flows; however, aid could also influence recipient exports (Johansson *et al.*, 2006; Johansson and Pettersson, 2009). Johansson and Pettersson find that aid flows have a positive effect not only on donor-recipient but also on recipient-donor exports and conclude that the donor-recipient aid relationship reduces 'the effective cost of geographic distance', impacting positively on trade flows and not only on export flows.

A few studies attempt to assess whether donors' tying practices lead to a net increase in employment in their countries (Jepma, 1991; Malek *et al.*, 1990; Morrissey, 1990; Morrissey and Rudaheranwa, 1998; focus on mixed credits: MacQuaide and Toye, 1986; Love and Dunlop, 1990; Morrissey, 1991). The conclusions are that tying of aid is not successful in generating substantial employment in donor countries but financial benefits seem to accrue to particular firms and groups in the donor country. Tying is a way of making internal transfers funded, usually through general taxation, to these beneficiary interest groups.

As tied aid has been justified for the positive impact expected on donors' balance of payments (BOP), some early studies make an attempt to empirically test this proposition and find a negligible impact (Hopkin, 1970; Levitt, 1970). Associated financing seems to have a proportionally more positive impact on the donor's BOP (Jepma, 1991; Toye and Clark, 1986).

Finally, it should be recognized that tying aid, and specific cases of aid malpractice, can have an important political rather than a narrowly economic impact on the donor country, as illustrated by the following examples. The Pergau dam scandal in the UK had longer term repercussions as it added momentum to the existing developmental concerns within the government, pushing towards a policy shift and the decision to untie British aid (Chinnock and Collinson, 1999). In Norway the Ship Export Campaign had important repercussions, leading Norway to offer debt forgiveness to the developing countries involved and recognizing irresponsible lending (Abildsnes, 2007, and see above Chapter 4).

Literature on tied aid is still very thin from a legal perspective; apart from a few articles tied aid has rarely been referred to in legal literature where a thorough analysis of tying practices and the connections to the current WTO legal framework is still missing (La Chimia, 2009).

To sum up, the more recent literature on the impact of tying on donor economies broadly reconfirms earlier findings; the

macroeconomic impact is found to be fairly limited whereas the 'limited' commercial benefits may be important to particular domestic interest groups.

5.4 The impacts of untying aid

There have been very few empirical investigations into the relative effectiveness of untied and tied aid on a comparable basis, or of the impacts of the actual untying of aid. The existing literature includes studies differing in scope and methodology and so findings are rarely generalisable or strictly comparable. Further evidence-based studies are needed on the consequences of the extensive untying that has occurred since the mid 1990s.

There are purely analytic or theoretical explorations that compare the hypothetical welfare and terms-of-trade effects of tied and untied aid (e.g. Chatterjee and Turnovsky, 2004; Michael and van Marewijk, 1998; Chatterjee *et al.*, 2003; Chatterjee and Turnovsky, 2007). These analyses typically conclude that under 'plausible conditions', untied aid benefits the recipient and the world economy more than tied aid.

Some studies are empirical in the sense that they model, usually *ex ante*, the potential consequences of untying, using actual values for key variables. Untied aid is presumed to benefit the recipient and so studies usually have a donor focus. The process of untying does not seem to entail a welfare loss for the donor country (Morrissey and Rudaheranwa, 1998). On the contrary, some studies demonstrate that the provision of untied aid might even increase donor exports to the recipient country as a consequence of goodwill generated (Arvin and Choudhry, 1997; Arvin *et al.*, 2000; Arvin and Baum, 1997; Arvin *et al.*, 1996; Arvin *et al.*, 2003). Jepma (1988) examined the impact of a hypothetical coordinated shift towards partial untying of aid on an EU scale on donors' trade flows prior to the introduction of the single market that would open national procurement to other member states. He concluded that such a shift in policy was likely to be beneficial from a donor's perspective.

With regard to the relative effectiveness of tied versus untied aid, Miquel-Florensa (2007) concludes that untied aid is more effective than tied aid in countries with policy environments more favourable to economic growth. Similarly, Amegashie *et al.* (2007) highlight the inefficiency of tied aid, but note it is better able to control moral hazard where there may be problems of corruption and direction of funds away from the envisaged aid priorities.

The debate over the effectiveness of tied versus untied aid has also given rise to a normative literature based on case examples. Quartey (2005) sees budgetary support as a way to overcome the problems of tied aid; Hendra (1987) contrasts Canada's bilateral development assistance (highly tied) with Scandinavian practices (more untied) and highlights the superiority of the latter. More comprehensive studies of

untying offer some useful insights on the potential benefits of untied aid (e.g. Putterside *et al.*, 2004), often using as a starting point the negative impacts of tied aid in country-case studies (ActionAid, 2003; Chinnock, 1998).

The existing literature inadequately covers the impacts of untied aid; the few studies carried out seem to have focused on the impact of untying from the donor's perspective. In contrast, evidence-based studies are lacking of the ex post, economy-wide impacts of actual untying for either individual recipient economies, groupings such as LDCs or regional communities. The literature is largely silent on the effect of untying on recipient countries (impact on local markets, procurement and/or promotion of regional trade) and on the efficiency of untied aid. This is a powerful argument in favour of country focused studies of untying practices. An important exception is the rapidly growing literature on the impacts of local and regional purchases made possible by the untying or partial untying of food aid (Box 5.1).

Box 5.1: Developmental impact of local and regional procurement of food aid

There has been a substantial increase in the scale and relative importance of local and regional purchases (LRPs) of food aid, notably in East and Southern Africa (WFP, 2006; see also Table 3.7). Evidence-based research has demonstrated efficiency gains from LRPs, and that these result directly from actual domestic and import parity prices of commodities sourced locally (40%) and within the region being typically 30% below delivered costs of foodstuffs procured on donor markets (OECD, 2006a). These efficiency differentials have been maintained even during the current period of escalating food prices (Tscherley, 2008). So far studies have been positive about greater net benefits for rural and urban populations of local (untied) rather than imported (tied) aid (NRI, 2005; Coulter *et al.*, 2007; WFP, 2006). The quality of commodities offered for purchase by local traders rises. Local processing is encouraged and distortions of local markets largely avoided. However, assuring sustained benefits for local agriculture and trade may be difficult where intervention is episodic (Tscherley and del Castillo, 2006). Findings are, of course, context specific and so generalisation will require an accumulation of case specific evidence for an under-researched area.

Most importantly, what seems to be missing is a fully developed analytic framework designed to provide the basis for exploring the impact of untying. In the analysis of the impact of tied aid, the starting point was represented by an idealised untied situation in which tying was introduced as a distortion. In the analysis of the impact of untying we have the reverse condition: in a world characterized by tied aid, one tries to

predict what would happen if the sourcing restriction were removed and aid untied. However, there is no reason to believe that what is observed in the tied aid framework is simply reversible. This is not a return to an idealised world in which goods and services can be simply sourced in competitive, undistorted markets. Furthermore, aid is an administered process with many formal and informal restrictions that are not necessarily altered when the formal restriction on sourcing is removed. The whole discussion is located within a highly constrained second-best framework. The investigation into the consequences of a modification in an aid regime has to focus on local optimality: efficiency gains (better value for money) within a *ceteris paribus* framework, and similarly with effectiveness. For this reason again, an analytic framework that sets out these possibilities in a systematic and logical way would be particularly helpful to the second phase of this evaluation and the wider assessment of the moves to untying.

As highlighted, studies on the consequences of untying are limited. However, there is a parallel literature that focuses on the use of aid modalities for which untying is a necessary (pre)condition. These modalities include what are sometimes called 'direct bilateral instruments', financial aid for GBS and new modalities of aid such as pooled funding.⁴¹ Several studies discuss the potential developmental benefits and impacts of budget support: reduction in transaction costs, facilitation of donors' co-ordination, improvement in the predictability of aid flows and higher allocative efficiency of public expenditure as well as strengthening of partners' ownership and institutional development (for example OECD DAC, 2006b; Naschold and Booth, 2002; Nilsson, 2004). An in-depth evaluation of the efficiency and effectiveness of GBS based on seven country case studies over the period 1994-2004 (IDD and Associates, 2006) concludes, whilst emphasising some intrinsic limitations⁴² of the investigation, that GBS is often 'an efficient, effective and sustainable way of supporting national poverty reduction strategies'. The evaluation also concludes that GBS has been successful: in strengthening ownership and accountability, as well as improving 'operational and allocative' efficiency of public spending; in improving harmonisation and alignment of donors. Thus GBS benefits seem to outweigh some negative unplanned effects (such as feeding corruption and unpredictability),

41 Strictly we are talking about *financial aid* as budgetary support. In the past programme commodity aid that the recipient government sells on the local market to generate 'counterpart funds' has been used to provide budgetary support. The most important case has been US program food aid. The record on impact was positive for the Marshall Plan, very negative especially in the Vietnam war. Such programme aid as was found to be poor value for money as development aid in 1980s and 1990s and drastically reduced by the US and phased out by other donors (Barrett and Maxwell, 2005; OECD, 2006a).

42 The evaluation is limited to seven countries and it is difficult to draw robust conclusions as GBS experiences are relatively recent. Differently from project aid, it can be difficult to isolate GBS and distinguish its effect from the aggregate ones as there are several interactions and forces at play. For a fuller analysis of the caveats see page 117 of the evaluation.

whilst recognising that there are political and other risks to its sustained use that should be carefully considered.

In conclusion, the review of the literature on untied aid broadly shows that there has been little formal investigation of the effectiveness of tied versus untied aid or on the impact of untying. Studies differ in scope, coverage and methodology and findings cannot be generalized. The discussion about untying has also failed to take into account the evidence about aid modalities for which untying is a necessary condition. Further empirical studies are needed in order to draw more robust conclusions, especially with respect to the impact of untying on the recipient countries. Most importantly, what seems to be missing is a conceptual framework to be used for systematic empirical investigations into the consequences of untying.

6. USES OF UNTIED AID IN SIX PARTNER COUNTRIES

6.1 Objectives and scope

Only a small minority of donors report tying for a fraction of their bilateral ODA. Formally tied aid is, apart from food aid and freestanding TC, exceptional. How then does this regime of formally untied aid work in practice? The survey of five donors at the HQ level, and wider informal soundings with the donors found that agency personnel, drawing on their own experience, see untying as associated with other changes in aid management. These include a shift to decentralise responsibility at a recipient country level, joint programming, uses of recipient country procedures and a reduced share of funding through direct contracting and open tendering by donor agencies. But in the absence of any systematic investigation these views were recognised as speculative. The implication is that the first task in the country level investigations was to *undertake a factual review of how untying works at this level*. The product of this initial part of the investigation is an account of the untying regime, its consistency with the OECD Recommendation and other voluntary understandings such as the guidelines on aid procurement.

The donor country HQ perspective as reflected in reporting to the OECD (Chapter 3) is that most aid is now formally untied. In contrast, partner country government officials, academics and others in civil society presented in initial contacts a quite different view. They argue that the process of formal untying was unsatisfactory in three ways: it failed first, to give ownership and secondly, to achieve alignment of much of the aid of many, including major, donors; whilst thirdly there was still extensive *de facto* tying. This latter concern was informally reiterated by some agency personnel with regard to certain aspects of their own programmes and especially to the practices of other donors.

The country studies, in providing a factual review of the extent of formal untying, first sought to confirm what was reported from HQ, by comparing country level sources with CRS data. Second, the review would be used to establish how the untying regime is working in terms of modalities and users of aid

at a country level. For example, is untying actually associated with the adoption of modalities that are conditional on untying such as direct bilateral instruments to provide budgetary support, pooling of project or programmatic funds and the use of country partners systems? In practice, monitoring may not distinguish modalities in this way. Therefore, as appropriate, the teams were to complement available information with a purposive survey of modalities and use of different procurement systems. After providing comparative profiles of the six countries in Section 6.2, the results of the investigations into modalities and uses are reported in Section 6.3.

The widespread scepticism encountered regarding the genuineness of some supposedly untied aid necessitated an investigative response. This response takes two forms. First, it was decided to undertake a country-level econometric investigation, reported in Section 6.4, into the relationship between bilateral aid and donor exports to test for evidence of continued trade distorting practices. Second, the study would consider for a representative selection of donor projects the geographical sourcing of 'head' contractors, who manage projects, sub-contracting and sourcing goods and services within projects. This is reported in Chapter 7.

Small two or three person teams undertook the country investigations over two months, involving collecting of information and interviews over a period of three to four weeks. They had to be highly selective, and heavily dependent on the data and documentation that was readily accessible through the co-operation of country partners and donors. These investigations should therefore be regarded as exploratory. For a more comprehensive assessment a similar level of resources would be needed for considering the consequences of untying by a single DAC donor in any one recipient partner country, and perhaps through repeated assessment once a benchmark were established.

Table 6.1 Profile of six case study countries

Region	Country	Development status¹ DAC Donors						Total ODA (bilateral and multi- lateral) US\$ mn	Multilat- eral ODA (%)	Bilat- eral ODA (%)	Bilateral ODA DAC Donors	GDP per capita Total ODA	ODA per capita Multi- lateral ODA (%)	Aid as % of GNI Bilat- eral ODA (%)	Aid as % of Public Expendi- ture²	Water & Sanitation		
		LDCs	OLICs	LMICs	UMICs	HIPCs	Total ODA US\$ mn									Multilat- eral ODA (%)	Bilateral ODA (%)	
West Africa	Burkina Faso	X				X	2,302	33.8	66.2	16		416	53	12.8	-	92.2	50.4	49.6
	Ghana		X			X	4,441	26.0	74.0	16		571	66	11.7	26.0	228.6	34.3	65.7
Southern Africa	Zambia	X				X	4,636	9.6	90.4	18		808	129	17.6	39.9	153.5	30.4	69.6
	South Africa				X		2,854	4.6	95.4	22		5,515	20	0.4	0.9	227.4	0.0	100.0
South East Asia	Lao PDR	X					850	28.4	71.6	15		592	47	8.4	89.7	39.7	1.2	98.8
	Vietnam		X				8,497	34.8	65.2	21		718	34	4.8	-	858.9	54.0	46.0

Source: OECD Creditor Reporting System (CRS) database; World Development Indicators (WDI).

Notes: 1. The development status of each country is defined according to the DAC list of ODA recipients (www.oecd.org/dac/stats/daclist).

2. Aid as % of Public Expenditure refers to 2007 and not to 2005-07.

3. Data are in current US\$ millions; ODA data are based on commitments.

Table 6.2 Tying status of ODA in six case study countries (2005-07)

Region	Country	Bilateral ODA				
		Loans as % of total bilateral ODA	Untied ODA as % total bilateral ODA	Partially Tied ODA as % total bilateral ODA	Tied ODA as % total bilateral ODA	Not Reported as % total bilateral ODA
West Africa	Burkina Faso	2.7	80.5	5.5	7.6	6.4
	Ghana	8.1	77.1	8.7	11.0	3.2
Southern Africa	Zambia	3.5	85.6	9.0	3.6	1.8
	South Africa	14.2	64.8	20.7	10.7	3.7
South East Asia	Lao PDR	5.7	70.4	3.0	4.4	22.2
	Vietnam	57.9	64.9	6.9	19.4	8.7

Source: OECD Creditor Reporting System (CRS) database.

Notes: 1. Data are based on commitments in current US\$.

6.2 Profile of six case study countries

The six countries were selected to be broadly representative of the range of developing country situations. The selection also takes into account regional and economic groupings, bearing in mind the importance accorded in the rationale for untying as set out in the Recommendation to promoting local and regional markets and enterprises. The survey includes five low-income countries (LICs) and one upper middle income country (UMIC), South Africa, within three regional pairing in West Africa, Southern Africa and SE Asia (Table 6.1).

The three African LICs are also full ACP members. Burkina Faso, Lao PDR and Zambia as LDCs, are covered by the 2001 Recommendation, as is Ghana as a non-LDC HIPC since 2008. These four countries can also be categorised as relatively more aid dependent in terms of aid/GNI and aid/government expenditure ratios (Table 6.1). ODA is less important for Vietnam: disbursements were 1.2% of GNI during 2005-07. Aid is of marginal significance for South Africa (under 1% of central government expenditure). The relative importance of loan and grant ODA reflects voluntary commitment to prioritise grant aid to LDCs (Burkina Faso, Lao PDR and Zambia). The high proportion of loan ODA for Vietnam is accounted for by the three largest donors being Japan, France and Germany, and that they continue to provide a comparatively high share of loan ODA. The study was to focus specially on the Water and Sanitation Sector (W&SS), and so there is a substantial amount of ODA in all cases. Finally, the purposively selected countries as a group reflect broadly the range of reported untying of bilateral aid for individual countries (Table 6.2) and together the share of untied, tied aid and non-reporting of tying status (Table B.3 in Annex B) is similar to those reported for all ODA (Table 3.2).

More background information on the six countries is provided in the executive summaries of the country studies (Annex D). Five countries, that is excepting South Africa, were also included in the pre-Accra 2008 Paris Declaration Evaluation (PDE) surveys on aid effectiveness.

6.3 Aid modalities and use of country procurement systems

A review of aid modalities and uses of CPS on a case by case basis provides evidence firstly on whether there are in fact differences between countries and, second, on whether there are systematic differences amongst individual donors in their untied aid practice. This review begins with Ghana, the pilot case study, and then considers the three LDCs covered by the Recommendation – Zambia, Burkina Faso, and Lao PDR – and next the two non-LDCs, Vietnam and finally South Africa. The statistical evidence on uses of modalities for each of the six countries is included in the executive summaries as Tables D.1-D.6 and uses of CPS summarised in Table 6.3.

Ghana has relatively good monitoring of aid. The government with World Bank support closely monitors aid disbursements in the form of the donor partner envelope (DPE) and reports to the Consultative Group (CG). There is a high level of reported full untying, 77% in 2005-07, with 8% partially untied (almost entirely EU), 11% tied and only 3% with non-reported tying status (Table 6.2). The findings of a survey on bilateral tying practices in 2006 were almost identical to the untying reported to the CRS, confirming that HQ data are used to determine untying status (MAP Consult, 2007). After this survey interest in monitoring untying lapsed.

A group of eight donors, including the EC, provide substantial general budget support and make extensive use of other

Table 6.3 Bilateral DAC donors (including EC) – Percent of aid to government using Country Procurement Systems (CPS) in 2007¹

Donor	Zambia	Lao PDR	Ghana	Vietnam	Burkina Faso ²	South Africa ¹	Six countries (average ³)
Ireland	100			100		100	100
Norway	96			100		100	99
Netherlands	94		100	97	79	100	94
Spain			--	83			83
Canada	100		82	100	10	100	78
Denmark	87		56	44	99	75	72
UK	93		99	44		29	66
Switzerland		0	91	48	96	88	65
Belgium				39	76	75	63
New Zealand		0		80		100	60
France		80	100	19	86	7	58
Sweden	76	72		0	79	42	54
Germany	90		69	14	55	33	52
Finland	84	0		30		85	50
EC	74	0	32	58	77	42	47
Japan	0	27	13	92		0	26
Austria					24	--	24
Italy				69	0	0	23
Luxembourg		0		--	41		21
Australia		0		40		20	20
USA	22	54	0	--	0	4	16

Source: OECD (2006b); OECD (2008d); OECD (2008e); OECD (2008f); OECD (2008g); OECD (2008h).

Notes: 1. Percent of aid using CPSs in 2005 (South Africa did not participate to PD Survey 2008 and therefore no data was collected for 2007).

2. Computed as 'aid disbursed using CPSs'/'aid for government sector'. However, in some cases aid disbursed using CPSs was higher than aid for government sector and therefore % of aid using 'CPSs' was computed as 'aid for government sector'/'aid disbursed using CPSs' (See OECD, 2008d for further details).

3. Computed as an unweighted average.

modalities associated with untying such as basket funding. Collectively, 55% of their aid in 2006-08 was provided through these modalities (Table D.1). These donors also reported substantial use of country procurement systems (CPS) in their aid to government (Table 6.3). Two of the five case study donors, Canada and Switzerland, also confirmed this high level of untied modalities and use of CPS. In contrast, two major donors, Japan, almost entirely, and the USA, wholly, continue to use a project approach and made little use of CPS (13% and 0% respectively). Three other donors, Belgium, Italy and Spain, provided only project aid, and did not report disbursements using the CPS. Ghanaian informants, whilst wishing to comment informally, argue that the only genuinely untied aid in terms of ownership and alignment were unrestricted funds made available to government and disbursed using the CPS.

Zambia has the highest reported level of untying amongst the six case study countries, 86% of commitments, with less than 5% reported as tied or non-reported during 2005-07

(Table 6.2). Government and donors within the Consultative Group again cooperate in monitoring aid performance. In the absence of donor specific information on use of modalities ten donors, including the EC and the World Bank, were asked to assist in providing information in response to a survey about modalities and procurement, and all did so (Table D.4). The survey complemented by information collected for the PDE confirms that there are wide variations in donor practices. Eight donors, including the EC and the World Bank, provided substantial support through programmatic and pooled funding modalities. In addition to programmatic support, some also used the Zambian CPS for pooled project aid. Two major donors, Japan and the USA, continue to use a project approach, with procurement outside the CPS. Japan uses the agency's own procurement rules. The USA funds are disbursed through non-state procedures of implementing agencies, contracted under international competitive tender; but these procedures have to conform to any applicable US legislation on sourcing goods and services. These differences in donor

practice are confirmed in the PDE survey, which indicates a high level of use of CPS, 74% to 100%, excepting Japan (0%) and the USA (22%) (Table 6.3). Again Zambian informants stressed the importance of unrestricted programme aid and use of CPS, implying ownership and alignment, as indicators of genuinely untied aid.

Burkina Faso: again the evidence indicates wide differences in donor practices associated with a high level of reported formal untying, 81% (Table 6.2). GBS as a proportion of all ODA disbursements, under 18% in the late nineties, has varied been 27% and 32% during 2001-07. GBS has been provided since 2001 by DAC bilaterals, including in 2007 Canada, Denmark, France, Germany, Netherlands, Sweden and Switzerland, as well as the EC (Table D.2). The proportion of bilateral commitments reported to the CRS as GBS is even more variable. In 2007 GBS was 29% of ODA and basket funding (Fonds communs) were reported separately for the first time as a further 7% of ODA. Meanwhile aid following a conventional project approach, and including a declining proportion of TC, still accounted for 64% of ODA (57% for the bilaterals giving GBS and basket funding). Two major donors, Japan and the USA, as well as Austria, Belgium, Italy and Luxembourg continue to use only a project approach. The use of CPS amongst donors has also been variable with two DAC donors, Italy and the USA making no use of national systems and others ranging between 55% and 96% of support to government (Table 6.3). Where investment feasibility studies were undertaken on a sectoral basis, this was more likely to lead to sectoral basket support, or pooling by donors committed to such an approach.

Lao PDR: the pattern of bilateral aid and untying appears to be quite different from those of the three low income countries in Africa. There is a small proportion of DAC loan ODA funding similar to the other LDCs. However, the extent of formal untying is lower (70%) with a high level of non-reporting (Table B.3 in Annex B). The non-reporting is mostly for Japan (56%), the largest bilateral, which provides also a high proportion of TC related assistance (CRS) and which, according to local informants, is *de facto* tied. Bilateral aid is overwhelming project type with little commitment of GBS in recent years. France, Sweden and to a more limited extent Japan use CPS. The low levels of GBS and CPS use are explained by donors as related to limited country partner financial management capacity.

Government reporting on bilateral aid includes non-DAC Asian donors providing an uncommon snapshot of their activities (Table D.5). Asian donors provided almost 60% of bilateral aid in 2005-06: Japan, 27%; Vietnam, 11.1%; China, 9.5%; Thailand, 8.4%; and Korea, 2.6%. Informants indicated that virtually all of the non-DAC aid (30% of bilateral aid) was *de facto* tied and also Japanese assistance, apart from local procurement.⁴³ This estimate would imply that at least two

thirds of all bilateral aid is *de facto* tied. Furthermore, taking into account apparently substantial, but unquantified official export credits from non-DAC sources, the implication is that in practice external funding for development to Lao PDR, an LDC, is overwhelmingly tied.

Vietnam as a rapidly developing LIC receives a high proportion of DAC member ODA as conventional project aid, mostly focused on infrastructure and economic sectors. This aid includes a high proportion of loans (58% of bilateral DAC ODA in 2005-07) and also substantial tying (19%) and non-reporting (9%) (Table 6.2). The high level of concessional loan ODA is explained by the three major bilateral donors, Japan, France (AFD) and Germany (KfW), being those that have retained a substantial loan element in their portfolio. Programmatic support is a relatively low 8.5% of ODA during 2006-07 (Table D.6) and DAC bilateral ODA in 2007 including only 2% of bilateral GBS.

The use of CPS by donors is extremely variable (Table 6.3). Different views were encountered too about capacity, especially below the level of central government, and corruption problems. In contrast to the other case study countries there was a high usage of CPS under Japanese supported programmes in 2007 under a bilateral agreement that experienced difficulties during 2008.

Vietnam also receives substantial but separately and partly reported concessional lending from non-DAC donors, including especially China as well as India, Korea, Kuwait, Singapore and Thailand. For example Korea committed over US\$ 100 mn of concessional export credits a year during 2007-09 which exceeds the level of ODA by all except the three largest DAC donors. The levels of concessional credits imply that the proportion of tied funding for development is, as in Lao PDR, very much higher than the reported levels. The extent of untying and domestic or regional sourcing very much depend on the ways in which project contracting and procurement within project is organised. The government is widely considered to adopt a strong negotiating stance on issues such as contracting and sourcing of ODA funded goods and services.

South Africa: bilateral ODA is relatively unimportant for an upper middle income country. In contrast to the five low income countries, government insists on taking direct responsibility for coordination negotiating and organising on a direct bilateral basis. There is unusual niche funding, such as support for some of the preparations for the 2010 World Cup (Clay *et al.*, 2008, Box 4.2). Another consequence is lack of statistical reporting on aid modalities and South Africa chose not to participate in the 2008 PDE survey of aid effectiveness.

Bilateral ODA is equivalent to less than 1% of public expenditure. A low proportion of ODA is reported as tied (10%) with little non-reporting (3%). Bilateral aid, as reported for 2005, also shows varying donor practices in using public finance management systems and CPS procurement (Table D.3). Three

43 A different perspective is provided by JICA that "it is not appropriate to treat Japan, a DAC member which has untying obligations, as other Asian non-DAC countries that do not have reporting obligations in the context of untying extent of ODA."

bilateral donors responded to the study survey indicating a mix of modalities and procurement arrangements through their own, government and non-government partner procedures. In discussion these choices, and so associated variance in CPS use, were found to be related to the way individual or a small number of bilateral projects had been designed. So it is difficult to draw more general conclusions. Nevertheless, some donors were again found to make little use of government systems, preferring their own procedures or those of contractors that had to conform with the funder's own regulations and legislation on sourcing and reporting.

The South African government takes a strong position, actively promoting local contracting and questioning donor choices where these involve other forms of sourcing. Finally, the view of government officials on tying practices, and taking EU procedures only as an example of a wider issue, were noteworthy in expressing in a forthright way a perspective common to most country partners:

"For many South African Government officials, the principle of tying often refers to the procedures and processes used in aid programmes. The focus is therefore on the alignment and ownership of aid with country systems over and above the procurement and sourcing of goods and services. An example of this is the EU aid model, cited by some Government officials as particularly tied. This perception relates largely to the EC requirement that unless certain eligibility criteria are met and a budget support aid modality is used, EU aid is, for the most part, governed by the EU's Practical Guide to Contract.⁴⁴ However, in South Africa, the fact that the EU imposes its own rules and conditions on how ODA is spent is in itself seen as problematic. In such cases, the use of donor country procurement systems is sometimes synonymous with tying." *(Ramkolowan and Stern, 2009).*

Overall Findings: There are certain iterative practices that emerge from a review of the six countries. First, the extent of formal untying and choice of aid instruments is broadly sensitive to country development status and current financial circumstances: the highest level of untying and use of grant aid is found in the four HIPC countries, Burkina Faso, Ghana, Lao PDR and Zambia. Second, the extent to which donors have adopted direct bilateral funding modalities with untied funds is very country context specific, which the joint evaluation of GBS confirms (IDD and Associates, 2006). Third, there are however wide differences in donor practice only partly reflected in the five donor case studies. The Nordic+ group including Canada with France, Germany, Luxembourg and Switzerland, and most recently Australia have funded such arrangements, along with the MFIs, especially the World Bank.

Fourth, there is a paucity of reliable quantitative information on the extent of pooled funding arrangements, which do not

⁴⁴ Procedures for EC external actions (commonly referred to as PRAG). Under these guidelines EU aid to South Africa is only partially tied to the EU states; the state that is a beneficiary of assistance and developing countries as specified by OECD DAC.

relate to conventional classifications of ODA such as sectors, instruments, TC components or tying status. On the evidence provided these modalities appear to involve subsets of donors within the wider group that are also willing to provide direct budgetary support. The 'experiments' with pooled funding going beyond conventional parallel joint funding are also in what donors perceive to be favourable country, sectoral and project specific circumstances. These developments cannot be said to be the result of untying, which is formally now almost general. Rather these initiatives are now more likely where a sectoral approach is adopted for investment planning. Those more likely to participate have regulatory flexibility in the ways funds can be used, including critically transferring these to another agency or the country partner to disburse. Some donors, including the two largest, the USA and Japan have not participated substantively in these arrangements or GBS. Nor have some European donors such as Austria, Italy, Spain, Portugal, the Czech Republic and Greece, even though pooling would seem to offer relatively the smaller donor both an opportunity to participate in major initiatives and to achieve efficiency savings in aid administration. There is so far also a lack of substantive evaluative evidence on the aid effectiveness, let alone the developmental impact of such initiatives.

The links between choice of modalities and the use of CPS are apparent but cannot be rigorously demonstrated, because the available data do not focus on these potential connections. The PDE country surveys provide some useful cross-sectional evidence on use of country systems, with which the findings of the case studies are broadly consistent. Again there are wide differences in donor practice that are both programmatic and to some degree reflect country circumstances.

The study sought to obtain more detailed information about pooling and baskets and procurement arrangements at an agency level within countries, but with very limited success. The explanation appeared to be some combination of donor survey fatigue after work preparatory to the September 2008 Accra meeting, the extent of in-country donor coordination on information, and sensitivity in some cases over providing evidence about procurement issues. Some projects were therefore selected (see below Chapter 7) for more in-depth review as examples of the way pooling and untying may be linked.

The widespread scepticism expressed in all six countries, but often informally and off the record, about the genuineness of untying on the part of some if not many donors prompted the study team to consider this issue in two ways. First, if there is extensive *de facto* tying, then the effect may be observable as an aid associated bias in favour of donor exports or trade distortion (Section 6.4). Second, as project type aid still predominates, actual practices should be more transparent at a project level, as considered in Chapter 7.

6.4 Econometric analysis of the implications of bilateral aid for donor exports

6.4.1 Introduction to econometric analysis

If one considers the exports from developed industrial donor countries that constitute the DAC to aid recipient developing countries, then one would expect the flow of exports from a donor country to a recipient country to be explained by factors such as the size of the exporting economy, the proximity or distance, and the sharing of a common language. Even the total level of aid might be an influence on the exports of all donor countries. However, in a multi-donor world, where no single donor dominates as the US did during the Marshall Plan era, there is no reason why the level of aid from a donor to a recipient would influence that donor's exports, unless bilateral aid were having a trade distorting effect through intended or unintended tying⁴⁵. Tying is widely considered to advantage exporters in the donor country. Untying is therefore expected to reduce the distorting bias of aid in favour of the donor's exports. Similarly, particular aid instruments, notably bilateral concessional loans, were thought to be often associated with donor exports, for example through a mixed credit arrangement. So phasing out of such arrangements with a decline in loans again ought to end distortions.

This section therefore investigates whether recent bilateral aid flows and associated practices have trade distorting effects. The aim is to understand whether bilateral ODA is an influence on a donor's exports, even with current high levels of untying, whilst taking into account other variables that might be influencing this relationship (such as FDI, export credits, EC disbursements). Conventionally, tying status and the different forms in which aid is provided, for example loans and grants, have been hypothesised to influence aggregate donor export flows at the country level.

In order to take into account country specifics, a similar econometric investigation has been undertaken for each of the six case country studies and the comparative results of the analysis for the six countries are reported in this section. The six countries are purposively paired according to trading region to isolate potential regional effects: Ghana and Burkina Faso in West Africa, Lao PDR and Vietnam in South East Asia region and ASEAN, and Zambia and South Africa in SADC region. Moreover, the six selected countries also differ for their DAC classification: Burkina Faso, Lao PDR, Zambia being LDCs, South Africa as UMIC, and Vietnam and Ghana as OLICs; Burkina Faso, Ghana and Zambia are also being classified as HIPC, as well as being full ACP members. The scope of the investigation and its theoretical framework are set out in Annex C, with only summary findings presented in this section.

6.4.2 Data

Empirical estimation includes aid from up to 22 DAC donors to recipient countries, with observations covering the years

2002-07⁴⁶ because of data quality issues and availability⁴⁷. The bilateral ODA data are taken from the OECD CRS database. The analysis uses aid disbursements and not commitments, because trade effects are expected to follow actual disbursements and not commitments. The available export series include only goods and so under-estimate economic flows from the donor to recipient, which involve also TC and other services in-kind financed at the donor end. These data issues are discussed further in Annex C.

6.4.3 Findings

The statistical results at the individual country level suggest probabilistic and not necessarily robust economic relationships. The relationships which are found may in turn be only a proxy for more complex underlying economic relationships between donor and recipient country. However, a comparison of results from all six countries, as presented here, provides a fuller and possibly more robust analysis, highlighting similar patterns and systematic differences. These results are summarised in Table 6.4 and discussed more fully in Annex C.

GDP of donor countries, which proxies for their economic size, is, as expected, an important determinant of donor bilateral exports. The larger the donor country's GDP the higher the level of exports, as countries such as Japan or United States clearly export more than Luxembourg or Switzerland.

⁴⁵ This conjecture is explored further through the project level analysis in Chapter 7.

⁴⁶ 2002-06 for South Africa.

⁴⁷ Further details can be found in Annex C and the background paper (Natali et al., 2009).

Table 6.4 Aid and other influences on DAC donor exports: comparative econometric results for six partner countries during 2002-07

	West Africa		Southern Africa – SADC		South East Asia – ASEAN	
Dependent variable: Exports	Ghana	Burkina Faso	South Africa	Zambia	Lao PDR	Viet Nam
GDP	(+) ^{***}	(+) ^{***}	(+) ^{***}	(+) ^{***}	(+) ^{***}	(+) ^{***}
GDP per capita		(-) ^{***}				
Distance						(-) ^{***}
Common language		(+) ^{***}				
FDI			(+) ^{***}			
Import residuals			(+) ^{***}		(+) ^{***}	(+) ^{***}
Tying status %	(+) ^{**}		(+) ^{**}	(+) ^{**}		
Grants i	(+) ^{***}	(+) ^{**}	(+) ^{***}	(+) ^{**}	(+) ^{***}	(+) ^{***}
Grants All-i						
Loans i		(+) ^{**}				(-) [*]
Loans All-i			(+) ^{**}			
Export credits						
EC disbursements	(+) ^{**}	(+) ^{***}		(+) ^{**}		(-) ^{***}
N observations	117	102	75	95	103	126
Period under analysis	2002-07	2002-07	2002-06*	2002-07	2002-07	2002-07

Notes: 1. All variables are in natural logarithms (except Common language, Import residuals and Tying status). All regressions include a time trend not reported.

Legend: * significance at 10 percent **significance at 5 percent *** significance at 1 percent.

A striking difference in results among countries relates to the common language. Language, as well as more general common cultural factors, can help to facilitate trade flows between countries. Sharing the same official language is however only strongly and positively linked with bilateral export flows for Francophone donors to Burkina Faso and does not hold for the three Anglophone countries⁴⁸, where no observable advantage is conferred. Apart from the shared language there are the links with France as the former colonial power; it is therefore hypothesized that a similar relationship might be found between some Spanish-speaking Latin American countries and Spain.

Other expected influences are however found to be mostly insignificant: *the level of development of donor countries*, measured by their income per capita, has no clear influence on bilateral export flows and only in Vietnam there is evidence, in accordance with the theory, that an increase in the distance is associated with a lower level of exports from donor countries.

Turning to the influence of aid flows, it is important to distinguish between a donor's ODA and ODA that the recipient

country receives from all other bilateral donors. The basic idea is to consider whether there are any trade distorting effects of aid at an aggregated level by examining whether bilateral aid from a particular donor to a recipient country affects trade between that donor and recipient pair differently from aid from other donors.

Results show that *aggregated* aid flows from a donor have a significant impact on that donor's exports, whereas ODA from the rest of bilateral donors is not a significant influence on that donor's exports. This suggests that an increase in donor aggregate aid flows is associated with a rise in exports even where aid is overwhelmingly untied. Also in countries such as South Africa and Zambia, where this aid-trade relationship does not seem to hold at an aggregated level, a disaggregation shows that *grants* from the donor country are positively associated with its exports, whereas grants from the rest of bilateral donors are not significant. Such results are again suggestive of some form of trade distortion: it is difficult to explain why bilateral grants from a particular donor to a recipient country should affect trade between that donor and recipient pair differently from grants from other donors. This result is suggestive of informal or *de facto* tying of grants. Among other possible explanations there could be the good-

48 In Vietnam and Lao PDR the common language variable is automatically dropped as no donors share a common official language with these countries.

will on the recipient's part towards the donor; still, the aid relationship might simply facilitate trade between the donor and the recipient, increasing recipient's proclivity to procure goods from the donor (reinforcing commercial ties)⁴⁹. *Loans*, which are an unimportant form of aid except in Vietnam, are not a significant influence on donor exports. This result might be explained in part by the relative levels of grants and loans in the countries analyzed, and so a disaggregation of ODA into loans and grants is not necessarily very meaningful.

To sum up, the aid variables are found to be an important influence on donor exports, suggesting that aid, despite formal untying, is nevertheless a significant part of the complex commercial relationship between donor and recipient. Although there is evidence of a positive impact of *formal tied aid* on donors' exports (especially in Sub-Saharan African countries), rather it is aid overall, even if formally untied, which appears to have a trade distorting impact on bilateral exports.

The analysis also found that *disbursements from the EC* positively associated with exports in full ACP member countries (Burkina Faso, Ghana and Zambia) supporting the idea that the ACP-EU relationship is a positive influence on exports from EU member states in ACP recipient countries.

Foreign direct investments (FDI) are another potentially important influence on trade between countries. Due to lack of data for individual DAC members this relationship is studied only for South Africa, where FDI are found to have a positive bearing on export flows. There are several ways beyond the initial investment in which FDI and exports could be strongly linked. No evidence is found that *export credits* have an impact on bilateral export flows in those countries where data were available, a result perhaps related to the poor quality of the data⁵⁰.

The statistical analysis can only highlight influences that are captured with the available data. There are other aspects to the economic relationship between donor-exporter and aid recipient importer, often difficult either to identify or measure, so an attempt is made to control for such *underlying relationships* by taking into account imports by the donor from the aid recipient⁵¹. In South Africa, Lao PDR and Vietnam (middle income and/or SE Asian countries), the results are suggestive of a complex reciprocal commercial relationship compared with a perhaps more aid dependent one for the three African ACP countries. If it is true that as a result of the donor-recipient relationship 'the effective cost of geographic distance' is reduced (Johansson and Petterson, 2009), then further research is needed on inter-country trade flows between donor and recipients and not just on donor exports

The results of this econometric analysis suggest that bilateral aid is still a distorting influence on trade, even after untying

of most bilateral ODA. That finding justifies a closer, disaggregated examination of the uses of aid and sourcing of goods and services with aid funds. The results especially for disaggregated aid flows suggest the existence of some continuing trade distorting effects of aid in the post-tying world, at least for grants. Loans, which are an unimportant form of aid in most of the countries analyzed, are not a significant influence on donor exports.

6.5 Conclusions

To sum up, the country level analysis highlights how the perceptions of donors and partner countries on tying and untying differ. Whereas from a donors' perspective untying is directly related to removing sourcing restrictions on procurement of goods and services, recipient countries perceive untying as a broader concept related to alignment and ownership of aid and local companies being able to compete successfully for contracts.

The review of aid modalities and use of CPS draws attention to systematic differences amongst bilateral donors. Donors, such as the Nordic+ Group, France, Germany and Switzerland, who make large use of programmatic approaches and CPS contrast with the two major donors, the USA and Japan, who are found to have mainly a project-type approach and made relatively little use of CPS in the countries under review. Other donors too are found to favour a project-type approach but are not active in all countries.

The review also indicated untying practices are country-specific. There are differences between partner countries according to their development status (the highest level of untying and use of grant aid is found in the four HIPCs); to their negotiation power (as South Africa and Vietnam case studies show, the extent of untying is related to partner countries' ownership and strength of national systems); and to their in-country capacities (the extent of untying can be limited by lack of country capacity). In Lao PDR little commitment to the use of GBS and CPS is mainly linked to limited country partner financial management capacity and possibly to the relative importance of non-DAC donors.

The analysis of aid modalities and use of CPS also highlight the paucity of existing data on aid modalities and in particular on pooled funding. Some country studies, such as Burkina Faso, Lao PDR and Vietnam also indicate discrepancies between the pattern of aid suggested by the CRS and local data to which governments and donors make reference at a country level.

Finally, doubts on the genuineness of aid untying seem to be supported by an econometric analysis: aid is found to have some trade distorting impact in a post tying world.

⁴⁹ See theoretical framework in Annex C for further details.

⁵⁰ See Annex C for further discussion.

⁵¹ Through the inclusion of an import residual variable (Annex C).

7. AN ASSESSMENT OF THE EFFECTIVENESS OF UNTIED ODA: FINDINGS OF PROJECT STUDIES

7.1 Introduction

Objectives and scope

This chapter presents the evidence from the 21 project case studies undertaken as part of the six country studies⁵². A number of key features of untying practice have already been considered and this chapter takes as its starting point the theoretical, econometric, donor and recipient country analyses of the previous chapters. The main aim is to complement these perspectives with ‘real life examples’ from current practice at the project level. The pilot study for Ghana showed how many of the variations in practice can only be properly understood in their individual context.

The project level review is organised in two parts. Section 7.2 considers the case studies in terms of input features; who funded what; and the terms and contracting arrangements employed. Then the consequences are considered of the way projects are organised and inputs sourced for aid efficiency, effectiveness and development in Sections 7.3 to 7.7.

Case study approach

The case study method was developed during the Ghana pilot country study on the assumption that many of the features of untying can only be understood in their project context. For each country the projects were selected jointly in consultation with country partner and donor agencies using the available information from the CRS and country databases. Selected projects were to be predominantly untied, in the Water & Sanitation Sector (W&SS), involve procurement of goods and/or services and be currently active (2008). Country teams then carried out a series of structured interviews with recipient and donor personnel, as well as end users, contractors, NGOs and other government entities, including the public procurement agencies. From these interviews and supplementary information provided, a profile of each project was prepared covering disbursement of funds at every stage, the decision-making process and factors likely to influence

outcomes. For some projects ‘Ground-Truthing’ visits to projects were carried out to verify ‘capital city level’ information and views about what was happening.

Practically, each country team was able to investigate three or four projects in depth during the two month period allocated. The pilot concluded that to ensure focus and comparability between projects the studies should concentrate primarily on one sector, water supply and sanitation. This sector was selected, because it is both an infrastructure and growth sector and has a strong social orientation with both rural and urban coverage. It involves the procurement of substantial amounts of both physical goods and civil engineering services, as well as having a significant TC component alongside a variety of aid delivery approaches. ODA usually plays a key role and many bilateral donors are involved. The project selection process aimed to provide widest coverage of donors across the six countries, and so some projects are in other sectors. The case studies should be regarded as providing examples of what agencies consider good practice.

*Tying and untying in practice*⁵³

Tying is ultimately about outcomes, the geography of sourcing, and not just about legal or allowable possibilities. When there is formal tying, because contracts are specifically restricted to organisations registered in the donor country, or the use of funds is limited to buying goods and services from the donor market, the outcome is unambiguous. Aid can be considered to be effectively untied where the contract is awarded to an organisation registered in the recipient country or to some third party.⁵⁴ The contract may be tendered

⁵² The EXSUMS are in Annex D and full versions of the reports will be available on the PDE website in due course.

⁵³ Unlike at the theoretical level, it is also possible to consider the effects of partial untying on a case by case basis because there is an answer to the question of which countries are included. Depending on which set of countries are unrestricted, partial untying can be closer to either tied aid or untied aid in terms of its effects.

⁵⁴ There may be disagreement as to the genuineness of such a registration. Some informants specifically questioned whether ‘Chinese’ companies registered in Ghana were genuinely local, having regard to the possible implications for employment and sourcing of goods.

internationally or only nationally by the funder or through the country procurement system (CPS), or even directly awarded.

De facto tying arises where funds are formally untied or partially untied but the contract is in fact awarded to a donor country organisation, or goods and services directly procured from the donor market. This outcome is *prima facie* evidence of *de facto* tying, but not conclusive. The outcome may be the intended or unintended consequence of the way in which the contract is organised. Some informants argue that the very activities selected for funding may lead to an unintended bias in favour of sourcing in the donor country, and reflect either the donor's own or the recipient's perception of the funder's comparative advantage: for example, Norwegian TC for oil exploration, Chinese road construction or Japanese cars or motorcycles.

The contracting process has to be examined to determine whether there are obstacles to organisations outside the donor country obtaining a contract, such as prequalification requirements or lack of information. These considerations lead to categorising contracting or procurement outcomes as 'untied' if sourced other than from the donor country. But if a contract goes to a donor country entity, that is at least an ambiguous outcome, potentially suggestive of *de facto* tying.

To demonstrate *de facto* tying is difficult. A case-by-case investigation can indicate whether there is a bias in favour of donor country organisations. Practices are agency specific, bound by organisational and national regulatory frameworks, as illustrated in Chapter 4, and so a comparison of a purposive sample of projects will highlight differences and their implications. What is difficult to establish is a counterfactual example, to compare with selected donor projects. However, the IDA (World Bank) reports on the geographical sourcing of contracts, usually by ICB, NCB, quality based selection and 'shopping' and this information provides a set of outcomes against which to compare surveyed bilateral projects⁵⁵.

Finally, cost-effectiveness analysis can provide an ex post test of the efficiency of choices. If outcomes of restrictive sourcing decisions are inefficient compared with actual or local market prices or costing of hypothetical alternative transactions that is suggestive of a bias.

A project case approach is potentially very time and resource intensive, and so is only possible to undertake on a highly selective basis. This approach also requires cooperation of funders, partners and implementing agents in making available what may be regarded as privileged or commercially sensitive information. The pilot indicated that project analysis was only feasible for current projects with personnel and documentation available in-country. So that limited the

choice of projects and donors. Country teams also found that cooperation depended on an organisation having a culture of transparency, and that some investigations were constrained by slow and incomplete responses.

The investigations recognise the importance of levels of contracting and so focus on three levels of procurement. First, there is the higher level implementing entity. In some cases this is the country partner ministry or the agency to which it has delegated responsibility. However, in many cases there is a head contract for the management of the project or the provider of technical cooperation to the local managing agency. This contract commonly involves supervising, disbursement and monitoring of expenditure on behalf of the funder. The bilateral funder conventionally awards the head contract, and the reported tying status of projects is based on the formal contracting rules adopted, and whether or not these at least in theory allow unrestricted sourcing. Second, sub-contracting occurred within almost all investment projects organised by the head contractor or local implementing organisations, and so may be subject to different contracting rules. Third, there is actual procurement or purchase of goods and services by head or sub contractors. An assessment of the tying status in terms of outcomes of a project should take into account all three levels of procurement.

The limited scale of tied ODA has resulted in focusing largely on formally untied ODA. This focus is continued at the project level: those identified for review were formally fully untied, except in four cases, which were explicitly mixed, or hybrid, including both tied and untied components. Despite this restriction, the case studies encompass a wide range of variety of types of aid and donor practice, demonstrating the increased range of donor practice with untied aid.

It was the intention to try and include at least two projects for all of the major donors and at least one project for all other DAC members. Limiting factors were the number of project case studies that each country team could carry out, the donors that were active in each of the recipient countries in the W&SS and the requirement that the projects were active in 2007/8 to ensure that the documentation and at least some of the implementing staff were still available in-country. The study was able to include projects supported by Australia (AusAID), Canada (CIDA), Denmark (Danida), the EU (EC), France (AFD), Germany (KfW), Ireland (IrishAid), Japan (JICA, MoFA), Luxembourg (LuxDev), Netherlands (VNG), Sweden (Sida), UK (DfID) and USA (USAID). A World Bank (IDA) project was also included as a counterfactual case study. Switzerland (SECO, SDC) provided useful information regarding their budgetary support and useful discussions were held with Norad, GTZ and the MCC. No projects funded directly by Austria, Belgium, Italy, New Zealand, Norway, Spain, or Switzerland, were included. Several non-DAC donors were also included as partner agencies in specific projects, as were several other multilaterals such as the regional development banks, UN agencies and the Global Fund. WaterAid and several private

⁵⁵ Another reference point to compare with IDA sourcing is the reporting of ex ante contract awards to the DAC. This outcome measure of untying could provide a valuable form of verification to compare with the formal commitments (input measure) also reported by donors.

foundations are also included as part funders. The project commitments ranged from approximately US\$ 500 thousand to US\$ 1.5 billion.

The geographical coverage of the 21 projects is shown in Table B.2 in Annex B, and the projects are also numbered for easy identification when they are cited. Table B.2 also lists the formal characteristics of the projects as reported to the OECD, donor and country databases.

In Southern Africa, the projects selected in South Africa include two in the health sector and only one in the W&SS, where there were few bilateral donor supported projects. All three mostly funded technical cooperation. In Zambia three projects were selected in the rural W&SS, mainly covering investment activities. A USAID project provides TC for Business Development, and a World Bank supported project was included for comparison.

In the ASEAN region there are four Vietnamese investment projects in the W&SS, one a multi-donor loose pooling arrangement. Projects in Lao PDR included roads, rural development, energy and one in the W&SS. The US\$ 1.5 billion energy project is jointly funded and led by the World Bank and has many private sector partners.

In West Africa the Burkina Faso study includes two health sector and two W&SS projects, all except one involving multi-donor funding. The Ghana pilot study considered two rural W&SS projects, including one pooled arrangement.

7.2 Input features: contracting arrangements and tying practice

7.2.1 Organisational features and tying status

The projects surveyed are all considered in terms of their organisational and contracting arrangements that explain their tying status. The study teams looked closely into organisational and especially contracting arrangements so as to establish sourcing outcomes. These findings are summarised in Tables 7.1 and 7.3.

Formal tying status

The study purposively selected projects that are reported as formally untied. Thirteen bilateral projects and an IDA supported project were reported as fully untied. All the EC support to projects is reported as partially untied. Five projects were reported as having both tied and untied components. As a comparison the CRS database indicated 79% of bilateral projects by value in the same six case study countries are untied (Table 3.3). A major factor determining formal tying status was the project start up date. Older projects originating in an earlier donor policy cycle were more likely to be reported as having tied components. For example, the CIDA supported W&SS Project 21 in Ghana includes tied elements, whereas the more recent iteration of this CIDA

project support is fully untied. Similarly, the KfW Project 5 in Zambia and the joint funded Project 18 in Burkina Faso both began before the 2001 Recommendation.

Untying in practice

Government and other informants in all partner countries expressed surprise at the extent of formal untying as indicated by the CRS. There is, as discussed in Chapter 6, a different conception of untying linked to ownership and alignment. Additionally, both local and international private sector contractors only saw aid as untied when there was a reasonable prospect that they could bid and win contracts. So, from the perspective of local firms, an ICB that would be awarded to an international company and beyond their reach appeared to have a tying-like restriction. The key to this gulf between donor declarations and country partner perceptions is linked to *de facto* tying. Making the simple distinction that if a contract is sourced in the donor country this is suggestive (*prima facie* evidence) of tying, the project case studies are used to establish first, what is the extent of untying, and second, what influences explain the different outcomes.

I. The extent of untying amongst case study projects

Bearing in mind that the study specifically targeted formally untied projects, 13 of the sampled 21 bilateral projects (62%) plus the IDA project were formally described as being fully untied (Table 7.1). Of the remaining projects, the two EC projects (2 and 16) were described as 100% partially untied, and five projects, (around 25%) numbers 3, 6, 14, 18, and 21, were described as having both tied and untied components. The classification of tying status is determined by whether the head contract is formally open to unrestricted international competition.

In contrast to reported untying status, looking at the geographical sourcing of head contracts, general TC and project components, only eight out of 21 (Projects 2, 5, 7, 9, 10, 15, 17, 19) were unambiguously fully untied. The majority of projects were hybrid or mixed (Table 7.1).

II. Components of projects that are more likely to be formally tied or de facto tied

The most commonly tied components or those likely to be sourced in the donor country were the head contract to manage the project and its funds, or, where a project is locally managed, the provision of either services-in-kind and/or consultancy contracts for TC. Often these aspects were bundled into a single head contract.

Ten (around 50%) of the bilateral head contracts directly signed by the donor were awarded to donor country organisations. Where head contracts were procured through framework agreements (by the donor HQ), 100% of these came from the donor country.

General TC/consultancy contracts tell a similar story. In 13 (62%) of the 21 projects the TC/consultancy was of donor

nationality, in four (19%) projects the TC/consultancy was of DAC member nationality' leaving only four (19%) projects where the TC/consultancy was of recipient nationality and no projects where the TC/consultancy was sourced from a non-DAC third party.

Provision of services-in-kind (Projects 8, 12 and 20) involved consultants from donor countries. Although competitively tendered often using framework agreements, services-in-kind allowed no opportunity to country partners to manage, or local firms to bid for these components.

Table 7.1 Project case studies: recipient relationship, implementing entity, head and TC contracts

Project Number	Recipient involvement	Implementing entity	Head contract procurement	Head contract nationality	TC/Consultant procurement	TC/Consultant nationality	Untied Aid share (top level)
SA1	+	Private	Framework agreement	Donor	Donor, Framework Agreement	Donor	82%
SA2	++	Recipient	Competitive	Recipient	Recipient	Recipient	100%*
SA3	+	Recipient	Tied	Donor	Donor	Donor	31%
ZM4	-	Private	Competitive	Donor	Unknown	Donor	71%
ZM5	+	Recipient	Competitive	Recipient	Donor	Recipient	100%
ZM6	-	Recipient	Competitive	Donor	Donor	Donor	15%
ZM7	+	Recipient	Unknown	Unknown	Recipient	Recipient	100%
VM8	++	Recipient	Competitive	Recipient	Private	Donor	92%
VM9	++	Recipient	Competitive	Recipient	Recipient	Recipient	100%
VM10	++	Recipient	Competitive	Recipient	Recipient	DAC member	100%
VM11	++	Recipient	Competitive	Recipient	Donor	DAC member	98%
LA12	++	Recipient	Competitive	Recipient	Donor	Donor	90%
LA13	-	Private	Competitive	Donor	Donor	Donor	95%
LA14	+	Recipient, Private	Tied	Donor	Donor, Tied	Donor	0%
LA15	+	Donors, Recipient	Non-competitive	Donor	Donor	Donor	100%
BF16	?	Recipient, Donor	Not applicable	N/A	Donor	Donor	57%
BF17	?	Recipient, Donor	Competitive	Donor	Donor	DAC member	100%
BF18	++	Recipient	Tied	Donor	Competitive	Donor	92%*
BF19	+	Recipient	Not applicable	N/A	Donor	DAC member	100%
GH20	+	Recipient	Framework agreement	Donor	Donor, Framework agreement	Donor	100%**
GH21	-	Private	Tied	Donor	Donor, Tied	Donor	74%

Notes: *Partially Untied, ** Excluding services-in-kind

Key to headings:

Project Number: Reference for project details in Table B.2

Recipient involvement: The amount of involvement by the recipient partner (dominant = ++, significant = +, mixed = ?, little = -).

Implementing entity: The dominant implementing entity.

Head contract procurement: The procurement systems used for the head contract, the primary contract signed with the donor.

Head contract nationality: The nationality of the head contractor.

TC/Consultant procurement: The procurement system used for the technical cooperation or consultancy services.

TC/Consultant nationality: The nationality of the TC or consultant(s)

Untied aid share (top level): The share of the project at the top level of contracting and contracts signed by the donor that are both formally untied and untied in practice according to whether there is a reasonable opportunity for firms other than from the donor nationality to be awarded contact.

III. Components that are likely to be untied

Those project components using CPS and, significantly, those involving sub-contracted procurement were more likely to be untied. All project components using CPS were found to be untied, that is without awards to donor country based entities.

Sub-contracting is a major secondary level source of untieing, whether or not the head contractor was a donor country partner organisation. In most cases contractors were allowed to sub-contract without tying restrictions. So, for example, 75% of funding was sub-contracted locally or regionally in the KfW funded Project 6 in Zambia, with a German sourced contractor.

World Bank contracting: a counterfactual. An IDA funded project in Zambia was purposively included to provide a counterfactual to bilateral practice. All TC and other sub-contracts on this project in Zambia were awarded to regional or local companies after the IDA threshold requiring ICB was raised to encourage local tenders. Many informants see the World Bank ICB tendering procedures as a model, for example for CPS. It is therefore interesting to compare the geographical distribution of World Bank contracts with the bilateral sourcing in the six case study recipient countries (Table 7.2). Whereas no bilateral contract was awarded outside the partner country to companies registered in regional LDC/HIPCs or other non-DAC countries, these accounted for 44% of Bank contracts in the W&SS and 26% of all Bank contracts. These same countries were also especially important in civil works (e.g. Vietnam and Chinese contractors in Lao PDR). The high proportion of bilateral TC/consultancy contracts awarded to companies from the donor economy (71% – 12 out of 17 wholly bilateral projects in Table 7.1), compared with only 23% for all DAC countries for Bank contracts suggests that formal or *de facto* tying is an influence on outcomes. This suggests that bilateral agencies could do significantly more to create a level playing field on both an individual and joint funding basis.

IV. Factors preventing local or regional firms from winning tenders

A key issue appears not to be one of local and regionally based firms being out-competed but rather that they were often not bidding for aid contracts.

One factor is unequal access to information. This is in practice linked to the level of procurement and resultant spread of advertising, and even the informal spread of information about contracts. NCB (which does allow international companies to tender) attracted far more local interest than ICB. Organisations that contribute to project design were more likely to be donor country based. Projects may well represent an explicit or informal continuation of a previous project and with a history of tied project implementation. Those same entities are in effect advantaged insiders in their knowledge of the donor's procedures, the focus of the project and in early informal access to information about the contract.

The local response to tenders is also related to the skills and capacity of the local market. LDCs are not able to supply all of the goods and services required for projects, so this depends on what is required and the project sector.

The size of lots put out for tender was a significant influence on the amount of local involvement. Project 7 raised the ICB threshold to increase local participation. Local firms sometimes did not have the capacity to bid and were often excluded at pre-qualification stages. Large lots are likely to have higher barriers to entry in the form of larger deposits, larger stocks of equipment and manpower and higher risk. For the most part this favoured international and large regional firms from more advanced developing countries.

Companies based in the LDCs were faced with other financial barriers such as the weak credit market and unavailability lo-

Table 7.2 World Bank Contracts by supplier development category signed in 2003-08 in the six case study countries (average percentage share of total)

Source Country	Water & Sanitation Sector				All sectors
	Civil works	Consultancy	Goods	Total	Total
DAC Members	12%	23%	55%	20%	38%
Local (aid recipient)	54%	53%	21%	36%	35%
Other (non-DAC)	18%	15%	1%	13%	15%
Regional LDC/HIPC	0%	4%	0%	1%	0%
Regional Other	16%	4%	23%	31%	11%
Total	100%	100%	100%	100%	100%

Source: World Bank Contract Awards dataset

Notes on source country: *Local* is sourcing from within the recipient partner country; *Regional Other* refers to non LDC/HIPC countries within the region (e.g. Thailand in SE Asia); *Other* refers to non-DAC, non-regional third parties. Where there is overlap of categories, then DAC members are recorded as DAC (e.g. Japan in SE Asia).

cally of professional indemnity insurance, giving international firms further advantages (Box 7.1).

V. How the procurement system can affect the level of untying

Nine of the 11 projects which used the CPS, also involved major local procurement compared to three of the nine projects which didn't, suggesting that the procurement system affects the level of untying. Procurement options seen in the sample projects were donor procurement (in all cases via HQ, there was little evidence of decentralised donor procurement), country procurement systems and procurement by a private entity following their appointment by the donor. Seven projects (33%) solely used the CPS. Only one project, which used the CPS for any component, was less than 90% untied. The government was (or was part of) the implementing entity for 16 (76%) of the 21 projects. Four projects were implemented solely by private entities and none were solely implemented by the donor.

VI. Recipient country partner influence and the aid environment

In every country with the possible exception of Vietnam, there was a wide variety of different contracting, funding and procurement procedures involving different relationships with different donors for specific projects. However, several features stood out.

Strong national systems and government ownership assists untying. Both South Africa and Vietnam, the two least aid dependent and richest recipient countries, exercise significant ownership by channelling aid funds through their national financial management systems.

In South Africa (apart from TC and framework head contracts) all procurement was local. The government vigorously challenged the use of a framework contract (Project 1) accepting it only on grounds that it would expedite disbursement. Project 3, involving twinning of Dutch and South African local authorities, is a partnership on flood protection, where the Netherlands is perceived to have special expertise.

In Vietnam, due to use of the CPS and strong government involvement there was a very high share of untied aid and locally led projects. This is exemplified in Project 10 where, despite a funder preference for continuing with the donor country based company that had been responsible for design, the main consultancy services were put to ICT and won by a company in another DAC member country.

In countries and sectors where SWAPs were in operation then pooled funds (which tend to be untied) were most likely to be organised, as in Ghana and Zambia.

7.2.2 Project characteristics

The formal features of the projects are summarised in Table B.2 in Annex B. This provides a conventional project description in terms of full project title, donors, value of donor contribution sectoral use and formal tying classification as reported

to the OECD. On the basis of the distinction made above between levels of contracting, projects are then profiled in Table 7.1 according to the ways 'top' level head contracts and TC are procured, geographical sourcing and their formal tying status. An assessment is made of the level of recipient partner involvement, which is qualitatively indicated as dominant (++), significant (+), unclear (?) and little (-). Thus as suggested above, a high level of involvement is found to be strongly associated with the choice of a competitive form of contracting and more likely to lead to a locally based organisation being awarded the head contract and/or to be provider of TC and consultancy services. Formal tying status provides no indicator of likely geographical sourcing.

Secondary level contracting and final sourcing outcomes are considered in Table 7.3. The importance of sub-contracting arrangements, including especially lot size, is highlighted as a determinant of the likely extent of contract awards which are local and regional. Smaller lots were mostly awarded locally, and this outcome is irrespective of whether or not the head contractor is donor country or locally based. Furthermore, the final outcome, taking into account secondary level contracting, indicates a very high level of untying. This link is so in the case of partial tying restrictions (Project 2 in South Africa and Project 18 in Burkina Faso) or where there was provision of TC services in-kind (Project 20 in Ghana). Apparent exceptions are a local authority twinning project in South Africa (Project 2) and a largely TC activity in Zambia (Project 4) which both reflect the low proportion of sub-contracting and sourcing of goods and services in the overall project design. Project 14 in Lao PDR, the only one for which information on sourcing was not available, was seemingly largely *de facto* tied. The key untying issue would seem to be whether in both project design and implementation there is a strong commitment to promoting local and regional sourcing of goods and services.

7.2.3 Untying and sourcing outcomes: a process approach

The process of delivering formally untied aid is complex, and so attempting to trace the likely sourcing consequences of the explicit and implicit (default) choices made by donor and recipient country partners is the only way to determine whether aid is in practice tied or untied. This also has to be the first step towards exploring the outcomes in terms of aid and

developmental effectiveness. Something of this complexity is presented in a stylised way in Figure 7.1. This flow diagram presents in qualitative, probabilistic terms what has been learnt in the project studies and discussions with country partner and agency officials and others with expertise about the more or less likely outcomes of choices made and the influences on the procurement process.

Table 7.3 Project case studies: procurement, subcontracting, aid modality and major inputs

Project Number	Main procurement system(s)	Lot size	Subcontracts and their sourcing	Modalities used	Project type / major inputs	Local procurement	Untied aid share (final)
SA1	Private	Small	+, Local	Project	TC, services	+	82%
SA2	CPS	Small	+, Local	Programme/SBS	TC, services	+	100%*
SA3	Donor	Small	-, Local	Project	TC, services	-	31%
ZM4	Donor	Small	+, Local	Project	TC, services	+	80%
ZM5	CPS	Small	-, Local	Programme	Civil Works	+	100%
ZM6	Donor	Large	-, Regional	Project	Civil Works, TC	+	75%
ZM7	CPS, IDA	Large	-, Intl.	Project	Civil Works	-	100%
VM8	CPS	Small	+, Local	Pool, Programme	TC, Civil Works	+	92%
VM9	CPS	Small	-, Local	Project	Civil Works	+	100%
VM10	CPS, Donor	Small	-, Local	Project	Civil Works,	+	100%
VM11	CPS, Donor	Small	-, Local	Project	Civil Works	+	98%
LA12	CPS	Small	+, Local	Project	Civil Works	+	0%
LA13	Private	Small	-, Local	Project	TC	-	95%
LA14	Private	Large	Unknown	Project	Civil Works	.	Unknown
LA15	Private	Large	-, Intl.	Project	Civil Works	+	100%
BF16	CPS	Small	+, Local	Project	Civil Works, TC	.	57%
BF17	Donor	Small	+, Local	Project	Works, TC	.	100%
BF18	IDA rules	Large	-, Local, Intl.	Project	Civil works, TC	.	92%*
BF19	CPS / IDA	Large & Small	+, Local	Pool, Programme	TC, Goods	.	100%
GH20	CPS	Small	+, Local	Project	Civil Works, TC	+	100%**
GH21	Private	Large & Small	-, Regional, Intl.	Project	Civil Works, TC	+	74%

Notes: *Partially Untied, ** Excluding services-in-kind

Key to headings:

Project Number: Reference for project details in Table B.2 in Annex B

Main procurement system(s): The main procurement system for the project.

Lot size: The size of the majority of contracts tendered for implementation

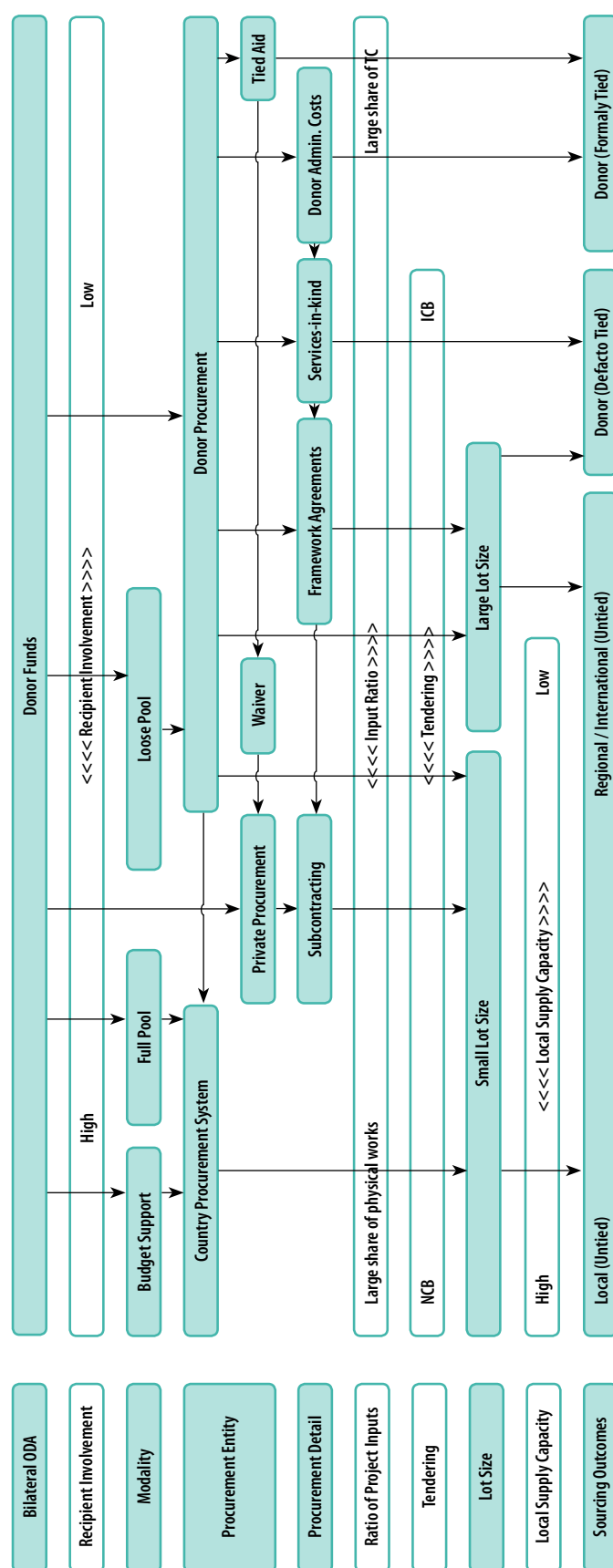
Subcontracts and sourcing: The number of subcontracts and their dominant sourcing location (Many = +, few = -, unknown =).

Modalities used: The aid modality.

Project type / major inputs: The dominant type of assistance and corresponding major inputs

Local procurement: The level of local procurement (major = +, minor = -).

Untied aid share (final): The share of the project at the level of final disbursement for implementation that are both formally untied and untied in practice according to whether there is a reasonable opportunity for firms other than from the donor nationality to be awarded contract.

Figure 7.1 Flow diagram of aid, untying practice and sourcing outcomes⁵⁶

56 By their nature flow diagrams are qualitative assessments so additionally, for example, it is important to note that some donors are able to untie some administrative costs and also source them locally which is not shown on the diagram.

Key influences on the sourcing outcome are:

- Ownership – the extent of recipient involvement;
- Choice of modality;
- Procurement system used (CPS, private non-state agency, donor) and its details (extent of sub-contracting, framework, agreements, etc.);
- Project activity in terms of the relative proportion of TC and physical investment (construction and plant);
- Contracting procedure (NCB, ICB, direct contracting, quality based selection, shopping);
- Size of tendered lots;
- Extent of local (and regional) capacity.

The outcomes are reflected in terms of the likely proportion of local, regional, other DAC and non-DAC donor country contracting and sourcing of goods and services. Even where aid is formally tied at head contract level the outcome may be mixed, if contractors are free from restrictions in sub-contracting and sourcing goods and services. Similarly, formally untied aid may be *de facto* tied to donor country sourcing.

The choices to be made at different levels in the process raise an important issue, the genuineness of the commitment to untying. Is tying perceived constructively or *positively* within a donor organisation or by its agents? Alternatively is untying perceived *negatively* as a modification to regulations on contracting and procurement necessary to conform to the requirement of untying status as in the OECD definitions and the 2001 Recommendation? A *positive* approach would imply encouraging project-type preferences and process choices that flow to the left-side untying outcomes. A *negative* or purely conformist approach would result in a preponderance of *de facto* tying outcomes on the right hand side of Figure 7.1. On the evidence of the 21 studies, first, there are still wide differences in donor practice, some intended and some unintended, and second, the outcomes are also strongly influenced by country partner involvement, capacity and the bargaining power that they feel *vis à vis* funders.

7.3 Consequences: interconnections and aid effectiveness

The interconnectedness of the processes through which the organisation of projects is contracted, inputs procured and the sourcing outcomes involve a large number of possible pathways, as illustrated in Figure 7.1. These interconnections make it difficult to isolate any single aspect of the process and to infer outcomes on a partial basis. The outcomes may be misleadingly attributed to a single influence. It is also important to reiterate that formal untying is not only the relaxation of a constraint that may considerably increase flexibility in the sourcing possibilities, but that it also opens up the choice of procedure that can be used. If the untying is genuine, then the use of the donor's funds is compatible with all procurement systems, forms of control, aid modalities and financial management systems.

One can look at the consequences and effectiveness of untying as both a policy and a process. The ToR for the study recognises three forms of effectiveness. Firstly, there is efficiency as mainly reflected in the literature on tying (Chapter 5) in terms of cost effectiveness and time efficiency, which is considered, in Section 7.4. Next the contribution of untying to the Paris Declaration aid effectiveness objectives of ownership, alignment and harmonisation are considered in Section 7.5. Then the issue of untying and transparency is considered in Section 7.6. Finally, there is the contribution of untying to developmental effectiveness in the recipient partner country as an outcome, including especially strengthening of local markets and regional integration (Section 7.7). The forms of evidence that could be assembled mean that the focus of investigation is mainly on direct effects and only suggestive about ultimate aid effectiveness and development outcomes.

7.4 Aid efficiency: cost-effectiveness and time

Cost-effectiveness has been the conventional rationale for untying aid. Theoretical analysis of tying implies that it is inefficient and the very limited empirical literature suggests that tied aid is between 15% and 35% more costly than unrestricted market prices. With this finding as basis for comparison, each country team undertook at least one cost-effectiveness analysis (CEA) at the project level, looking at the use of untied funds for sourcing of goods and services in comparison to local commercial market or international market prices.

The South African CEA looked at the cost effectiveness of local procurement for two projects. The civil works were apparently cost effective, but the low levels of competition from a combination of local only advertising, limited local capacity and preferential procurement was seen as a potential threat to price efficiency. Project 1, organised by a donor based consultant under a framework agreement, comprised wholly locally contracted TC to the health sector and the team found that the consultancy rates paid under South African procurement guidelines were higher than they would have been under donor guidelines. The EC supported Project 2 demonstrated the advantage of flexibility associated with even partial untying, as it was possible to shift to using the CPS during project implementation. Project 3 involved TC provided by a donor partner municipality in the Netherlands in flood protection as well as local procurement for minor civil works. The cost-effectiveness of TC could not be assessed because the estimated costs of TC were not available, and also there is no transparent market for such resources, but both sides perceive this as an area of donor comparative strength.

In Zambia, the study considered a representative sample of goods procured under IDA funded Project 7, which were all privately imported following IDA guidelines by the contractor from South Africa, the regionally dominant economy. The CEA showed the cost of the goods procured using untied aid

was lower by at least 6%, relative to the import parity price for comparable goods.

The Vietnam study's CEAs on components of three projects (8, 10 and 11) concerned local procurement through the CPS. The CEA indicated mixed results, with large variation in prices and goods procured around market reference prices. The study concluded that equipment and materials purchased for the projects were, in the majority of cases, actually more expensive compared to the market, due to problems of corruption or strong social networks, leading to cost inefficiencies.

In Lao PDR, CEAs on Projects 12 and 13, involving CPS and private local sourcing, also showed significant variation in procurement costs. But on balance cost savings were made on the purchase of equipment items and construction materials, relative to the market reference price. This implied cost-effective use of aid funds as a result of untying.

The Burkina Faso study was launched later than the others and at the time of drafting had no complete CEA available. However, provisional findings indicate quality issues concerning the importing of goods by local firms. Interestingly, Project 19 involved a competitive re-contracting, which resulted in a replacement bid from two local companies 15% below the mixed credit arrangement that it replaced.

The Ghana study considered CEA within Project 20, which combined TC services and unrestricted pooled funds. A Danish company provided TC for project management as services-in-kind funded by Danida HQ under an EU-wide tendered framework contract (formally partially tied and *de facto* tied). The costs of TC to the project were apparently not separable from those of a wider programme and it was not possible to estimate cost-effectiveness.

The DFID pooled contribution was paid directly to Danida for the project team to disburse, funding implementation of all investments under CPS, which were then considered to be contracts rather than sub-contracts. Procurement of contractors by national competitive bidding was carried out through sub-contracts at district level, with assistance by the regional government water department. Six of eight contractors were wholly local and two contracts were awarded to locally registered Chinese entities. Contractors were then unrestricted in their procurement. The goods and civil works procurement was broadly cost effective, matching reference prices from the local market.

The Ghana study also reports an example of drainage works where ICB led to substantially cheaper sourcing than either single sourcing or non-competitive selection. Three stretches of drainage were tendered by ICB, selective bidding and single sourcing. The section contracted by selective bidding was priced 47% higher than the single sourcing section, which was in turn 90% higher than the ICB contract.

There are broadly consistent findings from these country cases. Untied aid and local competitive sourcing were found to be cost effective for the procurement goods compared to market prices. The cost advantages in comparison with the previous evidence on tied aid were most apparent where untying led to increased and transparent competition. It proved impossible to test the cost-effectiveness of TC, an area of poor transparency from a country partner perspective. A further caution is necessary. The country studies are only able to provide illustrative examples in general relatively favourable circumstances of good donor-recipient relationships, better governance and economic stability.

As the study specifically looks at untied projects, the direct cost effect of competitive procurement is not surprising. Pertinent questions are therefore how does untying interact with current sourcing practices, and what are the key features associated with cost effectiveness?

Cost savings from untying were found to be far from automatic. Untying gives more options but is prone to some of the same pitfalls that bedevil public contracting, perhaps universally.

Cost effective procurement requires capacity and skills. If untying triggers a move to using country systems then in order to gain the benefits, CPS need adequate capacity. Untying highlighted the capacity challenges for CPS in each case study. However, untying also provided the opportunity (funding, training and a major incentive) for improvement. CPS were identified as lacking capacity especially at the provincial (district) level. CPS were not effective for procuring international TC, but had been given little opportunity to do this. The study found mixed results. Many projects succeeded using the CPS, where those responsible for other projects using other approaches were claiming that it was not found fit for purpose.

Realising the potential benefits of untying also requires the supply capacity to make possible genuine competition. Several studies reported low numbers of bidders both in procuring at local levels where there were low skill sets, and also internationally, due to the large size of some contracts (Box 7.1).

The importance of effective competition applied at either or both the local and international level, depending on what was being procured. For widely traded commodities such as aggregates and cement the requirements for efficient procurement were effective local competition and also widening the pool of expertise available to tender bids. Narrowly defined construction contracts, such as for drains or wells, also appear as areas in which the same criteria for efficiency apply.

Box 7.1 DFID Survey of constraints on local firms bidding for international contracts

Finding a lack of interest in bidding from companies in partner countries, DFID (UK) conducted a survey and held consultations with local businesses in India, Bangladesh, Nigeria and South America. The purpose was to jointly review constraints on local companies bidding for internationally tendered contracts for bilateral aid in their region, and to identify ways of breaking down the barriers to entry. The survey found that even where they were aware of the opportunities, developing country consultancies usually did not bid, perceiving the cost of preparing bids was greater than the reward, taking into account the perceived risk of not winning. Developing country consultancies face problems in submitting bids that were competitive with international consultancies because of the following:

- financial constraints of comparatively smaller firm based in a developing country with lower turnover (harder to meet prequalification), facing exchange rate risks, managing cash flow of costs and payments, and bid security;
- lack of capacity to understand ToRs and bidding documents, which are often vague and overly legal, in unfamiliar language and bidding practice, with terms not suited to local conditions;
- difficulty of sustaining partners which enable bidding on larger tenders or to compete with international consultancies for these partners; and
- lack of reputation outside their own country, even when experienced.

The problems were greater for LDC consultancies bidding for work in other LDCs, with experience but without local expertise and links. Suggestions for increasing the number of bids and their success rate included:

- raising the threshold for ICBs, and otherwise using NCB;
- circulating a list of local experts to level the information playing field;
- reducing prequalification requirements;
- making advance payments, as do development banks;
- increasing transparency of why the winner was chosen;
- modifying contract terms to suit local conditions; and
- assistance with understanding ToRs, bidding documents and current practices.

Source: DFID Procurement Group, Value for Money Department

Framework contracts can preclude the competition gains from untying to local and regional suppliers. Undoubtedly donors find these contracts convenient in achieving administrative efficiency savings and they may be cost effective from a perspective of managing a multi-country project portfolio. They may also be competitively tendered amongst developed country suppliers. However, at the individual project level and from the recipient perspective they appear to be a form of *de facto* tying that precludes local sourcing. Under the projects with framework agreements, contracts had been awarded to donor nationality firms. Framework contracts are often regarded as 'captured' by a small group of national firms (often working together). An option for achieving competition gains could be to prioritise increasing the ability of local firms to partner the framework contract winner.

Time efficiency

The implications of untying for time efficiency appear to depend on the procurement system. Untying allows a choice on the speed of procurement, balancing this against cost and other considerations.

ICB was found in both donor HQ and country level investigations to be widely regarded as time consuming, as well as costly and administratively inconvenient. Accordingly, it is only adopted where procurement goes beyond minimum thresholds. In practice, agencies were found to use various expedients to avoid ICB unless it was felt unavoidable or preferable on competition grounds.

The overwhelming view of informants was that CPS were typically faster for local tendering, whereas most donor systems were likely to be quicker for international tendering. There were even inconsistent views over using donor procedures. Government officials managing Project 2 commented unfavourably on the need for the approval of the EC's office in South Africa's for some items, but they also greatly appreciated the single tender procurement procedure under EU rules on other items.

Another alternative favoured by some donors is using an external agent (as in all projects with private procurement) which effectively unburdens the agent from both donor and government procedures. Private procurement was typically seen as very fast, as one would expect being less encumbered by agency rules. However, private procurement, using rules set by the donor, was found to be slow, as in the case of the MCA in Ghana, which precluded inclusion of one of that agency's projects in this study.

Taking a wider view the studies mostly found evidence that supports the combination of donors providing funding that is genuinely untied and so flexible and the use of country procurement systems. The area about which there is a widespread lack of transparency is TC costs and the efficiency of the way in which TC is contracted even for many of the projects on which donors were willing to cooperate with the study teams.

7.5 Aid effectiveness: ownership, alignment, harmonisation, and transparency

Untying contributes to the Aid Effectiveness agenda because untied aid is a necessary condition for many of the steps donors take to implement the Paris Declaration. So it is necessary to consider whether it is untying that is contributing to aid effectiveness, or the internal pressures within agencies to untie come from seeking the flexibility to forward the Paris Declaration Agenda.

The case study projects provided examples of potentially improved practice in PD effectiveness terms based on the ways in which untying is assisting donors in moving away from the conventional stand-alone project based approach to approaches that are cooperative. This movement facilitates alignment and harmonisation including budget support, pooling, delegated cooperation, use of the CPS and decentralisation. These steps, supported by many but not all donors (See Chapter 6), were found to be strongly supportive of PD goals of ownership and alignment (Box 7.2), which is one of the ultimate objectives of untying according to the Recommendation.

The studies prioritised project focused investigations making it more difficult to consider harmonisation amongst donors. Nevertheless, the strong association between cooperative use of programmatic modalities with untied funds, to which many government and agency informants drew attention, confirms the view that genuine untying contributes to harmonisation.

In Lao PDR where, of the six countries, conventional project-type assistance was most dominant, the team concluded that “to increase aid effectiveness in general, it is recommended on the basis of this study that further steps are taken to encourage the use of ‘newer’ aid modalities among donors (e.g. budget support and pooled funding) and increased use of country procurement systems” (Annex D, McCarty and Julian, 2009).

Transparency in donor procurement is one of the six PDE objectives and a key aspect of any untying audit. The following areas of donor contracting practices were found to be less than wholly transparent from a recipient country perspective:

- Donor contracting at HQ
- Framework contracts
- B2B
- Twinning/partnership arrangements
- Private management contracts

All of the above areas are fully compatible with untied aid. However, all of these offer scope for *de facto* tying practices. Transparency is needed to see whether the outcomes follow not just the formal rules but result in genuine untying. If transparency is essential and it is going to be hard to make these areas of contracting more fully transparent, then the alternative for development partners is to make less use of them.

These were also areas where in many cases study teams struggled to obtain information, which was ‘unavailable’ at a coun-

Box 7.2 Untying, ownership and alignment: country study conclusions

Ghana: “Untying is creating policy space for recipient country ownership, use of recipient country systems and alignment with recipient country priorities. The existence of strong country leadership, such as through the creation of SWAPs, was also seen as a driver of untying.”

Burkina Faso: “Le déliement est souvent accompagné par le transfert de gestion au pays bénéficiaires. Effectivement, l’alignement sur les procédures nationales, que veut la Déclaration de Paris, est difficilement envisageable sans déliement de l’aide.”

South Africa: “In an untied environment, donors are more likely to make use of recipient country procedures. The case studies show that the use of recipient country procurement systems enables government to pursue domestic policy priorities and improve alignment.” The EC supported Project 2 demonstrated the advantage of flexibility associated with even partial untying, as it was possible to shift to using the CPS during project implementation.

Zambia: “Untying has facilitated the increased use of GBS and SWAPs. This improves the transparency and alignment of aid.”

Lao PDR: “Untying has been associated with a shift away from donor priorities and towards the government’s needs and objectives (alignment), and has encouraged a decentralisation of responsibility and increased recipient ownership, supported by the fact that more government agencies are now responsible for project implementation and management.”

Vietnam: “From the cases reviewed, a significant effort has been made to ensure that ownership over ODA lies in the hands of government, through the use of country systems, national technical advisers and the greater involvement of government executing agencies.”

try level. The extent of transparency was variable. As the cost-effectiveness analyses demonstrate, some local agencies and some donors were willing in all countries to be open about contracting and procurement. However, some implementing entities, especially private contractors, were in practice unenthusiastic about what they regarded as privileged information. Some were so slow to respond that this precluded undertaking a CEA or fuller exploration of the contracting process.

On transparency, the most opaque aspects of donor practice concerned TC and associated consultancies, the areas of assistance where formal and *de facto* tying were found to be still most pervasive. As one country study concludes: “the high level of technical assistance and co-operation agreements in South Africa makes ODA less transparent and increases the potential for tying”.

7.6 Developmental impacts

The ToR for the thematic study draw attention to the many impacts that are aspects of developmental effectiveness: “effects on the market for local and regional producers, on promotion of the linkage of the local economy with regional networks, global networks, on employment, on pro-poor growth and poverty alleviation, and on gender and environment, impact of untied aid on Corporate Social Responsibility and on project lifetime cost savings.”

There are also multiple influences at work, which will determine the developmental impact of projects, donor programmes or the whole development cooperation effort. It is, as indicated already, difficult to trace the consequences of the relaxation of a single constraint for all these aspects of effectiveness. So instead country studies were asked to consider whether untying, and specifically at a project level, was supportive of rather than likely to impede effectiveness in terms of poverty reduction, advancing gender equality and so forth. And indeed the country studies found that most of the projects under review were likely to have positive broader developmental outcomes, but that these could not be attributed to untying *per se*.

The investigations focused more on areas where a more direct connection might be observed between untying and outcomes, specifically a higher proportion of the transfer flowing as employment, incomes and profit to the local economy, development of local business through greater use of local and regional contractors and sourcing from local suppliers through local markets and uses of local systems.

Country studies are cautiously positive, finding evidence of direct employment and income stream generation. However, these effects are highly sector and activity specific and so could not be attributed to untying *per se*. In Vietnam, “Local labour and local sourcing of goods increased the incomes and employment of some of (the) poorest provinces, where these development initiatives take place. Yet problems of seasonal or temporary

employment question the sustainable long-term development impact. Difficulties also lie in determining whether the effect on local employment is a direct effect of the untied nature of the projects, i.e. there is little evidence to assume that if these projects were tied that they would source labour from foreign markets.” Similarly, the Lao PDR study concluded (but cautiously) that local sourcing of contracts, consultants, workers and materials as a result of untying can have positive developmental effects, by providing increased employment opportunities and revenues for local manufacturers and suppliers. However, in the projects studied these benefits were severely constrained by lack of local capacity. The Zambia study found: “the evidence provided by these four projects suggests that, in general, the extensive use of local sub-contractors, which is made easier in an untied environment, has contributed to the creation of employment opportunities and a transfer of skills.”

The balance of sourcing of goods and services is shifted by untying towards local suppliers, as all studies indicate. This promotes local business development, but the linkage effects are limited by the underdeveloped structure of the economy. The direct effect on the local economy is dampened because most LICs do not produce many of the required goods domestically. For example, the Zambia study found in a detailed project investigation that a mix of local and foreign (but Zambian registered) companies won contracts through a combination of ICB and NCB, but virtually all the goods were imported⁵⁷. The Burkina Faso study reported a similar situation when they looked in depth at a project level.

The promotion of regional networking appears to be limited and likely to benefit the stronger economies such as South Africa and Vietnam. No projects reported contracts awarded to organisations from neighbouring LDCs or HIPC. The Zambian example again highlighted the absence of sourcing of goods and services from regional LDCs. In fact, none of the project studies reported sourcing from other regional LDCs. Again this finding may reflect the highly sector specific basket of goods and services under study. In contrast, food aid studies have reported regional procurement within SADC as highly contingent, reflecting the then current location of surpluses and deficits.⁵⁸

Untying was closely associated in most cases with use of CPS, except where private contractors were managing projects. Again studies are all cautiously positive about the way this use of CPS strengthens local capacity by building up experience. The lack of capacity was felt to limit use of CPS or a shift to programmatic modalities in Lao PDR. The South Africa and

⁵⁷ Untying in both the OECD definition and the literature refers to the first round effect i.e. no account is made of the origin of the good or service. Some donors do make use of national content requirements when tying their aid in order to capture the second round effects as well as the first round effects.

⁵⁸ At different times Malawi, Zambia, Zimbabwe and Tanzania as well as South Africa have exported aid funded food to other SADC countries.

Vietnam studies emphasise that specific efforts are needed to combine efficiency and capacity development.

The content of a project rather than nominal tying status was found to be critically important in determining outcomes. Two projects in Zambia and South Africa provided funding for local government to disburse directly, with apparent success. In contrast, in another South African project, a substantial proportion of the gains in terms of experience, management, track record, reputation and profit were captured by the donor country contractor under a framework agreement. Capacity building and knowledge transfer appear to be more likely where local and regional firms of medium capacity undertake project investment activities.

7.7 Awkward issues about untying: possible trade-offs and risks

Are there efficiency-development effectiveness trade-offs associated with untying? The consequence of untying having multiple objectives of increasing efficiency and aid effectiveness ultimately is that there may be areas in which donors and recipients face immediate trade-offs. A number of the projects were trading off alignment and harmonisation against cost and time of procurement by preferring to use donor and private procurement systems instead of the CPS. The administrative burden and inefficiencies of using local systems were commonly cited by donor informants. However, the administrative burden imposed by donor systems was also regarded as a substantial issue by local informants. The cost and time requirements of ICB predisposed some donors to favour framework agreements and direct contracting, whilst many local informants preferred NCB.

Several countries including South Africa and Ghana have preferential procurement policies. These may directly lower the assessed cost of local procurement relative to other sources in order to increase the share of local sourcing. They were used extensively in South Africa and very rarely in Ghana. A similar effect was that low local capacity meant that when procuring locally, projects could be paying a premium for certain skills due to the lack of competition.

Risk aversion appeared to be part of the explanation for widespread *de facto* tying. The projects reviewed illustrate a wide range of donor responses, not only to the opportunities but also to the perceived risks in contracting and procurement associated with untying. Most bilateral donors still show a revealed preference for contracting management and TC from within known social networks on grounds of risk aversion. This often hinted at but not explicitly stated preference is reflected in the high proportion of head contracts awarded to organisations registered in the donor country. Contract requirements, including preregistration, completion bonds and so forth, make such outcomes more likely. Some donors focus on such risks as part justification for adopting a 'business as usual' approach. For example, this was argued by a donor

directly tendering from HQ level for a private contractor as the implementing entity.

In most cases, even where head contracts were formally or *de facto* tied, there was willingness to use CPS for sub-contracting project components and the procurement of specific goods and services. These positive choices in use of untied aid were considered to reflect country and sectoral level assessments of risks about when employing CPS and also using direct budgetary instruments were appropriate. The possibility of poor outcomes due to inefficiency in contracting (e.g. delays or restricted dissemination of information about tenders) and corruption were recognised by informants and reported in country studies. Most donors considered these risks to be manageable through financial reporting and monitoring.

Because of concerns about transparency and accountability, untying had done little to reduce financial reporting and monitoring requirements by recipients or within donor agencies, even for pooled funding arrangements. So from a donor perspective one of the anticipated benefits of untying has yet to materialise. The South Africa and Vietnam studies suggest the appropriate response to risks of inefficiency or misuse of funds in contracting is an awareness of problems and cooperation with country partners to address the implications. In most countries efforts were noted to support the strengthening of local financial management capacity.

7.8 Conclusion

A priori analysis of whether a project is untied is impractical. The tying status is formally determined by whether the head contract is open to unrestricted international competition. However country level analysis indicates that the determination should take into account all three levels of procurement including subcontracts. The tying status also needs to take account of the extent of *de facto* tying. This chapter therefore sheds light on the *importance of the genuineness of the commitment to untying*. Is tying perceived constructively or positively within a donor organisation or by its agents? Alternatively is untying perceived negatively as a modification to regulations on contracting and procurement necessary to conform to the requirement of untying status as in the OECD definitions and the 2001 Recommendation?

A positive approach would imply the use of direct bilateral instruments and pooling arrangements which give ownership and alignment, where this is regarded as practical and also by trying to strengthen local financial management and procurement capacity. A considerable difference in the revealed preferences of donors was found (Chapter 6) with the two largest bilaterals, the US and Japan, making least use of such modalities.

A positive approach also implies encouraging project-type preferences and process choices such as using reducing tender sizes and raising ICB thresholds, i.e. designing contract

packages that are more likely result in untied outcomes. A negative or purely conformist approach does result in a preponderance of *de facto* tying outcomes.

These forms of positive untying are very micro in nature and based in a project type approach. But they show that the specific uses of the procurement system are important in determining the level of untying as well as obviously untied modalities such as budget support and full pooling.

In terms of *value for money or aid efficiency* the following can be concluded: local competitive sourcing using NCB or ICB was found to be cost effective for goods procurement compared to market prices and the efficiency gains were most clear where untying led to increased competition in comparison with tied aid. The cost savings from formally untying aid are far from automatic.

International competitive bidding, although often described as time consuming, costly and administratively inconvenient, resulted in increased competition through a much wider geographical sourcing of contractors including regionally. However, even where ICB was adopted, the project planning and contracting processes of several DAC members appeared to intentionally or unintentionally advantage donor-based companies. Some indication of this is given by the econometric results in Chapter 6 and also by the comparison with World Bank contracting and the associated different distribution of sourcing.

Issues such as unequal access to information and financial barriers preclude local (and regional LIC) firms from competing for tenders. In the project case studies this was particularly true for framework contracts. An option for achieving competition gains could be to prioritise increasing the ability of local firms to partner the framework contract. Other options include positive practices such as reducing tender sizes where appropriate.

Procurement using CPS minimised many of these barriers. However, the best results were achieved where CPS had capacity in place to achieve transparent and effective competition.

Realising the potential benefits of untying also requires the supply capacity to make possible genuine competition. This was sometimes constrained by low numbers of bidders both in procuring at local levels where there were low skill sets, and also internationally, due to the large size or specific nature of some contracts.

The following areas of donor contracting practices were found to be less than wholly transparent from a recipient country perspective: donor contracting at HQ; framework contracts; B2B, twinning/partnership arrangements; and private management contracts. All of these areas offer scope for *de facto* tying. The most opaque aspects of donor practice concerned

TC and associated consultancies, the areas of assistance where formal and *de facto* tying were found to be still most pervasive.

The country studies found many examples of potentially improved practice in PD effectiveness terms in the ways in which untying is assisting donors in moving away from the conventional stand-alone project based approach to cooperative approaches. This movement facilitates budget support, pooling, delegated cooperation, use of the CPS and decentralisation. These steps, supported by many but not all donors, were found to be strongly supportive of PD goals of ownership and alignment and harmonisation. Untying and ownership is a two-way relationship; untying supports ownership and strong national systems and ownership assist untying.

In terms of development effectiveness, country studies are cautiously positive, finding evidence of direct employment and income stream generation. However, these effects are highly sector and activity specific and so could not be attributed to untying *per se*.

The balance of sourcing of goods and services is shifted by untying towards local suppliers, as all studies indicate. This promotes local business development, but the linkage effects are limited by the underdeveloped structure of the economy. The promotion of regional networking was limited and more to benefit the stronger economies.

The content of a project rather than nominal tying status was found to be critically important in determining outcomes. Capacity building and knowledge transfer appear to be more likely where local and regional firms of medium capacity undertake project investment activities.

8. CONCLUSIONS

This final chapter draws together in summary form the conclusions from the whole study, Phase One, a desk and donor focused review, and Phase Two, partner country studies, which are set out more fully on a chapter by chapter basis. The conclusions are organised here in terms of the three questions proposed for evaluation:

- To what extent has donor behaviour changed as a result of the 2001 DAC Recommendation on Untying Aid to Least Developed Countries, i.e. to what extent have donors untied their aid further?
- What factors have enhanced or impeded fully untying development assistance?
- Is there evidence of the untying of aid having resulted in an increase of the effectiveness and efficiency of aid?

These conclusions are followed by recommendations for ways of ensuring the fulfilment of commitments to fully untie aid in an efficient and effective way.

The 2001 Recommendation and untying of aid

The annual reports on progress in untying, based on statistical information submitted to the CRS and the DAC, indicate continued progress on untying, and that all DAC members are at least to some degree in the process of untying. The proportion of untied aid rose from 46% in 1999-2001 to 76% in 2007 and for LDCs from 57% to 83%. If (untied) multilateral aid is taken into account then 83% of all ODA in 2007 was untied. Formally, the ODA of DAC members, and especially to LDCs, is overwhelmingly untied.

In terms of effort-sharing the DAC indicated two targets. The first is a straightforward target of 60% share of untied ODA in total aid to LDCs, which almost all donors had reached within six years, including those that historically provided aid on a largely tied basis. The second indicator is the ratio of untied bilateral LDC ODA and multilateral LDC ODA within GNI. A target equivalent to 0.04% of GNI was agreed and is reported to

have been exceeded. The scope of the Recommendation was extended in 2006 and 2008 and reinforced by the Paris Declaration. It has been a significant influence on the behaviour of DAC member states since 2001 in encouraging and sustaining the process of formal untying of bilateral ODA. At this overall level the response to the Recommendation is an aid success story.

This study has re-examined the data on tying status as reported to the OECD, and complemented this first by a selective review of donor policies and practices in responding to the Recommendation, and then through seeking views and evidence from partner countries. The review broadly confirms the annual reports on progress in untying as a *formal* process.

The review of five donor countries policies provided more specific evidence on how the untying process has been characterised by the removal of *formal* domestic regulatory restrictions on the sourcing of goods and services by donors, and in agreements with partner countries and contracts with aid implementing entities that were intended to favour domestic organisations in the donor countries. Governments such as those of Australia and Canada that prior to 2001 had largely tied aid made not just substantial changes in agency policy but agreed exemptions from domestic restrictions on use of public funds. The donor peer reviews and the 2008 study on promoting local and regional procurement (OECD DAC, 2008b) confirm that all DAC members have participated to varying degrees in the process.

There has been further progress year on year since the Phase One report reviewed the response in the five years up to 2006. Budgetary support and debt reduction, the two almost entirely untied categories of direct assistance to governments, declined from 23% of bilateral ODA in 2006 to 13% in 2007. Nevertheless, the overall proportion of untied aid increased by 2%, underlining the more general move towards untying.

Additionality of tied aid? Some who defend tying practices or caution against change argue that untying could result in a loss of domestic support for aid overall, or have diversionary effects away from LDCs to other partner countries. But absolute levels of ODA to LDCs had almost doubled by 2007 since 1999-2001. The share of LDCs in total ODA was also 5% higher, and even higher (13%) when the somewhat temporary surges in debt relief during 2005-06 are excluded. Again the donor review in this study confirmed that untying had had no negative effect on either total ODA or aid to LDCs.

A closer scrutiny indicates various ways in which the narrative of untying of aid as a success story should be qualified. The untying of forms of aid exempt from the Recommendation has been less than those included. Some 30% of technical cooperation (TC) and aid with a TC component was reported as tied, or its tying status was not reported. It is difficult to determine the full extent of tying of food aid, reported as part of assistance in three sectors: emergency aid (21% tying), development food aid (53% tying), and commodity aid (tying status virtually unreported). But it is also interesting to note that 20% of donor administrative costs are reported in 2007 as untied, although this category is exempted from the Recommendation.

There are still large variations in DAC members' untying and reporting on tying status of their aid. Seven DAC members reported over 90% untying in 2007. The US is the major donor that continues to tie extensively (37% of its bilateral ODA in 2007 and 57% of all reported tying). Half of all non-reporting was by Japan. There was a high level of non-reporting for TC and sectors in which tying of project aid might be expected: infrastructure, transport and energy. There is a lack of transparency that indicates the need for caution in making statistical inferences. Improved reporting is necessary as agreed in the 2008 Accra Agenda for Action (see below).

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?

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 (Chapter 3) finds further support in the donor review (Chapter 4) and from partner countries (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 (Chapter 6).

Factors enhancing and impeding fully untying development assistance

The review of five donors and further discussion with both country partners and agency personnel highlighted factors encouraging the moves to untying of aid. First, the Recommendation and the extent of its coverage continue to be a positive influence. Second, moves to fulfil the Paris Declaration objectives of giving greater ownership and alignment with partner country strategies and harmonisation of donor actions is associated with the adoption of aid modalities, general and sectoral budgetary support, basket funding of programmes and pooling of funding, for which untying is a necessary condition. Thirdly, untying increases programmatic flexibility, and virtually all country partner and aid agency personnel were in favour of that.

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 (OECD, 2008a), in part because of effective opposition from domestic interest groups.

The five donors review 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, support to governance, post-secondary education, research and Business to Business (B2B).

The country study evidence 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.

Aid effectiveness and developmental impacts of untying

Aid effectiveness is understood in terms of aid efficiency in providing value for money and the Paris Declaration aims of ownership, alignment, harmonisation managing for results and accountability. The donor policy review (Chapter 4) found that agencies associated untying with a shift to instruments that either give greater responsibility for financial management to country partners (direct programmatic support and use of country procurement systems (CPS)), or to joint donor partners through pooling of funds, or to civil society organisations employing their own procedures. There would also be decentralisation of management at country level. The role of HQ procurement was being much reduced.

Both governments and other informants in partner countries strongly affirmed that untying implies transferring responsibility for planning and handling funds from donors to recipients (Chapter 6). This is more a matter of contracts, modalities, uses of CPS and offering local business an opportunity to compete successfully for contracts. Recipient country stakeholders are less concerned about removing biases amongst donor partners in their trade, except where excessive inefficiencies of tying significantly reduce the resource transfer value of aid.

The literature review covering the efficiency and developmental impacts of tying and untying found an extensive body of economic analysis and a quite limited number of evidence-based studies, with few recent contributions, focused on the inefficiency of tying and potential trade distorting effects. Untying was typically found convincingly linked to evidence on the adopting of programmatic and pooling modalities, for which untying is a necessary condition. So far DAC members have also done little to systematically evaluate the actual consequences of tying. There is therefore no well established conceptual framework for empirical investigation into the consequences of untying. The six country studies required a pilot study in Ghana to develop a feasible analytic approach and should be regarded as an exploratory investigation, providing provisional findings.

The key issue raised by the country investigations is the genuineness of the commitment to untying. Is the role of untying perceived constructively or *positively* within a donor organisation or by its agents? Alternatively is untying perceived negatively as a modification to regulations on contracting and procurement necessary to conform to the requirement of untying status as in the OECD definitions and the 2001 Recommendation? A *positive* approach would first imply the use of direct bilateral instruments and pooling arrangements, which give ownership and alignment, where this is regarded as practical. Second, whether providing programmatic or project-type assistance it implies trying to strengthen local financial management and procurement capacity rather than seeing limited capacity as just a constraint. A positive approach also implies making choices in projects such as using CPS and designing contract packages that are more likely result in untied outcomes. A *negative* or purely conformist approach is likely to result in a preponderance of *de facto* tying outcomes.

Untying aid modalities

The critical choice for donor partners is that of aid modalities. There is a lack of comparative and consistent data on the uses of different modalities (particularly joint pooling) and also the use of partner country financial management and procurement systems. Nevertheless, taking an eclectic approach to the evidence, the country studies show that there are systematic differences amongst donors in the revealed preferences of donors was found in countries where their aid is overwhelmingly untied (Chapter 6). A group of DAC members provide a substantial part of their aid to support jointly programmatic approaches and use pooling arrangements. The country

survey for the PDE also confirms that broadly the same DAC members, the so-called Nordic+ group, as well as France, Germany and Switzerland make extensive use of CPS in aid to government. Others, including the two largest donors, USA and Japan, restrict themselves almost entirely to project-type support and make little use of CPS. Project-type support is still the dominant aid modality in all surveyed countries.

The project approach and aid effectiveness

Programmatic modalities have been evaluated elsewhere with broadly positive but highly country-specific findings (e.g. IDD, 2006). The study therefore focussed on the use of formally untied funding for a purposively selected sample of project types to illustrate the range of current practices. The findings for 21 projects funded singly or jointly by donors in six countries were broadly consistent and so permit a provisional set of conclusions on efficiency and aid effectiveness (Chapter 7).

Projects, even when formally untied, are rarely fully untied, but include elements of untying and *de facto* tying. In particular, it is highly likely that where there are head contracts for managing TC these will be sourced in the donor country. Recipients' power in negotiation is a key influence on whether implementing entities are local and the top-level contracts are subject to ICB. Where donors allow a high proportion of funds to be disbursed through CPS using ICB or NCB for subcontracting contracts are more likely to be awarded to local or regional firms.

Value for money – aid efficiency:

Local competitive sourcing using NCB or ICB was found to be cost effective in most cases for goods procurement compared to internal commercial or international market prices, and the efficiency gains were most clear where untying led to increased competition. However, direct contracting and NCB was in some cases more costly where there are local supply constraints and powerful social networks. Similarly a donor emphasis on 'quality' in contract specification rather than value for money can easily become a way of narrowing the range of supply options.

An unlevel playing field

International competitive bidding resulted in a much wider geographical sourcing of contractors including regionally. This is most evident in contrasting the sourcing of bilateral projects with those contracted by the World Bank using ICB and NCB in the six partner countries. However, even where ICB was adopted the project planning and contracting processes of several DAC members appeared to intentionally or unintentionally advantage donor based companies.

Many factors prevent local and regional firms from winning contracts when these are open to ICB, especially where this is undertaken by the donor under their own rules and at HQ level. These factors include lack of access to information, lack of skills and capacity, the size of lots put to tender, as well as other financial barriers such as weak credit markets and non-

availability locally of professional indemnity insurance. Where firms are likely to tender only for contracts in their country or region, then they run into a problem of actuarial risk associated with unsuccessful bids – in contrast with donor-based or multinational firms and non-profit organisations they are unable to spread preparation costs for proposals across many applications.

Framework contracts (a form of services-in-kind from the recipient and project perspective) can preclude competition gains from untying. An option for achieving competition gains could be to prioritise increasing the ability of local firms to partner in the framework contract.

Untying and aid effectiveness:

The country studies found many examples of potentially improved practice in PD effectiveness terms in the ways in which untying has allowed donors to move away from the conventional stand-alone project based approach to cooperative approaches. These moves, supported by many but not all donors, including budget support, pooling, delegated cooperation, use of the CPS and decentralisation, increase ownership, facilitate alignment and achieve harmonisation.

The following areas of donor contracting practices were found to be less than wholly transparent from a recipient country perspective: donor contracting at HQ; framework contracts; B2B, twinning/partnership arrangements; and private management contracts. The most opaque aspects of donor practice concerned TC and associated consultancies, the areas of assistance where formal and *de facto* tying were found to be still most pervasive.

Developmental impacts of untying

Country studies are cautiously positive, finding evidence of direct employment and income stream generation. However, these effects are highly sector and activity specific and so could not be attributed to untying *per se*.

The balance of sourcing of goods and services is shifted by untying towards local suppliers, as all studies indicate. This promotes local business development, but the linkage effects are limited by the underdeveloped structure of the economy.

The content of a project rather than nominal tying status was found to be critically important in determining outcomes. Capacity building and knowledge transfer appear to be more likely where local and regional firms of medium capacity undertake project investment activities.

Overall, and despite reservations on transparency, genuine untying emerges from the country studies as a critically important contributory factor towards achieving greater aid effectiveness and not one to be justified only in terms of efficiency gains or promoting local business development. The precise effects also depend very much on country specific circumstances, as is apparent from comparing any of the three country pairings.

The relatively new programmatic modalities: financial aid, as general and sectoral budgetary support and basket funding, is *de facto* untied and demonstrates genuinely untied practices. Funds directed to government and its agencies are most likely to be disbursed using country procurement systems.

In contrast, the formal tying status of a project provides little clue to the actual extent of untying and its consequences. Project type aid is now mostly reported as untied. That declaration is taken to mean that at least the head contract formally satisfies the OECD definition for untied aid even if in practice it is *de facto* tied.

In practice the typical project, as funded by most DAC donors individually or jointly is likely to be a hybrid or a mix of aid components that are formally or *de facto* tied and also formally or *de facto* untied. This reality implies a view of tying that is quite different from the simple categorical notion that aid is tied, partially tied or untied. From this perspective the untied content of a project can be increased through changes in contracting at different levels and different component activities.

Technical cooperation components of most projects considered were found to be *de facto*, if not formally, tied. This finding implies focusing on further practical steps to broaden the sourcing of TC and the management aspects of projects.

Beyond rhetoric: the future of untying in a rapidly evolving aid context

Before proceeding to make specific recommendations on how to move towards more fully untied aid, that narrowly focused discussion should be situated in its wider context, avoiding rhetoric and recognising political economic realities.

Fully untying aid obliges donors to give up two convenient practices, justifying their aid through tying and relying on their networks of domestically based organisations. So far some donors have been reluctant to do this resulting in both open and *de facto* tying.

Similarly, untying in practice exposes problems of recipient government capacity in financial management and governance. The use of CPS raises issues of capacity and also risks of corruption, as country studies have noted. Realising many of the potential benefits of untying depends on developing local capacity to supply both goods and services. This issue extends also to second level services such as efficiently functioning markets for credit and public liability insurance.

The changing global aid context raises strategic policy issues. The growing role of concessional funding for development provided by emerging non-DAC countries, such as China and India, most obviously in SE Asia but also in Africa, was an ever present background issue in undertaking the country studies. However, the scale and terms of such concessional flows could not be satisfactorily documented, let alone quantified.

This funding is often very large scale and mostly directed to basic infrastructure, facilitating commodity exports and some prestige projects. Mostly provided as concessional loans, it appeared to be largely tied but with little conditionality, and is therefore very attractive to many aid recipients. These countries are urged to accept DAC principles. But in any case the scale of such non-DAC flows raises the question of what is the future comparative strength of bilateral ODA of DAC members? What combination would be appropriate of wholly untied direct bilateral budgetary assistance and project-type investment and TC which are formally untied but in practice are almost all mixed packages of untied and *de facto* tied elements.

New vertical funding mechanisms, for example PEPFAR (President's Emergency Plan for AIDS Relief) and the GFATM (Global Fund to Fight AIDS, Tuberculosis and Malaria), could be at odds with the PD aid effectiveness principles that provide the rationale for untied aid. Due to their vertical nature these mechanisms may not be aligned nor harmonised, preferring parallel implementation structures to CPS. Their vertical nature may also work against individually tailored local sourcing arrangements.

Finally, 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.

The way forward: recommendations

The 2005 Paris Declaration includes a further qualitative commitment without any specific target (Indicator 8) to continue the process of untying. The 2008 Accra Agenda for Action on aid effectiveness reaffirmed this commitment, and called upon DAC members in responding to elaborate *individual plans by 2010 to untie their aid to the maximum extent and to improve reporting* on the 2001 Recommendation (OECD DAC, 2009). These proposals are strongly endorsed and further specific measures are suggested to support genuine untying and reduce, if not eliminate *de facto* tying practices.

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.

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

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.

Agencies whose untying practice is 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, following the positive example of Australia and Canada since 2001.

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 to be made a specific item for inclusion in future DAC member peer reviews.

The DAC should consider adding to the annual progress reports on untying a country partner focused review of progress in untying to be undertaken with the full cooperation of an LDC or HIPC country included in the Recommendation and also DAC members. Such country studies would both build on this thematic evaluation and give more substance to the annual reports. The first of such annual reviews might be undertaken in cooperation with a country in the Latin American and Caribbean region, which is not included in this study.

This study has only been able to provide a provisional assessment of the extent of untying and the implications for aid effectiveness. The assessment is on balance positive but there are many unknowns and too little transparency. There are the inevitable data problems. But these issues of full and genuine untying concern all DAC members. Untying and tying practices rarely appear on the evaluation agenda and so opportunities to know more are systematically missed. DAC members individually need to monitor and rigorously evaluate both their progress in untying and in making use of the capacities within partner countries. This study could provide a benchmark for future assessments when DAC members are sharing their findings and lessons learnt.

ANNEX A: TERMS OF REFERENCE

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 TERMS OF REFERENCE 22 FEBRUARY 2008

(Revised 14 May 2008)

1 Background

1. For decades, debates on aid effectiveness have focussed on the issue of the tying status of aid. It has been clearly documented that tied aid raises the cost of goods, services and works by 15% to 30% on average, and by as much as 40% or more for food aid. This is a conservative estimate of the real costs of tying, since it does not incorporate the indirect costs.
2. As a result, after extended and difficult negotiations, the OECD/DAC adopted in 2001 a Recommendation to untie much ODA to Least Developed Countries (LDCs). The Recommendation (amended in 2006) also invites DAC members to provide untied aid in areas not covered by the Recommendation and to study the possibilities of extending untied aid in such areas. Progress achieved in the proportion of ODA that is untied is tracked in the context of the Millennium Development Goals, e.g. target number 35. The 2005 Paris Declaration on Aid Effectiveness reiterated the 2001 DAC recommendation and progress in the share of aid that is untied is monitored through Indicator 8.
3. International conferences on development, such as the Monterrey International Conference on Financing for Development, have consistently highlighted that increasing the share of aid that is untied is a significant means to improve aid effectiveness. This view has been reiterated at successive G-8 Summits, most recently the June 2007 Heiligendamm G-8 Summit which noted in paragraph 21 the need to continue enhancing efforts to untie aid.
4. In view of these arguments and the calls for further untying a number of DAC donors have either fully untied their aid (e.g. Ireland, Norway, Luxembourg, and the United Kingdom) or almost completely untied their bilateral aid programmes (e.g. Australia, Belgium, Denmark, Finland, Sweden and Switzerland). In addition, the European Community has adopted two regulations governing access to EC external assistance under which all aid to LDCs is provided untied. Moreover, all expertise (e.g. technical co-operation) and food aid will be untied and aid from the EU budget (i.e. excluding the European Development Fund) will be open to other donors on the basis of reciprocity. Finally, the US Millennium Challenge Corporation (MCC) also provides its aid in untied form.
5. In preparation of the Third High Level Forum on Aid Effectiveness to be held in Accra, Ghana on 2-4 September 2008, Members of the Working Party on Aid Effectiveness and the DAC Network on Development Evaluation have asked for a Thematic Study of the extent to which development partners have untied their assistance and the key factors promoting or impeding progress on fully untying development assistance. Furthermore, they have asked to identify examples of benefits of fully untied aid.
6. In the context of the 2001 DAC Recommendation to Untie ODA to the LDCs a comprehensive evaluation, *inter alia*, of its impact is mandated for submission to the 2009 DAC High Level Meeting. (The comprehensive evaluation will also pay attention to the implementation of this Recommendation with respect to achieving a balance of efforts among DAC Members and promoting and sustaining ODA flows to LDCs.)
7. In light of the close communalities between the Thematic Study within the framework of the evaluation of the Paris Declaration on Aid Effectiveness and the DAC request for a comprehensive evaluation of 2001 DAC Recommendation on Untying ODA to the LDCs, **one** thematic study will be undertaken to assess the effectiveness of untied aid. The

evaluation study will include results assessments based on case studies in a number of partner countries.

2 Purpose

8. The purpose of the study is to provide the 3rd HLF in Accra in September 2008, the DAC and the 2009 HLM, as well as the wider development community, with a comprehensive assessment of current donor policies and practices regarding the tying status of aid and an assessment of the effects of the untying status on aid effectiveness. The Thematic Study should focus on the results of untied aid, and examine if, and to what extent the present effort for untying aid has contributed to aid effectiveness. The Study should also explore the prospects for increasing the share of untied aid, and where relevant provide policy recommendation on promising approaches on how to achieve this objective.

9. The questions to be addressed by the Evaluation study are:

- To what extent has donor behaviour changed as a result of the 2001 DAC Recommendation on Untying Aid to Least Developed Countries, i.e. to what extent has donors untied their aid further?
- What factors have enhanced or impeded fully untying development assistance?
- Is there evidence of untying of aid having resulted in an increase of the effectiveness and efficiency of aid?

3 Output

10. The Thematic Study will be undertaken through a consultative process with donors, partner countries and civil society. The evaluation study will be conducted in two stages.

- The output of the first stage will be a report providing a comprehensive overview of the current policies and practices of DAC members and non-DAC donors regarding the tying status of their aid and the effects on aid effectiveness. During this first stage to be based on documentary research and the DAC database, a methodology for the partner country case studies will also be developed.
- The output of the second stage will be a representative number of, evidence-based case studies in partner countries concerning the effects of the (un)-tying status of aid on aid effectiveness. The case studies will be undertaken in cooperation with local research centres, such as for instance the African Economic Research Consortium. This stage should also examine the extent to which untied aid has resulted in procurement from local/regional companies and its effect on aid effectiveness.

11. The comprehensive final report covering Stages I and II should outline practical policy recommendations for increasing the share of aid that is untied⁵⁹.

4 Activities

12. The overall assessment (e.g. Stages I and II) will be presented in a succinct, but comprehensive report that contains:

- An executive summary.
- Brief overview of the international rules and agreement concerning the tying status of ODA.
- A statistical analysis of trends in the tying status of ODA including tying/untying practices of emerging non DAC donors. [The report should also address issues of burden-sharing and transparency of processes and procedures].
- A survey of the political factor and national rules and regulations bearing on the tying status of ODA.
- An assessment of the developmental effectiveness of tied versus untied ODA based on a literature survey and the outcomes in a representative number of case studies in partner countries.
- Policy focussed conclusions and recommendation on promising approaches to increase the share of ODA that is untied and developmentally effective.

13. The chapter concerning the international rules and agreements regarding the tying status of ODA will provide a succinct and comprehensive overview of OECD arrangements and recommendations on tied and untied aid as well as WTO arrangements and agreements. The chapter should assess the current position on both sides of the debate as to the *de facto* credibility, balance and enforceability of untying.

14. The chapter concerning the statistical analyses by donor country of trends in the tying status of ODA will cover the period 1985-2005. It will aim at identifying robust statistical correlations between the extent of tied/untied ODA and;

- financial instruments, such as loans, grants or mixed credits, and innovative financing instruments, such as Global Funds (HIV/AIDS)
- types of aid, such as financial aid, technical assistance, food aid, programme aid, budget support and debt relief;
- bilateral and multilateral flows;

⁵⁹ PD para 31: "Untying aid generally increases aid effectiveness by reducing transaction costs for partner countries and improving country ownership and alignment. DAC Donors will continue to make progress on untying as encouraged by the 2001 DAC Recommendation on Untying Official Development Assistance to the Least Developed Countries (Indicator 8)."

- income categories, and
- ODA/GNI ratios (as a proxy for public support for the aid effort).

15. The chapter providing an overview of trends in DAC Members and non-DAC donors' policies and practices will be based on the existing data and documents, especially the annual Progress Report on the implementation of 2001 Untying Recommendation and the results of the DAC study concerning local and regional procurement which is currently being undertaken.

16. The chapter addressing the political factors influencing the tying status of ODA will provide an analytical assessment of the arguments made in different countries in support of tied aid such as, *inter alia*, capturing or preserving export markets for donors' companies, generating domestic support for the aid effort and strengthening the interaction between citizens from donor and partner countries. To assess the strength of arguments in favour of untying ODA, the chapter will address issues related to trade distortion, national as well as international policy coherence, cost effectiveness, and aid effectiveness.

17. The **second stage** of the evaluation study (e.g. Chapter vi) will assess the developmental effects (or effectiveness) of tied versus untied aid projects and programmes through a representative number of case studies in partner countries. This assessment will be based on the DAC evaluation criteria, e.g.

- *Relevance* (e.g. appropriateness of the procured goods, works or services, and whether the tying status of aid is consistent with the country's development objective and needs.
- *Efficiency* (e.g. cost and non-cost factors such as, quality of goods and services, delivery period, guarantee conditions, maintenance conditions, cost of repairs and spare parts, safety and health aspects)
- *Impact* (e.g. effects on the market for local and regional producers, on promotion of the linkage of the local economy with regional networks, global networks, on employment, on pro-poor growth and poverty alleviation, and on gender and environment, impact of untied aid on Corporate Social Responsibility and on project lifetime cost savings.

18. The assessments listed above (e.g. Chapters ii – vi) should be discussed with representatives from donors, partner countries, civil society and the private sector to arrive at a small set of key policy focussed conclusions to increase the effectiveness, quality, transparency and share of aid that is untied.⁶⁰ These recommendations should meet the DAC criteria

for reviewing possible ways to increase the share of aid that is untied. First, there should be broad-based support for the proposal and second, the magnitude of the potential benefits should be reasonable.

5 Timing

19. The initial report on Stage I should be ready in time for the Third High Level Forum on Aid Effectiveness, which will be held in Accra, Ghana on 2-4 September 2008. The specific timing of stage II, e.g. partner country case studies, will be decided when specific ToR have been developed and relevant case study countries identified and agreed upon. Tentative schedule:

1 August 2008: Phase One: Draft Report
 5 September 2008: Draft Paper on Methodology for Phase Two
 Mid Sept- mid October 2008: DAC/ Evaluators Agree on Detailed Plans for Phase Two
 Mid October - Mid November 2008: Recruiting/contracting for Country Studies
 November-December, 2008: Launch Country Studies
 March 2009: Draft Country Studies
 April 2009: Draft Report on Phase Two
 May 2009: Peer Review of Draft Report; Agency review
 June 2009: Presentation of Final Draft Report

6 Experts profile

20. The research team should combine training and experience in development policy, official development assistance financing, evaluation and procurement, and have a sound experience related to the issues of results assessments. They should also have experience regarding the issue of the tying status of aid and be familiar with related publications and works. The team should combine experts from different DAC Member States and from partner countries.

7 Reporting

21. At the start of the assignment the consultants will provide an inception report. During the assignment the consultants will provide progress reports on a continuous basis. Progress in work and provisional results will also be presented and discussed in regular meetings with a Management Group comprising representatives of the DAC Secretariat and the Reference Group for the Evaluation of the Paris Declaration. The consultants should accept suggestions and guidelines *agreed* upon at these meetings.

22. At the end of Stage I of the Thematic Study an interim report will be produced in English no later than 1 August 2008. This report will describe the results of the descriptive analysis, database, conclusions and references according to section 4 above. At the end of Stage II after the completion of the case studies, a comprehensive report will be produced in English no later than June 2009

⁶⁰ The modalities for this need to be established.

23. The report will then eventually be revised following comments from the Management Group. The final report, which should link a clear communications style with a rigorous analytical approach, will be published and shared with the OECD members and partner countries.

8 Budget

A maximum of € 310.000 is available. Distributed approximately as follows:

Phase I: EUR 52,000

Phase II:

Coordination and Synthesis: EUR 90,000

Four Country Case Studies: EUR 168,000

ANNEX B: ADDITIONAL STATISTICAL MATERIAL

Table B.1 DAC donor countries: bilateral ODA by consolidated sectors in 2007¹. Tying status as % of sector ODA.

Consolidated Sector	(US\$ million)	(%)					
	Bilateral ODA	Share of bilateral ODA	Untied	Partially tied	Tied	Not Reported	Untied share of bilateral ODA
I.1.a. Education, Level Unspecified	1,822	2.0	85.0	0.3	7.8	6.9	2.3
I.1.b. Basic Education	1,800	2.0	83.5	0.3	13.8	2.3	2.2
I.1.c. Secondary Education	764	0.8	68.7	0.0	10.3	21.0	0.8
I.1.d. Post-Secondary Education	3,781	4.2	48.9	0.0	39.5	11.6	2.7
I.2.a. Health, General	1,486	1.7	86.7	1.0	6.3	6.0	1.9
I.2.b. Basic Health	2,911	3.2	85.3	0.2	12.2	2.3	3.6
I.3. Population Pol./Progr. & Reproductive Health	6,482	7.2	90.9	0.1	8.3	0.7	8.6
I.4. Water Supply & Sanitation	4,402	4.9	89.0	0.4	8.1	2.5	5.7
I.5.a. Government & Civil Society-general	8,783	9.8	71.9	0.3	25.3	2.5	9.2
I.5.b. Conflict, Peace & Security	2,504	2.8	67.8	0.2	27.6	4.4	2.5
I.6. Other Social Infrastructure & Services	3,401	3.8	53.6	0.1	40.7	5.6	2.7
II.1. Transport & Storage	3,863	4.3	72.2	0.0	24.6	3.2	4.1
II.2. Communications	276	0.3	60.2	0.0	26.5	13.3	0.2
II.3. Energy	3,881	4.3	82.2	0.2	16.8	0.9	4.7
II.4. Banking & Financial Services	1,655	1.8	92.4	0.2	6.1	1.3	2.2
II.5. Business & Other Services	1,456	1.6	54.2	0.0	40.3	5.4	1.2
III.1.a. Agriculture	3,508	3.9	86.6	0.4	8.6	4.5	4.4
III.1.b. Forestry	565	0.6	92.2	0.0	1.5	6.3	0.8
III.1.c. Fishing	194	0.2	59.8	1.1	21.6	17.6	0.2
III.2.a. Industry	703	0.8	71.1	0.1	15.0	13.9	0.7
III.2.b. Mineral Resources & Mining	42	0.0	42.8	0.0	14.9	42.3	0.0
III.2.c. Construction	85	0.1	75.4	0.0	20.2	4.4	0.1
III.3.a. Trade Policies & Regulations	462	0.5	69.5	0.0	17.5	12.9	0.5
III.3.b. Tourism	46	0.1	43.9	0.0	31.2	24.8	0.0
IV.1. General Environment Protection	2,237	2.5	78.9	2.2	14.7	4.2	2.6
IV.2. Other Multisector	4,075	4.5	84.7	0.5	11.2	3.6	5.0
VI.1. General Budget Support	2,769	3.1	99.3	0.0	0.7	0.0	4.0
VI.2. Dev. Food Aid/Food Security Ass.	1,020	1.1	46.9	0.0	53.0	0.0	0.7
VI.3. Other Commodity Ass.	278	0.3	1.2	0.0	0.2	98.6	0.0
VII. Action Relating to Debt	9,010	10.0	100.0	0.0	0.0	0.0	13.2
VIII.1. Emergency Response	6,270	7.0	76.8	0.3	22.9	0.0	7.0
VIII.2. Reconstruction Relief & Rehabilitation	799	0.9	92.5	0.0	7.5	0.0	1.1
VIII.3. Disaster Prevention & Preparedness	132	0.1	95.4	0.0	4.0	0.6	0.2
IX. Administrative Costs of Donors	4,357	4.8	20.4	0.9	46.3	32.4	1.3
X. Support to NGO's	799	0.9	84.4	3.0	1.5	11.1	1.0
XI. Refugees in Donor Countries	1,968	2.2	59.2	0.0	31.9	8.9	1.7
XII. Unallocated / Unspecified	1,360	1.5	44.6	0.5	8.0	47.0	0.9
All sectors	89,945	100.0	76.0	0.3	18.0	5.7	100.0
All sectors (including EC ODA)	103,318		66.2	13.2	15.6	5.0	

Source: OECD CRS database.

Notes: 1. Data are based on commitments in current US\$ millions.

Table B.2 Formal features of the 21 project case studies

Project Number	Project Name	Country Partner	Donor(s)	Value of Donor contribution (millions)	Formal untied aid share ⁶¹	Sector	Major Input Type
1	RRHF (Rapid Response Health Fund)	South Africa	DFID	UK£ 15	100%	Health	TC
2	EPDPHCP (Extended Programme for Delivery of Primary Health Care)	South Africa	EC	€ 70	100% partially untied	Health	TC
3	Buffalo/Leiden Storm Water & Drainage	South Africa	VNG ⁶²	€ 0.3	31% untied	Water & Sanitation	TC
4	PROFIT (Production, Finance and Technology)	Zambia	USAID	US\$ 17.5	100%	Business	TC
5	WSSNP (Water Sector Support In Northern Province)	Zambia	Irish Aid	€ 2	100%	Water & Sanitation	Investment
6	SWSP (Southern Province Water Supply and Sanitation Project)	Zambia	KfW	DM 27	Tied and untied aid (shares unknown)	Water & Sanitation	Investment
7	WSPIP (Water Sector Performance Improvement Project)	Zambia	World Bank (IDA)	US\$ 33	100%	Water & Sanitation	Investment
8	NTP RWSS II (National Target Programme for Rural Water Supply & Sanitation)	Vietnam	AusAID, Danida, Netherlands	US\$ 125	100% plus services-in-kind	Water & Sanitation	Investment
9	Saigon River Lowlands Flood Prevention Project	Vietnam	AFD	US\$ 11.8	100%	Water & Sanitation	Investment
10	Phan Ri-Phan Thiet Irrigation Project	Vietnam	JICA	US\$ 51.9	100%	Water & Sanitation	Investment
11	Nam Tuan Irrigation Project	Vietnam	LuxDev	€ 3.3	100%	Water & Sanitation	Investment
12	Lao-Swedish Road Sector Project Phase III	Lao PDR	Sida	US\$ 20	100% plus services-in-kind	Roads	Investment
13	ICBRDP (Integrated Community Based Rural Development, Namor & Xay Districts, Oudomxay Province)	Lao PDR	EC	€ 1.1	100% partially untied	Rural Development	Investment
14	Vientiane Water Supply Development Project	Lao PDR	JICA, MOFA	US\$ 30.2	Tied and untied aid (shares unknown)	Water & Sanitation	Investment
15	Nam Theun II	Lao PDR	AFD, WB, Thai-Exim, ADB, EIB, Private Banks and Shareholders	US\$ 1,450	100% untied	Energy	Investment

61 It proved impossible to consistently identify projects in the CRS database therefore this column is populated with the study team's best estimate of the formal reporting of the untying status for each project

62 Association of Netherlands Municipalities.

Table B.2 (continuation) Formal features of the 21 project case studies

Project Number	Project Name	Recipient	Foreign Funder(s)	Value of Donor contribution (millions)	Formal untied aid share ⁶⁴	Sector	Major Input Type
16	PADSEA (Programme d'Appui au Développement du Secteur Eau et Assainissement)	Burkina Faso	Danida, Sida	CFAF 30.7	100% untied	Water & Sanitation	Investment
17	CNTS (Le Projet d'Appui au Centre National de Transfusion Sanguine)	Burkina Faso	LuxDev	CFAF 1.3	100% untied	Health	Investment
18	ZIGA (Le Projet d'Approvisionnement en Eau potable de la ville de Ouaga-dougou à partir du barrage de Ziga)	Burkina Faso	WB, AFD, EIB, EDF, IDB, BADEA, KfW, Belgium, OPEC, BERT	€ 228	92% untied and partially untied	Water & Sanitation	Investment
19	PADS (Le Programme d'Appui au Développement Sanitaire)	Burkina Faso	WB, Netherlands, Sida, AFD, ENFPA, PMNCH, GAVI, Gates Foundation, GFATM	CFAF 38	100% untied	Health	Investment
20	Damanko-Kpassa	Ghana	Danida/DFID	US\$ 2.5 ⁶⁵	100% plus services-in-kind	Water & Sanitation	Investment
21	NORWASP/NORST	Ghana	CIDA	CDN\$ 16.4	74% untied	Water & Sanitation	Investment

63 It proved impossible to consistently identify projects in the CRS database therefore this column is populated with the study team's best estimate of the formal reporting of the untying status for each project.

64 DfID contribution only as the value of the Danida supplied TC is not known.

Table B.3 DAC donors: representativeness of the purposive sample of six partner countries

Donor	All Developing Countries		Countries under review	
	Commitments 2005-07	Untied aid share of donor ODA (%)	Commitments 2005-07	Untied aid share of donor ODA (%)
Australia	5391	83.5	138	78.2
Austria	3725	77.5	67	43.6
Belgium	4710	94.9	282	73.6
Canada	8454	62.1	301	67.3
Denmark	4394	90.4	755	93.5
Finland	1941	83.3	212	87.8
France	26080	78.5	2174	72.7
Germany	28404	74.3	1527	80.7
Greece	652	28.0	4	55.3
Ireland	1948	97.9	196	100.0
Italy	6667	65.7	117	51.1
Japan	41882	78.2	3880	70.4
Luxembourg	670	100.0	105	100.0
Netherlands	18595	90.8	1266	88.1
New Zealand	875	64.4	35	65.2
Norway	7500	99.8	370	99.1
Portugal	1066	56.5	1	99.0
Spain	8390	49.7	120	48.3
Sweden	8078	92.0	440	98.8
Switzerland	4182	68.0	184	76.1
United Kingdom	26033	100.0	1566	100.0
United States	76758	45.5	2494	73.2
Total DAC donors	286393	71.6	16235	79.3

Source: OECD Creditor Reporting System (CRS) database.

Notes: 1. Data are based on commitments in current US\$ mn.

ANNEX C: ECONOMETRIC ANALYSIS OF THE IMPLICATIONS OF BILATERAL AID FOR DONOR EXPORTS

1 Introduction – objectives and scope of investigation

If one considers the exports from developed industrial donor countries that constitute the DAC to aid recipient developing countries then one would expect the flow of exports from the donor country to the recipient country to be explained by factors such as the size of the exporting economy, proximity or distance, and sharing a common language. Even the total level of aid might be an influence on the exports of all donor countries. However, in a multi-donor world where no single donor dominates, as the US did during the Marshall Plan era, there is no reason why the level of aid from a donor to a recipient would influence that donor's export, unless bilateral aid were having a trade distorting effect through explicit or implicit tying. Tying is widely considered to advantage exporters in the donor country. Untying is therefore expected to reduce the distorting bias of aid in favour of the donor's exports. Similarly bilateral concessional loans were thought to be often associated with donor exports, for example through a mixed credit arrangement.

This annex therefore investigates whether current bilateral aid flows and associated practices are having trade distorting effects. The aim is to understand whether bilateral ODA is an influence on donor export, even with current high levels of untying, whilst taking into account other variables that might be influencing this relationship (such as FDI, export credits, EC disbursements). Conventionally, tying status and the different forms in which aid is provided, for example loans and grants, have been hypothesised to influence aggregate donor export flows at the country level.

In order to take into account country specifics, a similar econometric investigation is being undertaken for each of the six case country studies⁶⁵ and an overall analysis for the six countries is provided in this section. The six countries are purposively paired according to trading region to isolate potential

regional effects: Ghana and Burkina Faso in West Africa, Lao PDR and Vietnam in South East Asia region and ASEAN, and Zambia and South Africa in SADC region. Moreover, the six selected countries also differ for their DAC classification: Burkina Faso, Lao PDR, Zambia being LDCs, South Africa as UMIC, and Vietnam and Ghana as OLICs; Burkina Faso, Ghana and Zambia are also being classified as HIPC.

The Annex is organized as follows. The first section briefly sets out the theoretical framework. Sections 3 and 4 respectively briefly describe the methodology and the data used. Section 5 discusses and compares the results of the empirical analysis of the relationship between aid and trade flows for the six countries under review.

2 Theoretical framework

The basic idea is to consider whether there is any trade distorting effects of aid at an aggregated level by examining whether bilateral aid from a particular donor to a recipient country affects trade between that donor and recipient pair differently from aid from other donors.

There could be several reasons why Official Development Assistance could lead to an increase in the donor's exports (*positive impact*).

The most obvious explanation is that *aid is formally tied* to exports from the donor country (*direct effect*); by definition tied aid results in trade dependency⁶⁶. However, there are several ways for a donor to effectively tie aid without a formal tying agreement. Therefore, also *de facto* tying by covert restrictions on sourcing can generate increased trade with the recipient. There are then other *indirect effects* that might lead to a positive correlation between ODA and donor's exports. Aid might have a *macroeconomic impact* in the recipient countries; higher rates of economic growth and structural economic

⁶⁵ The econometric analysis for each country can be found in Country Reports which will be placed on the PDE web-site in due course.

⁶⁶ Tied aid may simply finance donor exports that would have been procured from the donor country anyway; however, we would expect tied aid to usually increase donor's exports.

reforms such as trade liberalization might indirectly impact on donor's exports. Moreover, aid flows could result in an increase in trade with the donor, reflecting the *goodwill* of the recipient towards the donor. Finally, the aid relationship might facilitate trade between the donor and the recipient increasing recipient's *proclivity* to procure goods from the donor (reinforcing commercial ties).

In theory, bilateral aid could also decrease donor's exports to the recipient country (*negative impact*); if aid were tied there might be a straight forward *substitution effect* (Osei *et al.*, 2004; Wagner, 2003; Martínez-Zarzoso *et al.*, 2008; Zarin-Nejadan *et al.*, 2008;). Also if there were a partial tying restriction, for example to local, regional or developing country sourcing, that could have a negative effect.

In general, earlier studies (Nilsson, 1997; Wagner, 2003; Martínez-Zarzoso *et al.*, 2008; Zarin-Nejadan *et al.*, 2008; Nowak-Lehmann *et al.*, 2008; Petterson and Johansson, 2009) have found a positive correlation between donor aid and donor exports; these results have usually been seen to corroborate the hypothesis that aid is tied (formally or informally) to exports from the donor country (Petterson and Johansson, 2009).

3 Methodology – Empirical specification

The gravity approach has been often praised for its remarkable explanatory variable and it is solidly based in the empirical literature (as opposed to Tajoli methodology which is only a minor approach). Granger causality itself has several limitations⁶⁷ and would be difficult to implement given the limited number of observations available. For this reason it was decided to use a gravity model and adapt it to the country level.

In this section, the empirical specification used to test empirically the hypotheses⁶⁸ is set out. This follows closely the methodology adopted by Massa and Te Velde (2009).

First, the following regression is computed in order to understand whether aid flows have an impact on total donors' export flows to the recipient country at an aggregate level.

$$\ln(Exp_{it}) = \alpha + \beta_1 \ln(Y_{it}) + \beta_2 \ln(Ypc_{it}) + \beta_3 \ln(Dist_{it}) + \beta_4 \ln(ComL_{it}) + \beta_5 \ln(FDI_{it}) + \beta_6 \ln(ExpC_{it}) + \beta_7 \ln(ImpR_{it}) + \delta_1 \ln(ODA_{it}) + \delta_2 \ln(ODA_{All-it}) + \epsilon_{it}$$

(ODA aggregated)

The dependent variable Exp_{it} represents the export flows⁶⁹ from country i to the recipient country;

Y_i and Ypc_i measure respectively the GDP and GDP per capita of donor country i ;

$Dist_i$ stands for the distance between the exporting and the recipient country whereas $ComL_i$ is a dummy indicating whether the donor country and recipient share a common official language⁷⁰;

FDI_i stands for foreign direct investments to the recipient country;

$ExpC_i$ stands for export credits;

$ImpR_i$ stands for import residuals;

ODA_i is the country i 's Official Development Assistance to the recipient country whereas ODA_{All-i} represents ODA the recipient country receives from all the bilateral donors other than country i .

ϵ_i is the error term, normally distributed, with mean 0 and variance σ_ϵ^2 .

There might be a number of unmeasured influences that affect both aid and exports in the model. The omission of variables representing such influences (either difficult to measure and unquantifiable relationships such as political ties between the donor and the recipient, or simply underlying relationships not identified as potential determinants) could lead to attributing too great an importance to the explanatory power of foreign aid. Aid could be proxying for a complex relationship including several of these omitted variables. In order to overcome this problem an OLS regression of imports to the donor from the recipient is estimated and the *residuals* from this regression are included in the original equations. This procedure is carried out on the assumption that underlying relationships, and more in general unmeasured variables, between the donor and the recipient (trading partners in this case) affect imports and exports in the same way (Wagner, 2003).

67 See 'Problems in estimating the determinants of exports – the aid and trade relationship' section of the background paper for a full discussion on the direction of causality as well as Granger causality drawbacks.

68 See 'problems in estimating the determinants of exports related to the nature of the aid and trade relationship' section of the background paper (Natali *et al.*, 2009). The variable for the recipient having been in a colonial relationship, is also dropped; at the country level this variable loses its interest and moreover it is likely to be highly correlated with the common language variable.

69 Exports include all traded goods but not services. Ideally, exports of goods and services would have been used as a dependent variable; this exercise would have proved particularly interesting considering aid is often tied to consultancy services. However, exports of services had to be excluded due to the unavailability of disaggregated data (see data issues in the background paper for further details).

70 In order to adapt the original gravity model to the country level, the recipient's GDP and GDP per capita (which only vary across years and not across donors) are not included in the regressions. The dummy 'colony', indicating whether the donor and the recipient have been in a colonial relationship, is also dropped; at the country level this variable loses its interest and moreover it is likely to be highly correlated with the common language variable.

Second, the above regression is re-estimated including a potentially important extra variable TS (tying status). TSi stands for the share of donor ODA reported as tied. There is a direct link between formally tied aid and trade. When a donor provides tied aid, the recipient is constrained to the purchase of donor country exports.

$$\ln(Exp_{it}) = \alpha + \beta_1 \ln(Y_{it}) + \beta_2 \ln(Ypc_{it}) + \beta_3 \ln(Dist_{it}) + \beta_4 \ln(ComL_{it}) + \beta_5 \ln(FDI_{it}) + \beta_6 \ln(ExpC_{it}) + \beta_7 \ln(ImpR_{it}) + \beta_8 \ln(TS_{it}) + \delta_1 \ln(ODA_{it}) + \delta_2 \ln(ODA_{All-it}) + \epsilon_{it}$$

(Tying status)

Third, the regression above is re-estimated disaggregating ODA into loans and grants⁷¹ to test whether certain aid instruments impact differently on trade flows.

$$\ln(Exp_{it}) = \alpha + \beta_1 \ln(Y_{it}) + \beta_2 \ln(Ypc_{it}) + \beta_3 \ln(Dist_{it}) + \beta_4 \ln(ComL_{it}) + \beta_5 \ln(FDI_{it}) + \beta_6 \ln(ExpC_{it}) + \beta_7 \ln(ImpR_{it}) + \beta_8 \ln(TS_{it}) + \delta_1 \ln(Grants_{it}) + \delta_2 \ln(Grants_{All-it}) + \delta_3 \ln(Loans_{it}) + \delta_4 \ln(Loans_{All-it}) + \epsilon_{it}$$

(ODA disaggregated)

Aid instruments are distinguished based on the origin of the flows. $Grants_i$ is the country i 's grants to the recipient country whereas $Grants_{All-i}$ represents the grants the recipient country receives from all the bilateral donors other than country i . Similarly, $Loans_i$ and $Loans_{All-i}$ are respectively the loans the recipient country receives from exporting country i , and from all the countries other than country i ⁷².

However, the exclusion of certain potentially important factors may confound the influence of the explanatory variables on export flows. Therefore, the above regression is re-estimated including an EC variable; some donor personnel in Ghana suggested that the ACP-EU relationship might be an influence on exports from EU countries. In order to explore further this relationship a variable for EC disbursements is included.

The analysis uses aid disbursements and not commitments, because trade effects are expected to follow actual disbursements and not commitments. Data on the tying status of aid, however, is not available in disbursement form⁷³. Therefore, a proxy for the tying status is computed by applying the share of tied commitments to total commitments (average of the previous two years) and then assuming the tied share in disbursed aid to be the same.

Data for GDP and GDP per capita are taken from the World Development Indicators (WDI) Online database. All nominal variables (exports, export credits, GDP and GDP per capita, FDI) are deflated into 2000 constant US dollars using DAC deflators. Data for distance and common language dummy are taken from the CEPII Distance Database.

4 Data

The econometric analysis includes annual flows of exports and of aid and other development finance from up to 22 DAC donors to the six recipient countries with observations covering 2002-07 because of data availability and quality issues for earlier years. The bilateral trade data are from the IMF Direction of Trade Statistics database, ODA data are taken from the OECD CRS database, FDI come from the OECD International Direct Investment Statistics and official export credits are as reported to the OECD. The bilateral trade data are from the IMF Direction of Trade Statistics database, ODA data are taken from the OECD CRS database, FDI come from the OECD International Direct Investment Statistics and official export credits are as reported to the OECD.

71 Aggregated ODA includes loans, grants, equity investment and grant-like (see definitions section). However, with the disaggregated analysis information about equity investment and grant-like is lost.

72 One cannot compute the log(loans) or log(grants) when the variable is equal to zero (the log is undefined). To handle this type of problem we add 1 to the data before logging it – $\log(0+1)$. We assume that such adjustment is immaterial in the dataset as all positive values in the data are large numbers.

5 Comparative econometric results

Limitations on the availability and quality of the data, the small sample and potential problems with the econometric model, warrant caution in interpreting the results at the country level⁷⁴. Over-interpretation of results from small data sets should be avoided especially given the incomplete nature of the trade data: the analysis is restricted to trade in goods and therefore the potential trade distorting impact of technical assistance/cooperation, which is both a significant share of ODA and an even larger share of tied ODA, is not picked up.

More in general, findings at the country level suggest probabilistic and not necessarily robust economic relationships. However, this section will provide a fuller and possibly more robust analysis looking at the comparative results for the six cases, highlighting similar patterns and systematic explicable differences.

73 In the OECD Creditor Reporting System, tying status is reported against new commitments only.

74 See data section in background paper for further details.

It is interesting to compare results for six countries deliberately paired according to trading region: Ghana and Burkina Faso in West Africa, Lao PDR and Vietnam in South East Asia region and ASEAN, and Zambia and South Africa in SADC region. Moreover, the six selected countries also differ for their DAC classification: Burkina Faso, Lao PDR, Zambia being LDCs, South Africa as UMIC, and Vietnam and Ghana as OLICs; Burkina Faso, Ghana and Zambia are also being classified as HICs. Econometric results by country are reported in each country reports whereas a synthesis table (Table 6.4) with the econometric results for the six countries is reported in Chapter 6.

In line with expectations and previous published findings, the size of donor economy seems to be overall an important determinant of bilateral exports; an increase in GDP is associated with a rise in exports. However, the level of development of donor countries, measured by their *income per capita level*, has no impact on bilateral export flows⁷⁵.

Distance is not found to be significant and does not seem to affect the level of export flows. Only in Vietnam, in accordance with the theory, distance is found to be highly significant and negative; an increase in the distance leads to a decrease in exports from donor countries.

One striking difference in results among countries concerns the common language variable. The language variable proves to be strongly significant only for Francophone Burkina Faso; this does not hold for the rest of the countries⁷⁶; with English being the lingua franca of international commerce, no observable advantage is conferred on Anglophone countries. Sharing the same official language is strongly and positively linked with bilateral export flows from Francophone donors and Burkina Faso; such relationship however is not simply driven by a language issue but by the links with former colonist France as the estimation of an alternative specification, where the language variable is substituted with a colony variable, shows.

The direction of the relationship between formally tied aid and exports is as expected but not at all robust: the estimated *tying status* variable is positive but not always significant. The positive relationship implies that the higher the share of tied aid over donor ODA the higher the export flows from the donor country to the recipient (Ghana, South Africa and Zambia). This result is less trivial than might appear. It is not clear that tied aid always leads to an increase in donor exports as tied aid may simply finance donor exports that would have been procured from the donor country anyway (Pettersson and Johansson, 2009).

75 In Burkina Faso, however, the direction of the relationship between exports and the level of development of donor countries, measured by their income per capita level, is unexpected although apparently robust.

76 In Vietnam and Lao PDR, the common language variable is automatically dropped: no donors share the common official language with either Vietnam or Lao PDR.

When aid is disaggregated in terms of loans and grants⁷⁷, *grants* from the donor country are found to be positively associated with donors' exports whereas grants from the rest of bilateral donors are not significant. Such results are suggestive of some form of trade distortion: it is difficult to explain why bilateral grants from a particular donor to a recipient country should affect trade between that donor and recipient pair differently from grants from other donors. Grants result in an increase in trade with the donor could be seen as most likely reflecting informal or *de facto* tying of grants; among other possible explanations there could however be the goodwill on the recipient part towards the donor; still, the aid relationship might simply facilitate trade between the donor and the recipient, increasing recipient's proclivity to procure goods from the donor (reinforcing commercial ties)⁷⁸. In contrast, *loans*, which are an unimportant form of aid in most of the countries analyzed, are not a significant influence on donor exports. This might in part be explained by the grant/loan level in the countries analyzed: a disaggregation of ODA into loans and grants is not necessarily very meaningful since the loan component has been very small and therefore an unimportant form of aid in most countries apart from Vietnam.

To sum up, the aid variables are proved to be an important influence suggesting that aid despite the formal untangling is nevertheless a significant part of the complex commercial relationship. Results, as reported in the background paper where an aggregate ODA variable has been included, highlight that the overall explanation does not increase much in disaggregating from the total aid variable.

Other flows seem however to have a bear on bilateral export flows. Due to data restrictions this relationship is studied only in the South African⁷⁹ case where FDI are found to be a positive influence on bilateral exports toward the host country. This could be explained by patterns of intra-firm trade within multi-national enterprises (MNE), that is exports between home country parents and their foreign affiliates (Hejazi and Safarian, 2001). For instance, new facilities set up by a MNE subsidiary could be equipped using imported capital goods from the home country; there are however several other ways well beyond the initial investment in which FDI and exports could be strongly linked in South Africa.

Other potential influences are found to be wholly insignificant: *export credits* have no impact on bilateral export flows in those countries where such data was available. This might however be related to the poor quality of the data⁸⁰.

77 Econometric results for an aid aggregate variable are reported only in the background paper.

78 See theoretical framework.

79 An attempt was made to include FDI as an explanatory variable in the empirical specification for the remaining countries; however, reviewing that data it was found this would have led to a substantial loss of observations as 2007 data are still not available from the OECD International Direct Investment Statistics, and there are also many missing values in the data for some specific donors in particular years.

80 Very few observations and missing values have been treated as zeros (see data section in background paper).

The statistical relationships found highlight influences reflecting the available data; in the reality there are other relationships often difficult either to identify or measure. The *import residuals* variable, which is used to control for such underlying relationships between the donor and the recipient countries, is highly significant and positive for South Africa, Lao PDR and Vietnam (non ACP countries), implying that special relationships between trading partners do exist and impact positively on the exports level. This result is suggestive of a complex reciprocal commercial relationship for these countries; bilateral aid could increase recipient exports to donor countries in South Africa, Lao PDR and Vietnam. If it is true that as a result of the donor-recipient relationship 'the effective cost of geographic distance' reduces (Pettersson and Johansson, 2009), further research is needed to analyse recipient trade flows and not just export flows.

Finally, overall results suggest that *disbursements from the EC* impact positively on bilateral donors exports in full ACP member countries (Burkina Faso, Ghana and Zambia) supporting the idea that the ACP-EU relationship is a positive influence on exports from EU member states in ACP recipient countries.

6 Conclusion

Overall these results suggest that aid is still a distorting influence on trade, even after untying of most bilateral ODA, justifying a closer, disaggregated examination of the uses of aid and sourcing of goods and services with aid funds. In the post-tying world, also disaggregate aid flows estimates support the existence of some trade distorting effects of aid at least for grants; loans, which are an unimportant form of aid in most of the countries analyzed, are not a significant influence on donor exports.

ANNEX D: EXECUTIVE SUMMARIES OF COUNTRY STUDIES

The full country reports can be downloaded from
<http://www.oecd.org/dac/evaluationnetwork>

D.1 Ghana Country Study⁸¹

Introduction

This study is a contribution to Phase Two of the wider OECD DAC – PDE Thematic Study on Untied Aid⁸². The Thematic Study on Untied Aid is designed to provide both a comprehensive assessment of current donor policies and practices regarding the tying status of aid and an assessment of the effects of the untying status on aid effectiveness. The Ghana Country Study is funded partly under a grant from KfW to the Overseas Development Institute (ODI), London, and partly by the Secretariat for the Paris Declaration Evaluation and the DCD of the OECD in supporting the Thematic Study on Untied Aid.

The Phase One report⁸³ focused on the HQ level and the extent of the formal untying that has been reported by donors. Phase One concluded that ODA to LDCs, and to developing countries more generally, is now overwhelmingly formally untied, excepting exempted categories under the 2001 Recommendation. However, there has been very little systematic investigation into the effectiveness of untied aid, or even into understanding how untying works at the country level. This country study is part of a wider attempt to address this gap, and was designed to serve as the pilot for the subsequent series of five further recipient country studies.

In selecting Ghana for the pilot country study, several factors were taken into account:

- African states make up a large share of aid recipient countries.
- Ghana is widely regarded as having relatively good governance, and has not suffered any recent large-scale hu-

manitarian crisis or other shock that would have resulted in a high proportion of non-development aid.

- Donors employ a wide range of instruments and modalities.
- Ghana has a recently reformed procurement law and, in addition, a range of procurement options should be available.
- The Government is strongly committed to the PD process for aid effectiveness, as reflected in it hosting the Accra summit in 2008, therefore ensuring the requisite co-operation for a study focussed on the effectiveness of donor practices.

Ghana has a population of approximately 23 million and in recent years has enjoyed steady and increasing economic growth, as well as being the first Sub-Saharan African country to achieve the Millennium Development Goal (MDG) on poverty. GNI per capita was US\$ 450 in 2005, and ODA was 10.4% of GDP in 2005. ODA to Ghana amounted to US\$ 1,236 mn in 2007, equivalent to 10% of GNI and over US\$ 50 per capita. Ghana is regarded as a 'star' partner of the development co-operation community. Support is broad based: the World Bank provided 20.4% of ODA disbursements in 2007; Netherlands, 12.8%; UK, 11.9%; USA, 9.4%; EC, 6.7%; AfDB, 5.4 %; and Denmark 5%, with five other donors – Canada, France, Germany, Japan and Spain – each contributing between 2.5% and 4.7%. Bilateral donors increasingly dominate aid support in Ghana. As the pre-Accra aid performance review recognised, this multiplicity of donors exemplifies the need for action on implementation of the Paris Declaration on aid effectiveness.

Methodology

Untying in practice involves the relaxation of just one constraint on the provision of aid – on the sourcing of goods and services. The approach adopted is to consider the question of effectiveness in terms of five sequential issues. Firstly, it

⁸¹ The study was undertaken by Matthew Geddes, Emmanuel J. Mensah, Luisa Natali and Peter Quartey (m.geddes@odi.org.uk) (Geddes et al., 2009).

⁸² The full title is: 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.

⁸³ <http://www.oecd.org/dataoecd/5/22/41537529.pdf>

examines the association between formal untying and aid modalities and uses in statistical terms. Secondly, it looks at the connections between newer and potentially better practices in the PD aid effectiveness sense for which untying is a necessary condition. Thirdly, it investigates the effects of untying on procurement, in terms of procedures used, the sourcing of goods and services, and the implications for the local and wider regional economy. This leads to a provisional exploration of both the cost efficiency and finally developmental effectiveness implications of untying. It is hoped that this study will provide a benchmark against which further moves towards untying could be assessed.

In an initial review, including documentation and discussions with stakeholders, it became clear that to ensure focus and comparability between project studies this study should concentrate on one sector. Water and Sanitation was selected, because it is an infrastructure and growth sector with a strong social orientation, which involves procurement of substantial amounts of both physical goods and services as well as a significant TC component and a variety of approaches. It is also a sector in which ODA plays a key role, many bilateral donors are still involved, and it has both rural and urban coverage.

As an exploratory investigation, the study adopted an eclectic approach, combining different forms of analysis to document and then examine the consequences of current aid practice. This evidence-based investigation initially involved a desk review of the available statistical information, published and grey documents. The study team undertook a series of structured interviews, between November 2008 and February 2009, with major donors and those significant in water and sanitation and government and its agencies, about current policy and practice. A two-step project analysis included an initial review of six donor activities in the water sector and, due to data access problems, only two in-depth studies of current donor-supported projects, to investigate procurement practices and their implications for cost effectiveness. In one case, the team undertook 'ground-truthing' field visits.

Aid modalities and tying practices

A review based on OECD CRS data found that, formally, DAC bilateral ODA to Ghana was 75% untied, 11% partially untied, 11% tied and 3% not reported during 2005-07. This pattern is broadly similar to average reported tying status for bilateral ODA for LDCs and HIPC countries overall. There is, however, significant variation among donors, both in terms of tying and also of non-reporting.

There is an existing monitoring system for aid in Ghana (the Development Partner Envelope), reporting to the Government and donors in the Consultative Group (CG), focused on both the MDG and PD objectives that facilitated the study. A 2006 survey to the CG broadly confirmed the tying status of aid, as reported to the CRS. The disbursement by aid modality shows over 40% of bilateral ODA channelled through programmatic modalities, for which untying is necessary and also likely to involve country procurement systems including general and sectoral budgetary support and some forms of basket fund-

ing (Table D.1). The remainder of aid is disbursed through a project approach. Pooled funding of projects, a newer modality which is likely to be associated with untying, was identified as growing in importance but is not yet separately monitored. There are wide differences in donor practices with Canada, Denmark, France, Germany, Netherlands, Switzerland, the UK, as well as the EC and World Bank, strongly supporting the programmatic arrangements. Other donors prefer to continue largely with established project-related arrangements (Japan and some minor donors), or even to establish new parallel project-type arrangements (USA), which is seemingly out of step with the PD goal of harmonisation.

There is extensive use of country procurement systems (CPS), including over 50% of aid to the Government sector, implying that at least 20% of bilateral aid in a project approach also uses CPS. An attempted donor survey by the team, to quantify both use of pooling arrangements and different procurement practices, was unsuccessful due to poor response. This was partly because donors' own financial and statistical monitoring appear not to be organised to report directly on either tying practices or use of different procurement arrangements, and partly due to assessment fatigue following the survey undertaken in preparation for the Accra meeting on the PD.

There remain considerable inconsistencies between the high level of reported formal untying and the views of many stakeholders (including most Ghanaians) that, in practice, tying is still widespread, even pervasive, especially on the part of some donors. Ghanaians uniformly see untying not so much as avoiding aid-transfer inefficiencies and trade distortions, but rather in terms of ownership and alignment with national priorities for development, which is only assured with unrestricted programmatic aid and the use of the Ghanaian procurement system.

Much technical cooperation (TC) is closely associated with tied aid: between 2005 and 2007 only 35% of stand-alone TC aid was untied, compared with 80% of non-TC aid. Interview evidence suggests that this association is a consequence, not necessarily intended, of a number of factors. Donors choose areas where they have comparative professional strength, e.g. hydraulics and water engineering. Framework contracts favour national consultants and the provision of services in kind is explicit tying.

There are no evident formal links between the use of different aid instruments, grants or concessional loans and tying practices amongst DAC donors. However, this is apparently not so for new donors. The scale and modalities of concessional funding by new donors, such as China, remains outside of the CG and DAC monitoring processes, but appears to be large, growing and in the form of tied concessional export credits. Tying is, by definition, a practice that confers a competitive advantage on donor exporters of goods and services. If *de facto* tying were widespread, despite formal untying, then this would be reflected in donor exports compared with their competitors. An econometric analysis was, therefore, undertaken to determine whether ODA, formal tying status and the different forms in which aid is provided (loans and grants)

Table D.1 Ghana: bilateral DAC donors and EC – disbursements by aid modality 2006-08 (US\$ mn)

Donor	Project Approach	Basket-Funding	Sector Budget Support earmarked	Sector Budget Support unearmarked	General Budget Support	IMF ²	Total disbursements	Project Approach as % of donor disbursements
Belgium	2.0	0.0	0.0	0.0	0.0	-	2.0	100.0
Canada	81.4	0.0	55.8	0.0	46.2	-	183.4	44.4
Czech Republic	0.5	0.0	0.0	0.0	0.0	-	0.5	100.0
Denmark	1.7	161.9	12.3	0.0	24.4	-	200.3	0.9
EC	230.8	0.0	0.0	2.9	79.5	-	313.1	73.7
France	71.6	0.0	0.0	0.8	57.7	-	130.0	55.0
Germany	76.8	24.8	0.0	0.0	39.3	-	140.9	54.5
Italy	52.8	0.0	0.0	0.0	0.0	-	52.8	100.0
Japan	116.5	0.0	0.0	0.0	3.1	-	119.6	97.4
Netherlands	274.2	55.8	0.0	38.4	91.1	-	459.5	59.7
Spain	84.2	0.0	0.0	0.0	0.0	-	84.2	100.0
Switzerland	8.8	4.4	0.0	0.0	22.7	-	35.9	24.5
UK	94.0	24.7	12.7	88.6	227.0	-	447.0	21.0
USA	369.3	0.0	0.0	0.0	0.0	-	369.3	100.0
IMF/UN**	1083.5	40.2	0.0	45.0	433.9	116.6	1719.2	63.0
Total (excluding IMF/UN)	1464.5	271.6	80.9	130.7	591.0	0.0	2538.6	57.7
Total (including IMF/UN)	2548.0	311.8	80.9	175.7	1024.8	116.6	4257.7	59.8

Source: WB DPE, 2008

Notes: 1. 2006-07 data is based on actual disbursements whereas 2008 data is based on projected disbursements.

2. Support to Balance of Payments (only IMF)

3. It includes: AfDB, EIB, FAO, Global Fund, IFAD, ILO, IMF, IOM, NDF, UNAIDS, UNDP, UNESCO, UNFPA, UNHCR, UNICEF, UNIDO, WB, WFP, WHO.

had a discernible impact on aggregate donor export flows at a country level. The overall results suggest that the ODA in general, and grants in particular, have a trade distorting effect, and were felt to justify comparable investigations for the five other case study countries.

Project analysis

Untying is highly influenced by the modality of aid. Budget support and pooling arrangements where funding, once committed, is not distinguishable as coming from any one donor, are both highly associated with untied aid. In contrast, the extent of *de facto* tying or untying within projects is unclear. An initial review of the water sector related projects supported by seven donors, Canada, Denmark, the EC, Germany (KfW), Netherlands, the UK (DFID) and the USA confirmed that most projects are, whatever their formal status, typically hybrid,

comprising a mix of aid elements with different tying status, procedures, implementing agencies and rule sets.

More in-depth investigation into procurement practices and outcomes is resource intensive, and only practical for an on-going project where documentation is locally accessible and personnel in place. The study, therefore, restricted itself to two case studies of water improvement projects: a Danida-DFID (UK) pooled funded project and a CIDA (Canada) supported project. The case studies focused on project inputs and outputs and outcomes, such as the extent of local sourcing and cost-effectiveness.

The 'head contract' that determines tying status, as reported to the CRS, was found in practice to be tied in both case study projects. In both cases, the 'head contract' accounted for the majority of the TC resources. However, subcontracting practices and contractor nationalities within the projects were

more important in determining, for example, the extent of local sourcing of services and goods and likely trade effects. Use of country systems emerged as both an outcome of and an input to the untying process. Projects and parts of projects which procured goods and services through the country procurement system, using National Competitive Bidding, were untied and predominantly contracted locally and regionally. This appeared to be mainly a result of smaller lot sizes and local advertising under CPS.

An exploratory cost effectiveness analysis of procurement within the Danida-DFID supported project using CPS indicated that, for the most part, goods and civil works contracts were bought at competitive prices and done so locally. Once rules had been agreed, the pooling arrangement between Danida and DFID also led to savings from sharing auditing and monitoring, as well as matching responsibilities to sector expertise.

Conclusions

Untying in Ghana is contributing significantly to the aid effectiveness agenda. Untying is creating policy space for recipient country ownership, use of recipient country systems and alignment with recipient country priorities. The existence of strong country leadership, such as through the creation of SWAPs, was also seen as a driver of untying.

Knowing whether aid support is formally untied provides a quite limited indication as to the balance of actual tying and untying, and the developmental implications of these practices. To understand these relationships requires looking at the choice of modality and, for project-type aid, the actual arrangements for contracting, from the head contract to the lowest level of sub-contracting and the procurement of goods and services. As there is a dearth of empirical studies on how formally untied aid is working and its implications, this conclusion was felt to justify according a high priority to project analysis in the country studies, for a cross section of donors. At a macro-level, the donor choice of modalities and an *ex post* econometric investigation into the relationships between aid and trade flows provides further evidence on untied aid practice and its consequences.

Ghana has relatively good co-operative monitoring of aid by Government and the donor community. Nevertheless, what these reporting arrangements tell us about modalities and uses of national and other forms of procurement is quite limited. It also proved almost impossible to relate in detail aid as reported from donor HQ to the OECD and aid as being monitored at a country level. The conclusion from this pilot study is that investigating the extent of genuine untying, continuing *de facto* tying and the developmental implications of these practices is going to be far from easy, even with full co-operation from major stakeholders.

D.2 Etude de Pays Burkina Faso⁸⁴

Introduction

Ce rapport présente les résultats de l'étude de pays du Burkina Faso. L'étude mise à mettre ces grandes questions en avant à travers une brève revue statistique et économétrique des données disponibles et par l'évaluation de quatre études de cas. L'accent des études de cas était sur les pratiques des donateurs en matière d'approvisionnement et des arrangements locaux qui pourraient avoir un effet significatif sur la façon d'acheter les biens et services. Les études de cas concernaient deux projets au secteur de l'eau et de l'assainissement et deux au secteur de la santé. Il s'agit de deux projets bilatéraux, un projet financé par un cofinancement conjoint par un grand nombre de bailleurs et un projet financé par un fonds commun.

La revue statistique et économétrique

Le Burkina Faso reçoit des montants importants en aide publique au développement (APD). Depuis 1998 l'APD a pratiquement doublé de EUR 433 million à EUR 862 million en 2007. Ainsi, le Burkina Faso dépend largement de l'aide

extérieure qui représentait 15% du produit intérieur brut (PIB) et 47% de dépenses de l'Etat en 2007. Environ trois quarts de l'aide est fournie sous forme de dons. Parmi les dix premiers bailleurs de fonds on trouve cinq bailleurs bilatéraux, y compris la Commission Européenne, trois institutions financières internationales (IFI), le Système des Nations Unies (SNU) et une organisation non gouvernementale (ONG). La plupart des IFI octroient principalement des prêts, mais certaines, telle que la Banque mondiale, fournissent également des dons. En 2007, l'aide déboursée était répartie entre appui budgétaire général (29%), aide projet, y compris l'assistance technique (63%), fonds communs (7%) et aide alimentaire (1%).

Les données statistiques du système de notification des pays créditeurs (SNPC) de l'OCDE/CAD et des rapports de la Direction Générale de la Coopération (DGCOOP) montrent de grandes différences. Un grand nombre de partenaires du Burkina Faso ne sont pas membres ou partenaire de l'OCDE et par conséquent ne participent pas au SNPC. Quant aux pays dont la base de données du SNPC comprend les données on constate que les chiffres fournis en matière de déboursements

Table D.2 Burkina Faso: bilateral DAC donors and EC: disbursements by aid modality 2007 (US \$ mn)

Donor	Project Approach	Basket-Funding	Sector Budget Support earmarked	Sector Budget Support unearmarked	General Budget Support	Total disbursements	Project Approach as % of Total disbursements
Austria	4.4	0.0	0.0	0.0	0.0	4.4	100%
Belgium	5.4	0.0	0.0	0.0	0.0	5.4	100%
Canada	7.2	11.3	0.0	0.0	0.0	18.5	39%
Denmark	30.6	4.7	0.0	0.0	8.7	44.0	70%
EC	129.5	0.0	0.0	0.0	74	203.5	64%
France	44.4	6.6	0.0	0.0	9.5	60.5	73%
Germany	19.7	0.0	0.0	0.0	6.7	26.4	75%
Italy	2.9	0.0	0.0	0.0	0.0	2.9	100%
Japan	11.5	0.0	0.0	0.0	0.0	11.5	100%
Luxemburg	6.6	0.0	0.0	0.0	0.0	6.6	100%
Netherlands	14.7	26.4	0.0	0.0	19.9	61.0	24%
Spain	0	0.0	0.0	0.0	0.0	0.0	0%
Sweden	7.9	4.1	0.0	0.0	9.3	21.3	37%
Switzerland	3.1	2.6	0.0	0.0	7	12.7	24%
UK	0	0.0	0.0	0.0	0.0	0.0	0%
USA	12.9	0.0	0.0	0.0	0.0	12.9	100%
Total	300.8	55.7	0.0	0.0	135.1	491.6	61%

Source: DGCOOP, 2008

⁸⁴ The study is undertaken by Piet Lanser (Piet.Lanser@Ecorys.Com), Judith Matijssen (Judith.Matijssen@Ecorys.Com) and Elie Pare (Lanser et al., 2009).

au SNPC sont souvent supérieurs à ceux compris aux rapports de la DGCOOP. A part des différences dues aux erreurs et omissions, il paraît qu'une partie des l'APD destinée au Burkina Faso n'y est pas enregistrée.

La DGCOOP présente un chiffre de l'aide non liée de 92%. Cependant, il est apparu que ce chiffre est une simple estimation. Les questionnaires périodiques ne contiennent pas une question en la matière et l'indicateur 8 du système de suivi de la Déclaration de Paris n'est pas renseigné. L'OCDE présente un chiffre de l'aide bilatérale non liée de 80,5%. En incluant l'aide des institutions multilatérales ce chiffre monte à 87,1% à raison du caractère non lié des prêts. En réalité le taux de l'aide non liée serait moindre comme quelques pays déclarent que leur aide est lié contrairement aux données de l'OCDE et une partie des institutions financières non partenaires de l'OCDE donnent des prêts qui sont partiellement liés.

Le but de l'analyse économétrique est de déterminer si l'APD, la situation du liement et les différents modes de l'aide (dons et prêts) ont un impact perceptible sur les flux cumulés des exportations des donateurs au niveau du pays, dans ce cas le Burkina Faso. Les résultats suggèrent que l'APD en général et les dons en particulier pourraient effectivement avoir certains effets sur le commerce par les relations donneur-bénéficiaire.

Types de l'aide et liement

Selon les statistiques de la DGCOOP le type de l'aide prédominant est l'aide projet. Cependant, ce type comprend également l'aide programme qui n'est pas fourni sous forme d'aide budgétaire ou comme fonds commun. L'aide basée sur une approche programme aurait été 57% en 2007 selon le rapport 2008 sur le suivi de la déclaration de Paris. Dans la panoplie des instruments, l'appui budgétaire général prend une place important avec 29% des déboursments en 2007 et est appliqué par 11 bailleurs. Ce type d'aide est dépensé en utilisant les procédures nationales par définition. Les bailleurs ayant accepté l'appui budgétaire général souvent utilisent également au moins une partie des procédures nationales pour d'autres types d'aide.

Le pourcentage de l'aide utilisant les procédures nationales de la passation des marchés était 54% selon le rapport 2008 de l'OCDE en recul de 6% par rapport au rapport 2006. Ce chiffre contraste avec celui concernant l'aide bilatérale non liée de 92% selon le même rapport. Ceci implique qu'une partie de l'aide non liée est utilisée selon les procédures du donneur. Notons que les prêts des IFI sont souvent non liés, mais que l'utilisation des procédures des banques est souvent obligatoire.

Analyse des projets

Quatre projets ont été étudiés, qui ont tous passé un nombre important de marchés pour l'acquisition des biens et de services ou de l'exécution de travaux. Trois bénéficient de l'aide non liée, le quatrième connaissant une combinaison de l'aide liée, partiellement et non liée et non liée.

1. Le Programme d'Appui au Développement du Secteur Eau et Assainissement (PADSEA) a comme objectif d'assurer

l'accès durable à l'eau potable pour environ 300.000 personnes en milieu rural et pour environ 100.000 personnes en milieu semi-urbain dans trois régions du Burkina Faso. Le projet est un cofinancement du Danemark et de la Suède. La partie des travaux, y compris l'achat des biens et services y afférents, est gérée par les institutions burkinabè selon les procédures nationales. Les composantes concernant de l'assistance technique sont gérées au niveau de l'Ambassade Royale du Danemark selon les procédures de la Danida pour la partie danoise et au niveau de l'ASDI pour la partie suédoise. Les aides consistent en dons non liés. Tous les marchés passés par les services techniques ont été adjugés aux entreprises burkinabè. En matière des matériaux, la grande partie est importée, mais la mission n'a pas d'information quant à la provenance exacte. En tout cas, les dossier d'appel d'offres ne posent pas de conditions à ce niveau et laissent le choix aux soumissionnaires. La restriction la plus important est au niveau des pompes manuelles qui doivent être d'une des marques utilisés dans les régions. Les marchés sont de taille restreinte, ce qui limite les soumissions éventuelles de l'extérieure à cause de frais généraux élevés qu'engendraient les entreprises étrangères.

2. Le projet d'Approvisionnement en Eau Potable de la ville de Ouagadougou à partir du barrage de Ziga est un grand programme de plus de EUR 230 millions pour la première tranche de la première phase consistant en la construction d'un barrage, d'une station de pompage et de traitement de l'eau, des adductions jusqu'à Ouagadougou et le réseau de distribution et des branchements à Ouagadougou. Y compris l'Etat et l'Office National de l'Eau et de l'Assainissement (ONEA) le nombre total des financiers était de 15. Parmi les financements, un était lié, sept étaient partiellement liés et sept étaient non liés. Pour des raisons d'harmonisation et de coordinations, les institutions financières arabes ont fait une dérogation de la condition d'éligibilité. Malgré l'étendu des contrats, les fournisseurs se sont limité à des entreprises établies en France, en Allemagne et au Burkina Faso. Les frais d'approche et de mobilisation des chantiers ont gonflé les offres des entreprises sans base solide au Burkina Faso. Une deuxième raison pourrait avoir été l'origine allemande et francophone des bureaux d'études, financés sur des ressources liées, ayant résulté dans des dossiers techniques facilitant la soumission des entreprises de ces pays.

3. Le Programme d'Appui au développement Sanitaire (PADS) a pour objectif l'amélioration de l'état de santé des populations à travers la création et la gestion d'un fonds commun. Le PADS reçoit des financements d'un nombre de donateurs bilatéraux et multilatéraux et des fondations internationales. Tous les financements sont des dons non liés sauf le financement de la Banque mondiale (IDA) qui est en partie un prêt. Les fonds sont dépensés selon les procédures nationales sauf les fonds IDA qui suivent les procédures de la Banque. En 2008 le PADS a lancé 39 appels d'offres résultant en 60 marchés. Sur les 39 appels d'offres trois seulement ont fait l'objet d'un appel d'offres international résultant dans

quatre contrats dont les attributaires viennent de la France, de l'Allemagne, du Swaziland et du Burkina Faso. Il s'agit des marchés financés par l'IDA. Les procédures nationales fixent des seuils au-dessus desquels les marchés doivent passer par appel d'offres ouvert, mais pas de règles obligeant à des appels d'offres internationaux. La plupart des fournisseurs sont des établissements burkinabè, dont certains sont des concessionnaires des entreprises multinationales. Quatre marchés d'un montant important concernant la livraison des médicaments, vaccins et contraceptifs, passent de gré à gré avec l'UNICEF ou la Centrale d'Achat de Médicaments Essentiels et Génériques.

4. Le projet d'Appui au Centre national de Transfusion Sanguine (CNTS) est un projet bilatéral de la coopération Luxembourgeoise. Son objectif est d'assurer une disponibilité continue des produits sanguins de qualité et en quantité suffisante pour l'ensemble du territoire. L'appui est un don non lié, qui est géré ensemble avec Lux Development selon les procédures de cette agence. Depuis juillet 2007 on a enregistré 35 marchés pour un montant total de presque EUR 1 million. Onze marchés sont passés par appel d'offres ouvert représentant 91% du montant. La grande partie des fournisseurs viennent du Burkina Faso ou de la France, quoique quelques établissements burkinabè soient des concessionnaires des entreprises multinationales. Les autres fournisseurs viennent de l'Allemagne et du Luxembourg.

La grande partie de l'aide avait un caractère non lié par origine ou grâce à une dérogation. Le bénéficiaire principal du déliement paraît le Burkina Faso dont les fournisseurs se sont accaparés d'une grande partie des marchés. Ce phénomène serait lié à un nombre de causes. Le pays étant enclavé les frais d'approche et de mobilisation de chantiers sont élevés. En plus, le marché national est restreint ce qui limite l'intérêt du monde d'affaires international. La langue pourrait également constituer un obstacle à un milieu de prédominance anglophone. Le morcellement des acquisitions en des marchés de volume limité diminue l'intérêt éventuel des fournisseurs internationaux qui n'arrivent pas à récupérer leurs frais généraux sur des marchés restreints à un prix acceptable. Enfin, la publication des appels d'offres dans des journaux nationaux ou régionaux au niveau de la communauté ouest-africaine favorisera les établissements ayant déjà un œil sur ce marché.

Effacité en termes de coûts et de développement

L'information générale indique une diminution des coûts grâce au déliement. Le projet Ziga a fourni un exemple concret d'un marché qui est devenu moins cher dû au changement du caractère de liement au cours du processus. Cependant, le gain est annulé en partie par les procédures nationales généralement considérées plus longues. A ce niveau il faut noter que la décision du déliement est parfois couplée à une condition d'un avis de non objection du côté du bailleur, ce qui contribue également à la prolongation de la durée des procédures. Une autre restriction est que le moindre prix est parfois au détriment de la qualité.

Le déliement permet au pays de mieux définir les produits qui lui sont utiles. Tels est le cas de pompes à eau à motricité

humaine ou pour les branchements de l'eau en milieu urbain où une certaine standardisation des équipements s'est avérée nécessaire afin d'en assurer un niveau minimum de mécaniciens formés pour le type d'appareils précis et l'approvisionnement continu de pièces détachées.

L'attribution des marchés à des entreprises nationales a certainement un effet positif sur le développement économique. Cet effet se produira surtout au niveau de l'assemblage des produits importés, de la meilleure utilisation des compétences nationales, de la gestion et de l'intermédiation. Il y aura également une partie de profits qui parviennent au pays, quoiqu'une partie de ceux-ci disparaissent dans le cas des filiales des compagnies internationales.

Le déliement est souvent accompagné par le transfert de gestion au pays bénéficiaires. Dans la perception des interlocuteurs nationaux, le liement concernerait plutôt le mode de gestion que l'origine de projets. Effectivement, l'alignement sur les procédures nationales, que veut la Déclaration de Paris, est difficilement envisageable sans déliement de l'aide.

Au Burkina Faso il y a une tendance vers l'appui budgétaire et de l'approche programme avec de financement sous fonds commun. Ce type d'aide est incompatible avec l'aide liée. La passation de plus de bailleurs avec une plus grande partie de leurs fonds vers ces types d'aide favorisera également l'avancée dans le déliement de l'APD.

D.3 South Africa Country Study⁸⁵

Introduction

This study aims to highlight key issues through a short statistical and econometric review of the available data and through the assessment of three project case studies. The focus of the case studies was on the procurement practices of the donors, governmental executing agencies and implementing agents, that may have a significant impact on how goods and services are purchased, with implications for aid effectiveness.

The three projects selected as case studies were:

- a health sector project funded by DFID
- a health sector project funded by the EU
- a water sector project funded by the Association of Netherlands Municipalities (VNG) International.

Statistical and econometric analysis

ODA in South Africa has increased progressively and diversified since 1994-95, when official aid was first used to support national policy development. Yet total ODA commitments as a percentage of GDP remain very small, at less than 0.4% in 2007. ODA commitments have primarily been in the form of grants, and most aid has been from bilateral donors. The United States and the EU are South Africa's largest donor partners, respectively contributing 29.5% and 20.6% of total bilateral ODA to South Africa between 2005 and 2007.

As a non-LDC, South Africa was not originally covered by the 2001 DAC Recommendation, but ODA commitments reported as untied have shown a general upward trend since 2001 (though there remain inconsistencies between donor reporting of untied aid and studies commissioned by the South African Government). A large proportion of donor ODA to South Africa is in the form of technical co-operation (TC), and the tying status of much of this kind of ODA is not reported to the DAC. Projects where there was no reporting on project type accounted for 39% of total ODA between 2005 and 2007. In South Africa almost all Government officials expressed concern about the use of TC as a means to tie aid to home country consultants.

The aim of the econometric analysis is to determine whether ODA, the tying status and the different forms in which aid is provided (loans and grants) have any discernible impact on aggregate donor export flows at the country level, in this case to South Africa. The overall results suggest that ODA in general, and grants in particular, may have some trade distorting effect through the donor-recipient relationship, though the South Africa analysis is not conclusive.

Aid modalities and tying

Most donors in South Africa still make use of the traditional project approach. The apparent low usage of country systems is supported by analysis in the South African 2006 Survey on the Paris Declaration: less than half of all ODA made use of South Africa's financial or procurement systems. Based on in-

formation in Quist *et al.* (2008), just 7% of total donor funds received by South Africa in the 2007-2008 financial year were in the form of budget support, and only three donors have used the budget support modality between 2005 and 2008 (the EU, Netherlands and Ireland). Countries such as Japan, the United States, the UK and Germany, that report a high percentage of total ODA as untied (80%, 45%, 100% and 72% respectively for 2006⁸⁶), make very low usage of South African procurement systems based on the 2006 Survey on the Paris Declaration (Table D.3). In these cases, the possibility of *de facto* tying is more likely. In the country report on the 2008 Evaluation of the Implementation of the Paris Declaration, some reasons given by donors for not using South Africa's systems include concern that the use of country systems delays the quick implementation of projects and that donor HQs have directed local staff not to use local systems.

Table D.3 South Africa: donor use of country systems, 2005

Donor	Aid disbursed (US\$ mn)	Public financial management systems	Procurement systems
Australia	1	0%	20%
Belgium	6	75%	75%
Canada	0	100%	100%
Denmark	14	37%	75%
EC	139	42%	42%
Finland	9	85%	85%
France	1	2%	7%
Germany	21	33%	33%
Global Fund	10	67%	100%
Ireland	8	100%	100%
Italy	3	33%	0%
Japan	15	0%	0%
Netherlands	22	100%	100%
New Zealand	0	100%	100%
Norway	8	100%	100%
Sweden	7	42%	42%
Switzerland	0	88%	88%
UK	41	0%	29%
United Nations	2	81%	0%
USA	43	0%	4%
Total	351	38%	44%

Source: 2006 Survey on Monitoring the Paris Declaration: South Africa Country Chapter

Notes: 1. Percentage figures reflect the baseline ratios for each donor.

⁸⁶ Based on Clay *et al.* (2008).

⁸⁵ The study was undertaken by Yash Ramkolowan (yash.ramkolowan@dnafrika.com) and Matthew Stern (matthew.stern@dnafrika.com) (Ramkolowan and Stern, 2009).

Project analysis

Three donor projects were used as case studies for the South African analysis: two from the health sector (both relating to HIV/AIDS) and one from the water and sanitation sector. All three projects were similar in that they largely involved the procurement of services (especially relating to consulting services) rather than goods, yet all three projects had different contracting, funding and procurement procedures. This gave the opportunity to contrast the projects and to provide a more holistic view of the way untied aid works in South Africa. The three case study projects are summarised as follows:

1. The Rapid Response Health Fund (RRHF) was established in late 2008 as the fifth output of the Multi-sectoral HIV and AIDS Support Programme (MSP), funded by DFID. The RRHF was initiated during high level talks between South African and UK Government officials. At a meeting between the UK Secretary of State and the newly appointed South African Health Minister, it was agreed that a health fund would be made available to the Minister, in order to rapidly improve HIV/AIDS policy and delivery in South Africa and to assist with any unexpected problems that might arise. GBP 15 mn has been committed to the one-year programme, which runs from 2008 to 2009. The head contract was managed by HLSP, the local subsidiary of a British company, which had been awarded the management of the MSP under a framework contract.

2. The Extended Partnerships for the Delivery of Primary Health Care including HIV and AIDS Programme (EPDPHCP) is an EU funded programme that began in 2001. The programme aims to contribute to more accessible and affordable primary health care in South Africa by partnering with Not for Profit Organisations (NPOs). The programme has evolved over the period, both by expanding delivery of services from five to all nine of South Africa's provinces and by moving from EU to local systems and procedures. For the period 2001 to 2006, the EU committed EUR 25 mn. In the period 2007 to 2010 the EU has committed a further EUR 45 mn. The contracting agency for the EPDPHCP is the South African Government, through the National Department of Health.

3. The Storm-water Drainage and Sanitation project was implemented in 2005 through the municipal twinning arrangement between Buffalo City Municipality (South Africa) and the City of Leiden (Netherlands), and was funded through the City of Leiden by VNG International. VNG International is funded by, among others, the Netherlands Ministries of Foreign Affairs and Home Affairs, the EU, the World Bank and various United Nations agencies. For the year 2009-10 the budget application was EUR 566,815, of which EUR 297,000 was provided by Leiden in the form of technical assistance. VNG International requires that the contracting agency is a Dutch organisation; as such Leiden is seen as the contracting agency. However, Buffalo City is largely responsible for the management and execution of the storm-water project.

These three projects raise two very different sets of concerns:

- Firstly, the use of framework contracts can effectively exclude smaller and less experienced South African firms from participating in lucrative head contracts. For example, the RRHF contract was awarded to a UK-owned company, which already held a framework contract with DFID. This may have been necessary for expediency reasons, but it did effectively exclude South African health companies from tendering for this specific contract.
- Secondly, there is some evidence that the high level of technical assistance and co-operation agreements in South Africa makes ODA less transparent and increases the potential for tying. For example, in the case of the Buffalo City storm-water project, a significant amount of budget assistance was in the form of technical assistance from Leiden, and for travel and accommodation of both Leiden and Buffalo City officials. Buffalo City was also required to counter-fund a substantial amount for the procurement of consulting services relating to the project, with this counter-funding amount believed to be substantially more than the financial contribution by VNG.

Cost and developmental effectiveness

In the actual procurement of goods and services for all three projects, there is little evidence of implicit or *de facto* tying by donors, with all three projects making extensive use of local suppliers for both services and works contracts. The extent to which this has contributed to new or sustainable domestic capacity is less clear.

For the RRHF, the use of local consultants and companies certainly raises the potential for domestic capacity development, but many of the consultants contracted were already highly-sought, with specialised skills. The EPDPHCP has a much clearer development impact and has explicitly contributed to the establishment of technical and administrative capacity within the national and provincial health departments. The Buffalo City storm-water project has used a South African consortium for the major consulting work and local (based in the municipality) works companies for the minimal construction activities. This would have had positive spin-offs within the local community. However, from a budget perspective, technical assistance provided by Leiden, travel and accommodation account for over half the total international funding. The fact that Buffalo City has counter-funded over half the actual amount spent on the procurement of works and services (outside of travel and accommodation) reduces the potential benefit of aid provided. In addition, it is not clear that the twinning arrangement (i.e. information and knowledge exchange) has been used efficiently, so VNG International's actual contribution to long-lasting capacity and infrastructure development may be small.

Cost-effectiveness is often cited as a key reason for the untying of aid. Assessing the cost-effectiveness of consulting services is very difficult, given the varying degrees of quality and specialisation. Professional fees are difficult to compare and are usually treated as commercially sensitive. This study has revealed four issues that donors need to consider in an untied

environment in general and, specifically, when local systems and procedures are used:

- local rules and guidelines for consulting rates may differ from the international norm
- preferential procurement policies may raise the cost of certain goods and services
- the administrative burden of local procurement may be higher or more time consuming
- a lack of competition in some domestic markets may contribute to premium rates on certain skills.

Conclusion

South Africa is exceptional as a recipient of aid, largely because, in general, it is not very dependent on aid as a revenue stream, and also because it has the necessary institutions and capacity to co-ordinate donor activities and manage donor funds. This is confirmed by the econometric results: donor flows impose no significant distortions on the South African economy. The presumption is that this should, in practice, contribute to the more effective and efficient use of ODA. The case studies reveal three reasons why this is not always the case:

- Firstly, in two of the three cases, there remains some evidence of *de facto* tying, with source country consultants or companies brought in to do work that could potentially be done domestically.
- Secondly, although a large proportion of reported ODA is untied, the risk of non-reporting may increase in more developed countries. This is largely because, in countries like South Africa, a reasonably large proportion of overall ODA is provided as *ad hoc* or short-term technical co-operation. This form of assistance is generally less transparent than more conventional long-term development projects.
- Thirdly, in an untied environment, donors are more likely to make use of recipient country procedures. The case studies show that the use of recipient country procurement systems enables Governments to pursue domestic policy priorities and improve alignment. But, in some instances, this can raise the cost and diminish the effectiveness of specific donor programmes.

In the case of South Africa, it would appear that untying has contributed to improvements in the alignment and development effectiveness of aid. Moreover, although donors are minor funders in South Africa, they can play a critical role in deploying technical and financial resources quickly. The examples explored in this report highlight the significant contribution made by just three projects: rescuing various national HIV/AIDS programmes; providing high-level advice to a new Cabinet Minister; and protecting an impoverished community from severe flooding. Could more have been achieved if

these donors had adopted a more open procurement process, or made greater use of the South African system? Certainly, alignment and development effectiveness could be further enhanced, but these gains might be partially offset by the intended (policy-related) and unintended (inefficiencies) costs of alternative procurement procedures.

D.4 Zambia Country Study⁸⁷

Introduction

This study aims to highlight key issues through a short statistical review of the available data and through the assessment of a limited number of project case studies. The focus of the case studies was on the procurement practices of the donors, governmental executing agencies and implementing agents, that may have a significant impact how goods and services are purchased, with implications for aid effectiveness.

The four projects selected as case studies were:

- the Water Sector Support in Northern Province (WSSNP) supported by Irish Aid
- the Southern Water and Sanitation Project (SWSP) funded by Germany
- the Water Sector Performance Improvement Programme (WSPIP) financed by the World Bank
- the district focused agricultural development Production, Finance and Technology Project (PROFIT) funded by USAID.

Statistical and econometric analysis

Zambia has received significant levels of external assistance and currently ranks among the top 10 African country recipients of ODA. Aid flows, as a share of overall public expenditure, peaked at 53% in 2001 (i.e. the year when the DAC Recommendation on aid untying was passed). Since then, the contribution of ODA to public expenditure has declined steadily, to around 24% in the 2008 budget. In absolute terms, total ODA commitments halved between 2005 and 2007. The fall in the contribution of aid flows to Zambia can largely be explained by improved external conditions, arising from both debt relief and rising copper prices.

According to OECD/DAC statistics from 2005 to 2007, bilateral aid accounted for just over 90% of total ODA commitments. Almost all of this bilateral ODA takes the form of grants, with no new loan commitments made in 2007. The top bilateral donors, in terms of their commitments to Zambia, are Japan, the USA, Germany, the EC and the UK (in that order). Together, these five bilateral donors accounted for 70% of the total bilateral ODA to Zambia over this period.

The vast majority of bilateral ODA to Zambia is reported as untied (86%), with around 4% of bilateral ODA reported as tied and 9% as partially tied. But there are large discrepancies in approach between the different donors. Whereas the UK, Sweden, Austria, Ireland and Luxembourg reported all of their aid as untied, Switzerland reported that 46.1% of its ODA is tied. Among other major bilateral donors, Japan reported 94.2% of

its aid to Zambia as untied; the USA 81.8%, Germany 94.5%; and the EC just 17.7% untied. The largest proportion (82.3%) of EC aid is reported as partially untied.

Aid modalities and tying

Donors currently adopt four different mechanisms in operating in Zambia: Project Support, Integrated Project Support, Sector-Wide Approach (SWAp) and General Budget Support (GBS).

There is no official data on the use of these different mechanisms by the major donors, but a survey undertaken as part of this country study provides some information on the preferences of the ten participating donors based on 2007 disbursements (Table D.4). Seven of the ten donors use general budget support (GBS) and/or non-earmarked sector budget support (SBS) to disburse ODA to Zambia, with the EU disbursing two-thirds of its aid through this channel. Amongst the respondents, Canada, Japan and the USA disburse no ODA through this channel. Earmarked budget support is not widely used in Zambia.

The World Bank, Germany, Norway, Sweden, Japan, Canada and the UK generally adopt a Sector-Wide Approach and use the Zambian procurement system to fund non-pooled projects. More than 70% of World Bank disbursements and 44% of UK aid is channelled through this modality. Almost all USA ODA goes to non-pooled projects, but these disbursements follow US rules and guidelines. A number of small donors, including Canada, Finland and Sweden, do make use of pooled projects, with Canada distributing 83% of its total ODA through this channel. Japan adopts a very different approach, with more than 97% of all ODA restricted to specific projects and Japanese procurement. The EU, Germany, Sweden and the UK also use their own procurement systems to provide project support, but the proportion of overall ODA disbursed through this modality is much lower, at 28%, 18%, 17% and 13% respectively.

⁸⁷ The study was undertaken by by Oliver Saasa (oliver-saasa@coppernet.zm) and Chrispin Mphuka (mphukac1@yahoo.com) (Saasa and Mphuka, 2009).

Table D.4: Zambia: disbursements of ODA by selected donors in 2007/8

Donor	Total Disbursements	GBS & Unearmarked SBS	Earmarked SBS	Non-Pooled Projects		Pooled Funding	Project Funding involving agency's own procurement	
				using Zambian System	using non-state pro- cedures other than agency's		at local office	through HQ
	US\$ million	(%)	(%)	(%)	(%)	(%)	(%)	(%)
WB	54.4	18.4	0.0	71.3	0.0	10.1	0.0	0.0
Canada	15.7	0.0	0.0	1.5	0.3	82.7	5.9	9.6
Japan	34.4	0.0	0.0	2.6	0.0	0.0	97.4	0.0
EU	58.0	66.7	0.0	0.0	0.0	5.7	27.6	0.0
Germany	29.4	23.1	0.0	44.2	3.4	11.2	18.4	0.0
USA	212.9	0.0	0.0	0.0	99.9	0.1	0.0	0.0
Finland	17.7	39.0	0.0	0.0	14.7	43.5	0.0	0.0
UK	72.9	60.6	10.8	0.5	0.0	13.2	1.9	12.9
Sweden	52.2	27.2	0.0	8.2	4.6	42.7	17.2	0.0
Norway	72.7	24.9	22.7	10.3	36.7	5.4	0.0	0.0

Source: Data collected directly from donors through questionnaire administered by Premier Consult Limited in May 2009.

A number of implications can be drawn from this survey. Firstly, the results confirm the data reported to the OECD/DAC. Most donors use the GBS and/or non-earmarked sector budget support modality and the Zambian procurement system. Such support is *de jure* untied. Secondly, the survey raises some questions about the reporting of some specific donors. For example, although the UK reports all of its ODA to Zambia as untied, a large proportion of this funding is disbursed through host country and head-office procurement systems. This requires further analysis to explore whether, in fact, this ODA is truly untied. Finally, the survey highlights a number of countries that appear to avoid the use of Zambian procurement systems. Again, this would appear to raise the risk of *de facto* tying. Two of these countries (Japan and the USA) are among the largest donors.

Project analysis

Four projects were selected as case studies: three water and sanitation projects funded by Ireland, Germany and the World Bank; and a USAID-funded private sector competitiveness project.

1. WSSNP has its origins in the Irish Government's support to water supply and sanitation activities in the Northern Province of Zambia since 1983. Initially, the programme was implemented directly by Development Cooperation Ireland's (DCI) own staff. After a review in the mid 1990s, the Programme be-

gan its full integration into the Zambian Government's Water, Sanitation and Hygiene Education (WASHE) system in 1998, though full integration was only achieved in 2002. DCI staff have reduced their direct participation in Provincial WASHE (P-WASHE) meetings and currently attend only at the invitation of the Chair of the Committee. The Programme currently provides both financial and technical support to four districts in the Northern Province: Mbala, Isoka, Luwingu and Mpika.

2. SWSP was initiated in 1998 through the signing of a financial agreement worth DM 27 mn between the Zambian and German Governments. The agreement covered 8 towns in the Southern Province, excluding Livingstone. Later in 2000, an additional agreement for Livingstone worth DM 13 mn was signed. The objective of the project was to provide a continuous and sufficient supply of hygienically safe drinking water for the majority of the population and industry in the nine towns of the Southern province, through the repair of existing water supply systems and the expansion of new networks. The Project also provided support to the provision of adequate sewage and human waste disposal services in those towns that have sewage systems. SWSP was funded through German Financial Cooperation (KfW) and required a small counterpart funding from the Government of the Republic of Zambia. Although the Project was originally scheduled to commence in July 2000 and end by September 2003, a number of delays resulted in its extension to February 2009.

3. WSPIP was established in 2007 under a concessional loan agreement from the World Bank for US\$ 23 mn. It was initially planned to be completed within a period of three years, but has since been extended to 2012, with an additional injection of US\$ 10 mn. The objective of the Project is to support the Government's on-going commitment to urban and rural water sector reforms, and increased access to services, through the expansion of existing facilities. It includes support to the Government and its utilities to implement a comprehensive institutional structure which will lead to a better, more sustained and co-ordinated approach to the public and private provision of water and sanitation services.

4. PROFIT is a five-year USAID project that began in June 2005. The project is implemented by the Co-operative League of USA (CLUSA) in partnership with the global development consulting company, the Emerging Market Group (EMG). Funding of the Project was obligated in the bilateral Strategic Agreement for Economic Growth between the Zambian Government and the Government of the United States, and the total finance for PROFIT is US\$ 17.5 mn. PROFIT seeks to improve the competitiveness of selected industries in which large numbers of medium and small enterprises participate. This will enable firms and industries to respond to market demands, both in the short and long term, and to raise the benefits that these firms provide to market participants.

The rules and regulations for procurement differ across the four donors/projects. In the case of the Irish AID-supported WSSNP, the Project is completely untied, uses local procurement rules, regulations and systems, and has no restriction on procurement to a particular geographic region. The other three projects use donor rules and guidelines for procurement. Although these rules and regulations do not usually restrict sourcing of goods and services to the donor country, it was found that there are certain specifications that may require the sourcing of both equipment and consultants from the donor country. Furthermore, most Zambian local firms do not have the financial or technical capacity to meet the tender requirements of large donor projects. As a result, in the German-funded SWSP, about 85% of the project money went to German firms, whereas around 29% of the total funding from the USAID-funded PROFIT went to US organisations.

Cost and developmental effectiveness

All four projects examined demonstrated their developmental relevance to the extent that they are aligned to the Fifth National Development (FNDP) priorities. Partly as a result of untying, donors are seen to be working towards harmonising their programmes through the Joint Assistance Strategy for Zambia (JASZ). In addition, more of the donors currently use GBS and SBS as aid approaches (rather than project specific funding). Delegated co-operation is also being employed in Zambia.

Due to the limited number of projects evaluated in this study, it has not been possible to assess fully whether the untying of

aid leads to improved developmental effectiveness. Nevertheless, the evidence provided by these four projects suggests that, in general, the extensive use of local sub-contractors, which is made easier in an untied environment, has contributed to the creation of employment opportunities and a transfer of skills. This is certainly true of the WSSNP project, in which all works are now handled by Zambian firms. In other cases, however, such as the SWSP project, there was no sub-contracting involved (except for one joint-venture between a Zambian and a German company) and the development effectiveness is, therefore, likely to be considerably lower. The size and technical requirements of the project clearly have a strong bearing on the extent to which goods and services can be provided by local firms.

Another spin-off benefit of untying, in the Zambian context, is that it has probably contributed to the strengthening of local procurement systems. For example, the Irish-funded WSSNP is implemented at the district level, and the project has had to invest in improving planning, procurement, accounting, and monitoring and evaluation with councils, to enable them to contract local suppliers. Similarly, in the case of the German-funded SWSP, the use of local procurement systems helped to instil a sense of local ownership.

Measuring the cost effectiveness of untied aid proved difficult, and was limited to a set of items in one case study. In this example, the price of the goods procured using untied aid was lower by at least 6%, relative to the import parity price. There was no other evidence to suggest that untying had raised costs, in any of the studies, though this may require more comprehensive analysis. Such analysis would need to look beyond the monetary cost of untying and also consider the expected time benefits of procuring locally.

Conclusion

Zambia is a major beneficiary of ODA and aid flows constitute a substantial share of the country's budget and GDP. Improvements in the development and cost effectiveness of ODA are, therefore, likely to have a significant impact on individual beneficiaries and the country as a whole. The four case studies confirm the significant contribution made by these specific projects in Zambia and show how untying in general, and the use of local procurement systems and sub-contractors in particular, can contribute to employment creation and skills transfers.

In the actual procurement of goods and services, there is some evidence of implicit or *de facto* tying by donors. In the case of PROFIT, no local firms were involved in the initial tender, and participation by other international organisations was poor. In the award of SWSP, the Government indicated that it was asked to suggest firms for consideration and that German firms should be amongst those recommended. This project has made no use of local sub-contractors (except in one instance, as a joint venture with a German company).

There are two main reasons for the use of host country companies, consultants and materials in Zambia:

1. Although rules and regulations do not restrict the sourcing of goods and services, there are certain specifications that may require sourcing from the donor country. For example, in SWSP, replacement parts had to be purchased from Germany because this is where the existing water pumps came from. USAID imposes restrictions on the procurement of specific goods and services, such as motor vehicles and air travel (although these are not always enforced). In projects that require a consultant or an implementing agent, the prime contractor or consultant usually comes from the donor country.
2. Most Zambian firms do not have the financial capacity or technical experience to tender for large donor projects, regardless of whether or not the project is tied. For example, in the case of WSSIP, post qualification rules required that the bidding company should have delivered at least two contracts of at least the same value in the last three years, that have been successfully and substantially completed and that are similar to the proposed works. This criterion effectively disqualified almost all Zambian-based firms.

In addition to these examples, the increasing use of vertical funding arrangements such as the PEPFAR and the Global Fund, which are better resourced than most other programmes in Zambia and remain strictly tied, may diminish the gains from untying.

Finally, interviews with various donors and the statistical analysis revealed that untying has facilitated the increased use of GBS and SWAPs in Zambia. This improves the transparency and alignment of aid, but also raises new challenges. For Zambia, procurement capacity and systems need to be improved to manage additional funds well and provide donors with sufficient confidence. For the donors, there is need to work towards integrating their supported projects into the national system, and to reduce the transaction costs emanating from the parallel structures that often threaten the sustainability of project/programme outcomes.

D.5 Lao PDR Country Study⁸⁸

Introduction

In the 2008 Phase One study *The Developmental Effectiveness of Untied Aid*, it was found that aid to LDCs is now overwhelmingly untied (excluding exempt categories, technical co-operation and food aid). However, it was also found that there existed very little formal analysis of both the donor practices in partner countries and the actual consequences of untying aid at a country level. The Phase Two study is in response to the proposals of the Working Party on Aid Effectiveness and the Development Assistance Committee (DAC) Network on Development Evaluation and the reporting requirement in the 2001 DAC Recommendation on untying ODA to LDCs.

Phase Two of the project is intended to provide evidence-based conclusions about the implications of untying aid and its impact on aid effectiveness in selected case-study countries, for presentation to the DAC by December 2009. This report provides the results of the Lao PDR Country Study.

This study aims to highlight the key issue of the implications of untying aid for aid effectiveness in the context of Lao PDR, through a short statistical and econometric review of the available data and through an analysis of four project case studies. The focus of the case studies was placed on procurement practices of the donors, governmental executing agencies and implementing agents, that may have a significant impact on how goods and services are purchased, with implications for aid effectiveness.

The four projects selected as case studies were:

- SIDA funded road project
- EU funded rural development project with a water sector component
- AFD part-funded hydroelectric power project
- JICA funded water supply project.

Statistical and econometric analysis

Bilateral ODA to Lao PDR originated in the early 1960s, and multilateral ODA was first recorded in the late 1970s. Since then, total ODA has shown a strong increasing trend up to the present, although there has been some fluctuation year on year, with bilateral donors traditionally contributing the larger proportion of ODA. Total ODA in 2007 stood at US\$ 280 mn, which is approximately 7% of GDP – a large percentage relative to other aid recipients. Japan, France, and Sweden are Lao PDR's largest bilateral donors, contributing respectively 40.1%, 16.8% and 11.8% of total bilateral aid between 2005 and 2007. The aim of the econometric analysis is to determine whether ODA, the tying status and the instruments by which aid is provided (loans and grants) have any significant impact on aggregate donor export flows to the recipient, in this case to Lao PDR. Overall, the results show that aggregate ODA, and grants in particular, have significant trade distorting effects

through the increase in donor-recipient exports. This empirical evidence suggests that aid flows could be informally or *de facto* tied, when analysis of data from a cross section of donors to Lao PDR is performed. However, as outlined in the econometrics investigations this analysis has some caveats.

Aid modalities and tying

Lao PDR is classified as an LDC and is, therefore, covered by the 2001 DAC Recommendation to untie aid. Between 2005 and 2007 DAC donor countries formally untied over 70% of their ODA commitments to Lao PDR (CRS). Meanwhile, for the same period, 22% of bilateral ODA remained unreported with regard to tying status. The process of untying aid has improved over the last decade, despite the hesitation of some donors to move to non-project based aid modalities, such as budget support and pooled funding, which are often associated with untying. Lao PDR receives largely grant aid as an instrument (98% of DAC ODA in 2007) and project based aid modalities. Several donors also provide project based or free-standing technical co-operation, in many cases alongside grant funding for projects, which is often tied. For example, grants which involved no free-standing technical cooperation (FTC) reported a 96.8% untied share, whereas grants which had a whole FTC component reported an untied share of just 27.8% (CRS, 2005-07). The three largest donors to Lao PDR, Japan, France and Sweden, all reported a high proportion of their ODA as untied for 2007: 68.9%, 62.3% and 98.5% respectively. Lao PDR also receives substantial aid from non-DAC donors, that is considered to be largely tied and not necessarily conforming to OECD definitions of ODA (Table D.5).

⁸⁸ The study was undertaken by Adam McCarty and Alex Julian (2009) (adaminha-noi@gmail.com).

Table D.5 Lao PDR: bilateral ODA disbursements by source, 2005-06¹

Donor	CRS data		Local data	
	US\$ mn	%	US\$ mn	%
	DAC bilateral donors (including EC)			
Australia	12.8	6.8	17.2	7.7
Belgium	2.7	1.4	5.3	2.4
Canada	1.9	1.0		
Denmark	3.4	1.8		
EC	8.8	4.7		
Finland	2.0	1.1	1.7	0.8
France	15.9	8.5	17.7	7.9
Germany	18.3	9.8	6.3	2.8
Ireland	2.4	1.3		
Japan	66.2	35.2	62.2	27.8
Luxembourg	6.8	3.6	6.3	2.8
Netherlands	0.1	0.0		
New Zealand	2.5	1.3	1.8	0.9
Norway	11.4	6.1	14.7	6.6
Sweden	23.7	12.6	19.8	8.9
Switzerland	4.5	2.4		
UK	0.3	0.1		
USA	4.3	2.3		
	Non - DAC bilateral donors			
Vietnam			24.9	11.1
China			21.2	9.5
Thailand			18.8	8.4
Korea			5.9	2.6
Total	187.8	100.0	223.5	100.0

Source: OECD CRS database and Lao PDR Ministry of Planning and Investment

Notes: 1. Aid from non-DAC donors does not necessarily satisfy DAC criteria to qualify as ODA.

Project analysis

Four projects were selected from the top active bilateral donors to Lao PDR, to be used as case studies for the project analysis. Although water and sanitation was the target sector, exceptions had to be made in this country study due to low activity in that sector. An in-depth review of the four infrastructure projects was undertaken, to reveal methods of aid delivery and donor practices with respect to untying. The approach used involved tracking donor funds for each project, from commitment by the donor to disbursement by the lead implementing agency down to ground level. From this account, procurement and funding procedures were closely investigated to determine the exact origin of goods and services employed for the project, and whether any sourcing

restrictions on the basis of nationality occurred. The case studies also attempted to assess the impact of the sourcing of contracts on the cost effectiveness and developmental effectiveness of the original aid disbursement. All four projects were implemented using different funding channels, practices and implementation strategies, allowing a suitable range of factors to be investigated. The four case study projects are summarised as follows:

1. The Lao-Swedish Road Sector Project Phase III (LSRSP3) is a Sida funded project, designed to provide basic road access to remote village communities in 26 of the poorest districts in Lao PDR. This project phase commenced in October 2005, after the government, through the Ministry of Public Works and Transport (MPWT), requested continued support from Sida for the road sector. The total funding for the four year project period is a US\$ 20 mn grant from Sida (70%) and a US\$ 9 mn contribution from Government of Lao PDR (30%). The MPWT is responsible for the management and procurement on the project, where procurement was conducted using country systems.

2. The Integrated Community Based Rural Development Project in Namor and Xay Districts, Oudomxay Province is a three year EC project which started in January 2007, with an overall objective of making a positive impact on the improvement of the food security and socio-economic situation of the targeted 20 communities. The project was implemented by a German International NGO, which also contributed 25% of the total EUR 1,098,678 grant funds (75% from EC). The INGO was selected by international competitive selection by the EC, and all project procurement required EC rules.

3. The Nam Theun 2 Hydropower Project is one of the largest hydropower projects in Lao PDR, with a total value of US\$ 1.5 billion, which began the construction phase in June 2005 and has an expected completion date of December 2009. The funding arrangements of the project involve both private and public sources, which include part loan and grant funding by AFD, World Bank and ADB.

4. The Project for Vientiane Water Supply Development is an urban water supply project, undertaken in the Lao PDR capital from February 2006 to March 2009, with the main objectives to attain a stable water supply and improve the water supply service ratio in Vientiane Capital. JICA funded US\$ 30.2 mn for the project, in the form of grant aid. The executing agency was the MPWT, and the project utilised the donor's procurement guidelines.

Investigation of these four project case studies produced the following key descriptive results:

- Overall, contracts in these projects were found to be competitively sourced through standard bidding procedures, with the majority of (but not all) contracts for construction work, ground level workers and materials used for

construction originating from Lao PDR – the lowest cost and easiest available source.

- Some other project components remained sourced from the donor country/region in practice, even when sourced competitively, such as technical assistance, project consultants, large head contracts, and project implementing INGOs.

Cost and developmental effectiveness

The implications of donor practices on the four case study projects for cost, aid and developmental effectiveness can be summarised as follows:

- By reviewing and ground-truthing untied projects, information and price data obtained (where available) showed that cost savings were made on the purchase of equipment items and construction materials relative to market reference prices. This implies that untying led to more cost-effective use of aid funds, at least for equipment.
- Untying has been associated with a shift away from donor priorities and towards the Lao Government's needs and objectives (alignment), supported by the fact that more government agencies are now responsible for project implementation and management.
- Local sourcing of contracts, consultants, workers and materials as a result of untying can have positive developmental effects, by providing increased employment opportunities and revenues for local manufacturers and suppliers. However, as discovered from the account of project practices, it is not always practical to procure all goods and services domestically. Several equipment items or skills are unavailable locally, so must be imported. Quality standards may also require goods and services to be imported, for the end product to be sufficiently effective.

Conclusions and recommendations

The Lao PDR untied aid country study provides valuable insight into the practical functioning and processes of different donor funded infrastructure projects in the context of a South East Asian LDC – a useful contribution to an area with very little previous investigation. The benefit of the study is that it has enabled the identification and separation of the components of a project where both untying and tying are occurring. As one of six country studies, the Lao PDR study will contribute to a cross country comparison of donor practices with respect to untying and the corresponding impact on aid effectiveness, which will assist in the understanding of the international untying process and recommendations to further improve untied aid delivery and aid effectiveness.

From the in-depth project case study projects, three out of four were found to be largely untied. Some areas of *de facto* tying were still uncovered, including the areas of TA, head contractors and equipment. Interestingly, no equipment or

materials in the EU, Sida and AFD projects were found to be tied – a typical area of tying in the past. The analysis showed that project case study projects that were overall untied also displayed characteristics of being cost and developmentally effective, thereby providing evidence supporting the benefits of untied aid.

To improve the untying process further in Lao PDR, and to increase aid effectiveness in general, it is recommended on the basis of this study that further steps are taken to encourage the use of 'newer' aid modalities among donors (e.g. budget support and pooled funding) and increased use of country procurement systems. Further action should be taken to untie the service components and TA of projects, by developing the skilled labour sector through education and training activities, and by increasing the supply of qualified consultancy services in Lao PDR. Encouraging participation of non-DAC donors in untied aid policies is another potential channel to explore, for achieving further progress in untying aid with respect to both Lao PDR and internationally.

D.5 Vietnam Country Study⁸⁹

Introduction

In the 2008 Phase One study *The Developmental Effectiveness of Untied Aid*, it was found that aid to LDCs is now overwhelmingly untied (excluding exempt categories, technical co-operation and food aid). However, it was also found that there existed very little formal analysis of both the donor practices in partner countries and the actual consequences of untying aid at a country level. The Phase Two study is in response to the proposals of the Working Party on Aid Effectiveness and the Development Assistance Committee (DAC) Network on Development Evaluation and the reporting requirement in the 2001 DAC Recommendation on untying ODA to LDCs.

Phase Two of the project is intended to provide evidence-based conclusions about the implications of untying aid and its impact on aid effectiveness in selected case-study countries, for presentation to the DAC by December 2009. This report provides the results of the Vietnam Country Study.

This report provides the results of the Vietnam Country Study and is part of the LDC South East Asian Lao PDR-Vietnam Country pair. Using a sample of four project case-studies, combined with a brief statistical and econometric review, this study aims to contextualise the key issues of aid effectiveness and implications of untying aid in Vietnam. The selected project case-studies focus on procurement practices of the donors and governmental executing agencies, which may have a significant impact on how goods and services are purchased, with implications for aid effectiveness.

The four selected case studies were:

- two irrigation projects funded respectively by Lux-Development and JICA
- a water supply and sanitation programme funded by AusAID, Danida and the Netherlands
- a flood prevention construction project funded by AfD.

Statistical and econometric analysis

ODA commitments to Vietnam have increased steadily since 1993, with larger contributions in the past decade. In an overall review of OECD ODA to Vietnam, donor countries had by 2007 formally untied over 70% of their ODA commitments. From 2005 to 2007, Vietnam received aid through both grants (41%) and loans (59%), with donors providing a significant amount of technical assistance. Approximately 65% of all ODA commitment to Vietnam was untied from 2005 to 2007. A large proportion of donor ODA to Vietnam is in the form of technical co-operation (TC) (Table D.6), and the tying status of much of this form of ODA is not reported to the DAC.

The aim of the econometric analysis is to determine whether ODA, the tying status and the different modalities through which aid is provided (loans and grants) have any significant

impact on aggregate donor export flows at the country level, in this case to Vietnam. The results suggest that grants from donor countries have trade-distorting effects on donor exports, and possibly allude to informal or *de facto* tying of grants. However, the analysis for Vietnam is not conclusive.

Aid modalities and tying

Although the majority of donors in Vietnam continue to provide ODA through a project based approach, there is an increasing trend to move towards non-project based modalities and use country systems, through general or sector budgetary support and pooled funding. Donors providing ODA through project based approaches are progressively tailoring projects to ensure untying status through greater use of country systems, by decentralising project implementation and execution at sub-national levels and, in some cases, ensuring government agencies remain the main contracting authority for procurement. As of 2008, 'untied aid' represented 74.3% of all committed aid received by Vietnam from DAC countries.

Table D.6 Vietnam: aid commitments and disbursements by type of assistance 2006-07

Type of Assistance	Commitments		Disbursements	
	US\$ mn	%	US\$ mn	%
Emergency and Relief Assistance	167	3.2	61	1.7
Free-standing Technical Cooperation	683	13.0	697	19.1
Investment Project Assistance	1841	35.0	1252	34.3
Investment Project Assistance with a TC Component	1538	29.2	1240	34.0
Investment-related Technical Cooperation	36	0.7	30	0.8
Programme/Budgetary Aid or Balance of Payments Support	467	8.9	308	8.5
Unspecified	533	10.1	58	1.6
Total	5264	100.0	3646	100.0

Source: DAC database Vietnam

Project analysis

The four selected case studies consisted of three active projects and one programme, all located within the water supply and sanitation sector. Aid modalities varied across the case studies, yet all four were similar in that they largely involved procurement of services, while the procurement of equipment and materials was relatively similar, allowing for cross-comparison.

1. The Saigon River Lowlands Flood Prevention Project was handed over for financing to AfD in 2007, after the Gov-

⁸⁹ The study was undertaken by Adam McCarty et al. (2009) (adaminhanoi@gmail.com).

ernment of Vietnam decided it was no longer able to continue funding the project. AfD is contributing US\$ 11.8 mn, through general budget support. The executing agency through MARD is the Hydraulic Project Investment and Construction Management Board 9 (ICMB-9), responsible for the projects along the right bank, and the Ho Chi Minh City PMU for projects along the left side of the Saigon River.

2. The Rural Water Supply and Sanitation National Targeted Programme II (RWSS NTP II) is a follow up programme to the Rural Water Supply and Sanitation programme (RWSS NTP I), which started in the early 1990s in co-operation with Australia and Denmark, with the government. The RWSS NTP II is a pooled funding programme between Denmark, Australia, the Netherlands and the government, and it is expected to run from 2006 to 2011. Total funding for the project is US\$ 315 mn, of which AusAID has committed US\$ 34 mn. Danida contracted the Danish company Mercer Ewer to assist in the procurement of the international TAs, while AusAID contracted the Australian company URS to procure national consultants and TAs for this programme.

3. The Nam-Tuan Irrigation project is a single-donor project which commenced in April 2006, and is expected to complete in April 2010. Luxembourg Development is supporting the project, at the request of the government, through a non-reimbursable grant of EUR 3,293,100. The international TC is of British nationality, directly appointed by Lux-Dev. Lux-Dev remains the contracting authority for all services and construction works contracts, but the executing agency responsible for procurement is the DARD, specifically the PMU of the Nam-Tuan Irrigation project, led by the international TC.

4. The Phan Ri-Phan Tiet Irrigation project is being funded by JICA through a loan agreement, and was intended to be implemented from March 2006 until December 2012. JICA is the sole donor, committing a total ODA loan of US\$ 51.9 mn to the government. The aid modality is project based aid assistance, and the project is executed through the 'Central Project Office' (CPO) under MARD, which is responsible for its management, including holding responsibility for procurement of contractors and the employment of consultants. BCEOM Company (France) was awarded the contract to provide consultancy services for project implementation, and was procured through short listed method. All construction contracts were awarded to Vietnamese firms.

Cost and developmental effectiveness

At the sub-national and national level, development effectiveness was improved through knowledge transfers, firstly between donors and the government, and secondly between the international TAs and national consultants or project owners. Local labour and local sourcing of goods increased the incomes and employment of some of Vietnam's poorest provinces, where these development initiatives take place. Yet problems of seasonal or temporary employment question the sustainable long-term development impact. Difficulties also

lie in determining whether the effect on local employment is a direct effect of the untied nature of the projects, i.e. there is little evidence to assume that if these projects were tied that they would source labour from foreign markets.

In terms of cost effectiveness, certain projects indicated a clear trade-off between time-efficiency and cost effectiveness, such as the Nam Tuan Irrigation Project and the AfD Saigon River Flood Prevention, both of which used Vietnamese government agencies to procure consulting services and construction works. However, the projects suffered delays due to bureaucratic procedures or often in efforts to prevent collusion. By comparison, AusAID outsourced the procurement of national consultants to an Australian firm, which led to the timely procurement and awarding of national consultancy contracts. The four case studies indicated that prices paid for equipment and materials procured through the GoV project implementation units is likely to have been above or equal to the market price due to the effect of direct contracting, local supply constraints and social networks.

Conclusion and recommendations

In actual practice, the procurement of goods and services for all four projects suggests little evidence of implicit or *de facto* tying of aid by donors, since the decentralisation of all four projects ensured extensive use of local suppliers for both services and works contracts.

The biggest obstacle to untying aid completely in Vietnam is the government's current capacity to procure quality contracts in a timely, effective and transparent manner. Efforts have been made by all four donors to enhance the Vietnamese Procurement Law (VPL) in various ways to improve this. However, this can lead to confusion and overlapping, inevitably resulting in an ineffective procurement system. Further efforts need to be made to ensure an improved VPL is applied to all donor projects.

Furthermore, the strong donor focus on monitoring and evaluation constrains ODA from being completely untied. Based on the findings from the case studies, policies which strengthen government's capacity in international procurement and enhance the government's financial and project monitoring systems would perhaps bring about some improvement.

ICB is the preferred method of selection, since it is considered the most open and most competitive, and is strongly related to untying. If ICB is not practical, this encourages uncompetitive selection and direct hire. Therefore, as international competitors increase their presence in Vietnam and have greater market access, this will also enable more ICB selection procedures and greater untying.

Regardless of the aid modality, from the cases reviewed, a significant effort has been made to ensure that ownership over ODA lies in the hands of the government, through the use of country systems, national TAs and the greater involvement of government executing agencies. Although counterfactuals are not available for comparison for this report, untying aid is judged to have contributed to improving aid effectiveness on development in Vietnam. Furthermore, despite Vietnam's fast

approaching middle-income country status, donor provision of ODA continues to play a significant role in the country's economic and social development, which could be accelerated by continuing to open the procurement process and enable more recipient country ownership.

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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, published in October 2008 and subsequent case studies in Burkina Faso, Ghana, Laos, South Africa, Vietnam and Zambia.

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