

Unclassified

DCD/DAC(2010)3

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

19-Jan-2010

English - Or. English

DEVELOPMENT CO-OPERATION DIRECTORATE
DEVELOPMENT ASSISTANCE COMMITTEE

DCD/DAC(2010)3
Unclassified

**UNTYING AID: 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**

DAC Meeting, 12 February 2010

This note is submitted for DISCUSSION under Item 4 of the Draft Annotated DAC Agenda [DCD/DAC/A(2010)2].

The note provides the summary and recommendations of the independent evaluation on the developmental effectiveness of untied aid, which was undertaken by ODI in the context of the Paris Declaration on Aid Effectiveness and the 2001 DAC Recommendation on Untying ODA .

The full study (some 130 pages) is available from the OECD untying website at: <http://www.oecd.org/dataoecd/51/35/44375975.pdf>

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JT03277185

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UNTYING AID: IS IT WORKING?

THEMATIC STUDY ON THE DEVELOPMENTAL EFFECTIVENESS OF UNTIED AID: EVALUATION OF THE IMPLEMENTATION OF THE PARIS DECLARATION AND OF THE 2001 DAC RECOMMENDATION ON UNTYING ODA TO THE LDCs: SYNTHESIS REPORT

SUMMARY AND RECOMMENDATIONS¹

Background

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

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

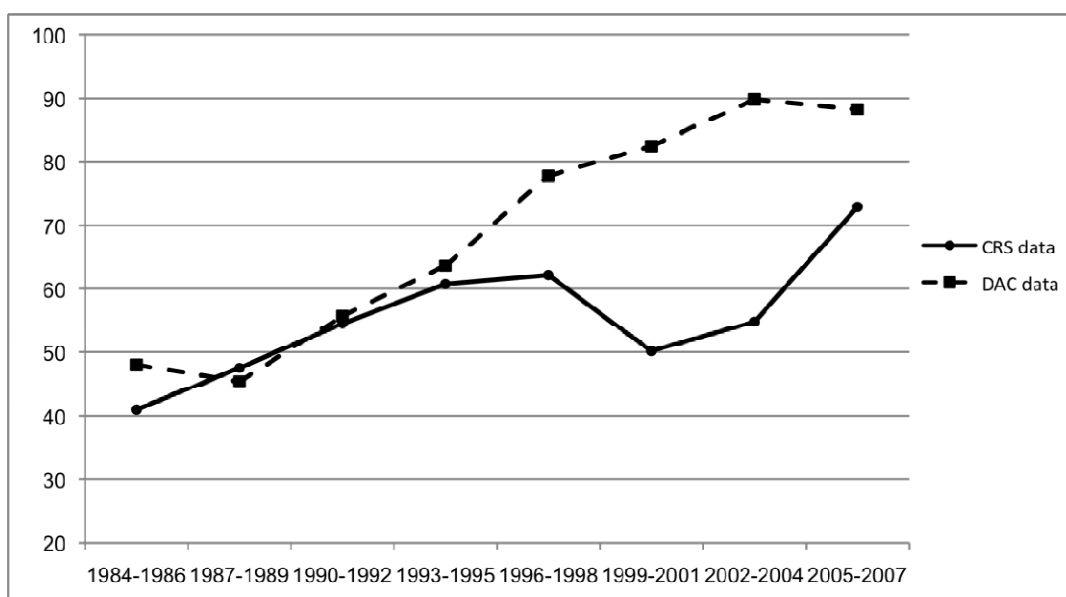
3. ***The 2001 Recommendation and untying of aid:*** the overall picture is very positive in terms of progress by DAC donors in the *formal untying* of their aid, removing legal and regulatory impediments to the procurement of goods and services outside the donor's own market (Synthesis Report (SR) Chapters 3 and 4). The proportion of fully untied bilateral aid rose progressively from 46% in 1999-2001 to 76% in 2007 (Figure 1 and Table 1), and for LDCs it has increased from 57% to 86 %. Taking into account

¹ This document has been prepared by the Core Group for the Thematic Study (Dr E. J. Clay, Ms L. Natali and Mr M. Geddes of ODI, London) to be made available to the members of the DAC prior to its meeting on 12 February 2010, when the study will be presented and there will be an opportunity for discussion. The document is based on the Summary of the Synthesis Report (SR) and incorporates some additional more detailed findings and conclusions from Chapter 8 of the Synthesis Report that are considered to be of particular interest to the DAC with its responsibility for oversight of the 2001 Recommendation on untying aid.

multilateral aid, the proportion of untied ODA has risen to 83% overall. The changes over the past 10 years indicate that the 2001 Recommendation on untying of aid, together with other international agreements such as the Paris Declaration, have had an overall positive impact on further untying aid. But there are important qualifications.

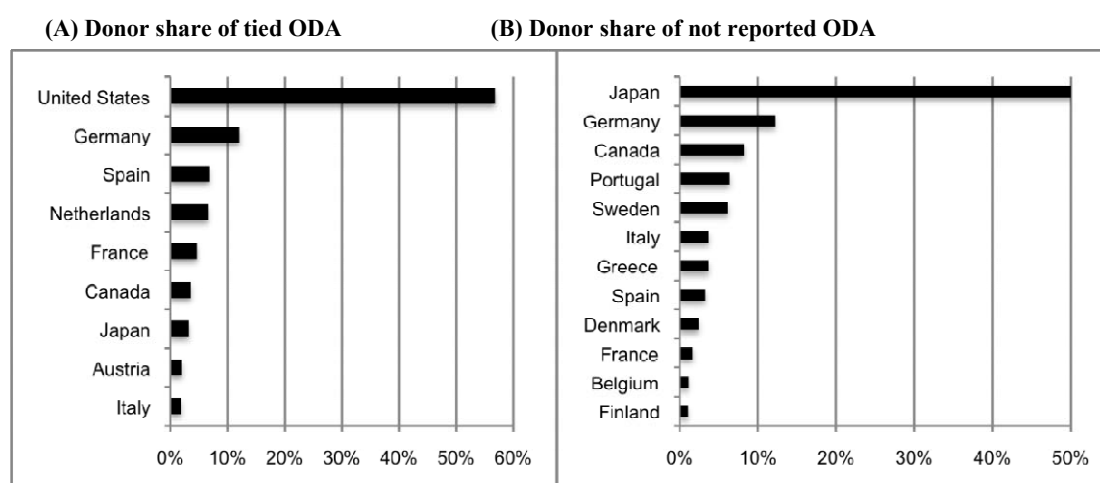
4. Free-standing technical cooperation and food aid were excluded from the Recommendation and both remain significant 'grey areas', with 30% and at least 50% respectively still reported as tied, and the tying status of significant proportions not being reported by some donors (Figure 2 and Table 1).

Figure 1 Share of total bilateral aid that is untied, three year averages (1984-2007)



Source: Figure 3.2 of Synthesis Report (original source: OECD DAC & CRS databases)

Figure 2 Donor share of total bilateral 'tied/not reported' ODA in 2007



Source: Figure 3.1 of Synthesis Report (original source: OECD Creditor Reporting System CRS)

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

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

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

8. ***Impediments to formal untying*** include the effort needed to change regulatory and legislative frameworks. There is also the carry over effect of continuing projects and programmes. In the important case of the USA, legislative restrictions on use of public funds remain in place (whilst allowing for waivers) and for food aid almost entirely (OECD, 2008a), in part because of effective opposition from domestic interest groups.

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

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

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

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

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

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

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

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

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

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

The way forward: recommendations

19. Donors and their partners can do much more to complete the process of untying and to exploit the opportunities offered by untying to increase aid effectiveness and its development impacts. These actions need to be set clearly within the changing global context of aid including:

- ‘The elephant in the room’ – a better understanding is needed about the growing role of concessional and largely tied development funding provided by emerging non-DAC donors;

- New vertical funding mechanisms that could be at odds with the PD aid effectiveness principles which provide the rationale for untied aid;
- New forms of financing seem likely to be required to address the challenges posed both by the global financial crisis in the short-term and climate change in the longer term.

20. The 2008 Accra Agenda for Action (AAA) on aid effectiveness reaffirmed the commitment to continue the process of untying and calls upon DAC Members in responding *to elaborate individual plans by 2010 to 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.

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

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

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

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

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

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

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

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

Table 1 DAC donor countries: tying status of bilateral ODA in 2007 (including donor administrative costs)

Donor	Bilateral ODA (US\$ mn)	Tying status as % of donor ODA				Tying status as % of bilateral ODA			
		Untied	Partially untied	Tied	Not Reported	Untied	Partially untied	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	100	100	100
All donors (including EC)	103,318	66	13	16	5				

Source: Table 3.2 of Synthesis Report (original source: OECD CRS).

Table 2 Bilateral DAC donors (including EC) - Percent of aid to government using Country Procurement Systems (CPS) in 2007¹

Donor	Zambia	Lao PDR	Ghana	Vietnam	Burkina Faso	South Africa	Sample average
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
US	22	54	0	--	0	4	16

Source: Table 6.3 of Synthesis Report (original source: OECD DAC).