Overseas Development Institute

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

Phase I Report

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List of Acronyms

ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement
ANZGPA	Australian and New Zealand Government Procurement Agreement
B2B	Business to Business
BOP	Balance of Payments
CIDA	Canadian International Development Agency
CPG	Commonwealth Procurement Guidelines (Australia)
CRS	Creditor Reporting System (OECD)
DANIDA	Danish International Development Agency
DAC	Development Assistance Committee
DFID	Department for International Development (UK)
DFI	Directly Financing Imports
DDR	Doha Development Round
EEA	European Economic Area
EFTA	European Free Trade Association
EU	European Union
FAC	Food Aid Convention
FAO	Food and Agriculture Organization
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GST	Goods and Service Tax
GNI	Gross National Income
HQ	Headquarters
HLM	High Level Meeting
IDRC	International Development Research Centre
LDC	Least Developed Country
LRPs	Local and Regional Purchases
MERX	Canadian Public Tendering System
MCA	Mixed Credits Arrangement
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organisation
NMFA	Norwegian Ministry of Foreign Affairs
NDFI	Not Directly Financing Imports
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
O&M	Operation and Maintenance
RTE	Resource Transfer Efficiency
SDC	Swiss Agency for Development and Cooperation
SECO	State Secretariat for Economic Affairs (Switzerland)
TC	Technical Cooperation
UNDB	United Nations Development Business
WFP	UN World Food Programme
WTO	World Trade Organisation

Summary

This report presents the results of Phase I of a thematic study being undertaken to assess the effectiveness of untied aid. The study is in response to the proposals of the Working Party on Aid Effectiveness and the DAC Network on Development Evaluation and the request in the 2001 DAC Recommendation to untie ODA to the LDCs for a comprehensive evaluation of its impact by 2009. The preliminary findings and conclusions of this study are as follows.

DAC donor countries had by 2006 formally untied over four fifths (82%) of their ODA to LDCs, against a 60% benchmark for untying bilateral aid linked to the Recommendation. A wider process of aid untying appears to be continuing: in 2006 70% of bilateral ODA for non-LDCs was untied and if (untied) multilateral aid is taken into account, then 85% of all ODA was untied. Untying has had no apparent negative effects on support for aid, or any related diversion of resources to non-LDCs. A statistical analysis comparing 22 DAC donors indicates that the Recommendation is an important influence on the extent to which aid is untied. But reporting on tying practices is still far from complete or consistent or timely and needs to be improved. This should be a matter of priority for aid agency statisticians.

A review of donor policies and practices including a purposive survey of five donors that had already largely untied or were actively untying after 2001 (Australia, Canada, Denmark, Norway and Switzerland) suggests that:

- The Recommendation has had different implications, especially significant for those DAC members that had previously taken very limited steps towards untying.
- Untying is widely seen as closely linked with decentralisation of responsibility for aid programming to a country office level.
- There has been a shift to forms of aid that pass responsibility for disbursement to country partners, other joint donor partners, and civil society organisations.
- There is also a much-reduced donors' role in contracting organisations to provide goods and implement projects. There are several remaining relatively grey areas of tying practice in which it is not clear if tying is an issue of importance.

A literature review on tying practices confirms that the theoretical case for untying on both effectiveness and efficiency grounds is regarded as unequivocal by economists. There is also a substantial body of evidence on the negative effects of tying practices, especially a substantial loss of resource transfer value to recipients (at least 15-30%). In contrast, the actual consequences of untying have hardly been investigated in any systematic way.

So Phase II of the thematic study offers an important and timely opportunity to fill that gap. A set of country studies done with the full cooperation of recipient countries and donor agencies would enable the DAC and its partners to acquire a better understanding of how untying works, its impact and whether it is contributing to aid effectiveness as envisaged in the Paris Declaration.

1. INTRODUCTION

1.1 Background[1]

For decades, debates on aid effectiveness have focused on the issue of the tying status of aid (See below Section 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.[2] 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.[3]

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 and in 2008) 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. Basically, areas not covered are technical cooperation (TC), food aid and donor administrative costs.[4] 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, e.g. target number 35. The 2005 Paris Declaration on Aid Effectiveness reiterated the 2001 DAC Recommendation and envisaged that progress in the share of aid that is untied be monitored through Indicator 8.[5]

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 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).[6] So in the light of the close communalities between the thematic study within the framework of the evaluation of the Paris Declaration, and the request for an evaluation in the 2001 DAC Recommendation, this one thematic study is being undertaken to assess the effectiveness of untied aid.

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[1] Section 1 of this report is adapted from the Terms of Reference for the Thematic Study (Annex D).

[2] 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 (2006) study: for further discussion see Section 5 below.

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

[4] 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 Section 3.3.2 and Tables 3.6 and A1.2).

[5] "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.

[6] '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.

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 thematic 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 relevant provides policy recommendations on promising approaches 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 is being conducted in two stages:

- The first stage, which began in May 2008, is to produce a report envisaged as 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 a methodology for stage two including partner country case studies is also being developed for presentation to DAC members in October 2008.
- The second stage will consider the effects of the tying status of aid on aid effectiveness on the basis of a representative number of evidence-based case studies in partner countries. The case studies will be undertaken in cooperation with local research centres. 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. The precise timing of Stage II, including partner country case studies, will be decided when specific ToR have been developed and relevant case study countries identified and agreed upon. Provisionally this will be undertaken between November 2008 and March 2009.

A comprehensive final report covering Stages I and II will include practical policy recommendations for increasing the share of aid that is untied.

1.3 Stage I: approach, activities and outline of report

It is envisaged that the thematic study will be undertaken through a *consultative process* with donors, partner countries and civil society, and so this intention has shaped the way Stage I is being carried out. Stage I is based on preliminary analyses of three complementary sources of evidence.

First, there is a statistical analysis of tying and untying practice as reported to the OECD databases to provide an independent reassessment of progress towards untying. 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 have responded to the 2001 Recommendation. In view of the lack of documentation on untying policies and practices, and also time limitations (the study began formally on 6th May 2008), it was decided to focus in more detail on the bilateral aid programmes of five member governments to provide evidence for a representative range of case examples of the untying process and practices as well as residual tying practices. The aid agencies of the following five countries were approached, Australia, Canada, Denmark, Norway and Switzerland, and they agreed to participate in this partial survey to be based on meetings and/or telephone interviews with headquarters (HQ) staff. These countries were chosen for inclusion in the survey for a combination of reasons. 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 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.

The report is organised as follows. In Section 2 there is a brief overview of the international rules and agreements concerning the tying status of ODA. Section 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.[7] In Section 4 the findings of the exploratory survey of changing donor policies and practices are summarised. Section 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.[8] Finally, Section 6 sets out preliminary conclusions from investigations undertaken so far, including a brief statement of the implications for Phase Two.

[7] OECD/DAC (2008a) Para 13: the DAC average share of bilateral ODA to LDCs that is untied increased from 1999-2001 baseline of 57% to 84% in 2006.

[8] 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).

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

This section 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.

Definitions of tying status: at the international level the first set of concerns has been a focus of discussion in the OECD DAC. This has resulted in agreements that include the definition of tying/untying practices and agreements involving voluntary, non-binding commitments to move towards untying of bilateral aid. 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.

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).

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 Creditor Reporting System (CRS) on tied and partially untied aid transactions. Reporting on TC was specifically made voluntary. However, reporting on TC became mandatory following the revision of the CRS Reporting Directives in 1999. Apart from technical problems of ensuring consistent reporting, some donors choose not to report on the tying status of their bilateral aid to the DAC and some do 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 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 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, 2006). Issues for investigation are, therefore, the extent to which the exemptions and thresholds have been an influence on donor policies and practices.

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.

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

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.[9] The package also reinforced monitoring procedures for tied aid credits. These have been extended since 2005 on a voluntarily basis to untied aid credits that qualify as ODA. A chronology of the

[9] See OECD (1991), OECD (2008b) and, for an account of the process that led to the Helsinki Accord, see Ray (1995).

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 finance imports* (DFI) 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 possibly ‘grey areas’ where there is some element of implicit tying (Section 4 below).

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
- 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 WTO (World Trade Organisation) agreements and procedures for disputes. However, this has been in effect resolved by exempting ODA from the Agreement on Government Procurement GATT (1979).

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 has also been an issue in the export competition pillar of the agricultural negotiations for the Doha Development Round (DDR). The DAC definitions of tying status have been adopted in draft modalities for food aid (WTO, 2008).

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

This section 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 2006, the most recent year for which OECD DAC data are available. Donor performance is compared to the Recommendation and related targets agreed by the DAC. Finally, there is a multivariate statistical analysis of the relationships between untying, types of aid and donor characteristics. Because of the severe limitations of the available data, this is to be regarded as a preliminary statistical exploration.

3.1 An incomplete picture of untying and tying status of ODA

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, 2008b). 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 confirms 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 37% during 1999-2001 to 17% in 2004-06. Second, there are examples of donors reclassifying the tying status of their aid to be more fully consistent with the practice of other donors.[10] Third, as discussed above, there are inconsistencies in the status of aid reported as partially untied.

Table 3.1 DAC donor countries: tying status of bilateral ODA to LDCs and non-LDCs in 1999-2001 and 2004-2006 (percentages based on 3 year averages) [1]

Period	Recipient country grouping	Untied (1)	Partially untied (2)	Untied & Partially untied (3)=(1+2)	Tied (4)	Tying status Not Reported (5)	Total (3+4+5)
1999-2001	LDCs (%)	58	3.3	61	8	31	100
	Non-LDCs (%)	50	1.9	52	9	39	100
	All DCs(%)	**51**	**2.2**	**53**	**9**	**37**	**100**
2004-2006	LDCs (%)	77	0.1	77	10	12	100
	Non-LDCs (%)	62	0.6	62	19	18	100
	All DCs (%)	**65**	**0.5**	**66**	**17**	**17**	**100**

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

[10] 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.

The current extent of the incomplete information and non-reporting of the tying status of ODA is indicated in Table 3.2 for individual DAC donors. The most widely available annual assessment of tying status is the annual Development Cooperation Report, which is based on aggregate commitments[11] reported to the DAC, excludes TC, on which donor reporting is optional, and donor administrative costs. The reporting on tying status was 79.5% for 2006 (OECD DAC, 2008a: Tables 23-24). Taking into account TC that represents about 24% of total ODA, then the overall estimate of untying of 94.5% relates to say 60% of total bilateral ODA.

Table 3.2 CRS and DAC aggregate data coverage of tying status in 2006 [1]

	CRS Bilateral ODA[2]	CRS Bilateral ODA share of DAC Bilateral ODA (%)	Reporting of tying status in the CRS as a share of DAC bilateral ODA (%)	Reporting rate for DAC bilateral ODA excluding TC and admin costs (%)
Australia (2005)	(1429)	(80)	(72)	79.5
Austria	1083	100	100	0
Belgium	1545	100	100	100
Canada	1924	72	68	100
Denmark	1369	100	100	100
Finland	600	99	92	100
France	9450	95	79	100
Germany	9465	100	88	100
Greece	195	103	34	100
Ireland	633	100	100	100
Italy (2005)	(2218)	(88)	(88)	99.5
Japan	12945	95	80	100
Luxembourg	198	97	97	100
Netherlands	10830	105	105	100
New Zealand	289	97	92	0
Norway	2653	100	100	100
Portugal	189	87	87	100
Spain	2663	109	52	100
Sweden	3061	99	97	100
Switzerland	1269	102	79	100
United Kingdom	6950	75	75	100
United States	24287	100	100	100
All Donors (including TC)	**95247**	**96**	**89**	**79.5 (60%)**

Source: OECD DAC and CRS databases.
Notes: 1. Data are for 2006 and are commitments in current US$ millions.
2. The CRS database functions at the activities level as compared to the donor aggregate level of the DAC database.

[11] For example, the UK DFID reported to the DAC on a disbursement rather than commitment basis in 2006 which appears to explain why the UK's ODA reported to the CRS and a percent of DAC bilateral ODA was only 75% (Table 3.2).

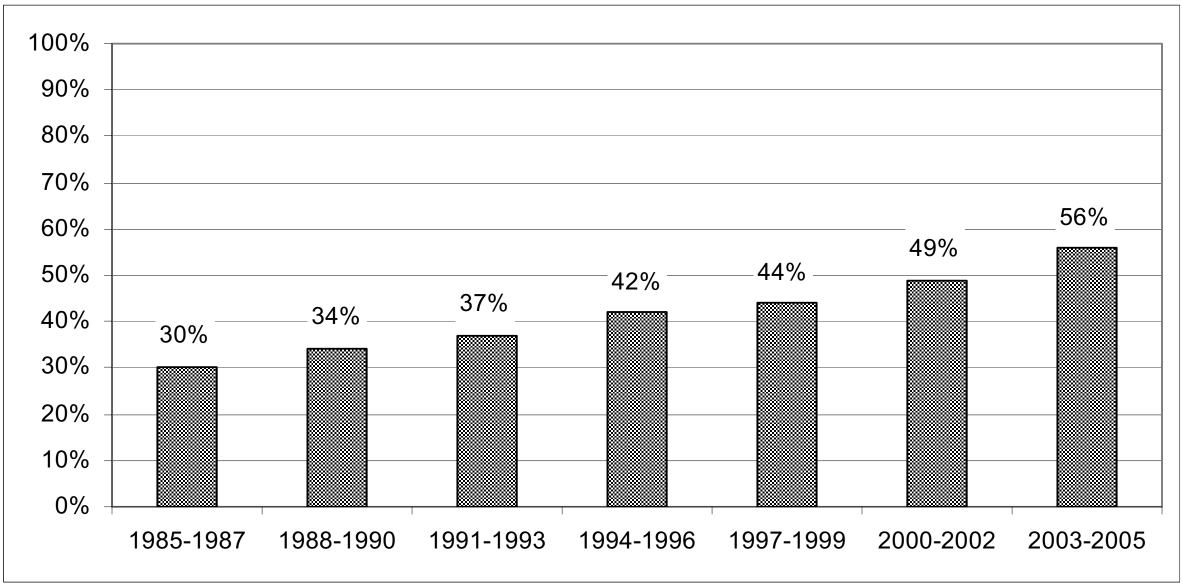
The OECD Creditor Reporting System (CRS), to which donors report their commitments on an activity basis, has a more comprehensive coverage of tying status than the DAC tables, but still remains incomplete. For most DAC members the coverage is complete or close to complete. A few donors (e.g. Canada, France) experience difficulties in reporting at the activity level aid extended by some government departments and local governments. Some donors report, but with a delay (e.g. Australia and Italy for 2006). Even so the reporting of tying status to the CRS for 2006 is 93% of bilateral ODA, in contrast to under 50% a decade ago. 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 3.1). Despite substantial improvements, the comprehensiveness of data on tying status is still sufficiently unsatisfactory to justify a strong recommendation to donors to improve on their reporting in two respects: first, for those that have yet to do so, to report more comprehensively to both the DAC and the CRS and, second, to make their data as consistent as possible with the reporting directives. Thirdly, some form of validation might be introduced.

3.2 Tying status: trends and recent donor performance

3.2.1 The continuing trend to untying of ODA

The DAC donors have moved from a largely tied regime for bilateral ODA to an untied one: *ODA reported as untied* rose from around one third in the late 1980s to over 50% in 2003 - 2005 (Figure 3.1). There is continuing progress with aid reported as untied rising to 73% in 2006. The actual proportion of untied aid is also probably higher than the figures suggest because some donor non-reporting and partial reporting in individual years was found in discussions with statisticians in donor agencies to be due to technical problems. For example, on the basis of their reports for previous years and other evidence, Australia (non-reporting) and Switzerland (partly reporting) were found respectively to have all untied part or almost all their aid.

Figure 3.1 Share of total bilateral aid that is untied, three year averages (1985-2005)



Source: OECD DAC and CRS databases.

Table 3.3 DAC donor countries: tying status of bilateral ODA in 2006 (% of bilateral ODA) [1]

	Untied aid (%) (1)	Partially tied aid (%) (2)	Untied & Partially untied aid (%) (1+2)	Tied aid (%) (3)	Aid where the tying status is not reported (%) (4)
United Kingdom	100	0.0	100	0.0	0.0
Ireland	100	0.0	100	0.0	0.0
Luxembourg	100	0.0	100	0.0	0.0
Norway	100	0.0	100	0.1	0.0
Netherlands	98	0.0	98	1.8	0.1
Sweden	96	0.0	96	1.9	1.7
Denmark	96	0.0	96	4.4	0.0
Belgium	95	0.0	95	5.3	0.0
Portugal	92	0.0	92	7.5	0.0
Japan	80	0.0	80	3.8	15.9
Italy (2005)	(80)	(2.3)	(82)	(17.3)	(0.5)
France	79	0.1	79	3.6	17.1
Finland	79	0.0	79	14.1	6.7
New Zealand	79	14.1	93	1.8	5.6
Austria	78	2.9	81	19.3	0.0
Switzerland	74	0.0	74	3.1	22.7
Germany	72	0.0	72	16.1	11.6
Canada	61	0.3	61	34.3	4.7
Australia (2005)	(54)	(0.0)	(54)	(36.8)	(9.6)
United States	45	0.0	45	54.5	0.0
Greece	32	0.9	33	0.2	67.3
Spain	22	0.0	22	25.9	51.9
All Donors	**73**	**0.1**	**73**	**19.5**	**7.3**

Source: OECD CRS database.

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 58% to 77% and from 50% to 62% for non-LDCs. There was an apparent increase in tying associated with the sharp fall in non-reporting. 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 2006. 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 is possible 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 Section 4.

3.2.2 Tying status of ODA in 2006: a cross-sectional analysis

The progress towards untying is indicated in Table 3.3: nearly three quarters of all bilateral aid was reported as untied (73%), 20% as tied or partially untied and 7% not reported. Nine members reported 94% or more untied aid. A tenth, Switzerland had reported over 95% untying in 2005 but did not fully report for 2006.[12] Two other donors that had until recently provided a high proportion of tied aid (Australia and Canada) and a third that had almost entirely tied aid (the USA) have reported substantial progress (Table 3.3).[13] 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 2006 this has been substantially exceeded by almost all members (except Greece, Spain and possibly Italy and Australia). The extent of untying of bilateral aid to LDCs, 82%, is substantially greater than for non-LDCs (70%) and overall was 73% in 2006 (Table 3.4). If (untied) multilateral aid is taken into account, then 85% of all ODA was untied, with only two members, Spain and the USA, retaining tying for a large part of ODA, 46% and 50% respectively. The broad conclusion is that formally DAC members' ODA to the LDCs is overwhelmingly untied. Even those such as Australia and Canada that had a large proportion of tied aid have moved decisively towards untying (see Section 4 below). The USA is the major donor that continues to tie. 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. 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.

[12] When the Swiss Agency for Development and Cooperation (SDC) started reporting under the new CRS++ system (convergence between CRS/DAC) in 2005, TC and administrative costs were notified without an indication on tying status (according to DAC rules).

[13] 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.

Table 3.4 DAC donor countries: tying status of aid in 2006[1]

	Untied aid share of total bilateral ODA (%)	Untied aid to LDCs as share of bilateral aid to LDCs (%)	Untied aid to non-LDCs as share of bilateral aid to Non-LDCs (%)	Untied aid Ratio [2] (%)
United Kingdom	100	100	100	100
Ireland	100	100	100	100
Luxembourg	100	100	100	100
Norway	100	100	100	100
Netherlands	98	96	98	98
Sweden	96	99	95	97
Denmark	96	97	95	97
Belgium	95	100	92	97
Portugal	92	90	100	96
Japan	80	81	80	85
Italy (2005)	80	35	90	90
France	79	80	79	86
Finland	79	98	66	87
New Zealand	79	80	78	82
Austria	78	91	77	84
Switzerland	74	83	72	83
Germany	72	84	70	80
Canada	61	71	55	73
Australia (2005)	54	48	55	68
United States	45	71	37	50
Greece	32	10	34	69
Spain	22	3	24	54
All Donors	**73**	**82**	**70**	**85**

Source: OECD CRS database.
Notes:
1. Data are commitments in current US$ millions.
2. The untied aid ratio is the sum of: the percent of bilateral aid (reported as untied to the CRS) multiplied by bilateral ODA (as reported to the DAC) and DAC multilateral ODA, divided by DAC total ODA.

Table 3.5 DAC donor countries: tying status of bilateral ODA to LDCs according to grant/non-grant status and technical cooperation component in 2006[1]

	Bilateral ODA	Untied & Partially untied (%)	Tied (%)	Not Reported (%)
Grant ODA (a=b+c)	20421	84	11	5
Without TC component (b)	14598	93	5	2
With some TC component (c)	5823	61	27	12
Wholly TC[2] (d)	5795	60	27	12
Loan ODA (e)	733	48	51	1
Total ODA[3] (a+e)	21159	82	13	5

Source: OECD CRS database.
Notes: 1. Data are for 2006 and are commitments in US$ millions.
2. Projects where TC is the only component.
3. Approximately as Grant-Like ODA and Equity Investment are excluded here.

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 that was untied in 2006 (48%) was substantially below that for grant aid (84%) (Table 3.5). The scale of bilateral loan aid has also contracted sharply. Two explanatory factors are concerns about indebtedness and a narrowing of 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 61% of aid as TC or including a TC component was reported as untied in 2006 (Table 3.5). A more detailed review of donor practices confirms efforts to untie many forms of TC.

A *sectoral classification* of bilateral ODA for 2006 indicates areas where untying has made more progress, as well as types of aid in which formal tying has been retained to a greater extent (Figure 3.6 and A.2). As would be expected, the extent of untying is greatest for debt relief (99%), support to NGOs (98%) and social sectors, such as basic education (90%) and general health (84%). The extensive non-reporting of the tying status of general budgetary support (75% before adjusting the database numbers), which accounts for 8.4% of bilateral ODA, is likely to include a high level of untied, fungible assistance. This suggests that the full extent of formal untying may be obscured by non-reporting. However, the high level of non-reporting in other sectors in which tying of project aid might be expected, infrastructure, transport, industry and energy, indicate that caution is required in making inferences from statistical data about untying practices at an aggregate or individual donor level.

Table 3.6 DAC donor countries: bilateral ODA by consolidated sectors in 2006[1]

	Bilateral ODA	Untied & Partially untied (%)	Tied (%)	Not Reported (%)
Social Infrastructure & Services	26560	63	28	9
Debt	18417	99	1	1
Economic Infrastructure	11511	71	25	4
Government and Civil Society	8107	61	29	9
Emergency Assistance & Reconstruction	6499	79	18	3
Multi-sector	5695	67	22	12
NGO Support	3772	98	0	2
Budget Support	3209	100	0	0
Production Sectors: Agriculture, Forestry & Fishing	2949	75	15	10
Donor Administrative Costs	2321	27	45	28
Production Sectors: Other	2021	63	25	12
Refugees in Donor Countries	1701	35	36	30
Unspecified	1149	49	5	46
Food Aid	1039	40	51	9
Commodity Aid / Program Assistance	296	66	34	0
All Sectors	**95247**	**66**	**22**	**12**

Source: OECD CRS database.
Notes: 1. Data are for 2006 and are 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. It includes local purchases in recipient countries and triangular purchases in third countries.
2. These are sourced in the donor country or in the case of the EU within the single European market.

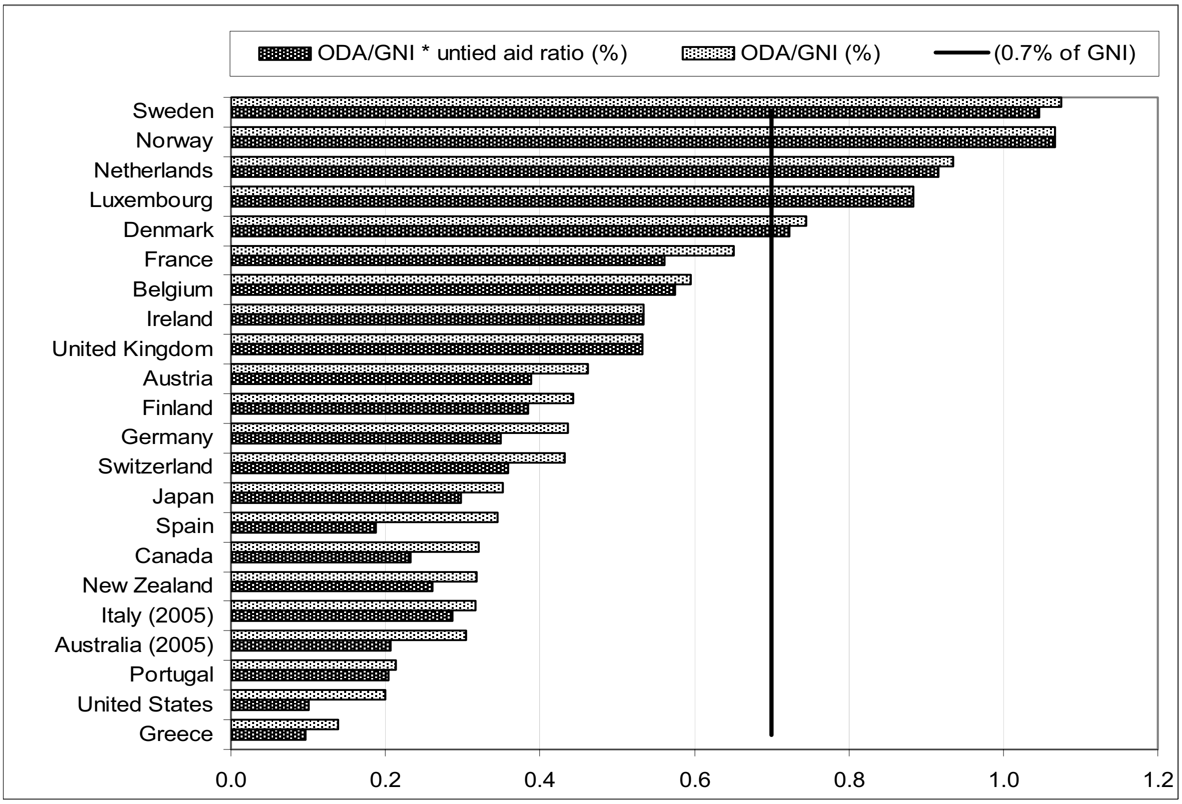
Food aid is exempt from the 2001 Recommendation. It is also difficult to determine the full extent of untying from OECD CRS and DAC data for a form of aid that is reported as part of a number of sectors, including commodity aid, emergency assistance and development food aid. The OECD (2006) study found 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 recipient (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.[14] 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 have 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). These ODA/GNI ratios for 2006 are shown in Figure 3.2 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 five 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 and GNI. A target equivalent to 0.04% of GNI was agreed and is reported to have been exceeded (OECD DAC, 2008a). 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.

[14] 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 including pulses, vegetable oils, sugar and dairy products of this category makes interpretation of statistical data more difficult.

Figure 3.2 DAC donor countries' effort-sharing – ODA and untied ODA as a percent of Gross National Income in 2006[1]



Source: OECD DAC and CRS databases (ODA and tying status) and World Bank World Development Indicators 2008 (GNI).

Notes: 1. The *untied aid ratio (untied ODA/GNI)* is the sum of the untied percentage of bilateral aid reported to the CRS multiplied by bilateral ODA plus multilateral ODA, then divided by total ODA and expressed as a percentage of GNI. Bilateral, multilateral and total ODA are as reported to the DAC. GNI is calculated using the Atlas method. The value for The Netherlands is based on the values in OECD document No. 38354517 adjusted for the average difference in calculation methods between the OECD and this study.

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 indicators of the aid untying the proportion of untied aid plus that channelled multilaterally is estimated in Table 3.4. When untied ODA is expressed as a percentage of GNI in Figure 3.2, effort-sharing appears to be closely related to overall ODA/GNI –those giving relatively more aid appear also to provide relatively more untied aid. This putative relationship is explored further in Section 3.4.

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 2006, since the base period of 1999-2001. The share of LDCs in total ODA was also 5% higher, and even higher (13%) excluding the somewhat temporary surges in debt relief during 2005-2006 (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 have 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 have sustained their real levels of food aid, whilst flows from those providing domestically sourced commodities have 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).

3.4 A multivariate analysis of the relationships between tying status and other aid and donor characteristics

The analysis so far has confirmed the substantial differences in individual donor tying practices. The partial or one to one relationships that have been identified between the share of untied aid and forms of aid and aid instruments are suggestive of a more complex set of relationships that are better explored in two ways: first through a more systematic multivariate statistical analysis, which is attempted next, and second by focusing more directly and in depth on donor policies in Section 4.

Following on from the review of tying and untying practices, an exploratory statistical investigation using regression analysis has been undertaken into the relationship between the extent of untying and a number of key variables that reflect the use of aid instruments and donor characteristics. *The issue being explored is whether there are systematic relationships between tying practices and other aspects of aid policy and donor characteristics, or whether tying status is just some idiosyncratic feature of individual aid donor policy.* But a caution - such statistical correlations do not explain the influences behind differences in tying practices, but clarify by quantifying relationships that are otherwise a matter of speculation. The analysis and results summarized below are described fully in Annex B.

Two *dependent variables* represent the extent of untying: untied aid as a percentage of total bilateral aid and the effort-sharing ratio (as described above). After looking at different definitions of these variables, such as including partial untying, all were found to be very highly correlated, and so the analysis focused on untied aid as a share of total bilateral aid.

The *explanatory variables* considered include aid instruments and types of aid as well as donor characteristics. If the 2001 Recommendation has been an influence on untying we would expect that donors giving a higher *share of aid to LDCs* would also untie a higher share of their bilateral aid. Aid instruments might also play a role in the decision to untie: the historical connections between tying and loans, especially in mixed credit packages, suggest that a higher *share of grants* might be linked to a relative higher share of untied bilateral aid. *TC* and *food aid*, both exempt from the Recommendation, could be associated with tying practices implying a negative impact on untying. Amongst donor characteristics, *ODA/GNI* and *GNI per capita* were considered as proxies for the effort sharing and differences in donor's wealth: those countries who are more willing to give aid and more concerned about maximizing the positive impact of aid on the recipient country and the wealthy may be less concerned about domestic benefits of aid. A number of other possible explanatory variables such as the ratio of bilateral to multilateral ODA, GNI, a dummy for European countries, total value of ODA and a the Commitment to Development Index were initially considered but subsequently dropped.

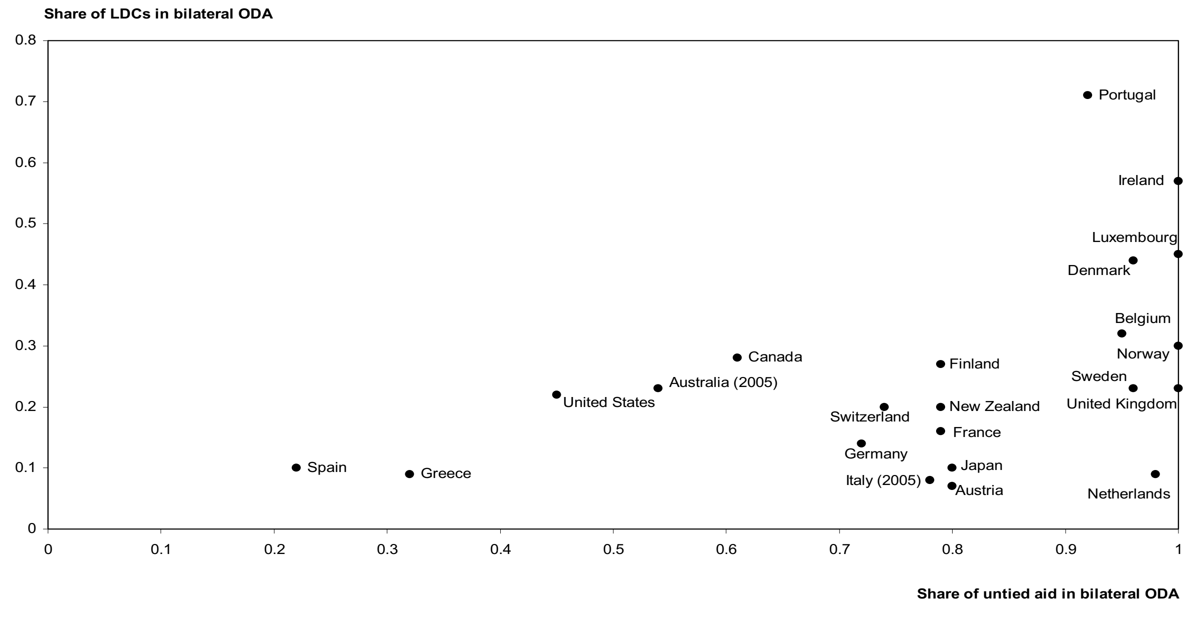
This preliminary analysis was carried out using data for 22 donors using the latest available headline figures from section 3. A trend analysis was ruled out due to changes in donors' reporting practices and a high percentage of non-reporting, which varies considerably across time and countries. The final sequence of variables in the regression is shown in table A.2.3 in Annex B.

When the relationships between *the share of untied aid* and the independent variables were considered together, the regression model is statistically significant and explains 66% of the variation in untying. The stronger relationships or explanatory variables in order of significance are:

- The share of aid received by LDCs *is highly* significant. This suggests that *the Recommendation is an influence on the extent to which aid is untied*. But, as Figure 3.3 shows, there is a considerable variability in the untying practices of those providing a high level of aid to LDCs, which is explained to some degree by the other variables.
- The *share of food aid in bilateral ODA* is always significant and positively *associated with higher levels of tying.* This confirms our expectation that a high share of bilateral food aid is associated with tying practices.
- Both the shares of *TC* and *GNI per capita* are highly significant in some formulations but never together. A higher *share of TC* and a lower *GNI per capita* are associated with a lower share of untied aid both confirming patterns expected.
- None of the remaining explanatory variables included in the final regression was found to be statistically significant.

Taken together these results suggest that the Recommendation has had a significant impact, and 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.

Figure 3.3 Relationship between share of untied bilateral ODA and share of bilateral ODA received by LDCs in 2006[1]



Source: OECD DAC and CRS databases.
Notes: 1. Data are commitments in current US$ millions.

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 draws largely on the annual progress reports to the DAC that monitor donor performance in relation to the 2001 Recommendation.[15] 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. 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. 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 statistical analysis of ODA as reported to the OECD, reviewing official documentation and interviews and telephone conversations with aid officials at donor HQ 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 it would be appropriate to explore 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, 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.

[15] The latest report is OECD DAC (2008a).

4.2 Preliminary findings

Performance on untying

All five donors have successfully responded to the Recommendation, in some cases virtually untying all of their bilateral aid in the 'eligible categories'. 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 not 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 answers to questions about how it works and impacts are felt to be answerable only at a partner country level.

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 donors role in contracting organisations to implement projects (Denmark, Norway, Switzerland).

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. Although outside the Recommendation all five donors have either largely removed formal tying requirements for food aid or permit local and regional sourcing (partial untying), 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? Discussions with donor officials and reviewing the documentation they made available, including evaluations, suggest three different models where the potential impact of untying needs to be evaluated separately:

Model A: Highly divisible goods (and some services?) that are widely traded on competitive, but not necessarily perfectly competitive markets (i.e. the food aid type case). 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.

Model B: 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 stations, ports and dams, some industrial units e.g. fishing facilities and telecommunications systems (air traffic control!). The OECD rules on officially supported export credits have been drawn up with the aim of precluding crude subsidisation of nationally based companies in what is generally a small group situation. Do multilaterally funded projects offer a standard for comparison?

Model C: Business to Business (B2B) is based on a third model where, for example, the developing country private sector is *disadvantaged in terms of information* as well as in access to funding. The partnerships are seen as a way of overcoming these obstacles. Are there positive cases or examples of this process working successfully? If so, B2B lies outside the two models where a competitive market is deemed to provide a framework for untied assistance. There may be a number of possible variants of this type of situation and the outcomes may prove to be highly context specific.[16]

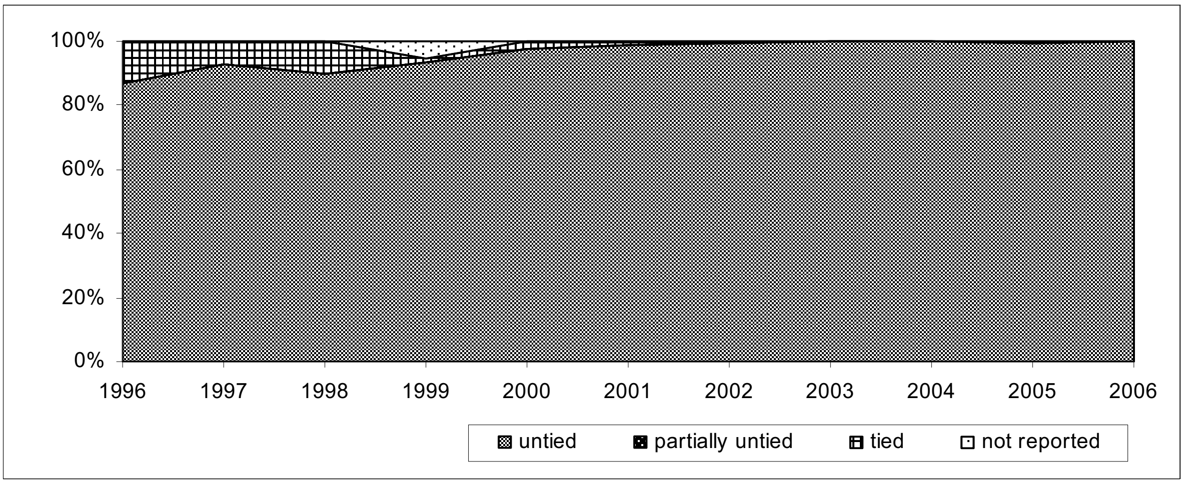
[16] The OECD study on promoting local and regional procurement identifies information and dialogue obstacles to local firms' successful participation in procurement. (OECD, 2008b).

4.3 Donor country experiences of untying

4.3.1 Norway

Untying aid began in the 1980s, and by 2002 there were only a few residual areas of tying (Fig 4.1.1). 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 B2B[17], post-secondary education and research.

Figure 4.1.1 Norwegian bilateral ODA: tying status 1996-2006[1]



Source: OECD CRS database.
Notes: 1. Data is commitments in current US$ millions.

Apart from the general economic development arguments in favour of untying – 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.[18] 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 untying (Stokke, 1989; 2005; Abildsnes, 2007).[19] 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 some Norwegian technical expertise will be funded (NORAD, 2007a; 2007b).

Only 0.13% of bilateral aid was reported as tied in 2006. 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. 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

[17] These are called 'Matching Making Programmes' in Norway (NMFA, 2004).
[18] These were, of course, early concerns about managing the problems of 'Dutch disease' in an economy expected to experience a structural trade surplus.
[19] There are parallels with the Pergau Dam affair that led to a political commitment to complete untying of UK bilateral aid implemented in 1997.

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.[20] 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 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.

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.[21] This practice explains why there are severe and Europe-wide limits on donor tying possibilities.

Box 4.1 The Decline of Mixed Credits Arrangements (MCA)

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 100mn 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 organising a project for Laos 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.

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MCAs are an example of how untying may lead to the decline in use of aid instruments. MCAs could be phased out (Box 4.1).

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20 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, 2000).

21 The current thresholds (according to Norwegian Government regulations) require national tendering over NOK 500,000. Above NOK 1.2 million 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.

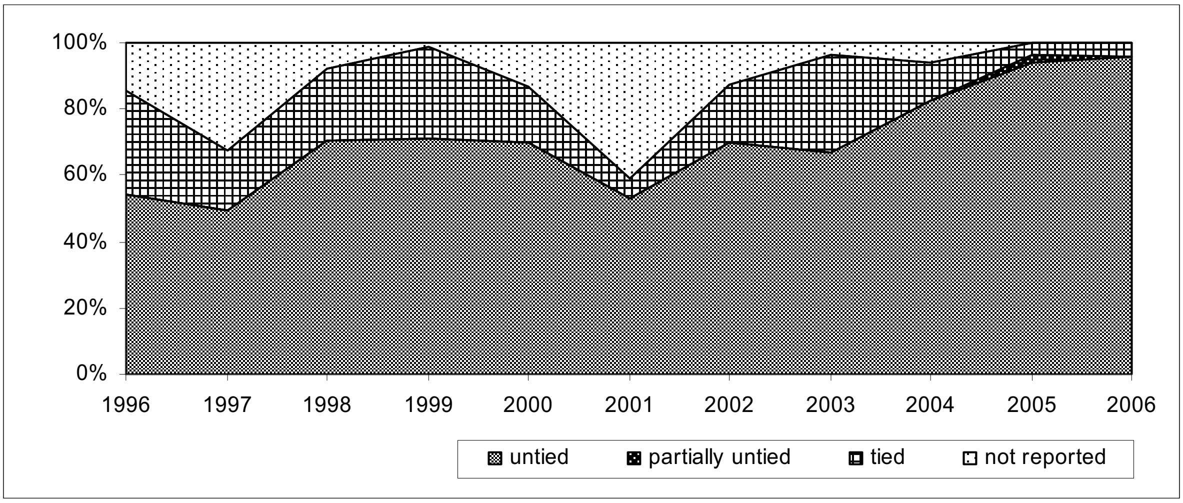
The residual areas of tying and contracting practice under an untying regime raise the interesting and important issue - *when is the market the most appropriate regulator?*

4.3.2 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 4.2.1). This untying process has continued, including both TC and food aid, and in 2006 over 95% of bilateral aid was reported as untied. Tying has been retained for mixed credits. Support for private sector development (B2B) is an ambiguous 'grey' area in this and other 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$32mn and US$20mn in 2006. Apart from support for WFP, most humanitarian aid is also in-kind.

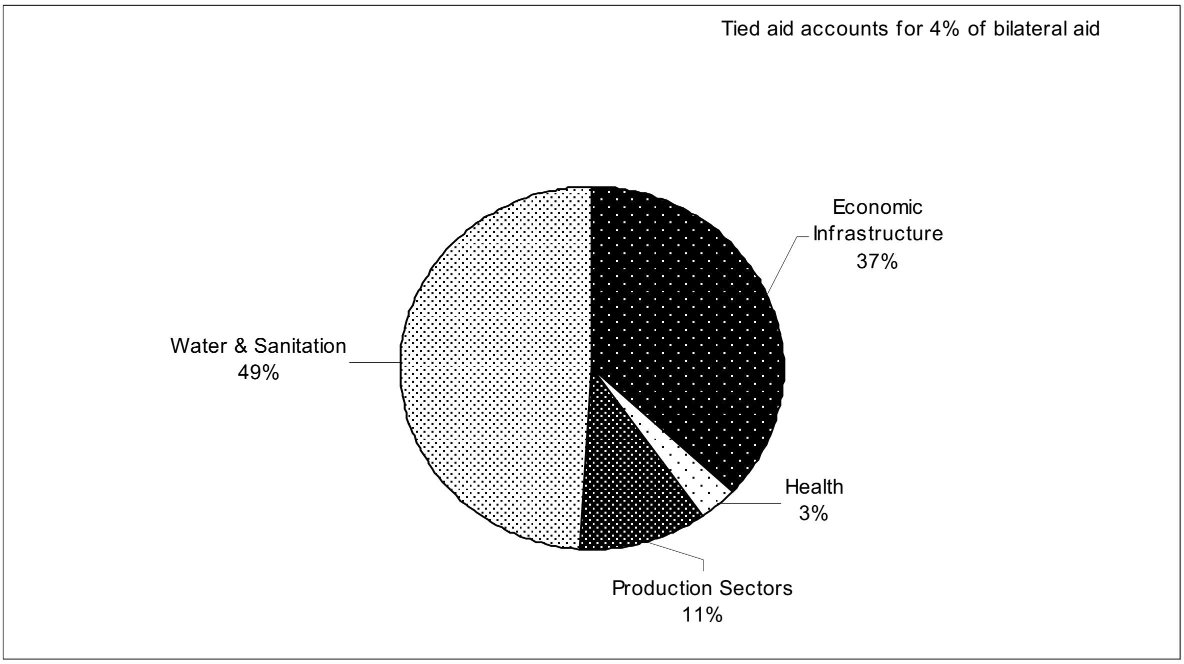
Historically, a high proportion of Danish aid was tied with strong links, for example, to agriculture and agribusiness as well as high tech areas. The EU regulations on public procurement, introduced following the creation of the European Single Market in 1992, provided a strong impetus for the untying 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.

Figure 4.2.1 Danish bilateral ODA: tying status 1996-2006[1]



Source: OECD CRS database.

Figure 4.2.2 Danish bilateral ODA: tied aid by sector in 2006[1]



Source: OECD CRS database.
Notes: 1. Data is commitments in current US$ millions.

Denmark has deliberately retained some tying in support of private sector development and to fund infrastructure, accounting for around 2-3% of ODA.[22] 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.

B2B is seen to be largely demand driven. Developing country businesses are invited to seek assistance from 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 (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 and time required might explain the declining use of contracted projects that required open competitive tendering in favour of other modalities.[23]

[22] 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.
[23] In 2006 procurement through HQs had fallen to around 5% of bilateral ODA (OECD DAC, 2008b). Contract of less than DKr 500,000 can be contracted directly. Then under DKr 975,000 (€ 125,000) there is a letter of notification; and evidence is required of 3 offers, but not a formal tender procedure. Over DKr 975,000 DANIDA is required to make an international openly competitive tender (equivalent €125,000 under EU directives); and this

Box 4.2 South Africa: supporting partner country priorities and procedures

The Danish urban development programme launched in 2007 involves funding of US$31 mn. It was formulated according to South African priorities and all money is channelled through and is administered in accordance with South Africa's own systems; procurement takes place according to South African government procedures. There is no requirement for any of the funds to be used in the donor country or the EU (DANIDA 2007a).

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Denmark has also engaged in efforts to untie TC, which by 2006 was free of sourcing restrictions. Research and higher education remain areas where funding is directed to Danish institutions.

4.3.3 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. Approximately three quarters of Swiss bilateral ODA commitments in 2006 were reported as untied (Figure 4.3.1), so that, including multilateral aid, over 81% of ODA was reported as untied. The actual proportion of untied ODA is somewhat higher. This is because the tying status of TC and donor administrative costs (11% of ODA) was not reported, although much is formally untied. The substantial proportion of commitments unreported (22%) is seen by the statisticians as a consequence of the transition to reporting under the new CRS++ system as of 2005.

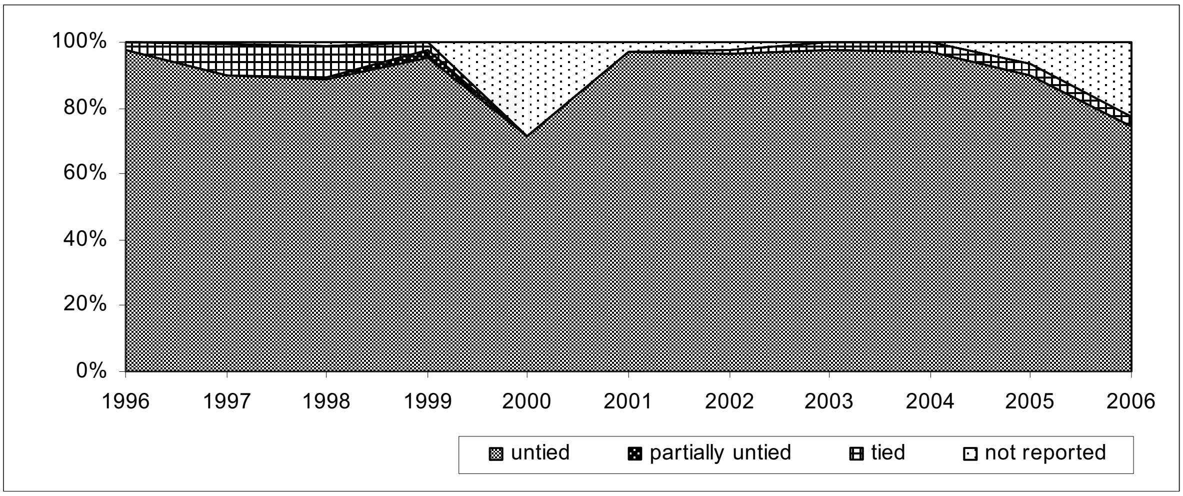
Switzerland's aid was overwhelming untied prior to 2002 (Figure 4.3.1).[24] The key moment in moving on untying was 1994, when the current framework within which almost all Swiss ODA is formally untied was established in response to three developments: the Helsinki Accord in 1991, the introduction of 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.[25] Tying practices were gradually phased out. The State Secretariat for Economic Affairs (SECO), which is responsible for development cooperation, macroeconomics and business, phased out mixed credits from the late 1990s. In meeting FAC commitments SDC began to replace cereals food aid in kind with cash from 1995 (Ferreira Duarte and Metz, 1996).

typically needs 7 months for full procedure, a committee established involving partners, embassy and technical advisory services.

[24] 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.

[25] 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

Figure 4.3.1 Swiss bilateral ODA: tying status 1996-2006[1]



Source: OECD CRS database.
Notes: 1. Data is commitments in current US$ millions.

Remaining areas of tying include dairy aid, emergency relief and TC, especially higher education and research.[26] In-kind dairy aid, costing $15 mn in 2006, is 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 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 and university, 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 HQs 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.[27] 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

[26] Switzerland does not report tying status of TC and administrative costs commitments to the CRS, partly explaining the high level of non-reporting shown in Figure 4.3.1.
[27] The SDF categories are that procurement under CHF 50,000 can be directly contracted. Contracts up to approximately CHF 250,000 (limited to the EU directive euro 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.

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.

4.3.4 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 40% of bilateral ODA was untied and 5% partially untied. By 2006, at least 64% of bilateral aid was untied, the full extent of the shift being partly obscured by non-reporting (Figure 4.4.1).[28] The remaining areas of tying are outside the Recommendation: TC (60%) and emergency or disaster relief. CIDA is also committed to reviewing its experience in untying since 2002.

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 in 2008 to the remainder.

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).

[28] In 2006 the non-reporting was by IDRC (International Development Research Centre) of its funding for research related activities. However, in a separate DAC questionnaire for 2006 IDRC estimated that some 70% of these activities were untied. This example supports the view that untied aid activities as well as tying practices are partially obscured by non-reporting (Section 3.2.1 above).

Box 4.3: Untying Canadian food sid

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, the remainder was similarly partially untied. These steps were made following NGOs meeting with domestic agricultural interests to emphasise the benefits of local and regional sourcing on developing country small farmers and the likely negligible effects on Canadian agricultural exports.

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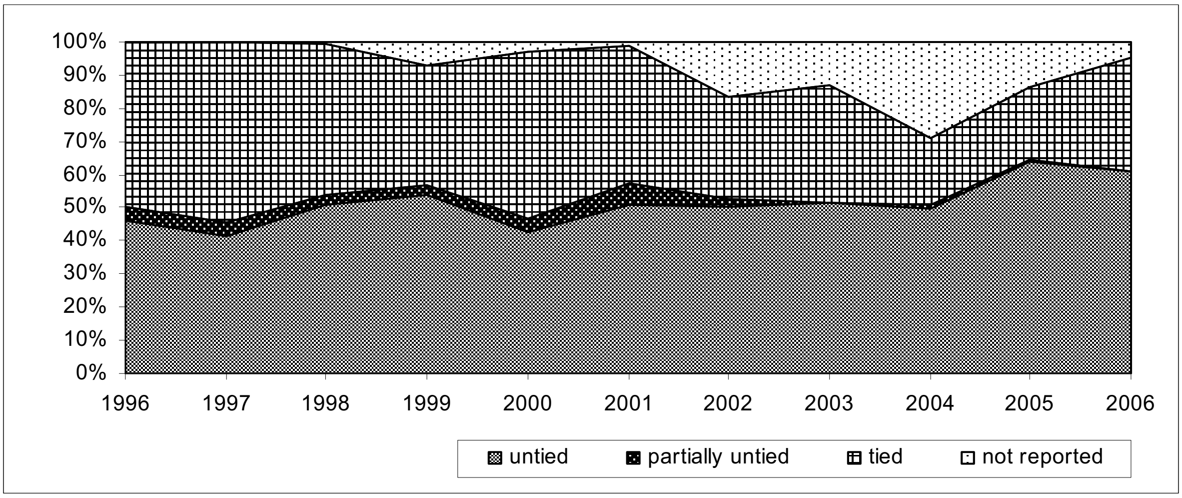
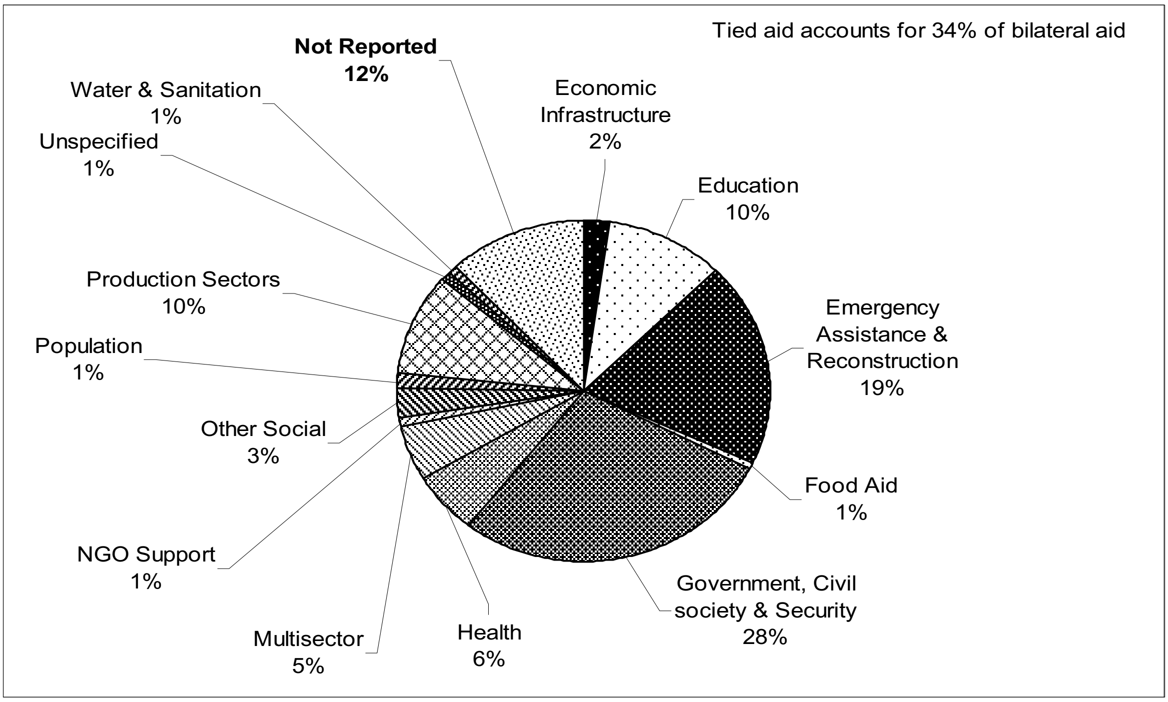
Figure 4.4.1 Canadian bilateral ODA: tying status 1996-2006[1]



Source: OECD CRS database.
Notes: 1. Data is commitments in current US$ millions.

Figure 4.4.2 Canadian bilateral ODA: tied aid by sector and non-reported tying status in 2006



Source: OECD CRS database.
Notes: 1. Data is commitments in current US$ millions.

Presently the main areas of tying are TC, 40% untied in 2006, and sectorally both education (10%) and support to governance and civil society (28%) which have a high TC component, as well as emergency assistance and reconstruction (19%) (Figure 4.4.2). 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.[29]

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 and an impact evaluation is envisaged in 2008/9. The preparations for the evaluation included the formulation of a logic framework to make more explicit the objectives of untying from a donor perspective. This could be of assistance to Phase Two of the OECD thematic study (see below Section 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. [30]

[29] As of the beginning of 2008 all Canadian partner agreements are free of conditions on grant use as so are from the donor perspective untied. Past differences in donor reporting on are another indication of the difficulty of inferring trends in tying practices.
[30] However if funding is from CIDA's Operation and Maintenance 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 $76,500.00, however, for NAFTA (including GST – Goods and Service Tax) for which the CIDA have to go through the Canadian Public Tendering System (MERX) that allows for NAFTA competition.

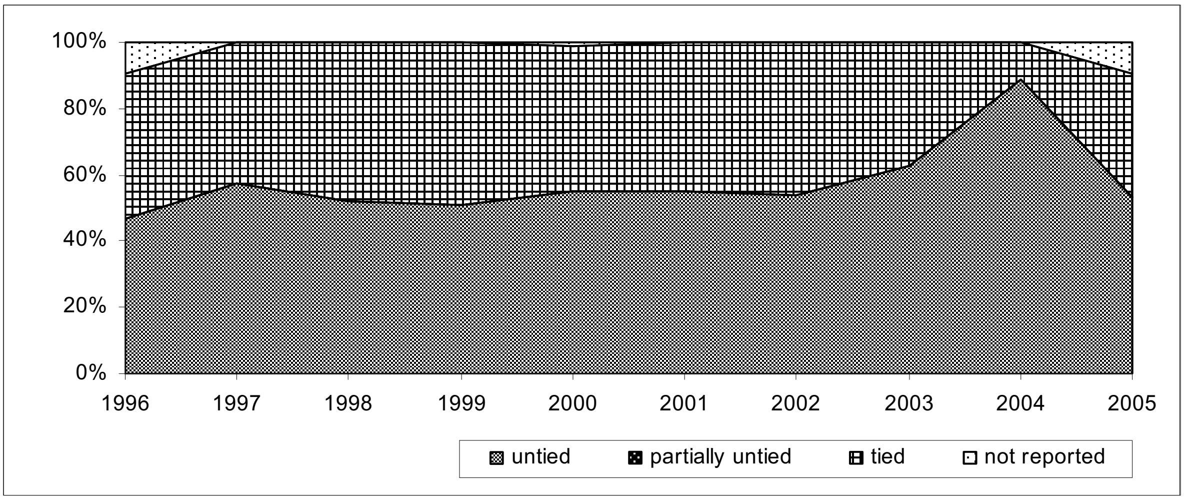
4.3.5 Australia

Prior to 2001 about 40% 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, covering approximately half of bilateral ODA - 52% in 2005 (Fig 4.5.1).

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.[31]

Technical problems, which have delayed reporting of ODA commitments, mean that the full extent of untying in 2006 is not yet reflected in OECD statistics (OECD DAC, 2008a, Table 24). Progress towards untying prior to the 2006 decision is indicated in Figure 4.5.1 with a growing annual share of untied and partially untied aid from 1997 to 2004. Then there is an unexplained fall in 2005. The remaining sectoral areas of tying in 2005 are shown in Figure 4.5.2: TC in governance and civil society being of notable significance (23%).

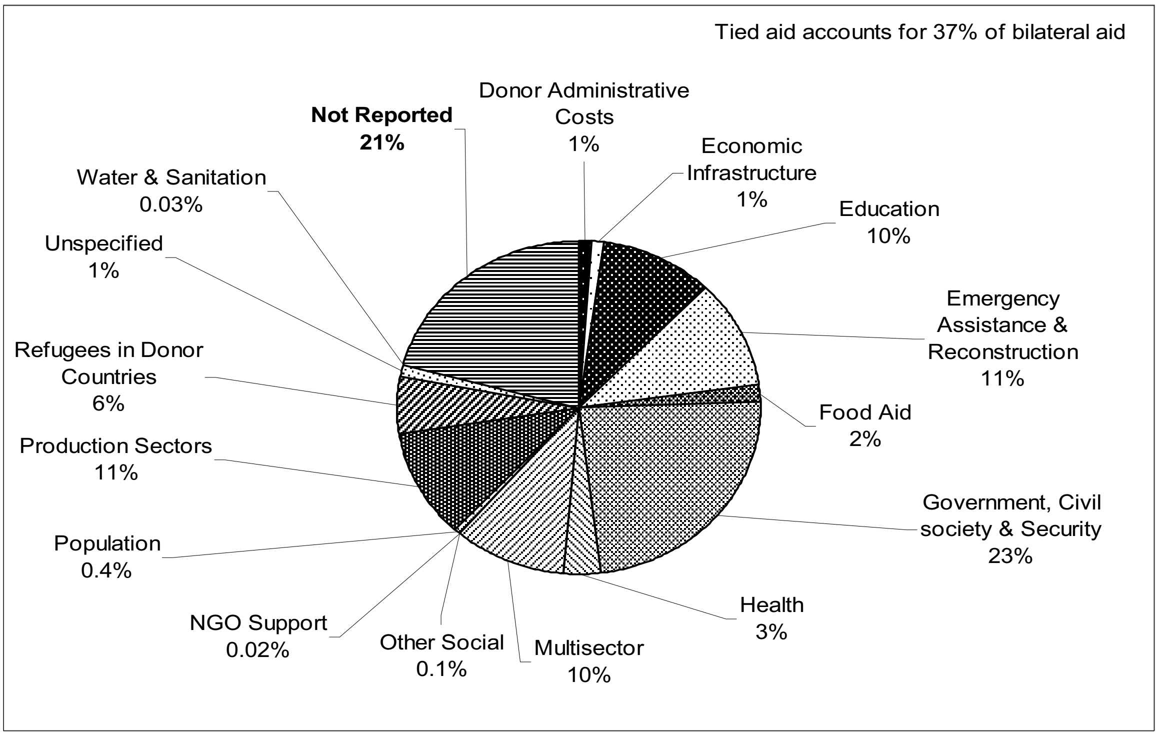
Figure 4.5.1 Australian bilateral ODA: tying status 1996-2005 [1]



Source: OECD CRS database.
Notes: 1. Data is commitments in current US$ millions.

[31] Under this agreement, which predates the untying policy, Australia also provided $500 million worth of concessional loans.

Figure 4.5.2 Australian bilateral ODA: tied aid by sector and non-reported tying status in 2005[1]



Source: OECD CRS database.
Notes: 1. Data is commitments in current US$ millions.

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, n.d.).

Prior to 2001, bilateral trade arrangements with New Zealand gave favoured nation status.[32] 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. 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).

The immediate consequences 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 is 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

[32] 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.

AusAid with DANIDA and BMZ providing further guidance on implementing these policies (Land, 2007).

Box 4.4: Information about AusAid, open competitive tenders

Recognising that the problem of information that 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.

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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.

In an attempt to comprehensively review academic literature, contributions from civil society, information gathered through visits to donor agencies and internal donor reports, this review is structured as follows. The review 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 difficulties of inferring what will be a better policy in a second best world.

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* (comparative static versus a comparative dynamic model) used in the analysis 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 argue 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.

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 The 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 (1960-1990) concludes that the excess cost to recipients is in the range of 15 to 30 per cent. 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, 2006). 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 per cent. A similar conclusion (overpricing in the range of 5-25 per cent), 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, 2006; 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 y 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).

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 The 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; Lloyd *et al.,* 2000; 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 time (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.[33] Some studies, however, find a substantial positive relationship between aid flows and exports from donor countries (Nilsson, 1997; Wagner, 2003; Larrú, 2003; Larrú y González, 2004; Nowak-

[33] 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.

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.

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 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).

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 often 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. Taking two 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); secondly, 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 Section 4).

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 these '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, of course, 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). 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 anticipated benefits of untying in such studies are broadly similar to those set out below in Figure 5.1.

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, 2006). These efficiency differentials have been maintained even during the current period of escalating food prices (Tschirley, 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 (Tschirley 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.

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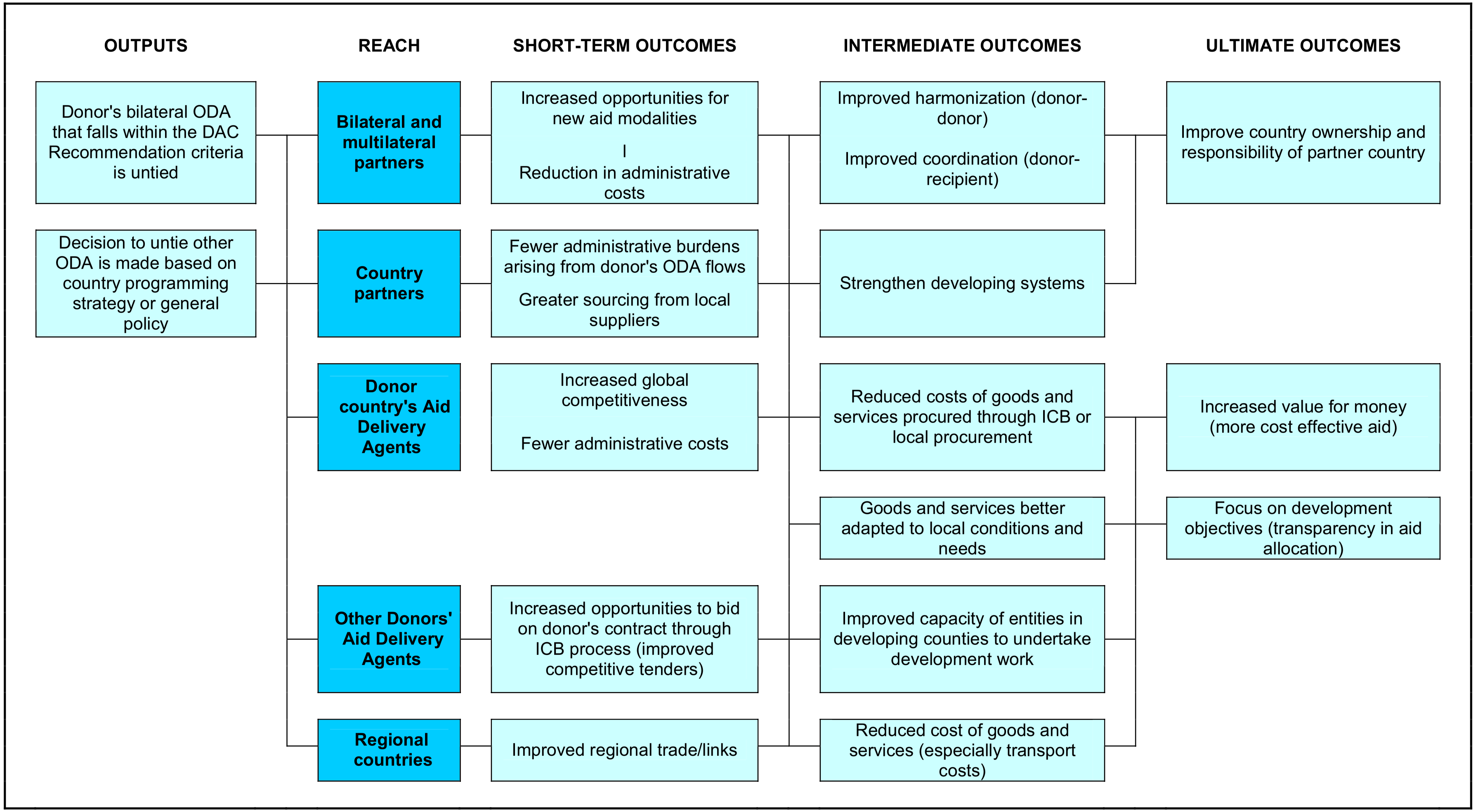
Most importantly, what seems to be missing is a *fully developed analytic framework* designed to provide the basis for exploring the impact of untying. In the analysis of the impact of tied aid, the starting point was represented by an idealised untied situation in which tying was introduced as a distortion.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

To date, there have been few systematic attempts to provide such a framework. An example is the ‘logic model’ elaborated in the preparation for an evaluation of Canada’s decision on untying made in response to the Recommendation (Universalia, 2008). This model (Figure 5.1), which is relevant to the investigations proposed for Phase II, is discussed further in Section 6.

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 and/or the impact of untying. Studies differ in scope, coverage and methodology and findings cannot be generalized. 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.

Figure 5.1 Logic model: consequences of aid untying from the viewpoint of a bilateral donor



Based on: Universalia (2008) 'Evaluability Assessment of the Policy on Tied-Untied Aid'

6. PRELIMINARY FINDINGS AND IMPLICATIONS FOR DESIGN OF PHASE II

6.1 Responding to the 2001 Recommendation

The 2001 DAC Recommendation on Untying ODA to the LDCs monitors member's efforts against a 60% benchmark for untying bilateral aid. By 2006 this has been substantially exceeded by almost all members (except Greece, Spain and possibly Italy). The extent of untying (82%) is substantially greater than for non-LDCs (70%), and overall was 73%. If (untied) multilateral aid is taken into account, then 85% of all ODA was untied, with only two members, Spain and the USA, retaining tying for a large part of ODA, 46% and 50% respectively. The broad conclusion is that formally DAC members' ODA is overwhelmingly untied. But a caution – the reporting on tying and untying practices is still far from satisfactory.

There has been substantial but variable progress towards untying for different aid instruments: 48% of bilateral loans were untied in 2006, substantially less than grant aid (84%). Similarly, there has been untying of TC that was excluded from the Recommendation: 61% of aid as TC, or including a TC component, was reported as untied in 2006.

The non-reporting in terms of sectors of use also appears to be uneven. There are 'growth' sectors with a high proportion of non-reporting of tying status, more than two thirds of commitments in 2006 for transport, energy and industry sectors, and so it is unclear whether there actually is extensive unreported tying.

Untying has had no apparent negative effects on support for aid or any related diversion of resources to non-LDCs. Absolute levels of ODA to LDCs had almost doubled by 2006, since the base period of 1999-2001. The share of LDCs in total ODA was also 5% higher, and even higher (13%) excluding the somewhat temporary surge in debt relief during 2005-2006. Food aid provides a striking example: aid from donors that have or are in the process of untying has been sustained through a period of rising prices. Untied and partially untied cereals aid, sourced in recipient and in other developing countries, increased from 10% in 2001 to 42% in 2007, and the quantity delivered rose by 121%, whilst aid sourced in donor countries fell by more than half.

A multivariate statistical analysis comparing 22 DAC donors in 2006 indicates that *the Recommendation is an important influence on the extent to which aid is untied*. Those providing a high level of aid to LDCs have untied aid to a greater extent. Countries that give more ODA as a share of national income also give relatively more untied aid. A high share of food aid in bilateral ODA, specifically exempt from the Recommendation, is associated with more tying.

Overall, the statistical investigations in Phase I of the study point to the need for continued efforts for strengthening of reporting in terms of providing timely, consistent and complete information and for all donors to include all forms of ODA in their reporting on tying status of their bilateral aid.

Donor policies and practices: a review of documentation was complemented by a purposive survey of five donors that had already largely untied or were actively untying after 2001, namely Australia, Canada, Denmark, Norway and Switzerland, leading to the following preliminary findings:

- The Recommendation has had different implications, especially significant for those DAC members that had previously taken very limited steps towards untying. Canada, for example, has to introduce or modify legal and internal regulatory instruments and then as with Australia has developed procedures for the administration of untied aid.
- Untying is widely seen as closely linked with decentralisation of responsibility for aid programming to a country office level. Therefore many of the answers to questions about how it works and impacts are felt to be answerable only at a partner country level.[34]
- There has been a shift to forms of aid that pass responsibility for disbursement to country partners, other joint donor partners, and civil society organisations, and so
- There is also a much-reduced donors' role in contracting organisations to provide goods and implement projects.

There are several remaining relatively *grey areas* of tying practice in which it is not clear if tying is an issue of importance:

- Substantial levels of emergency and humanitarian aid, provided both in-kind and through personnel;
- Funding national NGOs;
- TC, support to governance, post-secondary education and research; and
- Promoting business development, including aid for trade.

These practices raise challenging questions:

- Is visible evidence of a direct link between bilateral aid and impacts in beneficiary countries required, especially in the case of humanitarian aid?
- Are there areas in which markets alone are either not necessarily able to deliver (i.e. emergency equipment)?
- When are markets not the best regulators? For example, the developing country private sector is *disadvantaged in terms of information* as well as in access to funding.

The impacts of tying and untying practices: an extensive survey of the largely economic literature on tying practices since circa 1990 broadly reconfirms earlier findings. First, tied aid is found to involve a substantial loss of resource transfer value to recipients (*at least* 15-30%). Second, there has been 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. Third, regarding the impact of tying on donor economies, the macroeconomic impact in terms of higher exports, output and employment is found to be fairly limited, whereas these 'limited' commercial benefits may be important to particular domestic interest groups.

[34] Decentralisation to country level has been highlighted as a key factor in moves to implement the Paris Declaration more generally (Wood *et al*., 2008).

The literature review found that there has been little evidence-based investigation of the impact of untying, despite the shift from a largely tied to a largely untied regime for bilateral aid. Studies differ in scope, coverage and methodology and findings cannot be generalized. 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.

6.2 Implications for Phase II

The second phase of this thematic study is envisaged as including a set of recipient partner country studies to complement the donor-focused preliminary investigations of Phase I. For these studies a more complex framework of analysis is needed rather than the three country (donor, recipient, global economy) models that underlie most analytic investigations into the impacts of tying practices. The simple implications of the 'economist' literature taken at face value is that tied aid should be replaced by predictable, single or periodic lump sum unrestricted transfers of foreign exchange. Then recipients, donors or their agents, where that is not possible, should procure goods and services by unrestricted competitive international tenders.

Untying in practice involves the relaxation of just one restriction on the provision of aid – on the sourcing of goods and services. In this context the 'logic model' developed for CIDA, focusing on one government's decision to untie in response to the Recommendation (Figure 5.1) is useful in considering how the next phase of the current study could be conducted. The '*reach*' of the untying decision points to a multi-party framework, involving bilateral and multilateral partners, and in addition, civil society (NGOs) which account for a fifth of the bilateral aid of some donors (e.g. Norway and Switzerland). *Country partners* involve 'host' governments, and again in most cases civil society. The *delivery agents* include national commercial and non-commercial organizations, as well as third parties. The third parties need to be differentiated into organisations in other OECD countries, the recipient region and emerging economies.

The distinction made in the logic model between short-term, intermediate and ultimate outcomes corresponds approximately with the issues raised in reviewing 'the consequences' of donor policies on untying and which should be the focus of Phase II. First, how does untying work in practice? Second, what are the impacts? Third, is it possible to establish with any confidence the implications for aid effectiveness?

Another question is how should country studies on the consequence of untying of aid be designed? The investigations so far suggest that it will be useful to focus on forms of aid (loans and grants) and even sectors, rather than to consider aid in purely aggregate, absolute terms. The consequences of untying are potentially different for, say, commodity assistance, discrete investment projects and information related TC. Cases may need to be chosen so as to consider explicitly different forms, uses and sources of aid.

Recipient perspectives: the 'logic model' discussed above is framed from a donor perspective. A complementary model of untying, framed from a recipient partner country perspective, is needed on the benefits and costs of untying. Perhaps this task should be undertaken in consultation with government, civil society and donor country level staff.
A literature review and informal consultations in the course of the study have drawn attention to a widespread concern about a possible gap between formal declarations on untying of bilateral aid and what is actually happening. The range of doubts and grumbles expressed is reflected in the following questions. How should untying be undertaken and what are the likely consequences? On the donor side does *de jure* untying translate into *de facto* untying?

Are there intended or unintended informal constraints - follows-on, pre-qualification processes, and so forth - on the opportunities for suppliers outside the donor country? What if untying does not reduce administrative costs, but involves additional costs? What about ‘grey areas’ such as donor governments transfers to national NGOs, even if these allow unrestricted sourcing of goods and services? When is international competitive tendering appropriate? What if a market is an oligopolistic practice dominated by few multinational companies? What if untying benefits subsidiaries of national companies rather than genuinely local companies? What about in-kind emergency aid - is a separate investigation needed for humanitarian aid? Are there context specific characteristics that strongly influence or even determine outcomes, such as well-established regional trade? Do the benefits of untying require good governance? What if a recipient country government is corrupt or the public finances are inefficiently managed?

The range of doubts and grumbles expressed about the consequences of untying suggest that findings are likely to be context specific, and so generalisation will require an accumulation of case specific evidence for an under-researched area. Does the lack of experience of evidence-based evaluations into the consequences of untying and the range of issues raised indicate the need for a two-stage approach? First, a pilot or exploratory study at a country level, adopting a highly consultative process, could be used to develop a method of investigation that could be feasibly extended to a range of country circumstances. Second, a purposively selected set of country studies would then be undertaken.

The preliminary conclusions of this study are as follows. DAC donor countries have formally untied over four fifths of their ODA to LDCs, and a wider process of untying their aid appears to be continuing. But reporting is still far from complete or consistent and needs to be improved. The theoretical case for untying on effectiveness and efficiency grounds is unequivocal. There is a substantial body of evidence on the negative effects of tying practices. In contrast, the actual consequences of untying have hardly been investigated. So Phase II of the thematic study offers an important and timely opportunity to fill that gap. A set of country studies done with the full cooperation of recipient countries and donor agencies would enable the DAC and its partners to acquire a better understanding of how untying works, its impact and whether it is contributing to aid effectiveness as envisaged in the Paris Declaration.

Annexes to Phase One Draft Report

Annex A: Statistical tables

Table A.1 DAC donor ODA overview for 2006 (US$ million) [1]

	Total ODA reported to DAC	Bilateral ODA	Bilateral ODA as share of total ODA (%)	Technical Co-operation (TC) [2] as share of Bilateral ODA (%)	Food Aid [2] as share of bilateral ODA (%)	Bilateral ODA (excluding Food Aid and TC) as share of bilateral ODA (%)
Australia	2,123	1,796	85	48	2.47	50
Austria	1,519	1,083	71	15	0.19	85
Belgium	2,413	1,545	64	41	1.43	58
Canada	3,831	2,678	70	26	5.27	69
Denmark	2,110	1,369	65	5	0.88	94
Finland	964	606	63	24	0.00	76
France	15,026	9,944	66	28	0.39	71
Germany	13,230	9,477	72	33	1.01	66
Greece	424	189	45	47	0.04	53
Ireland	1,022	632	62	3	2.24	95
Italy	4,138	2,508	61	8	0.26	92
Japan	17,344	13,612	78	14	0.62	86
Luxembourg	291	205	70	3	8.57	89
Netherlands	12,061	10,266	85	6	0.46	94
New Zealand	356	297	84	27	1.33	72
Norway	3,404	2,648	78	17	2.89	81
Portugal	402	217	54	54	0.00	46
Spain	4,160	2,438	59	18	1.45	81
Sweden	4,249	3,103	73	3	0.05	97
Switzerland	1,880	1,243	66	10	4.04	86
UK	13,075	9.274	71	9	1.51	89
USA	26,678	24,293	91	45	8.18	47
All Donors	**131,591**	**100,100**	**76**	**24**	**2.82**	**73**

Source: OECD DAC database.

Notes:
1. Data are for 2006 and are commitments in current US$ millions.
2. Food aid comprises the sum of line *I.A.1.4 Developmental Food Aid* and line *I.A.1.5 of which: Relief Food Aid*. Technical Co-operation is represented by line *I.A.1.2. Technical Co-operation*.

Table A.2 DAC donors bilateral ODA by sector in 2006 (US$ million) [1]

	Bilateral ODA	Untied & Partially untied (%)	Tied (%)	Not Reported (%)
I.1.a) Education, Level Unspecified	1274	74	9	17
I.1.b) Basic Education	3360	90	5	4
I.1.c) Secondary Education	542	40	11	49
I.1.d) Post-Secondary Education	3470	47	35	18
I.2.a) Health, General	1993	84	8	8
I.2.b) Basic Health	3089	75	21	4
I.3 Population Programmes	4442	47	52	1
I.4 Water Supply & Sanitation	4001	83	13	4
I.5.a) Government and civil society – general	6568	62	29	9
I.5.b) Conflict, Peace and Security	1539	61	29	9
I.6 Other Social Infrastructure & Services	4389	34	54	13
II.1Transport & Storage	4507	61	32	7
II.2Communications	353	60	23	17
II.3 Energy	3928	71	28	1
II.4 Banking & Financial Services	1353	95	3	2
II.5 Business & Other Services	1370	79	16	5
III.1.a) Agriculture	2378	73	18	9
III.1.b) Forestry	393	85	7	9
III.1.c) Fishing	179	67	4	29
III.2.a) Industry	624	54	24	22
III.2.b) Mining	312	17	78	6
III.2.c) Construction	25	79	6	15
III.3 Trade Policy and Regulations	634	72	16	12
III.4 Tourism	425	95	1	4
IV.1 General Environment Protection	1518	74	17	8
IV.2 Women In Development	19	100	0	0
IV.3 Other Multi-sector	4158	64	24	13
VI.1 General Budget Support	3209	100	0	0
VI.2 Dev. Food Aid/Food Security Assistance	1039	40	51	9
VI.3 Other Commodity Assistance	296	66	34	0
VII. Action Relating to Debt	18417	99	1	1
VIII.2 Other Emergency and Distress Relief	5669	77	20	3
VIII.3 Reconstruction relief	794	90	6	4
VIII.4 Disaster prevention & preparedness	37	29	53	18
IX. Administrative costs of donors	2321	27	45	28
X. Support to NGO's	3772	98	0	2
XI. Refugees in Donor Countries	1701	35	36	30
XII. Unallocated/Unspecified	1149	49	5	46
Total	**95247**	**67**	**21**	**11**

Source: OECD CRS database.
Notes: 1. Data are for 2006 and are commitments in current US$ millions.

Modifications to data from the OECD CRS database

The following three main changes were made to the CRS database as downloaded from the OECD website. First, all negative entries were turned positive, as it is assumed that these were data entry errors: a negative amount of aid reported by tying status is not sensible. Secondly, budget support is assumed to be untied by definition – all cases of budget support were changed to untied. Thirdly, Australia informed us that they had not report the tying status of aid in 2006. However the CRS database shows all Australian aid in 2006 as untied; this was changed to 'not reported'.

Table 3.6 is an aggregated version of table A.2 in the Appendix. The following aggregations were applied.

- Social Infrastructure & Services
  - I.1.a) Education, Level Unspecified
  - I.1.b) Basic Education
  - I.1.c) Secondary Education
  - I.1.d) Post-Secondary Education
  - I.2.a) Health, General
  - I.2.b) Basic Health
  - I.3 Population Programmes
  - I.4 Water Supply & Sanitation
  - I.6 Other Social Infrastructure & Services
- Emergency Assistance & Reconstruction
  - VIII.2 Other Emergency and Distress Relief
  - VIII.3 Reconstruction relief
  - VIII.4 Disaster prevention & preparedness
- Production Sectors: Other
  - III.2.a) Industry
  - III.2.b) Mining
  - III.2.c) Construction
  - III.3 Trade Policy and Regulations
  - III.4 Tourism
- Government & Civil Society
  - I.5.a) Government and civil society - general
  - I.5.b) Conflict, Peace and Security
- Food Aid
  - VI.2 Developmental Food Aid/Food Security Assistance
- Debt
  - VII. Action Relating to Debt
- NGO Support
  - X. Support to NGO's
- Unspecified
  - XII. Unallocated/Unspecified
- Economic Infrastructure
  - II.1Transport & Storage
  - II.2Communications
  - II.2Communications
  - II.3 Energy
  - II.4 Banking & Financial Services
  - II.5 Business & Other Services
- Production Sectors: Agriculture, Forestry & Fishing
  - III.1.a) Agriculture
  - III.1.b) Forestry
  - III.1.c) Fishing
- Multisector
  - IV.1 General Environment Protection
  - IV.2 Women In Development
  - IV.3 Other Multisector
- Commodity Aid / Program Assistance
  - VI.3 Other Commodity Assistance
- Budget Support
  - VI.1 General Budget Support
- Donor Administrative Costs
  - IX. Administrative costs of donors
- Refugee s in Donor Countries
  - XI. Refugees in Donor Countries

Annex B: Explaining the share of untying in bilateral ODA: a regression analysis

B.1 Definition of the dependent variable and selection of key explanatory variables

An exploratory statistical investigation using regression analysis has been undertaken into the relationship between the extent of untying and a number of key variables that reflect the use of aid instruments and donor characteristics. The issue being explored is whether there are systematic associations between tying practices and other aspects of aid policy and donor characteristics, or whether tying status is just some idiosyncratic feature of individual aid donor policy.[35] The issue of causation is clearly more complex, but the statistical relationships found in this analysis provide a starting point for a focused discussion of what influences lie behind differences in tying practices.

The two main dependent variables representing the extent of aid untying were identified as: the untied percentage of total bilateral aid *(untied share of bilateral ODA)* and the effort sharing ratio (*effort sharing - untied).* The effort sharing ratio is calculated as the share of untying (reported to the CRS) multiplied by bilateral ODA (reported to the DAC), added together with DAC multilateral ODA, as a share of DAC total ODA. Each dependent variable was also tested with the sum of untied and partially tied aid replacing that of just untied aid to create *untied & partially tied share of bilateral ODA* and *effort sharing - untied and partially tied* respectively. All four dependent variables were highly correlated (See Table B.1) therefore the analysis proceeded with *untied share of bilateral ODA* only and the results should be roughly generalisable to the other dependent variables.

Whereas the dependent variables were mainly taken from the CRS dataset, the explanatory variables were drawn from the DAC dataset in order to minimize collinearity with the dependent variables. They cover aid instruments and types of aid, as well as donor characteristics and are chosen based on a mix of theory from the literature review and relationships suggested in the tables in Section 3:

- Bilateral ODA in grant form / total bilateral ODA (*share of grants)*
- ODA received by LDCs / ODA (*share of LDCs*)
- ODA which is TC / ODA (*share of TC*)
- Food aid / ODA (*share of food aid*)
- ODA/GNI (*ODA/GNI*)
- GNI/population (*GNI per capita*)

[35] This statistical investigation is in response to the requirement in the ToR (Para 14) that the study 'will aim at identifying robust statistical correlations between the extent of tied/untied ODA and financial instruments, such as loans, grants; financing instruments such as technical assistance, income categories, and ODA/GNI ratios (as a proxy for public support for the aid effort).

Table B.1 Dependent variable correlation matrix

	untied share of bilateral ODA	untied and partially untied share of bilateral ODA	effort sharing - untied	effort sharing - untied & partially untied
untied share of bilateral ODA	1			
untied and partially untied share of bilateral ODA	0.9911	1		
effort sharing – untied	0.9511	0.9368	1	
effort sharing - untied & partially untied	0.9441	0.9527	0.9851	1

Source: DAC and CRS databases, OECD and authors own calculations.

In order to determine whether the 2001 Recommendation has been driving the process of untying, our analysis includes the donors' share of bilateral ODA directed to LDCs. We would expect that, as donors give a higher share of aid to the poorest and most needy countries - namely LDCs - they also untie a higher share of their bilateral aid. This is not only good practice but may also be the result of pressure stemming from the Recommendation. The introduction of this variable does raise causality issues as it cannot be excluded *a priori* that those donor countries with a higher share of untied aid are also those who give a higher share of aid to LDCs.

Aid instruments might also play a role in the decision to untie. In particular, it could be hypothesized that those countries which offer a higher share of their bilateral aid without imposing on the recipient country the burden of future repayments (i.e. higher *share of grants*) might also be those with a relative higher share of untied bilateral aid. If grants represent a more 'altruistic' instrument to provide aid (as compared to loans) then we would expect donors with a high share of their bilateral aid in grants to be more concerned about the conditions under which aid is given and this could be reflected in a higher share of untied aid.

To take into account different impacts of different types of aid we also controlled for *the share of technical cooperation* and *the share of food aid* in bilateral ODA. TC is exempt from the Recommendation and could therefore be more easily associated with tying practices. For this reason we would expect to see a negative impact of TC share on untying. Similarly, one might expect the share of bilateral food aid to affect negatively the share of bilateral untied aid. Food aid is also excluded from the 2001 Recommendation and is more likely to be provided by those donor countries that have surpluses to dispose of or farm exports to promote, both of which are inherently tied.

ODA/GNI and GNI per capita are donor characteristics. If *ODA/GNI* proxies for the effort sharing of the donor country then we would expect it to have a positive impact on the level of untying; those countries who are more willing to give aid (as a proportion of their GNI) are also those more concerned about maximizing the positive impact of aid on the recipient country. Finally, *GNI per capita* expressed in log terms is added in order to investigate whether differences in donor's wealth are reflected in the level of untying

Other explanatory variables such as the ratio of bilateral to multilateral ODA, GNI (in logged terms)[36], a dummy variable for European countries[37], total value of ODA[38] (in log form) and the Commitment to Development Index[39] were initially considered. However, they were dropped at a later stage and have not been included in our final analysis either because of collinearity issues, limited economic rationale supporting their inclusion, or to avoid further reduction of the already limited set of observations.

B.2 Data constraints and preliminary analysis

Our econometric analysis makes use of the 22 observations which make up the headline figures in section 3. Changes in donors reporting practices to the DAC and CRS databases and a high rate of non-reporting in earlier years have created a situation where the data available varies considerably across time/countries and is likely to be skewed towards certain flows, instruments, types of aid, particularly those where tying is higher.

The initial descriptive analysis indicated that a number of variables are relatively closely correlated with untying. The independent variable correlation matrix (Table B.2) shows that share *of LDCs, share of TC* and *GNI per capita* are the most correlated with the *untied share of bilateral ODA*. We would therefore expect that these variables might be the most significant predictor variables in the regression analysis. Among the independent variables the pairings of *GNI per capita* and *share of bilateral TC, share of bilateral food aid, ODA/GNI* respectively are the most highly correlated; however, none of the pairings was correlated to an extent which might warrant their exclusion at this stage[40]

Table B.2 Independent variable correlation matrix

	Untied share of bilateral ODA	Share of Grants	Share of LDCs	Share of TC	Share of Food Aid	ODA/GNI	GNI per capita
Untied share of bilateral ODA	1						
Share of Grants	0.1254	1					
Share of LDCs	0.4597	0.2991	1				
Share of TC	-0.4889	0.0409	0.0963	1			
Share of Food Aid	-0.0833	0.2580	0.2273	-0.0014	1		
ODA/GNI	0.1938	0.2793	-0.0399	-0.1697	0.3872	1	
GNI per capita	0.4142	0.2497	0.0265	-0.5690	0.5209	0.4975	1

Source: DAC and CRS databases, OECD and authors own calculations

36 GNI could be used as a proxy for the size of the economy. It has been suggested that small countries are more willing to untie aid, especially TC.

37 The dummy for European countries was considered in order to identify whether regional trade agreements have an influence on the share of bilateral untied aid.

38 Total value of ODA was initially considered to see if donor size influenced untying practice.

39 CDI was initially included in an attempt to measure non-aid development policies and hence "true" efforts towards development (in addition to the volume of aid).

40 Although the logarithm of GNI per capita is correlated with at least three variables (share of bilateral food aid and TC and ODA/GNI).

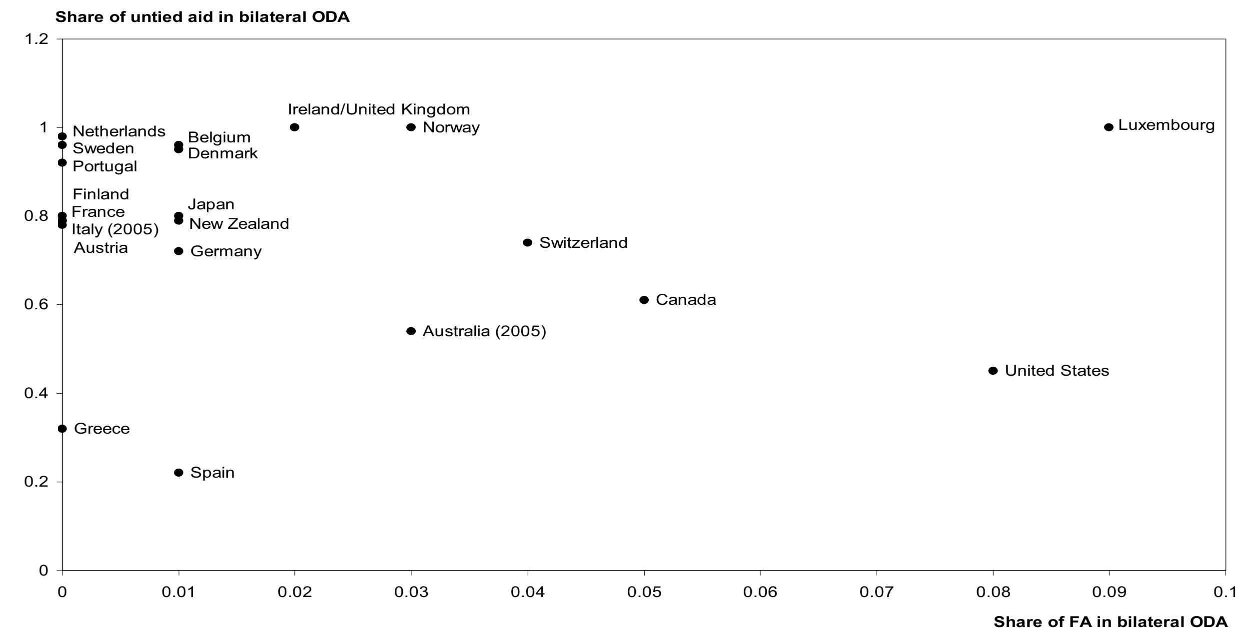
B.3 Findings

Given the low observation count, potential for both collinearity and omitted variable bias, a number of different specifications of the model were run. Table B3 reports the results of four specifications where the untied share of bilateral ODA is first regressed on a reduced set of variables most strongly identified in the theory (i.e. share of bilateral ODA to LDCs, share of bilateral food aid and share of TC) and then on an extended set of variables.

The share of bilateral ODA directed to LDCs and the share of food aid in bilateral ODA are both significant in all variations. The share of bilateral ODA directed to LDCs over total bilateral ODA is highly significant (at the 1% level) and positive. This suggests that the status of the Recommendation and LDCs is significantly important in 'determining' the extent to which aid is untied (See Figure 3.3). However, as noted previously, reverse causality cannot be excluded *a priori*. It might be the case that LDCs which untie their aid further are also those which give greater shares to LDCs. Further statistical investigations would be needed to explore the direction of causality; time constraints and difficulties in finding adequate instrumental variables currently prevent this.

The share of food aid is statistically significant (at the 5% level, 10% in specification 3) and negative. This confirms our expectation that a high share of bilateral food aid is associated with tying practices although full untying of food aid is recognised as a problematic and as a critical area (especially emergency aid). Further investigation is needed of what lies behind the statistical results. For example, donors that have largely untied their food aid are probably channelling a higher proportion multilaterally, explaining the cluster of donors who provide little or no food aid on a bilateral basis (Figure B.1). Nevertheless, the clear association between bilateral food aid and tying is supportive of an extension in coverage of the Recommendation.

Figure B.1 Relationship between share of untied bilateral ODA and share of food aid in bilateral ODA in 2006 [1]

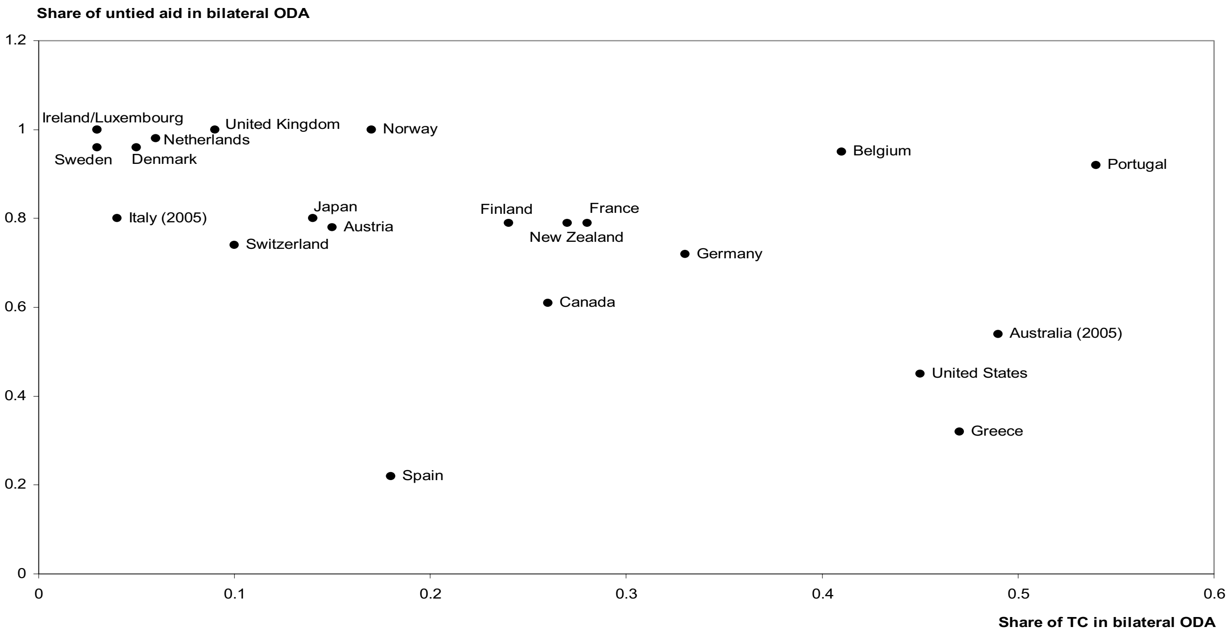


Source: OECD DAC and CRS databases
Notes: 1. Data are commitments in current US$ millions.

Finally, in specifications 1 and 2, TC is highly significant (at the 1% level) and negative. Although such finding is in accordance with our earlier hypothesis, caution is needed in drawing conclusions. The high (negative) correlation between GNI per capita and TC, as reported in the independent variable correlation matrix, makes it difficult to disentangle the individual effects of these two variables (more data would be needed). This is testified by the fact that once GNI per capita is included as a regressor (specification 4) TC losses much of its power; moreover, when GNI per capita is included and TC dropped, GNI per capita is found to be highly significant potentially capturing much of the impact of TC.

The ODA/GNI variable, proxying for donors' effort sharing, is significant (at the 10% level) only in specification (2). Although the variable behaves as expected (a positive impact), the result does not seem to be robust. Surprisingly, the share of bilateral grants has not been found to play a role in determining the extent of untying and the coefficient is never significant.

Figure B.2 Relationship between share of untied bilateral ODA and share of technical cooperation in bilateral ODA in 2006 [1]



Source: OECD DAC and CRS databases
Notes: 1. Data are commitments in current US$ millions.

Table B.3 Preliminary regression analysis of the extent of untying

Dependent variable: Untied Bilateral ODA / Bilateral ODA				
	(1)	(2)	(3)	(4)
VARIABLES				
Untied share of bilateral ODA	0.760***	0.810***	0.838***	0.837***
	(-0.196)	(-0.188)	-0.198	(-0.212)
Share of bilateral Food aid	-1.866**	-2.777**	-5.282***	-4.410**
	(-0.669)	(-0.987)	-1.454	(-1.667)
Share of bilateral TC	-0.733***	-0.677***		-0.359
	(-0.166)	(-0.186)		(-0.307)
ODA/GNI		12.58*	7.341	8.096
		(-6.761)	-7.782	(-5.836)
Share of bilateral grants		-0.0547	-0.251	-0.171
		(-0.302)	-0.287	(-0.246)
GNI per capita (log)			0.474***	0.317
			-0.134	(-0.219)
Constant	0.785***	0.750**	-4.155**	-2.511
	(-0.0778)	(-0.323)	-1.444	(-2.428)
Observations	22	22	22	22
R-squared	0.541	0.594	0.623	0.661
Robust standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

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