

Development, untied

Unleashing the catalytic power of Official Development Assistance through renewed action on untying

September 2018



In 2015 alone, donor governments around the world spent an estimated **US\$55 billion – or more than 44 per cent of Real Official Development Assistanceⁱ (ODA)** – on the procurement of goods and services. Such high budgets have the potential to catalyse far-reaching change in the global south. ODA procurement can build local supply chains for essential goods and services such as food and medicines; it can incentivise local companies to act in equitable, socially responsible and environmentally sensitive ways; and it can start a chain reaction of local economic growth by getting vital cash into the hands of small businesses in the global south.

However, ‘tied’ ODA procurement, which requires goods and services to be sourced from companies in the donor country, puts the commercial priorities of firms based in rich countries before development impact. In 2016, some **\$25 billion of ODA was reported as formally tied** – more than one sixth of Real ODA, and more than the total bilateral ODA spent on health, population and water combined. This is partly made possible because the rules that govern tying under the Organisation for Economic Co-operation and Development’s Development Assistance Committee leave out key countries and sectors.

In reality, the true level of tying is even higher, since ODA that is reported as untied can still be tied ‘informally’, through procedural restrictions that give companies from the donor country an unfair advantage. No official estimate of informal tying exists, but the best available proxy – data on donors’ ODA contract awards – shows that **more than half of all reported contracts in 2016 were awarded back to firms in the donor country** (analysis by value of contracts).

Furthermore:

- For three donors (the USA, Australia and the UK) the share of reported contract awards going back to domestic firms was at least 90 per cent while two of these donors reported 100 per cent of their ODA as untied (Australia and the UK).
- In contrast, of the total value of reported contracts implemented in the very poorest countries, only 13 per cent flowed back to local companies.

Firms in the global south face even greater inequities that don’t show up in these statistics. This is because:

- These companies tend to miss out on the more lucrative sectors such as technical assistance.
- Sometimes even when a contract appears to be led by a company based in the global south, the main players are actually based in the global north.

The toll taken by tying in the global south is too far-reaching to quantify in full. However, we estimate conservatively that the immediate cost of tying – that is, the cost of being unable to shop around for the best price – was **between \$1.95 billion and \$5.43 billion** in 2016. And that is before factoring in the far greater cost of missed opportunities to catalyse local economic, social and environmental development over the long term.

What is more, recent changes to the ODA reporting rules on donor support to the private sector risk creating new loopholes that would allow informal tying to proliferate more than ever.

Simple strategies for opening up procurement to firms in the global south have been well documented for many years. These include advertising contracts in the local media, setting manageable contract sizes and undertaking procurement in local languages. Yet our survey of donor agencies showed that such strategies are often ignored.

If donors are really committed to maximising the catalytic impact of ODA for development in the global south – not just for their own companies – it is urgent that they take action to untie their ODA and improve their procurement processes.

The power of procurement

For this briefing, we define procurement as the purchase of goods and services by governments through a contracting process, in order to implement public projects or provide public services.

The sheer scale of ODA procurement spending brings enormous purchasing power, with ramifications far beyond the immediate programme for which goods and services are being bought. Procurement can foster sustainable local production of foods and medicines that enable communities to withstand external shocks; it can create incentives for suppliers to uphold environmental standards and human rights; and it can have important redistributive effects, channelling income towards local people who are experiencing inequalities.

In general, ODA procurement is likely to have the highest development impact when it is directed through local procurement systems in the global south. However in reality donors tend to bypass local systems and retain control over procurement. Correspondingly, in this analysis we focus on the procurement behaviour of donors in the global north, as that is where some of the biggest risks to development impact occur.

ⁱ ‘Real ODA’ is a measure developed by Brian Tomlinson (Executive Director of AidWatch Canada) to capture the value of ODA that is genuinely available for initiatives to reduce poverty and inequalities in the global south.

The true extent of tied aid

Tied aid is given on the condition that it is used to purchase goods and services from the donor country's own domestic companies. This can be highly detrimental to development. In the short term, tied ODA can mean imposing goods and services that are more expensive (15-30 per cent more expensive, according to some estimates) and potentially ill-suited to the local context. Tying also means that ODA cannot be used to engage local producers and suppliers of goods and services. Over the long term, this implies missing out on the well-documented 'double dividend' that local procurement can bring when the context is right – delivering immediate results while also building up sustainable local businesses and potential tax revenues for the future.

In 2001, members of the Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC) agreed to a Recommendation on Untying ODA. However, 17 years on, donors reported some \$25 billion of ODA as formally tied – more than one sixth of Real ODA, and more than the total bilateral ODA spent on health, population and water combined.

Formally tied ODA is just the most visible part of a wider problem. Even where ODA is formally untied, there is a risk that donors informally tie their ODA through procurement barriers that prevent firms from outside the donor country from competing – for example, only advertising the tender in the donor country's language, or requiring that the successful bidder has a 'demonstrable knowledge of the donor government'.

No official estimate of informal tying exists, but the best available proxy – data on donors' ODA contract awards – shows that more than half of all reported contracts in 2016 were awarded back to firms in the donor country (analysis by value of contracts). For three donors the share of contract awards going back to domestic firms was at least 90 per cent, while two of these donors reported 100 per cent of their ODA as untied (Table 1 and Figure 1). In contrast, of the total value of reported contracts implemented in the very poorest countries, only 13 per cent flowed back to local companies.

Table 1

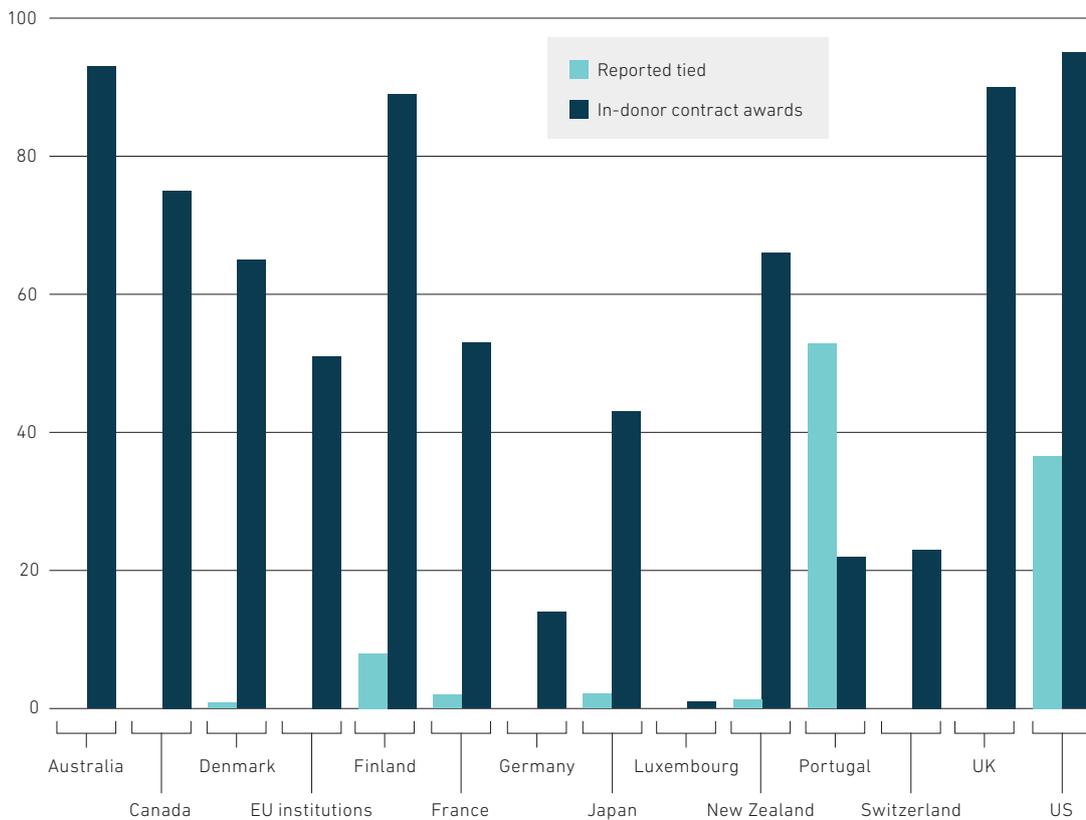
Share of bilateral ODA contracts reported to the DAC that were awarded to firms in the donor country in 2015 and 2016 (by value)

DAC member	Proportion of contract value awarded in-donor	Reporting too incomplete to allow analysis (see notes below)
United States	95%	Belgium
Australia	93%	Iceland
United Kingdom	90%	Korea
Finland	89%	The Netherlands
Canada	75%	Norway
New Zealand	66%	Sweden
Denmark	65%	
France	53%	
EU Institutions	51%	
Japan	43%	
Switzerland	23%	
Portugal	22%	
Germany	14%	
Luxembourg	1%	

Notes on Table 1 and Figure 1: (1) While the contract database used for this analysis includes some contract awards beyond the scope of the Recommendation, its main focus is on showing where contract spending covered by the Recommendation actually flows. (2) This analysis excludes donors that only reported on a very small proportion of their total contract awards – Belgium, Iceland, Korea, the Netherlands, Norway and Sweden (this involved a degree of judgement, as described in Table 1). (3) Austria, the Czech Republic, Greece, Ireland, Italy, Poland, Slovakia, Slovenia and Spain delivered a large share of their ODA through channels that do not involve direct award of contracts – e.g. multilateral agencies and/or civil society organisations (although it remains vital that some of these members step up their efforts to untie the share of their ODA that is channelled through contracts). Hungary, as a new DAC member, was not required to report on contract awards in 2015-2016. (4) Data for the EU covers 2016 only. (5) Contract award data for Luxembourg excludes 'individual expert contracts'. (6) Data on the level of ODA reported tied excludes administrative costs and in-donor refugee costs (which are tied by their nature).

Figure 1

Reported proportion of bilateral tied ODA within the scope of the *Recommendation on Untying* vs proportion of contracts awarded to donor country 2015-2016 (analysed by value)



Even these statistics do not show the full extent of the inequities that firms in the global south face. Firstly, there are further inequities in the sectors where contracts are awarded: companies based in the global south tend to be overlooked when donors award contracts in more lucrative – and politically sensitive – sectors such as technical assistance.

Secondly, some companies are recorded as being based in the global south, even when actually the main players are based in the global north. Current discussions at the DAC will have significant implications for the level of tying observed in future – potentially in both positive and negative ways (Box 1).

Box 1: Live DAC debates with important implications for tying

The scope of the Recommendation on Untying ODA – a chance to change for the better

In 2016, more than \$20 billion out of the total \$25 billion in tied ODA fell outside the scope of the Recommendation. The Recommendation excludes free-standing technical cooperation, and leaves it to DAC members' discretion whether to untie food aid. The Recommendation's scope is also limited to Least Developed Countries and Heavily Indebted Poor Countries: all the other countries on the DAC's list of eligible ODA recipients are excluded.

In 2018, the DAC is reviewing the latter of these restrictions – the countries covered by the Recommendation. In theory, this process could reduce the scope of the Recommendation still further – but it is also an opening to make the Recommendation more ambitious. Eurodad is calling for the DAC to extend the Recommendation, so that the wide-reaching benefits of untying are felt in all countries eligible to receive ODA.

The rules on private sector instruments – a new risk of tying by the back door

The DAC is currently finalising new reporting rules that aim to incentivise greater use of ODA to finance private sector companies (so-called private sector instruments). In principle, there is no reason why such use of aid could not be fully untied. However, in practice the complexity of the new rules risks creating new loopholes that would allow donors to conceal support for their own domestic companies.

With the new rules likely to come into force from 2019, it is urgent for the DAC to put in place plans for how it will monitor and mitigate the risk that private sector instruments may usher in an increase in informally tied ODA.

Counting the cost of tying

Drawing on the best available estimate that tying adds 15 – 30 per cent to the cost of goods and services, we modelled a range of scenarios to estimate the short-term cost of tying in 2016. Even with fairly cautious assumptions, this suggested that the extra cost of untying was in the range between \$1.95 billion and \$5.43 billion.

And that is before factoring in the far greater cost of missed opportunities to catalyse local economic, social and environmental development over the long term.

Levelling the playing field for suppliers in the global south: missed opportunities

Many of the barriers to firms from the global south winning ODA contracts have been well documented for many years. To investigate how far some of these barriers have been addressed, we conducted a survey of DAC members' procurement practices. 18 out of the 30 DAC members completed the survey.

Our main finding was that key barriers for firms in the global south persist, namely:

- Inconsistent use of local media outlets. Most DAC members advertise contract opportunities in the local media sometimes, but not always. Every contract that is not advertised through local media is likely to exclude a substantial share of the local supplier base.
- Large contract sizes. We asked donors for the size of the largest contract that they had advertised in the 2016-17 financial year, and within that whole contract, the largest individual component advertised on its own. Out of nine DAC members that answered this question, four said that the largest component was well in excess of €1 million. The largest single such advertisement was from Australia – over €275 million.
- Donors' languages dominate. Four donors told us they had only used their own country's official language for major procurement processes. In contrast, based on the survey responses and on available online information, it appears that only two DAC members advertised in any languages of non-DAC and non-European countries – and even for these donors, it is not clear how frequently this happened.

Conclusions and recommendations

Tied ODA robs people living in poverty of vital resources, of long-term economic opportunities, and of autonomy. Well-documented specific advice on untying ODA has been available for many years: 17 years after the DAC issued its Recommendation on Untying, it is inexcusable that more than one in every six dollars of Real ODA remains tied.

Urgent action is needed to set the untying agenda back on track, as the following recommendations set out. If donors are serious about using scarce ODA resources to achieve maximum impact for the Sustainable Development Goals, these recommendations cannot wait.

Recommendations for bilateral and multilateral donors:

1. Align all procurement with the principle of democratic ownership of development priorities by people in the global south, with particular attention to the priorities of the most marginalised. **Donors should prefer budget support to project-based ODA, and use local procurement systems for all aid modalities, provided that local people agree this is the best option.**

Even if this is not possible over the short term, donors should, as a minimum:

2. **Untie all ODA, to all countries and all sectors.**
3. **Ensure that all procurement meets internationally agreed commitments on human rights, reducing inequalities, decent work and environmental sustainability** while supporting local suppliers to address any gaps in their own social or environmental standards. Donors should ensure that their procurement activities are not contributing to international corporate tax avoidance, including by never procuring from multinational companies unless they are willing to report their financial accounts on a country by country basis, and by supporting international initiatives to improve transparency over the ultimate 'beneficial' ownership of firms.
4. **Overhaul procurement processes, to give firms in the global south a fair chance.** Donors should urgently tackle the well-known barriers that exclude firms from the global south, especially smaller firms, from procurement markets. This includes addressing the barriers highlighted in our survey, by: splitting tenders into smaller lots; advertising through local media outlets; advertising in local languages; and enhancing procurement skills in donor agency field offices. At the same time, donors should invest in capacity building for local firms, exploiting synergies with existing private sector development programming where possible.

Recommendations for international decision-making bodies

5. United Nations Member States should develop an **ambitious time-bound proposal for the steps that governments can take to end informally tied ODA.**
6. The Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC) should **tighten accountability over tying**, including by:
 - i. widening the scope of its *Recommendation on Untying*, to include all countries, all sectors, and informal as well as formal tying;
 - ii. toughening reporting requirements, and using the data to produce annual estimates on each donor's level of informal tying;
 - iii. taking urgent steps to research and mitigate the tying risks associated with the new rules on Private Sector Instruments; and
 - iv. delving deeper into the risks of 'back-door' tying as part of its peer-review process.
7. The Global Partnership for Effective Development Cooperation should **enhance its qualitative reporting on untying ODA**, by including increased emphasis on where contracts are actually awarded, on perspectives from governments in the global south, and on the implications of the new Private Sector Instrument rules.