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Development, untied

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

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Contents

Acronyms

DAC	Development Assistance Committee (of the Organisation for Economic Co-operation and Development)
DCD	Development Co-operation Directorate (of the Organisation for Economic Co-operation and Development)
EU	European Union
GPEDC	Global Partnership for Effective Development Co-operation
HIPC	Heavily Indebted Poor Countries
LDC	Least Developed Countries
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
UNCTAD	United Nations Conference on Trade and Development

Executive Summary

In 2015 alone, donor governments around the world spent an estimated **US$55 billion – or more than 44 per cent of Real Official Development Assistance (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 such as foods 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 *un*tied (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 aid 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.

Eurodad is calling for the following key steps:

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. 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 Co-operation 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.

Section 1: Introduction

Procurement: catalysing development

Procurement has a fundamental impact on the quality of development co-operation.

In 2015 and 2016, donors in the Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC) reported spending some $49 billion of bilateral Official Development Assistance (ODA) on procurement – i.e. around $24 billion just in 2015.[1]

Extrapolating across multilateral ODA, and across seven bilateral donors who did not report complete data, and making some other minor adjustments to allow for timing differences and to ensure a conservative estimate, we estimate that the total for 2015 increases to at least $40 billion. Furthermore, some ODA is channelled through the procurement systems of countries in the global south and used for procurement locally: including this too would bring the total to more than **$55 billion**.[2] This means that **procurement accounted for around 44 per cent of gross Real ODA disbursements[3] in 2015** (please see workings in Annex 2 for more details).[4]

For this report, 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 contracting process distinguishes procurement from other types of public spending such as grants to civil society organisations, or transfers to other government institutions and multilateral bodies, which are outside the current report's scope.[5] Even with this limitation, procurement covers a huge diversity of situations – from the purchase of 'hard' goods at scale to the sourcing of niche expertise.

The fact that so many functions of ODA are outsourced to the private sector and to others outside government is not uncontroversial. But there is little controversy over the conclusion that **such high budgets bring enormous purchasing power**. Decisions made by procurement officials have ramifications far beyond the immediate programme for which goods and services are being bought. They can foster sustainable local production of foods and medicines that enable communities to withstand external shocks; they can create incentives for suppliers to shift away from environmentally and socially harmful activities; and they can stimulate stronger dialogue between governments and citizens over how public money is spent.

Procurement: a key issue for reducing inequalities

The sheer scale of public procurement means it has a powerful role to play in the fight against inequalities. Procurement can create an important incentive for the private sector to uphold the rights of marginalised people as consumers – for example, by requiring that goods and services be accessible to persons with disabilities.[6] Procurement can also help break down the barriers that hold back marginalised people as producers.[7] For example, in Brazil and Colombia, cooperatives of highly marginalised informal sector waste pickers have been given access to public procurement markets.[8] However, bad procurement decisions can also reproduce existing patterns of marginalisation and exacerbate inequalities even further.

To illustrate, Box 1 sets out some of the potential positive and negative impacts of procurement in the context of women's equality.

Box 1: Procurement and women's equality

Procurement has profound implications for women's rights, on both the demand and the supply sides. On the demand side, women service users are likely to have differential requirements that need to be factored into procurement decisions. For example, women may be disproportionately reliant on public services such as healthcare, education and social care, due to inequalities in the distribution of household economic resources and of caring responsibilities. Procuring in a way that promotes the availability, accessibility, acceptability and quality of such services is therefore particularly important for women's equality. Similarly, decisions on the procurement of infrastructure need to consider the different burdens and risks that women may face in using infrastructure such as water supplies or transport services.

On the supply side, women tend to face barriers to equal participation in the economy, such as a lack of access to finance, and time constraints associated with unpaid care work. As an important part of any economy,[9] procurement has significant potential to disrupt these barriers – or to entrench them further by ignoring them. Possible procurement strategies to address women's inequality include: offering preferences for women suppliers; and insisting that suppliers take action to support the substantive equality of women within their workforce and supply chains. However, these strategies can carry risks as well as opportunities (for example, the risk that benefits accrue disproportionately to élite women rather than the most marginalised, or the risk of backlash from male competitors). This means that, in any context, consultation with marginalised women about procurement policies is always key.[10]

Fundamental characteristics of impactful ODA procurement

ODA procurement is used in very different contexts – for long-term development programmes or sudden humanitarian interventions; and in recipient countries with very different levels of income and inequality. This means there is not one right way to do ODA procurement, but many. However, with so much at stake, there are some basic principles that should always apply:

i. The preferences of local people should guide all donor decisions, following a human rights-based approach to local ownership (see Box 2).

ii. Procurement should do no harm – either to the environment, or to local communities, or to workers and others in the supply chain. Rather, donors should leverage the purchasing power of procurement as a force for good that can tackle inequalities.

iii. Wherever possible and consistent with (i) and (ii), procurement should be seen as an opportunity to support long-term development in the community receiving ODA, including by channelling funds through local institutions and local businesses.

The three principles are interrelated, but this report will concentrate on principles (i) and (iii). That is because these principles are central to the case for 'untying' ODA – an issue that has slowly been rising up the DAC's agenda in recent years, and is in urgent need of redoubled attention. We hope to explore principle (ii) in more depth in a subsequent briefing.

Box 2: Human rights-based approaches in the context of procurement

The implications of human rights-based approaches have been unpacked in some depth for the design, planning and implementation of development programmes.[11] Less has been written about what a human rights-based approach means in the context of procurement – but we would argue that the fundamental principle of aligning all decisions with human rights obligations is as relevant for procurement as for any other sphere of activity. In particular, human rights-based approaches stress the need to understand the unequal power dynamics experienced by more marginalised segments of the population, through local dialogue. As set out above, procurement affects the enjoyment of rights by marginalised population groups on both the supply and demand sides. Local dialogue with members of such groups is therefore essential to ensure that procurement does not exacerbate the inequalities they face.

ODA procurement: the sharp end of wider challenges in effective development co-operation

ODA procurement cannot be isolated from wider questions of effective development co-operation – in particular, the principle that development priorities should be democratically owned by people in the global south.[12] In general, we would expect that local people would prioritise giving accountable governments in the global south more control over ODA spending, and giving external donors less. This would mean favouring sector-wide support to government budgets (or, as a second best, at least pooling funding among different donors) rather than project-based approaches led by a single donor agency. Crucially, it would also mean letting recipient governments make their own decisions on ODA procurement in a democratically accountable way.

However, the reality of ODA delivery is currently very different: in 2016, only 37 per cent of ODA to the public sector was channelled through governments' own procurement systems in the global south – with donors from the global north keeping control of the rest.[13] For this reason, this paper focuses largely on the procurement behaviour of donors from the global north – not because it is ideal that they have retained control over so much contract spending, but rather because, as long as this is the reality, it is also where some of the biggest risks to development impact occur.

Section 2: Tied aid – a drain on development for decades

Tied ODA holds development back

If ODA is tied, this means that it must be used to purchase goods and services from the donor country's own domestic companies. In other words, tying puts the commercial interests of organisations in the global north[14] ahead of the priorities of people living in poverty. This pattern is far from new. However, its persistence is striking, given that development actors have been committing to untie for almost two decades, starting with the DAC's *Recommendation on Untying ODA* in 2001, and reinforced by successive development effectiveness and UN financing for development agreements.[15]

Tying can be highly detrimental to development. This has been comprehensively dealt with in the literature,[16] and we produced a synopsis of some of the key arguments in our 2017 briefing, *Unravelling Tied Aid*.[17] In summary:

- 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)[18] and potentially ill-suited to the local context. Major tied ODA programmes during 2016 included:[19]
  - providing emergency food aid for people in Iraq
  - constructing and equipping a hospital in Laos
  - a programme to enhance educational outcomes by providing nutrition and educational interventions for primary school children in Tanzania.

  In all of these programmes, second-best value for money would have significant consequences for people's lives.
- In the long term, tying means that ODA cannot be used to engage local producers and suppliers of goods and services. It ignores 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.[20]

Governments engaged in tying may argue that the prospect of benefits to the donor country shores up political support for ODA, making it possible to increase ODA volumes overall. Any such argument, which implies that the human rights obligation[21] to provide ODA can be subordinated to the self-interest of the provider country, is intrinsically hard to defend. But not only is this position ethically unsound, it is also out of kilter with the evidence. A literature review commissioned by the DAC in 2009 found that, based on the limited available evidence, "the macroeconomic impact [of tying for donors] is found to be fairly limited."[22] A 2014 academic report went further, and concluded that, "While some econometric studies have shown a positive correlation between aid flows and donor exports, … the vast majority of scholars have concluded that tied aid does not generate significant trade benefits to donors, not least because it accounts only for a small percentage of their exports".[23] This means that, even for those who believe ODA should be used in the national interest in order to bolster public support, tying is not the answer, as the evidence of national level benefits does not stand up to scrutiny. On the contrary, the wastage and ineffectiveness associated with tying run the risk of eroding public support for ODA over the long term.

In the context of the compelling case for untying, the rest of this report seeks to expose more fully the extent to which tying still persists, and to explore some of the barriers that are preventing the full benefits of smart ODA procurement being felt everywhere that ODA is spent in the global south.

Almost one in every five ODA dollars is reported as tied

In 2016, DAC donors reported around **$25 billion of ODA as tied**.[24]

To put this in context:

- In 2016, total gross Real ODA disbursements were around $134 billion.[25]
- The combined gross Real ODA disbursements of Belgium, Canada, Denmark, Finland, France, Korea and Sweden in 2016 were just under $25 billion.[26]
- In 2016, combined bilateral ODA for health, the population/reproductive health sector and water was $19 billion.[27]

What is more, the headline value of $25 billion is likely to be an understatement, as the reliability of donor reporting on tying is variable.[28]

Limitations in the *Recommendation on Untying ODA* – and a chance for change

In 2016, more than $20 billion out of the total $25 billion in tied ODA fell outside the scope of the DAC's *Recommendation on Untying*.[29] The Recommendation excludes free-standing technical co-operation, 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.

But this year, the scope of the Recommendation is up for review. The review focuses on the geographic coverage of the Recommendation: DAC members are taking stock of their earlier decision that Heavily Indebted Poor Countries should be included. In theory, this process could reduce the scope of the Recommendation still further. However, it is also an opening for DAC members to increase their ambition, and to extend the scope of the Recommendation to all ODA-eligible countries.

The exclusion of many ODA-eligible countries from the current scope of the Recommendation is at odds with the Sustainable Development Goals' objectives on the eradication of poverty and reduction of inequalities. Available data suggests that, out of the 783 million people who live in extreme poverty globally, around half[30] reside in countries that the Recommendation does not cover. If ODA is delivered in a way that wastes precious resources, does not meet local needs or misses opportunities to support pro-poor local growth, these people will suffer the consequences.

Those who oppose extending the Recommendation to all countries that are eligible for ODA argue that untying makes less sense in contexts with well-developed local industries, such as G20 countries. However, this argument overlooks the diversity of ways in which untying can contribute to development. While supporting local industry can be the priority in some contexts, in other contexts untying is essential for minimising whole-life costs, purchasing more locally appropriate products, or potentially supporting supplier groups that may be marginalised even in contexts where industrial development is otherwise healthy. These arguments for untying are as valid in G20 countries as elsewhere. Indeed, the arguments in terms of quality and cost-effectiveness may apply particularly strongly where local industry is already better established.

The forthcoming review of the Recommendation's scope is not sufficient for achieving full untying – questions of sectoral scope and of implementation remain. However, it is a vital step forwards in unleashing the benefits of untying for all ODA-eligible countries, in the G20 and beyond.

Section 3: Following the money: the murky business of informal tying

Firms based in donor countries are the biggest beneficiaries of bilateral ODA procurement

Formally tied ODA is just the most visible part of a wider problem. The real acid test of whether donors are putting domestic companies' interests ahead of development priorities is to look at how procurement operates in practice. 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. Examples of such barriers include only advertising the tender in the donor country's language, or requiring that the successful bidder has a 'demonstrable knowledge of the donor government'.[31]

We spoke to the head of the Aid Co-operation Permanent Secretariat in the Government of Madagascar to understand more about his experience of formal and informal tying. He said that when stakeholders in Madagascar see the data on formally tied aid in the country, "they are amazed by the figures''. They seem so far from the reality of contract awards flowing back to firms linked to the donor country.

This informant described how donors approach procurement in Madagascar. It was clear that the situation was complex and challenging – but nonetheless that donors were missing opportunities to open up their practices. For example, on occasions donors appear to be deliberately designing contract specifications to give their local companies an advantage. Our informant described a contract for solar panels at a hospital: the contract specified components that were only manufactured by a company in the donor country.

Informal tying is, by its nature, a practice that lacks transparency. No official estimates of informally tied ODA exist. The best available proxy is to look at the levels of ODA that flow back to firms in donor countries. In 2015 and 2016 combined, donors reported to the DAC on some $49 billion of individual ODA contracts. In 2016, **51 per cent of contracts were awarded back to firms in the country providing the ODA**, and a further 9 per cent to firms in other donor countries (analysis by value).[32]

Table 1 ranks donors based on the value of ODA contracts that were awarded to firms in their own countries, drawn from data reported to the DAC. This data has gaps: not all donors report all their contract awards. For the six donors listed on the right-hand side of the table, data was particularly sparse or non-existent. If all donors reported complete data, it is likely that even more awards to donor country firms would be exposed. However, the picture is already alarming. In 2015-2016, eight donors reported that substantially more than half of their contract awards (by value) went to firms in their own countries. **For three donors the share of contract awards going back to domestic firms was at least 90 per cent**. In the US alone, this meant that more than $14.6 billion was reported as flowing back to domestic companies.[33]

Indeed, a 2014 academic analysis of the United States Agency for International Development (USAID)'s ODA procurement found that "many development dollars end up circulating in the richest counties in the United States, an especially ironic twist on the commitment of USAID to the development of 'local capacity'."[34]

With informal tying included, tied ODA increases to almost $30 billion

Some donors report very high levels of contract awards to firms in their own countries while also reporting very low levels of formally tied aid (see Figure 1). For example, **the UK reports that its aid is fully untied, but 90 per cent of its reported contract awards flowed back to UK firms in 2015-2016**. For Australia, which also reports its aid as fully untied, the figure was 93 per cent.[35]

It would be misleading to say that all of these contracts were informally tied. A variety of factors can lead donors to award contracts to firms in their own countries. Nonetheless, in our view, if more than half of contracts are being awarded to firms in the donor country, this is *prima facie* evidence that not enough has been done to stop domestic firms having an unfair advantage.

In the absence of an official figure on the level of informal tying, we have used the DAC's data on contract awards to calculate an estimate. We focused on those donors awarding more than half their contracts to companies in their own countries,[36] and took their total reported contract spending that flowed to donor country companies in 2016. We then modelled a range of assumptions on the share of this spending that was informally tied (our full workings are in Annex 3). If 50 per cent of such spending was informally tied, then informally tied ODA in 2016 amounted to $2.9 billion. If 75 per cent was informally tied, the total would be $4.6 billion. **This brings the total level of tied ODA (formally + informally tied) to between $27.9 billion and $29.6 billion**.

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)

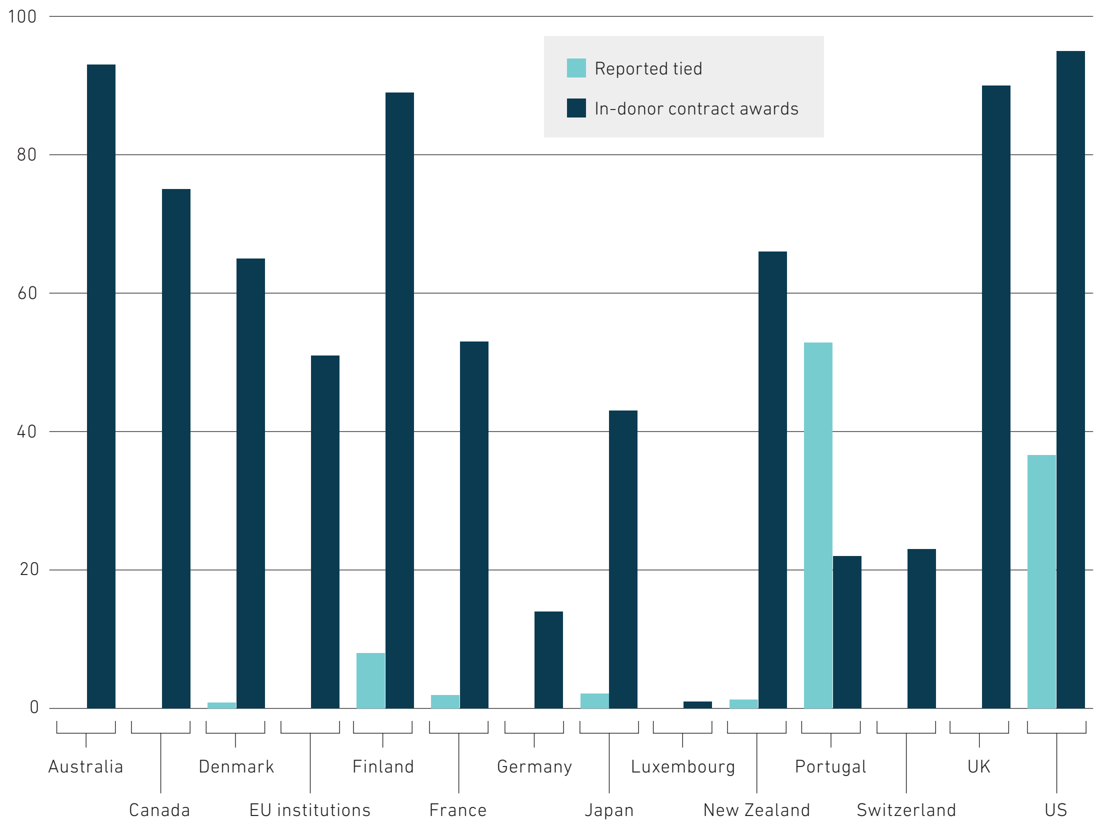
DAC member	Proportion of contract value awarded in-donor	Reporting too incomplete to allow analysis (see notes below)
United States	95%	Belgium
Australia	93%	Iceland
United Kingdom	90%	Korea
Finland	89%	The Netherlands
Canada	75%	Norway
New Zealand	66%	Sweden
Denmark	65%	
France	53%	
EU Institutions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

Note: (1) The dataset used for this analysis focuses on awards within the scope of the Recommendation, but includes some contracts outside the Recommendation's scope too. (2) We have used judgement to assess the completeness of donors' reporting, taking into account year-on-year levels of bilateral ODA within the scope of the Recommendation, and evidence on spending patterns from the DAC's Creditor Reporting System database and from correspondence with individual donors. (3) Austria, the Czech Republic, Greece, Ireland, Italy, Poland, Slovakia, Slovenia and Spain delivered most 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) Data for Luxembourg excludes 'individual expert contracts'.

Source: Eurodad analysis of Organisation for Economic Co-operation and Development Development Co-operation Directorate (DCD)/DAC 2018 Report on the DAC Untying Recommendation

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)



Notes: (1) If there is no light blue bar on the chart, this means the donor reported 100 per cent of its bilateral ODA within the scope of the Recommendation as untied. (2) 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. (3) 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). (4) 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. (5) Data for the EU covers 2016 only. (6) Contract award data for Luxembourg excludes 'individual expert contracts'. (7) Data on the level of ODA reported tied excludes administrative costs and in-donor refugee costs (which are tied by their nature).

Source: Eurodad analysis of Organisation for Economic Co-operation and Development DCD/DAC 2018 Report on the DAC *Untying Recommendation*, Tables 1 and 6

Firms in the global south are losing out

Whereas 51 per cent of the value of bilateral ODA contracts reported to the DAC flowed to firms in donors' own countries in 2016, only 7 per cent flowed to firms based in Least Developed Countries (LDCs) or Heavily Indebted Poor Countries (HIPCs).[37]

The 7 per cent figure includes projects implemented across the whole range of ODA eligible countries – Middle Income Countries included. It is arguable that firms from the poorest countries might have less chance of competing successfully for contracts in middle-income settings. But even if we narrow the analysis to projects implemented within the borders of LDCs and HIPCs, **the share of contract value going to local firms in 2015-16 was still only 13 per cent**.[38] Firms in some countries in the global south are faring even less well. For example, between 2008 and 2016, only 5.2% of the total value of contracts awarded in Ghana went to Ghanaian firms.[39] This represents a huge missed opportunity to reap the 'double dividends' of local procurement, described above.

Several donors argue that suppliers from the global south fare better at the level of sub-contracts. However, data on the geographic distribution of sub-contracts is very hard to obtain. And even if suppliers in the global south are winning sub-contracts, they are still deprived of the potential commercial and capacity-building benefits of being at the top of the supply chain.

Headlines on awards to the global south mask additional resource flows to the global north

Even when donors report that the winner of a contract was based in the global south, this does not always tell the full story. A firm may be located in the global south, but the main benefits of its operations may flow to individuals or companies based in the global north, through salaries, dividends and other transfers.[40]

It is hard to get a complete picture of who is really benefitting from ODA procurement in the global south, because not all DAC donors report this level of detail publicly, and because many of the companies in question do not disclose full details of their ownership. To dig more deeply into who benefits from contract awards, we looked in detail at the database of European Union ODA contracts managed centrally by the European Commission and its delegations – one of the most comprehensive sources published by any of the DAC donors.[41]

According to this database, in 2016, the European Union institutions awarded a total of 38 contracts worth over €1 million to firms based in LDCs or HIPCs.[42] We researched each awardee in as much detail as possible on the internet, and found that at least four out of the 38 awardees seemed to have strong links with companies or individuals in DAC member countries (Table 2).[43] In addition, a further three companies appeared to have strong links with companies in China.

While this analysis focused on the European Union database, available data suggests the same pattern applies more broadly. In 2017, the UK Independent Commission on Aid Impact examined the Department for International Development's procurement in depth. It found that, in 2016-17, only 3 per cent (UK£36 million) of UK aid contracts went to suppliers from 'developing countries' as prime contractors: of this £36 million, £30 million had been awarded to McKinsey Ethiopia[44] – affiliated to the US-based McKinsey corporation.

Of course, companies with links to the global north may still deliver important development benefits in the global south, if they pay their fair share of taxes (Box 3), and employ local people at all levels of seniority: in some cases such procurement may be the best way to meet locally determined priorities.

Box 3: The vital importance of tax compliance by firms operating in the global south

Tax revenue is the most reliable and sustainable source of development financing for all countries, yet estimates by the United Nations Conference on Trade and Development (UNCTAD) suggest countries in the global south lose \$70–\$120 billion annually to corporate tax avoidance.[45] Corporate taxes are a particularly important source of revenue for countries in the global south, due to the nature of economies and large informal sectors. However, weaknesses in international tax laws and co-operation, the use of offshore financial centres, intra-company operations within multinational corporations, and financial secrecy allow multinationals to dodge tax in the global south.

Nonetheless, as long as donors award contracts to companies in the global south that channel some of the gains from ODA procurement back to the global north, the resulting development gains are likely to be very different from those that accrue from 'true' local procurement, especially if such procurement follows pro-poor approaches.[46] Describing such awards in the same way as procurement from more locally rooted firms risks disguising informally tied ODA, and giving a misleading picture of which kinds of dividends – corporate or development – are accruing where.

Table 2: Major beneficiaries of European Union development contracts located in the global south, but with strong links to the global north

Company	Contracts awarded	Notes
S R Nicholas Ltd	€6.5 million for school construction in Malawi	It appears this company was founded by a South African Greek and an Italian, and now has leadership of Italian origin: http://www.srnicholas.com/about-us/history; http://www.srnicholas.com/about-us/directors
Korea and Ghana Development Firm	€5.9 million for housing and infrastructure construction in Ghana	As the name suggests, the company appears to have very strong links with Korea: https://bit.ly/2PKkuuN; https://bit.ly/2pgZfFN
CFAO Niger SA	€2.4 million for supply of vehicles in Niger	At the time of the contract award, CFAO had been acquired by the Toyota Tsusho Corporation: http://www.cfaogroup.com/en/history
Atelier d'Architecture DDV KIN SPRL	€1 million for hospital infrastructure in the Democratic Republic of Congo	This company appears to be based in Belgium: http://www.ddv-archi.com/ddv.php

Source: Eurodad analysis of the European Commission "Search Tool for Recipients of Funds" database

Sectoral allocations raise questions about local ownership of development priorities

The share of contracts awarded to companies in donor countries versus countries in the global south varies markedly depending on the sector. At one end of the spectrum, 35 per cent of reported agriculture contracts between 2010 and 2016 were awarded to suppliers in LDCs and HIPCs. At the other, 100 per cent of contracts relating to "trade policy and regional trade related adjustment" were awarded to suppliers in the country providing ODA.[47]

For a more granular understanding of sectoral variations, we again turned to the detailed contract-level data in the European Union procurement database. We examined all contracts above €1 million, and found a stark contrast. The large majority of contracts awarded to firms in the global south were categorised as "works" – for example, road building, school construction etc. On the other hand, technical assistance and advisory contracts made up a large share of contracts awarded to firms in European Union DAC member states (Figure 2).[48]

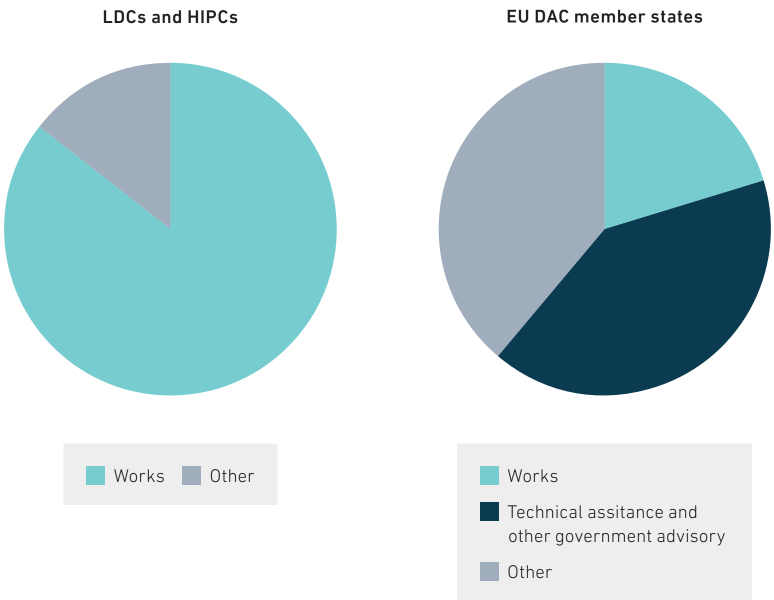
This is worrying for several reasons. First, the profit margins on technical assistance and consultancy are in general likely to be particularly high, so this represents a correspondingly high opportunity cost for local firms.[49]

Second, such a sharp disparity in the allocation of technical assistance contracts may suggest that recipient governments played a limited role in the selection process of such experts, if at all. As past studies have shown, technical assistance can pose serious threats to the established principle that populations in the global south should have ownership of their own development priorities,[50] because providers of technical assistance have such privileged access to government policy-making.[51] It was outside the scope of this research to look at the local ownership implications of individual technical assistance contracts in the European Union's database on a case-by-case basis. However, the fact that so many contracts in such a politically sensitive area went to companies based in the global north, while none went to firms in LDCs and HIPCs, does raise some alarm bells.

While the European Union's contract database lends itself unusually well to this kind of analysis, this pattern is unlikely to be confined to the European Union alone. It is harder to draw firm conclusions from the very broad categories in DAC data on contract awards. However, "trade policy and regional trade related adjustment" is a sector with many political sensitivities and potential conflicts of interest. The fact that 100 per cent of contracts in this sector were awarded to firms based in the country providing ODA raises further questions about the extent to which donors' procurement choices are really supporting local ownership of development priorities.

Figure 2

European Union ODA contract awards by company location and sector in 2016



Note: As there is no 'technical assistance' category in the database, we used our judgement to classify projects. Projects were deemed to be technical assistance either where the project description used this phrase (the majority of cases) or where the description otherwise seemed strongly to suggest that the contract involved technical advice on strategic governance issues (a small minority of cases covering, for example, implementation of budget support, monitoring and evaluation, trade facilitation, support to the institutional reform of a regional commission). We excluded general financing for budget support and other financing for public sector organisations (either in the global south or north) from this analysis.

Source: Eurodad analysis of the European Union "Search Tool for Recipients of Funds" database

Not all costs of tying can be quantified – but those that can are in the billions

In general, the biggest cost of tying is the long-term opportunity cost of wasted chances to develop democratically accountable pro-poor procurement systems, and sustainable and inclusive local markets. This opportunity cost has such far-reaching implications that it is hard to quantify them fully.

However, tying also has more immediate costs, many of which are somewhat easier to measure. As noted in Section 2, the best available data suggests that tying can add between 15 per cent and 30 per cent to the cost of goods and services procured.[52]

A note on the 15-30 per cent estimate

This estimate is a composite, derived by combining the results of a number of detailed studies that took place before 2009. These studies used a variety of methods: most commonly they compared actual differences in prices of goods and services; one also interviewed project managers about their experiences of price differences, and others used country-specific examples. The researchers who compiled the composite estimate recognise that all these methods have some limitations (e.g. gaps in data availability, and the need to make assumptions about the extent of informal tying), but also note that 15-30 per cent is quite conservative given the many other known indirect costs of tying that are not included in the estimate (such as additional maintenance costs or shipping expenses).[53]

The estimate is now old, but overall we judge that its outcome remains highly plausible, given that tying removes the opportunity to shop around. Until more detailed new analysis is possible, we consider this figure to be the best available proxy.

Modelling the immediate cost of tying

In the absence of more detailed economic research and data on local procurement patterns, we have made some – somewhat arbitrary but also cautious – assumptions to model the immediate cost of tying.

- We worked on the basis that, if ODA had been untied and procurement had followed local priorities, minimising costs would have been one important objective – but not necessarily the only one, and that trade-offs might sometimes be made. We therefore modelled a range of scenarios. At one extreme, we assumed that getting a low price was the priority for just one-third of procurement spending (whereas it was traded off against factors such as quality in the other two-thirds). At the other extreme, we assumed that getting a low price was the priority in 100 per cent of cases.
- We assumed that, wherever price was the deciding factor, the additional cost of tying would be 22.5 per cent [the mid-point between 15 per cent and 30 per cent].

Taking these assumptions together with the range of estimates for total tied ODA calculated earlier in this section gives the range of results below. (Please see Annex 4 for our workings).

	Price prioritised in 1/3 of cases	Price prioritised in 100% of cases
Total tying = $27.9 billion	**Cost of tying = $1.95 billion**	**Cost of tying = $5.12 billion**
Total tying = $29.6 billion	**Cost of tying = $2.06 billion**	**Cost of tying = $5.43 billion**

In other words, even with fairly cautious assumptions, **the immediate cost of tying falls in the range between $1.95 billion and $5.43 billion**. By way of context, total gross ODA disbursements to Afghanistan and Ethiopia combined in 2015-2016 came to $5.3 billion.[54,55]

What is more, when ODA is offered as loans rather than grants, the losses from tying may partially cancel out the 'gain' from the concessional terms of a loan. Drawing on a methodology developed by Yassin,[56] and data on ODA loans offered in 2016,[57] we modelled how far the losses from tying cancelled out the 'gain' from concessional terms on a loan. Our calculations (in Annex 5) indicated that tying would **reduce the concessionality of an average loan by over 10 per cent**.

Japan gave more tied ODA loans than any other DAC donor in 2016 – some $2.4 billion.[58] Japan's loans were reported as being on highly concessional terms, but if the losses from tying were factored in, this would **reduce the concessional 'gift' that Japan is giving by $125 million** (see Annex 5).

To encourage members to give ODA on more generous terms, the DAC set a target that every donor's total ODA should have a concessional element of at least 86 per cent.[59] In 2016, the concessional element of Japan's ODA was hovering on the margins of this threshold, at 85.7 per cent.[60] But if the dampening effect of tying was factored in, the concessionality of Japanese ODA would slip to 85.2 per cent. This may sound a small change, but it is very material in the context – it means that, rather than rounding up to 86 per cent, **the concessional element of Japanese ODA would be pushed down to 85 per cent, below the DAC's target threshold**.

Recent rule changes may open the door for more informal tying

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 – indeed, untying is essential to the stated objectives of the private sector agenda, which includes supporting local private sector development and, ultimately, accelerating progress towards the Sustainable Development Goals.

However, in practice the complexity of the new rules risks creating new loopholes that allow donors to conceal support for their own domestic companies. The recent DAC peer review of Finland illustrates the challenges of reconciling private sector instruments with the untying agenda: it found that "Finland's introduction of new private sector instruments is likely to present further challenges to its untying record. The new business impact programme and public sector investment facility are both largely tied instruments."[61]

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.

Section 4: Towards a more level playing field

Almost a decade ago, the DAC commissioned an evaluation into progress on untying ODA, which included an in-depth examination of barriers that prevent firms in the global south from winning ODA contracts. In 2011 Eurodad conducted further research on this topic, drawing on six detailed country case studies. These pieces of research identified a number of important barriers:

- **Barriers in access to information**. For example:
  - A lack of access to events for prospective suppliers organised through donors' embassies or in donors' capital cities.
  - A lack of access to information on live opportunities, as information from different donors is often fragmented, and rarely shared through the media channels that are most popular with local contractors.
- **Barriers built into the tender process**. For example:
  - Unmanageably large contracts for bidding.
  - Requirements that suppliers have a track record of delivering large projects, or a certain turnover.
  - Unnecessarily complex specifications.
  - Implicit links with previous projects, which may give incumbent (often donor country-based) suppliers an advantage.
  - Requirements to submit proposals in the language of the donor country.
  - Long delays before payment, which create a disadvantage for companies in contexts where credit is less readily available.
  - No allowance made for the fact that growing industries in the global south may have higher costs than established firms in donor countries (due to the need to invest in developing their capacities, and due to a lack of economies of scale).[62]

Now, almost ten years later, we decided to investigate how far these barriers have been addressed. To test this, we identified a handful of bellwether indicators from the list above, and developed a survey for procurement officials across the DAC membership. We then triangulated the results through interviews with a small number of officials from donor agencies; experts from the DAC and Global Partnership for Effective Development Co-operation secretariats; informants from the global south who had dealt with ODA procurement (a government official and the representative of a business association); and academics or professionals with experience studying procurement and tied ODA.

We distributed the survey to all 30 members of the DAC, and the majority responded:

- 18 donors completed the survey.
- a further three donors informed us that procurement did not make up a material share of their ODA, as they instead focus on multilateral organisations and/or civil society. This is broadly corroborated by data in the DAC's Creditor Reporting System database.[63]
- Seven donors did not respond. These were Finland, France, Hungary, Iceland, Italy, Poland and Spain. The USA also did not respond to the survey, although it did send some other information on its procurement practices.[64]

Overall the countries that responded account for around 66 per cent of Real bilateral ODA gross disbursements in 2016.[65] There is some nuance behind this total of 66 per cent, as different donors organise their ODA procurement in different ways. Often our respondents worked at headquarters, and told us their responses might not be fully representative of procurement processes delegated to field offices. Nonetheless head offices tend to handle larger contracts, and it is here that the greatest risk of barriers to bidders from the global south arises, so we consider our survey responses give a good snapshot of the progress that has been made in tackling such barriers.

Barriers for firms in the global south remain rife

The main finding is that key barriers for firms in the global south persist, even though these barriers have been well documented for almost a decade.

Inconsistent use of local media outlets

We asked donors whether they used local media to advertise new contract opportunities. Most responded that they did such advertising sometimes, but not always. While it is encouraging that most respondents are making some attempt to use local media, it is also disappointing that this is not yet standard practice. Every contract that is not advertised through local media is likely to exclude a substantial share of the local supplier base.

We spoke to a representative from the Afghan Women's Business Federation – an umbrella not-for-profit organisation working on behalf of Afghan-owned businesses and enterprises, especially on behalf of businesswomen. He described how, in Afghanistan, donors tend to advertise contract opportunities on their own websites, but not routinely in the local press. It is difficult for local firms to know where to look, and people without internet access are particularly excluded. Often local business people only hear of opportunities by word of mouth as the deadline approaches, and they end up submitting rushed bids. In contrast the Government of Afghanistan tends to advertise small projects in the local press – an approach that this informant recommended donors should replicate.

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. Nine donors gave quantified responses. Four said that the largest component was well in excess of €1 million – a size that would be unmanageable for most micro, small and medium enterprises based in the global south (and for many based in the global north too). The largest single such advertisement was from Australia – **over €275 million**.[66]

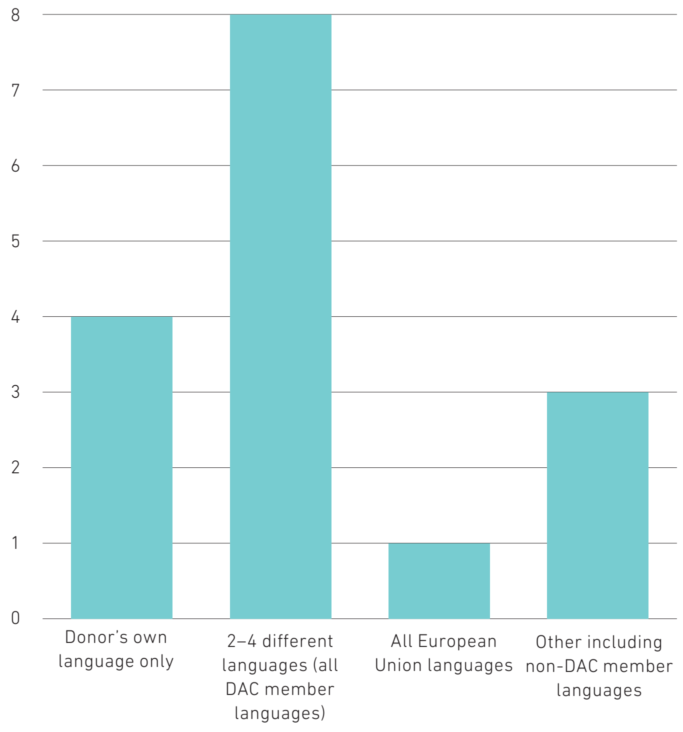
Donors' languages dominate

If ODA procurement is to achieve its full potential for empowering local suppliers, contracts need to be advertised in languages that local people feel confident in. We would expect contracts to be advertised in the main local language of the area where the project takes place, as well as the languages of any marginalised minorities living in that area (e.g. indigenous peoples' languages, where appropriate).

In practice, it seems that contracts are advertised in a much narrower range of languages than we would expect to see. We asked donors which languages they had used to advertise tenders in the preceding year (see Figure 3). Four donors had only used their own country's official language for major procurement processes. For example, the UK had only advertised in English, and Portugal had only advertised in Portuguese.

In contrast, based on the survey responses and on available online information, it appears that only Enabel in Belgium and KfW in Germany advertised in any languages of non-DAC and non-European countries – and even for these donors, it is not clear how frequently this happened.[67]

Figure 3
Most contracting takes place in a small range of DAC member languages



Source: Eurodad analysis of survey responses. "Other including non-DAC member languages" comprises Belgium, Germany and Czech Republic.

The representative of the Afghan Women's Business Federation described the impact that the use of non-local languages can have. He said that, in Afghanistan, advertisements are usually just in English. He added that many businesspeople don't know English, and it is typical that businesses hire a staff member specifically to do their proposal writing and applications. Clearly the extra costs of hiring such staff members are likely to erode Afghan firms' ability to compete with Anglophone companies – and will rule some smaller Afghan businesses out of bidding altogether.

Box 4: A more positive example – Luxembourg

It is difficult to be categorical about good and bad practice without more in-depth investigation of individual donor projects and the contexts in which they are implemented.

Nonetheless, it is striking that Luxembourg seems not to fall foul of many of the common pitfalls that can prevent companies from the global south from participating in ODA procurement.[68] Based on the survey responses, Luxembourg avoids the very largest of contracts; it advertises all tenders through local outlets; and it gives preference to local tenders whenever there is a choice between bids that are otherwise equivalent.

These more flexible procurement practices correspond to better local procurement results. In 2015-2016 Luxembourg awarded 54 per cent of ODA contract value to suppliers based in LDCs or HIPCs – far ahead of the DAC average of 7 per cent.[69]

Further barriers

Our survey focused on a few key indicators, and it was beyond the scope of this work to map comprehensively the other barriers that firms in the global south face (although this would be an important area for future research). However, our enquiries did point out in passing some additional barriers that may warrant further attention.

First, two survey respondents and one expert interviewee highlighted that there can sometimes be a lack of procurement capacity in field offices. This is a particular missed opportunity, since field offices often have greater flexibility and stronger local knowledge and networks, which in theory makes them especially well placed to buy locally. It seems there may be scope for donors to invest more in training or recruitment to fill procurement capacity gaps at field office level.

Second, one respondent said that suppliers in the global south may suffer in the bidding process because they may be competing against suppliers from the global north that are exempt from Value Added Tax (VAT) in their home countries. In the long term, this would be an important observation to contribute to the on-going debate on taxation and ODA.[70] In the meantime, this seems a further argument in favour of donors taking a nuanced approach to procurement, one that factors in the potential whole-life benefits of local procurement, as well as any additional up-front costs.

Removing barriers: radical, but not unrealistic

Donors can take quick steps to resolve some of the barriers facing suppliers from the global south, such as always advertising tenders in the local media. However, really opening up ODA procurement, including for smaller and more marginalised local suppliers, will also require more radical changes. For example, donors need to invest in language skills within their agencies in order to advertise and manage contracts in local languages. Splitting contracts into smaller components, and working with contractors who cannot access the internet, requires extra investment in contract management teams.

These investments may sound unrealistic. But the alternative is to continue to exclude more marginalised suppliers, exacerbating the inequality that they experience. In the context of human rights standards and the Sustainable Development Goals, which both emphasise the role of ODA in tackling inequalities,[71] this alternative is even less tenable than making new investments.

Pioneering work by some organisations already shows what is possible. For example, the UN Development Programme in Somalia is exploring the possibility of setting up a service desk to allow people without the internet to participate in bidding, whilst also translating key documents into the Somali language.[72]

It is true that every investment in procurement teams carries an opportunity cost, and in exceptional circumstances there might be a strong case that the resources could achieve more for the reduction of inequalities if spent in other ways. However, in general the presumption should be that supporting marginalised local suppliers is a sound and very sustainable investment in inequality reduction, and exceptions should only be made if they have the full and informed support of local people, particularly those who are experiencing inequalities themselves.

Supply-side barriers: no reason for inaction

Challenges on the supply side loom large in donors' perceptions

We asked donor officials about their perceptions of the main barriers to local procurement. As the evidence presented above shows, suppliers from the global south face many barriers on the demand side, in the form of donor procurement policies that do not give them a fair chance. However, when it comes to perceptions, many officials focus instead on the supply side.

We asked survey respondents to list the three biggest barriers that stop local suppliers benefiting from local procurement. Of the 15 respondents who answered this question, 60 per cent mentioned at least one barrier relating to local supplier capacity. Three mentioned *only* supply-side barriers, without any mention of barriers on the donor side.

Building supply-side capacity, and procuring locally: two sides of the same coin

It was beyond the scope of this research to judge how far donor agency officials are accurate in their assessment that supply markets in the global south have capacity gaps. But what we can say is that, if gaps do exist, creatively structured local procurement can make an important contribution to filling them, as part of a gradual process of market development. The UK Independent Commission on Aid Impact recently made a similar recommendation in its review of procurement by the Department for International Development.[73] Possible approaches to capacity building may include arranging direct training and mentorship for staff, financing further education for managers and funding assets that will help companies deliver to a higher standard.[74]

Some donor agencies run dedicated private sector development programmes to foster local businesses, in the same countries where they spend significant sums of money through procurement. Depending on the sectoral focus of the business development programmes, this can offer strong opportunities for synergy – for example, by using business development programmes as an entry point to train local suppliers on the workings of donor tendering processes. However, anecdotal evidence from our interviews suggests this opportunity is sometimes missed, and that in practice, private sector development programmes and procurement tend to be dealt with in separate siloes.

Local procurement vs. environmental and social standards: a false choice

One particularly vexed question on the supply side is the matter of compliance with environmental and social standards. During our enquiries, donors or other experts sometimes suggested a choice had to be made between buying locally, and meeting their environmental and social commitments.

While it was outside the scope of this report to examine different firms' standards, we accept in principle that there may be contexts where local firms do not meet basic environmental and social benchmarks. And where this is the case, we agree that fundamental environmental sustainability and human rights concerns should not be compromised.

However, donors should never use environmental and social standards as a justification to write off the possibility of procuring locally, for two main reasons.

First, at a practical level, there are many different ways of assessing compliance with environmental and social standards, and donors cannot always be relied upon to select a proportionate approach that gives local suppliers a fair chance. One expert interviewee said that certain donors tended to rely on unnecessarily onerous processes to assess firms' standards – the equivalent of "using a sledgehammer to crack a nut". Such onerous requirements may even sometimes be used deliberately to disguise informal tying. For example, we have heard anecdotally of one donor that insisted on very high environmental standards in shipping – standards that only its own domestic companies already met.

Second, more fundamentally, ignoring local suppliers is counter-productive for sustainable, human rights-based development in the long term. Even if local suppliers really do not meet basic thresholds in the short term, donors should prioritise steps to build their capacity, with a view to buying locally in the near future. In this way they can leverage wider improvements in environmental and social standards that go beyond any individual programme, and they increase the likelihood that public procurement continues to promote environmental and social standards even after ODA providers withdraw.

We hope to return to the issue of environmentally and socially responsible procurement in more depth in a subsequent briefing.

Conclusions and Recommendations

Tied ODA robs people living in poverty of vital resources, of long-term economic opportunities, and of autonomy. We conservatively estimate that the immediate opportunity 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 even factoring in the far greater cost of missed opportunities to catalyse local economic, social and environmental development for the long term.

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.

At the start of this paper, we set out three principles that we would expect to see in high-impact ODA procurement: (i) the preferences of local people should guide all donor decisions; (ii) procurement should do no harm, but rather should serve as a force for good to tackle inequalities and incentivise positive behaviours; (iii) wherever possible, procurement should be seen as an opportunity to support long-term development in the community receiving ODA, including by channelling funds through local institutions and local businesses.

Focusing particularly on principles (i) and (iii), the preceding analysis has shown that current donor procurement falls far short of these basic expectations. In 2016 over half of all reported contracts were awarded back to firms in the donor country, whereas just 13 per cent of contracts implemented in the very poorest countries flowed to local companies (analysis by value). Recent changes to the ODA reporting rules on support for the private sector could make things even worse.

Urgent action is needed to set the untying agenda back on track, as the following recommendations set out.[75] If donors are serious about using scarce ODA resources to achieve maximum impact for the Sustainable Development Goals, these recommendations cannot wait.

(Note: the recommendations target actors in the global north, as that is where Eurodad's legitimacy and expertise is. However, we hope these recommendations will also be useful to governments, civil society members and other stakeholders in the global south, as they engage with northern governments to make the case for global south-led procurement).

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.** Democratic ownership ensures ODA is appropriate for local contexts; brings long-term dividends by strengthening local capacities and systems; and is essential for redressing historic power imbalances between the global north and global south. In a procurement context, democratic ownership means **favouring support to local budgets, and the use of local procurement systems for all aid modalities**. If, in exceptional cases, local people identify a compelling human rights, environmental, or development effectiveness reason why local systems cannot be used, donors should see this as a temporary measure, and should support locally-led interventions to improve systems for the long term.

However, even if donors are unable or unwilling to use country systems as the default option in the short term, and retain direct responsibility for procurement themselves, they should as a minimum:

2. **Untie all ODA**. Tying is the antithesis of democratic ownership. It is urgent that DAC members untie all ODA to all countries and all sectors.

3. **Ensure that procurement activities uphold obligations and commitments on human rights, decent work and environmental sustainability.** Public money used in ODA procurement must never do harm. On the contrary, it must incentivise private sector actors to comply with their responsibilities, and must disrupt – never exacerbate – inequalities.

   Donors should design proportionate and context-appropriate ways to verify suppliers' compliance with human rights, labour and environmental standards, in consultation with local civil society groups and with local suppliers themselves. They should invest in locally-led capacity building on human rights, decent work and environmental sustainability, to develop a wide pool of suppliers from whom they can procure locally.

   Strong policies on **responsible tax behaviour** are a prerequisite for fulfilling human rights obligations. 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. As an intermediate step, the donor should forward the country by country reports to all relevant tax authorities, including the local tax authorities, and eventually, this information should be placed in the public domain for all stakeholders to access. Donors should also support international initiatives to improve transparency over the ultimate 'beneficial' ownership of firms.

4. **Give local firms in the global south, especially smaller firms, a fair chance of winning ODA procurement contracts.** Where the context is right, buying from firms in the global south can stimulate a virtuous cycle of local economic growth. It is urgent to tackle well-known barriers that these firms face, including: inaccessible information, asymmetries in access to support networks such as embassies, unnecessary complexity, restrictive expectations in terms of company size and experience, unmanageable requirements for raising credit, and an excessive focus on short-term costs without fully considering the long-term benefits of buying locally. In addition, our research highlighted a pressing need for donors to:[76]

   – split tenders into smaller lots[77]

   – advertise tenders through local media outlets, using offline as well as online channels

   – advertise tenders in the main language of the area where the project will take place, as well as any minority languages favoured by marginalised supplier groups

   – build procurement staff capacity, particularly in field offices, to engage with local suppliers in a way that does not put up unnecessary barriers

   – explore amending any laws that restrict the countries eligible to benefit from ODA contracts (e.g. laws requiring that only the donor language be used for tendering).

   Donors should match these demand-side actions with supply-side work to build the capacity of local businesses, taking advantage of any synergies with private sector development programmes taking place in the same country.

Recommendations for international decision-making and norm-setting bodies

5. United Nations Member States from the global north and global south should **put forward an ambitious proposal for the steps that governments need to take to put an end to informally tied ODA**.[78] Informal tying holds back the contribution that scarce ODA resources can make to the Sustainable Development Goals. The proposal should reflect this urgency, by laying out concrete and exacting timescales for action.

6. The DAC should **tighten accountability over tying**. The DAC has a vital role to play in closing loopholes and holding laggards to account. Key steps include:

   – **Widening the scope of the *Recommendation on Untying***, so that it covers ODA to all countries and all sectors, and covers informal as well as formal tying.

   – **Toughening the requirement for DAC members to adhere to transparency provisions**, which call for *ex ante* notification of untied aid offers as well as reporting of *ex post* contract awards. Reporting on *ex post* contract awards has seen some improvement in recent years but remains very incomplete, and adherence to *ex ante* notification reporting is weaker still.[79]

   – **Producing an annual estimate of the value of informally tied ODA from each DAC member**, extrapolating from the transparency data on contract awards.

   – **Requiring DAC members to give a written explanation** whenever a contract is awarded to a firm in their own country, with particularly close scrutiny of in-donor awards of technical assistance.

   – Taking urgent steps to **analyse in detail the risks of informal tying associated with delivering ODA through private sector instruments, and to put in place comprehensive mitigations**.

   – **Giving greater emphasis to untying in the DAC peer review process**. Peer review teams should consider the full range of 'back door' tying risks exposed in this paper, including looking at available data on the beneficial ownership of firms that win contracts.

7. The Global Partnership for Effective Development Co-operation (GPEDC)[80] should **develop its qualitative reporting on untying ODA, to capture more information on informal, as well as formal, tying**. The GPEDC monitoring exercise draws global attention to development effectiveness issues, including untying, so it is important to be as comprehensive as possible. The GPEDC can do this by:

   – Including information on the value of ODA contracts awarded to companies in donor countries, as a counterpoint to formal tying data.

   – Encouraging governments in the global south to provide detailed comments on the extent to which reported levels of tied ODA correspond to their actual experience of procurement processes, and making recommendations for donors based on the findings.

   – Including analysis on how the new private sector instrument rules may affect informal tying.

Annex 1 — Methodology

This report draws on four main methods:

i. **Quantitative analysis** of data on ODA procurement. Key sources were the DAC's 2018 Report on the DAC *Untying Recommendation*,[81] the DAC's Creditor Reporting System database[82] and the European Commission's contract database.[83]

ii. **A review of key academic, official and practitioner literature**, identified through a combination of internet searches, correspondence with officials and recommendations from members of the expert reference group who advised on this report.

iii. A short qualitative **survey** on procurement practices distributed to officials in all DAC members' aid agencies.

iv. **Interviews** to triangulate and expand on findings from the preceding methods, with: three DAC member officials involved in procurement (two from long-established DAC members, one from a newer DAC member); officials from the DAC and Global Partnership for Effective Development Co-operation secretariats; experts from an independent scrutiny body in one DAC member country; one government official from an ODA recipient country; one representative from a business federation in an ODA recipient country; and a number of expert academics and civil society organisation practitioners.

Annex 2 — Estimate of total ODA procurement

This methodology draws closely on that used in Eurodad's 2011 report, *How to spend it*.[84]

- Total ODA procurement consists of three broad elements: (A) ODA spent on procurement by bilateral donors; (B) ODA spent on procurement by multilateral donors; and (C) ODA spent on procurement through the systems of recipient countries. We calculated an estimate for 2015, because this was the most recent year for which data was available across elements (A), (B) and (C).
- To calculate (A):
  - For most donors, we took 2015-2016 procurement values reported to the DAC as per Table 6 of the 2018 Report on the DAC Untying Recommendation. We then compared this with those donors' total bilateral spending within the scope of the Recommendation (as per Table 1 of the Report on the DAC Untying Recommendation) and made some minor adjustments for timing etc., to identify a proxy percentage for the total share of ODA spent on procurement by bilateral donors (83 per cent).
  - We identified that reporting by a few donors on procurement in 2015-16 appeared to be very incomplete (a judgemental assessment based on their reported procurement spending and reported total bilateral spending within the scope of the Recommendation, triangulated with data from the Creditor Reporting System on overall spending patterns, and from correspondence with donors). For these donors, we modelled the share of their ODA spent on procurement, by applying a percentage of 83 per cent to their total spending within the scope of the Recommendation.
  - Finally, we divided the total by two, to arrive at an estimate for spending in 2015 in isolation from 2016.
  - It should be noted that this approach is conservative, because it focuses on spending within the scope of the Recommendation, and also because it excludes procurement activities undertaken by civil society organisations in receipt of ODA grants.
- To calculate (B): we took total gross multilateral disbursements in 2015 from the DAC's Creditor Reporting System table DAC1,[85] but stripped out EU expenditure to avoid double counting since the EU is considered a bilateral DAC member, and its data is already included in element (A) above. We then applied the percentage of 83 per cent, calculated above, to these multilateral disbursements. This gave a total of $21.4 billion.

- To calculate (C), we took the share of "direct disbursements for the public sector" channelled through local procurement systems in recipient countries where this data is available, from monitoring data gathered by the Global Partnership for Effective Development Co-operation.[86] For 2015, this was 37 per cent. We then estimated the total value of "direct disbursements for the public sector" by applying a filter to the DAC Creditor Reporting System database. (We sense-checked this data against the data for a few countries in Global Partnership for Effective Development Co-operation's monitoring report, and this confirmed that our approach was conservative). We applied the percentage of 37 per cent to this total value of disbursements. This gave a total of $14.9 billion.
- Adding elements (A), (B) and (C) gave a grand total of $55.3 billion.
- We then compared this total with gross Real ODA disbursements for 2015 (i.e. total gross disbursements, less imputed student costs, debt relief, in-donor refugee costs and interest received – calculated from the DAC Creditor Reporting System database). This showed that, according to our estimates, 43.9 per cent of gross Real ODA disbursements in 2015 were spent on procurement.

Annex 3 — Detailed estimate of the value of ODA informally tied

- In 2015-16, eight donors reported awarding materially over 50 per cent of ODA contracts (by value) back to firms in their own countries – as shown in Table 1 in Section 3.[87] Focusing on just these eight donors, rather than all DAC members, produces a conservative estimate.
- We judged this to be strong *prima facie* evidence that these donors are not doing enough to stop informal tying. However, we also recognised that not all these contract awards could necessarily be regarded as tied. So we considered a range of scenarios: at most, we assumed that 75 per cent of contracts awarded in-donor were actually informally tied; at least, we assumed that only 50 per cent of contracts awarded in-donor were informally tied. So for example, if a donor awards 90 per cent of its contracts to domestic firms, then we would assume that between 45 per cent and 67.5 per cent of its contracts were informally tied – a conservative approach.
- For each of the eight donors, we took their estimated spending on contracts in 2016, extracted by applying filters to the disbursements data in DAC's Creditor Reporting System database. (Deciding which filters to use requires a degree of judgement, but we erred on the side of producing a low estimate, for caution).
- For each of the eight donors, we multiplied estimated contract spending by the share assumed to be tied, to arrive at an estimate for the total level of tied ODA (formal + informal).
- Finally, to avoid double counting, we compared our estimated level of tied ODA with that reported in Table 14 of the Report on the DAC Untying Recommendation. We took whichever value was higher, and excluded the other from the calculations.
- This gave an estimated level of tying in the range from $12.7-$14.4 billion for the eight donors in question. Adding this to the reported level of tying across other DAC donors gave a total in the range from $27.9-$29.6 billion.
- The total level of [formally] tied ODA actually reported to the DAC for 2016 was $25 billion. So it follows that the total level of informal tying in 2016 was in the range from $2.9-$4.6 billion (calculated as 27.9 minus 25, and 29.6 minus 25).

Annex 4 – Estimating the immediate cost of tying

- We modelled two scenarios – one where tying led to a price differential in 100 per cent of cases; and one where tying led to a price differential in just one third of cases.
- We assumed that, wherever there was a price differential, the additional cost of tying would be 22.5 per cent (the mid-point of the range estimated in the literature).
- In other words, if there is a price differential in 100 per cent of cases, then the cost tied = 1.225 x the cost untied. Based on this basic relationship, and our estimate of the total level of tied ODA in 2016, we then used algebra to work out the additional cost of tying in the different scenarios.

Annex 5 — Detailed calculations on the effect of tying on loan concessionality

This methodology is based on the work of Yassin.[88] The basic principles are that:

- The grant element (concessional part) of a loan is equal to: its face value LESS the present value of future repayments, expressed as a percentage of the face value.
- However, in the case of a tied ODA loan, the face value needs to be discounted, to allow for the additional costs of tying.

Looking at all ODA loans in 2015-2016:

- The average grant element reported by the DAC was 67.2 per cent.[89]
- So for a loan with a face value of $100 million, the present value of future repayments would be $32.8 million (i.e. $100 million – $67.2 million)
- However, if that loan was tied, assuming that tying adds 22.5 per cent to the cost of goods and services, then the discounted face value would become $100 million/1.225, i.e. $81.6 million.
- Then the grant element would be ($81.6 million – $32.8 million)/$81.6 million, i.e. 59.8 per cent. This is a reduction of more than 10 per cent relative to the grant element of 67.2 per cent reported by the DAC.

Looking at Japanese ODA loans in 2015-2016:

For loans only:

- The grant element of Japanese ODA loans was 78.7 per cent in 2015 and 2016.[90] Granular data that itemises the grant element for ODA loans separately in 2015 and 2016 is not available, but we can infer that it was probably slightly lower in 2016 – let us say, 77 per cent.[91]
- So for a loan with a face value of $100 million, the present value of future repayments would be $23 million (i.e. $100 million – $77 million).
- However, if the loan was tied, then the discounted face value would become $81.6 million.
- This gives a grant element of ($81.6 million – $23 million)/$81.6 million, i.e. 71.8 per cent.
- Japan extended $2.4 billion of tied ODA loans in 2016.[92]
- Because tying reduces the effective grant element, the value of these loans that is truly concessional would reduce to (77 per cent - 71.8 per cent) x $2.4 billion, i.e. $125 million.

For grants plus loans:

- In 2016, out of a total Japanese ODA package of $23.784 billion, the overall grant element (i.e. comprising grants + concessional loans) in 2016 was just on the margins of the DAC's target level (85.7 per cent vs. DAC target 86 per cent).[93]
- This equates to $20.383 billion (85.7 per cent x $23.784 billion).
- However, if the losses of $125 million from tying were deducted, this would decrease to $20.258 billion.
- This in turn would reduce the grant element of Japanese ODA to 85.2 per cent ($20.258 billion/$23.784 billion). This may sound a small change, but it is very material in the context – it means that, rather than rounding up to 86 per cent, the concessional element of Japanese ODA would now clearly round to 85 per cent, below the DAC's target threshold.

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2 Eurodad analysis of Organisation for Economic Co-operation and Development, Development Co-operation Directorate / Development Assistance Committee, '2018 Report on the DAC Untying Recommendation', 13 June 2018, http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/DCD-DAC(2018)12-REV2.en.pdf; OECD DAC Creditor Reporting System database, https://stats.oecd.org/Index.aspx?DataSetCode=CRS1; and OECD and UN Development Programme, 'Making Development Co-operation More Effective: 2016 Progress Report'. Please see Annex 2 for full workings.
3 Real ODA is a measure developed by Brian Tomlinson to capture the value of ODA that is genuinely available for initiatives to reduce poverty and inequalities in the global south. It is calculated as total ODA, less in-donor refugee costs; imputed student costs; debt relief; and interest repayments (source: OECD DAC Creditor Reporting System, Tables DAC 1 and DAC 2a: https://stats.oecd.org/index.aspx?DataSetCode=CRS1).
4 The other 66 per cent was used in diverse ways, including grants to civil society organisations, transfers to multilateral institutions and direct investment in private sector companies.
5 This could make an interesting follow-up report, since these forms of spending are not immune from manipulation to serve the economic interests of companies in donor countries, albeit in less direct ways than bilateral contract spending.
6 Alexandre Cote and Polly Meeks, "'Disability Is Always an Afterthought': Why Progress on Inclusion Demands Action on Budgets," July 2018, p6.
7 While it would be an exaggeration to say that all of the 'most marginalised' people are in a position to participate in markets as suppliers, the extent of their participation – and the role that public procurement can play in breaking down the barriers they face – is often underestimated. (For more analysis on the participation of highly marginalised people in markets, see J. Thorpe, A. Mathie and Y. Ghore, 'A typology of market-based approaches to include the most marginalised', 2017, https://www.ids.ac.uk/publication/a-typology-of-market-based-approaches-to-include-the-most-marginalised.
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10 Drawing on S.N. Nyeck, '(Out) Bidding Women: Public Procurement Reform Diffusion and Gender Equality in Africa'; Emilie Combaz, 'Models of gender-sensitive procurement used by international aid entities', 2018, https://assets.publishing.service.gov.uk/media/5b3b697fe5274a6ffac66ac3/Gender_sensitive_procuremt.pdf, accessed 4 September 2018; Megan Daigle, 'Making the Case for Macroeconomics and Gender Equality', 2016, https://static1.squarespace.com/static/536c4ee8e4b0b60bc6ca7c74/t/572b47268a65e2da126e6d07/1462454055330/Making+the+case+for+macroeconomics+and+gender+equality.pdf, accessed 4 September 2018.
11 See for example, Brian Tomlinson, 'Implementing a Human Rights Based Approach: Lessons from the Experience of Providers of International Assistance', 2017, http://aidwatchcanada.ca/wp-content/uploads/2017/11/Final-Implementing-a-HRBA-by-Providers.pdf.
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13 Global Partnership for Effective Development Co-operation, 'Making Development Co-Operation More Effective: 2016 Progress Report', 2016, http://www.undp.org/content/undp/en/home/librarypage/development-impact/making-development-co-operation-more-effective--2016-progress-re.html, accessed 4 September 2018. Table 9b. Granular data is not available to convert this figure into Real ODA terms.
14 Tying also exists in South-South co-operation. Donors from the global north have sometimes used this as an argument for tying their own ODA: they argue that they need to 'compete' with donors from the global south. However, this argument is just another illustration of the self-interested motives behind tying. If donors were really seeking to prioritise the "economic development and welfare of developing countries" (as per the DAC definition of ODA), then donors should be competing not to satisfy their own commercial objectives, but rather the development objectives of people in recipient countries, which are best served by ODA that is untied.
15 Organisation for Economic Co-operation and Development, Development Co-operation Directorate / Development Assistance Committee, "Revised DAC Recommendation on Untying Official Development Assistance to the Least Developed Countries and Heavily Indebted Poor Countries," 2008, http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/Revised%20DAC%20Recommendation%20on%20Untying%20Official%20Development%20Assistance%20to%20the%20Least%20Developed.pdf, accessed 4 September 2018; Organisation for Economic Co-operation and Development, 'The Paris Declaration on Aid Effectiveness and the Accra Agenda for Action', 2005 and 2008, http://www.oecd.org/dac/effectiveness/34428351.pdf, accessed 4 September 2018; 'Busan Partnership for Effective Development Co-operation' as above; United Nations, 'Monterrey Consensus on Financing for Development', 2002, http://www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf, accessed 4 September 2018; United Nations, 'Addis Ababa Action Agenda of the Third International Conference on Financing for Development', 2015, http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf, accessed 4 September 2018; Global Partnership for Effective Development Co-operation, 'Global Partnership for Effective Development Co-operation Nairobi Outcome Document', 2016, http://effectiveco-operation.org/wp-content/uploads/2016/11/HLM2-Outcome-Doc-Third-Draft-14-Nov-16.pdf, accessed 4 September 2018.
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24 Eurodad analysis of Organisation for Economic Co-operation and Development, Development Co-operation Directorate / Development Assistance Committee, '2018 Report on the DAC Untying Recommendation'.
25 Source: Eurodad analysis of the Organisation for Economic Co-operation and Development's Creditor Reporting System database. Comparing Real ODA with reported tied ODA is not a perfect like-for-like comparison, due to asymmetries in the treatment of debt relief and interest repayments. However our calculations based on available data indicate these nuances would not fundamentally undermine the meaningfulness of this

comparison.
26 Source: Eurodad analysis of the Creditor Reporting System database, as above.
27 Eurodad analysis of OECD DAC, Statistics on Resource Flows to Developing Countries, http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/statisticsonresourceflowstodevelopingcountries.htm, accessed 18 June 2018. We had to make some assumptions on interpreting the data, and there was not enough granular data to convert this figure to Real ODA, but these nuances are very unlikely to affect the overall finding that this value is less than the total value of tied ODA; if anything, more granular data would have been likely to reveal a more extreme comparison still.
28 In addition, this total excludes administrative costs and in-donor refugee costs, which are tied by nature and cannot be untied.
29 Eurodad analysis of Development Co-operation Directorate / Development Assistance Committee, '2018 Report on the DAC Untying Recommendation'.
30 Eurodad analysis of Development Initiatives' Development Data Hub, http://data.devinit.org/, accessed 5 September 2018.
31 The latter example was cited by one of our expert interviewees.
32 Organisation for Economic Co-operation and Development, Development Co-operation Directorate / Development Assistance Committee, '2018 Report on the DAC Untying Recommendation'.
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36 Excluding the EU. The EU reported that 51 per cent of its contracts, by value, went to firms in the 28 EU countries in 2016. While this is still a large number, and we would hope to see more contracts go to firms in the global south in future, we consider this represents a less extreme imbalance between in-donor and external bidders than if the same figure had been reported by one single country.
37 Organisation for Economic Co-operation and Development, Development Co-operation Directorate / Development Assistance Committee, '2018 Report on the DAC Untying Recommendation'.
38 Source: correspondence with colleagues in the OECD Development Co-operation Directorate.
39 Organisation for Economic Co-operation and Development, Development Co-operation Directorate / Development Assistance Committee, '2018 Report on the DAC Untying Recommendation'.
40 An academic reviewer of this paper pointed out that the reform of procurement laws in some African countries has allowed the subsidiaries of companies from the global north to obtain national status, so that they can participate in National Competitive Bidding. This opens up further room for benefits to flow to the global north even as contracts are nominally awarded to firms from the global south. (Source: personal correspondence).
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54 Source: 'Statistics on Resource Flows to Developing Countries', accessed 27 August 2018, http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/statisticsonresourceflowstodevelopingcountries.htm. Table 32. Granular data to convert this to Real ODA was not available, but had this been possible, the comparison would have been even more extreme.
55 It has sometimes been argued that the cost of tying may be wholly or partially offset by savings in administrative costs from simpler procurement processes. It was outside the scope of our research to look into the details of the evidence on such administrative costs in different contexts. However, this argument misses the point that the fundamental benefit of untying is the flexibility it brings to adapt procurement to different contexts and to balance competing objectives – including, but not limited to, cost reduction. Tying ODA in order to save administrative costs puts the cart before the horse – it means presuming that short-term cost savings should take precedence and prematurely foreclosing other procurement approaches, such as building up local markets that can deliver cost savings in the long term, before they have even been considered.
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63 However, this is a grey area: some of these donors' procurement spend, although small, is not trivial, and we note with gratitude that other donors with similar spending patterns did opt to share their data with us (for example, the Czech Republic and Slovakia).
64 One further donor attempted to respond but was thwarted by technical difficulties.
65 Calculated from Organisation for Economic Co-operation and Development, Development Co-operation Directorate / Development Assistance Committee, '2018 Report on the DAC Untying Recommendation', Table 14 and from analysis of the Organisation for Economic Co-operation and Development Creditor Reporting System database.
66 Based on exchange rates at 18 June 2018.
67 In addition, the Czech Republic uses Russian, Ukrainian and Bosnian for small contracts in those countries. However, Czech procurement law requires that larger contracts should be conducted via electronic tools that are currently only operated in Czech.
68 A second promising example is Belgium, which appears to share some of the same behaviours as Luxembourg, and which also seems to have awarded a relatively high share of contract value to firms in LDCs and HIPCs (51 per cent, based on the limited data reported).

69 The comparison requires a degree of caution, since Luxembourg does not report on 'individual expert contracts' – but available data from the Creditor Reporting System suggests this spending would not be enough to affect the overall conclusion that Luxembourg is substantially above the DAC average in terms of the share of its contracts going to suppliers in the poorest countries.
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73 See, for example, Independent Commission on Aid Impact, 'Achieving value for money through procurement', 2017, as above.
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75 The recommendations draw on both the findings in this report, and on earlier Eurodad work, including Ellmers, 'How to Spend It: Smart Procurement for More Effective Aid' and Polly Meeks, 'Unravelling Tied Aid'.
76 Given the long-term benefits of procuring locally, the cost of taking these steps should not be used as a justification for inaction, unless there are exceptional circumstances, and unless the local people (including the most marginalised) are in full agreement.
77 Whilst also reviewing sign-off thresholds if needed, to ensure that the use of smaller lots does not undermine controls associated with contracts that have a large total value.
78 i.e. ODA that is nominally open to bidding by suppliers from different countries, but where informal barriers in the procurement process give suppliers from the donor country an unfair advantage in practice (see Section 3 for more detail).
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85 See https://stats.oecd.org/Index.aspx?DataSetCode=CRS1#
86 Global Partnership for Effective Development Co-operation, 'Making Development Co-operation More Effective', p.50.
87 Excluding the EU. The EU reported that 51 per cent of its contracts, by value, went to firms in the 28 EU countries in 2016. While this is still a large number, and we would hope to see more contracts go to firms in the global south in future, we consider this represents a less extreme imbalance between in-donor and external bidders than if the same figure had been reported by one single country.
88 Yassin, 'Aid-Tying and the Real Value of Foreign Assistance: The Case of Sudan'.
89 'Statistics on Resource Flows to Developing Countries,' Table 20.
90 'Statistics on Resource Flows to Developing Countries,' Table 20.
91 Based on comparing the grant element for *all* ODA in 2015 and 2016, in 'Statistics on Resource Flows to Developing Countries', Table 21.
92 Source: Eurodad analysis of the OECD DAC Creditor Reporting System database.
93 'Statistics on Resource Flows to Developing Countries,' Table 21.

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All opinions are Eurodad's alone, and all errors and omissions are the responsibility of the author.

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