

DEVELOPMENT CENTRE STUDIES

THE TYING OF AID

BY
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DEVELOPMENT CENTRE
OF THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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PREFACE

The tying of aid has important consequences for developing countries. One of its negative effects, which have been recognised for years, is that it may increase costs to the recipient by as much as 20 to 30 per cent.

Among the arguments advanced in favour of continuing aid tying are those relating to the minimization of the negative effects of aid on the balance of payments position of donor countries. Since the beginning of the 1980s, employment considerations have also been an argument.

Although the debate on the tying of aid has been raging for some time, and the stakes for recipient countries in particular are known to be high, no systematic study of this policy area has been undertaken to date. This may be due to the fact that no widely applicable model exists to quantify the effects of aid tying in a methodical and rational fashion.

This volume therefore fills a gap. Professor Jepma explores the current literature on the tying of aid from both the conceptual and practical points of view, before going on to analyse the underlying economic and political motivations for its use.

The author is very careful in his conclusions, but I believe this important study does mean a step forward on the road to a satisfactory solution to the practice of aid tying.

Louis Emmerij
President of the OECD Development Centre
October 1990

EXECUTIVE SUMMARY

Systematic empirical research about the costs of aid tying to recipients is rather scanty. Due to the delicate relationship between donors and recipients, the issue has always been avoided. The relatively limited number of studies carried out in the field is also explained by the lack of reliable official statistics as well as the paucity of information concerning the degree of fungibility. Even if the effective size of tying could be calculated, it would still be difficult to determine what the recipient's economy would have looked like in its absence.

Tying Practices by Bilateral Donors: General Remarks

Three forms of tying exist: tying to specific development projects/programmes, to specific commodities/services to be procured, and to the country/region where procurement has to take place. One needs to make this distinction because the effects of the first two forms of "tying" may be analogous to the last one, upon which this report focuses.

The definitions of tied, partially tied and untied aid employed by the Development Assistance Committee (DAC) may seem quite straightforward at first glance, but they are rather difficult to apply when it comes to assessing the practice precisely. It is very hard to determine when and under what circumstances official development aid (ODA) is, in effect, tied.

It is not only critical to know to what extent a tying regime can be effectively imposed on the recipient. It is equally important to determine whether tying creates a net expansion in the volume of the donor's exports. Here, the debate focuses on the fungibility concept, that is, the degree to which tying results in non-additional export flows. If the flow of exports generated by tied aid is not additional, the tying regime is ineffective from an economic standpoint, even if tying is "effective" in terms of official definitions.

Although the degree of fungibility is a critical element for assessing the real impact of tying on the donor's economy, it is surprising to note how few serious studies have been conducted to examine this phenomenon. Current OECD statistics on aid tying are too recent to draw conclusions as to whether the practice has increased or not. A great deal of additional information is required concerning informal tying practices. If multilateral ODA is taken into account, and partially untied aid considered a separate category, the average level of formal tying of total ODA from DAC countries is approximately 40 per cent or less, while it is an estimated 50 per cent when these adjustments are not made.

Profiting from procurement based on the untied part of its own, as well as other untied ODA to the recipient, the total procurement for a particular donor country will generally exceed that which is based on tied aid alone.

On the basis of information on individual countries, it can be concluded that some 70 per cent of bilateral aid of the European Economic Community countries has led directly to procurement in the donor countries. This is roughly some 20 percentage points higher than procurement based on tied aid alone.

In 1986 the DAC approved a list of commonly accepted good procurement practices, most of which applied to procurement in general, rather than to procurement practices under tied aid only. Some of these practices were already being followed by most DAC members;

others, however, were not. It should be noted that most of the donors who authorise recipient procurement content themselves with the application of the Minimum Conditions for Effective International Competitive Bidding (ICB).

Some Aspects of Bilateral Aid Tying

Despite pleas to shift from tied aid to partially untied aid, the share of the latter in total bilateral ODA remains relatively small, judging from the statistics, and for most countries, practically negligible. Although a recent tendency for partially untied aid to increase has been witnessed, this has not necessarily meant heavier procurement in the less developed countries (LDCs). DAC figures reflect the heavy emphasis of aid programmes on improving social, administrative, and economic infrastructures. Infrastructure support currently accounts for over 50 per cent of ODA, a quarter of which is destined for educational purposes. Recent official information about tying of technical co-operation is rather scanty. OECD and donor country experts suggest that, in practice, the major part of technical co-operation is tied.

During the 1970s, most donors set up associated financing programmes. The bulk of the funds provided through these financing schemes are tied to procurement in the donor country, but exceptions are made for local cost financing. In the 1983-1987 period, between 3 and 4 per cent of DAC bilateral ODA was designated for operations of this type.

In 1983, the DAC formulated the first guiding principles on the use of aid in association with export credits and other market funds. Evidence exists that mixed credit facilities have a proportionally more positive impact on the donors' balance of payments than other forms of bilateral aid.

Even untied development aid may in the long run benefit the donor's own export interests, for indirectly, such aid may stimulate the recipient's economic growth and consequently, that country's imports, as well as encourage policies of a more externally-oriented nature.

There are many ways of *de facto* tying aid. The sectoral composition of aid projects may be such that it increases the chances of procurement in the donor country, even if aid is not officially tied.

Evidence clearly indicates areas of specialisation among the donors with respect to the particular activities supported in the developing countries as far as overall ODA is concerned. These areas of specialisation largely reflect the comparative advantages which donor countries enjoy. Apart from the sectoral distribution of aid, the types of activities supported is also significant. Balance-of-payments support, for example, offers much less opportunity for tying than project support. In particular, it is relatively easier to tie aid to capital development projects than to projects aimed at meeting basic human needs.

Recently, the volume of aid directed towards capital project financing seems to have substantially increased. Moreover, some donor countries, which had not been major supporters of capital projects in the past, are expanding their participation in this area. Mixed credits play a major role in financing this increase.

Tying and Multilateral Institutions

It is generally perceived that multilateral aid cannot be tied in the sense of imposing regional restrictions. This perception, however, is not entirely accurate. Tying percentages of multilateral aid are generally quite small, smaller in any case than those of bilateral aid. Moreover, multilateral institutions tend to apply clear and precise procurement rules, which also favour untying. Thus a shift from bilateral to multilateral aid may be expected to induce some overall movement towards untying.

Empirical research leads to the conclusion that bilateral aid allocations are made largely in support of the donors' perceived economic, political and security interests. By contrast, aid flows from multilateral sources are found to be allocated essentially in accordance with recipient needs criteria.

During the 1980s, the share of multilateral aid of total ODA stabilized at approximately 25 per cent. During this same period, the position of multilateral institutions was strengthened by new perceptions of development strategies: an orientation towards more policy-related lending, a stronger role for multilateral agencies in reinforcing the coherence of development programmes and policies, as well as towards greater co-financing. However, these new perceptions have not led to an increased share of multilateral aid of all DAC members as a group.

Even if the countries contributing to multilateral agencies are not strongly involved in the decision-making process regarding procurement of projects and programmes financed with multilateral lending, this does not signify that they are totally indifferent to these agencies' procurement practices. Consequently, many donors are very eager to obtain information about the actual procurement based on multilateral lending.

A country can make its contribution to the multinational institution dependent on the size of domestic procurement. This practice is considered rather unfashionable, however, and has rarely been applied. Procurement practices of individual donors may be involved in multilateral financing via co-financing activities between bilateral donors and multilateral institutions. This type of operation is expanding and may enhance tendencies towards untying for it obliges donors to improve their co-operation.

Explicitly or implicitly, most donors seem to hold the opinion that procurement based on multilateral aid should be equitably distributed, that is to say roughly corresponding to the donor country's contributions to multilateral agencies, and research suggests that most multilateral institutions apply reasonably fair procurement practices.

Economic Motives for Tying

As a result of the economic recession in the early 1980s, attention to the impact of tying on the donor economy shifted from concern about the balance of payments (BOP) to employment.

Tied aid represents only a small percentage of the donor countries' total exports. Thus, it is improbable that aid tying provides significant macro-economic benefits to any donor's domestic employment or BOP-aggregates. The case for tying is therefore essentially political rather than macro-economic. The former only applies to the impact of tying on the total exports of individual donors, not on the exports of individual sectors or business firms.

Evidently, on that level of aggregation, the advantages can be very substantial indeed. Empirical studies tend to support the hypothesis that tying benefits those areas of the donor economy which are already strong rather than bolstering weak sectors.

To assess the true net increase in exports due to aid tying, one needs to know the degree of fungibility, that is, the amount of exports which are financed by aid but which would have occurred anyway. No clear conclusion about the degree of fungibility can be drawn from existing empirical studies. It is evident, however, that this effect can be very substantial, attaining several tenths of percentage points.

Based on such evidence, the effect of tying on overall employment in the donor economy cannot possibly be substantial. Moreover, given the phenomenon of fungibility, it is not possible to arrive at more than rough estimates regarding the net increase in employment. Country studies have demonstrated that created employment generally represents only a small percentage of employment associated with exports to LDCs.

Political Motives for Tying

Several different motives determine the regional distribution of aid flows. Historical ties play a role, as do trade relations, geopolitical considerations, and cultural affinities. Although most donors give aid to quite a wide variety of recipients, the importance they attach to individual recipients clearly differs: donors support countries with which they have, or hope to have, strong ties.

According to empirical studies, donors' interests play the largest role in explaining the variation in bilateral aid flows. In multilateral aid, however, recipient need criteria clearly become more significant. In the 1970s, there was a substantial shift in the composition of total aid flows from DAC member countries, away from donor interest aid towards recipient need aid.

Tying of aid is a form of protectionism. Although recent literature has increasingly emphasized the political and economic aspects of protectionism, empirical literature on the impact of lobbying on tying practices is scanty. The practice is increasingly justified as defensive or retaliatory with regard to other donors. Associated financing practices have been explicitly motivated by this factor. Donor countries find themselves caught in a dilemma: those donors who initiate the process of untying damage their own interests if others do not follow. Collective and co-ordinated action on the part of donors would enhance the possibility of substantial untying. However, even if such steps were taken, it would not necessarily mean that all donors involved would gain; nor that potential gains would be equally distributed among the donors.

The possibility of partially untying bilateral aid in the EC should be seriously considered. Such a move would be in line with both the free market philosophy of the Community, and its basic objective to pursue development co-operation. Empirical research has demonstrated that such untying would not create major problems for the donors' economies, because the positive effects of tying are much smaller than is commonly assumed. The abolition of tying practices would therefore not affect EC countries' exports to LDCs in a significant way.

The Direct Costs of Tying to the Recipient

The costs of tying to the recipient depend on the degree to which the donor is able to impose its tied aid obligations effectively. In so far as fungibility undermines the donor's room to manoeuvre, the costs of tying will be less than might be expected at first sight. In so far as informal tying adds to the official tying rules, the opposite holds true. Lacking precise empirical information about the size of effective tying, one can only try to make rough estimates of the costs of tying to the recipient. Such approximations are rendered even more crude due to the added factor of indirect tying costs.

The costs to the recipient vary according to a certain number of parameters:

- the flexibility of substitution, in that the recipient country enjoys access to more than a single source of foreign funds;
- the extent to which such exploitation of substitution possibilities is permitted by the donor countries;
- the willingness and ability of the recipient country, via optimal procurement practices and related policies, to exploit such substitution possibilities by promoting competition among donors.

The price of aid-financed commodities/services procured in the donor country is just one out of a large number of delivery conditions that, together, determine their attractiveness to the recipients.

The actual costs of tying can be ascribed only partly to the tying practice of the donor; the remaining part is attributable to the procurement situation and the recipient's behaviour. To say that the costs of tying are uniquely ascribable to the donor's behaviour would be to exaggerate the role played by the latter. Empirical information about the voluntary acceptance of less than optimal supply conditions by the recipient is extremely scarce.

The issue of tying costs to the recipient does not easily lend itself to empirical testing, due to the difficulty in obtaining data on delivery prices, and in comparing them to the prices of comparable goods and services. The best way to assess the costs of tying to the recipient is to compare aid-financed deliveries with comparable deliveries not based on an explicit aid policy. However, there have been a limited number of systematic studies conducted along these lines.

Early work on the excess costs of tied aid to the recipients produced aggregate figures ranging between 10 and 30 per cent; however, much higher figures were recorded in certain individual cases. If one accepts 20 per cent as an approximate average, one can calculate the true value of development aid to the recipient, if, in addition, the average grant element and tied aid percentage are known.

Studies of the situation in the 1960s and 1970s have shown that tying reduced the real value of aid, in relation to its nominal value, by some 15 per cent. Although these early calculations may not automatically apply to the present situation, more recent empirical research indicates that 20 per cent may still serve as an approximate figure.

Although it is hard to compare the results of the more recent empirical studies assessing tying costs to recipients, an average of 15 to 30 per cent still seems to be the best aggregate estimate of the direct excess costs of tied aid. However, recent circumstantial evidence indicates that in individual cases, much higher, or even extreme, excess cost margins exist.

The Indirect Costs of Tying to the Recipients

For an overall assessment of the tying costs to the recipients, one must also take into consideration the several types of indirect costs involved. These include costs due to additional administrative overheads and delays, as well as those arising from a lack of donor co-ordination. In addition, several biases in aid policies may exist which, when taken together, all contribute to a devaluation of the aid from the recipient's point of view. One should therefore keep in mind that the direct cost factors in procurement, mentioned earlier, are only part of an overall picture which often renders tied aid a costly proposition to the recipients.

The following cost-raising distortions in the use of aid have been identified in the literature:

- a preference accorded to projects requiring major imports in areas of particular export interest to the donor;
- a corresponding bias against projects and programmes with low import content, such as rural development projects, and in particular those involving local-cost financing;
- a privileged place accorded to "commercially interesting" projects;
- impaired credibility of donors in the development policy dialogue with recipients;
- donor reluctance to channel aid through multilateral institutions.

The impact of these distortions may be such, that the goods and services offered are of low priority to the recipient, excessively capital-intensive, highly dependent on Western technologies, and import-oriented.

The literature has also indicated the donor's predilection for large-scale projects, if only for the sake of saving on administrative overheads. In a general way, this preference provokes the need for more technical assistance. In addition, there is a bias towards projects which are tangible and, therefore, enhance the prestige of the donor and/or recipient.

Donors often tend to provide insufficient financing of the local-cost component, thus transferring part of the bill, as well as the risks in case of unexpected adverse effects, to the local government, while also sometimes obliging the latter to revise its priorities.

One may argue that the key points to consider in evolving effective aid policies are, first of all, whether or not the project promotes development and fits into the country's socio-economic structure, as well as the duration of its impact. This is especially important, because the selection of projects to be financed with development aid will often be influenced by special interest groups in the donor country. Since there is no clear link between the developmental impact of aid and its tying, one cannot, *a priori*, conclude that tied aid, whether or not procured on competitive terms, is necessarily worse for the recipient than untied aid.

INTRODUCTION

Despite extensive discussions concerning the negative impact of tying of development aid, little progress has, in fact, been made towards undoing the practice. As early as 1972, the issue had already surfaced within the DAC and follow-up discussions fuelled primarily by the US delegation resulted in draft agreements on the unlinking of aid and on formal bidding procedures. These draft texts were not carried any further, however, mainly because of conflicting opinions regarding ensuing reporting obligations. As a result, little real progress was made during the 1970s towards untying bilateral aid and, in fact, the reduction in DAC tied aid in the 1970s is attributable to a shift from bilateral to multilateral aid funding (Coverdale and Healey, 1981, pp. 185-99).

The 1980s presents a similar picture to that of the 1970s. Tying has still not become a leading issue in the North-South dialogue nor has it been forcefully advanced, in general, for several reasons: an increase in non-project support and a concomitant decline in tied aid; the inconclusive nature of empirical estimates of the costs of tying; recipients' fear that the amount of aid provided would be diminished if they reacted too harshly; the possibility of eluding tied aid obligations by the recipients by using such aid to purchase goods from the donor which would have been procured anyway; as well as the political liabilities of foreign aid issues in donor countries. (A survey published in the *New York Times* of 31st October 1983, p. A18, indicated that the US public's desire to reduce foreign aid surpassed its fear of nuclear war. A 1980 US public opinion poll cited in the *1984 DAC Report*, p. 131, provided similar findings, 82 per cent of the respondents said foreign economic assistance should be reduced). On the other hand, some new forms of tying emerged during the 1970s and the early 1980s.

The purpose of this report is to provide a descriptive bibliography of the main aspects of tied aid. It focuses mainly on aid practices of OECD countries, responsible for over 80 per cent of ODA, but some attention will also be given to aid policies of multilateral organisations. To the extent possible, findings have been based on empirically-derived and quantitative information.

Part A of the study provides a conceptual framework and overview of tying practices: its forms, definitions and procedures; procurement practices, new forms of tying, as well as its measurement. Part B explores the economic and political motives underlying tied aid. The impact of tying on the donor countries' economies and the concept of fungibility are discussed. Political motivations, due to their importance are dealt with separately. The final part of the study presents insights gleaned from the literature concerning the costs of tying to the recipients, with a distinction made between direct and indirect costs. The former are the result of less than fully competitive tendering procedures and the recipients limited freedom in allocating funds; while the latter refers to administrative costs as well as to costs resulting from economic and political restructuring in the recipient countries, due to their involvement in aid relationships with the donors.

Overall, it should be noted that systematic empirical research about the costs of tying, in general, and for recipient countries in particular, is rather scanty. The issue of costs and benefits of development aid to both parties has always been rather sensitive because of the delicate relationship between donor and recipient – the recipient has no legal right to aid. Empirical weaknesses have also contributed to a lack of research in the field: official data on

tying are rather unreliable; little is known about the amount of fungibility, and even if the effective size of tying could be calculated, it would still be difficult to determine what the recipient's economy would look like in its absence, for one can only guess to what extent untying would affect the willingness of donors to give aid. Advanced simulation models are required to try to reach a world with less and less tied aid. The bulk of empirical literature in fact, focuses on case studies based on far more partial models, or on circumstantial evidence.

PART A

TYING PRACTICES

Forms of Tying

Tying of aid signifies that the recipient is in some way restricted in the allocation of the financial resources it receives in the form of an official grant or loan. As was already indicated by Bhagwati in 1967 (see also Hamilton, 1978), these restrictions may take different forms. Aid may be linked to a specific development project or programme, thus possibly limiting the local government's development policy options. The major share of both bilateral and multilateral aid is tied in this way. A second restriction, which is partially connected to the first, relates to the specific commodities and/or services which have to be financed with the help of the aid. Even if the donor does not directly oblige the recipient to make procurement in the donor country itself, the choice of the sectors supported can produce a similar result. However, the most commonly acknowledged way of restricting the allocation of aid is regional tying, that is, the recipient is required to make procurement in specific countries or regions, usually including in the donor country itself.

Although this report will deal primarily with regional tying, it is important to emphasize that three distinct forms of tying exist since the consequences of the first two forms may be indistinguishable from those of regional tying.

Until recently, the DAC distinguished several categories of regional tying in their Creditor Reporting System (CRS). The six categories defined were based upon the size and character of the regions or countries to which procurement was restricted. According to this classification scheme, untied aid consisted of: contributions to multilateral aid agencies with procurement possibilities in substantially all countries; bilateral flows directly financing imports whereby procurement is authorised in all OECD, and substantially all developing countries; flows not directly financing imports such as balance-of-payments support, local cost financing, debt relief, food aid, etc.; and the untied part of technical co-operation. Partially untied aid was defined as all bilateral flows directly financing imports wherein procurement is limited to the donor and to substantially all developing countries, as well as partially untied technical co-operation. All other ODA categories were considered tied aid.

Difficulties in obtaining data at such a detailed level from most of the donors led to a paring down of the classification scheme (for the main documents, see OECD DAC (83)29, DAC (87)27, DAC (88)10, and DAC (89)30). Currently, three main distinctions are made: tied ODA, untied ODA and partially untied ODA. In the DAC Guiding Principles on "Associated Financing and Tied and Partially Untied Official Development Assistance" (Press/A(87)23, April 1987), the following definitions are employed: untied ODA are loans

or grants which are in effect freely and fully available to finance procurement from substantially all developing countries and from OECD countries; funds for local cost financing are also considered to be untied aid. Tied ODA, instead, refers to loans or grants which are either in effect tied to the procurement of goods and services from the donor country, or which are subject to procurement modalities implying limited geographic procurement eligibility. Thus an aid regime which would allow the recipient the choice of procurement in any EC country – a regime which might be advocated in view of the creation of the European internal market – would constitute tied aid.

Obviously, commodities which have been purchased in the donor country and delivered to the recipient as goods ready for use on arrival (specified as aid-in-kind), are considered tied aid. The remaining part, usually referred to as partially untied ODA, is defined as loans or grants which are, in effect, tied to procurement of goods and services from the donor country and from a restricted number of countries including substantially all developing countries. In the latter case, the donor has to inform the DAC of the countries specifically eligible for procurement.

While these definitions may seem quite straightforward, in practice they are weak when it comes to precisely assessing the nature of tied aid relationships. The definitions themselves imply that tying is not only determined by formal agreements, but also informal understanding, or even as a secondary consequence of an arrangement already in effect. Clearly it is very hard to determine when and under what circumstances ODA is in effect tied, especially in the absence of any formal agreement. Examples of informal tying abound. The choice of programmes and projects and/or commodities and services financed has already been mentioned as an example. Another example is the potential impact of monetary unions between donors and recipients as is the case with the Franc zone between France and its former African colonies. Procurement procedures can also be a means to tie the aid effectively (for an overview of aid procedures, see OECD, *Compendium of Aid Procedures*, 1981). In addition, although difficult to substantiate, the phenomenon of "silent understanding" or "mutual interests" often based on bilateral relations which go beyond the donor-recipient aid relationship, does play an important role in spending practices; which, in turn, may be reinforced by the fact that the initiative in development projects is often taken by experts who are formally or informally involved with the donor's aid policy. Finally, informal tying may be the result of convenience combined with tradition: entering the phase of "shopping around" is not even considered because information costs are too high; Thus, traditional patterns of procurement tend to be reinforced.

The Amount of Tying

Prior to actually measuring the amount of tying of bilateral aid flows, some choices must be made:

- whether to consider "official tying" only or to attempt to calculate the amount of informal tying as well;
- whether to measure only the gross impact of procurement on donor country exports or to measure its effect on the net expansion of exports, as well;
- whether to focus on the tying regime of disbursements or on that of commitments, on all ODA or bilateral ODA only, on grants and grant-like contributions exclusively or also on loans, etc.

Clearly tying percentages will vary, depending on the conceptual framework established. (For an illuminating graphical presentation of the above-mentioned aspects of tying, see Germidis and Panayotopoulos, 1976, pp. 112-34).

Few explicit studies have been carried out to try to assess the degree of informal tying. Given the recent DAC CRS directives on tying, whereby informal tying is incorporated into the tying definition and thus into the reporting system, there should be no need to differentiate between formal and informal tying. However, given the wide-ranging interpretations of the definition of tying and despite the improvements in CRS reporting especially since 1984, it may nevertheless be worthwhile to try to assess the size of informal tying as objectively as possible. The need to assess the amount of informal tying is especially important since donors who dislike the reputation of being "heavy tiers", may create a downward bias in their reporting. Moreover, DAC experts themselves admit that on occasion they are forced to adjust the information received to the required format on the basis of "guesstimates".

One of the few studies which explicitly focused on assessing the size of informal tying was Jepma and De Haan, 1984, dealing with bilateral aid flows of the Netherlands from 1964 to 1980. Aid experts involved in reporting activities were asked to estimate the amount of actual (formal and informal) tying of bilateral aid per budget category. The numbers thus arrived at were subsequently used to determine a weighted average expressing the tying regime per individual recipient. This procedure was carried out for individual years and countries and was applied to 37 recipients. It turned out that the aggregate actual tying for the 1970-1980 period was 63 per cent. This figure was well above the corresponding official rate of 47 per cent as reported to the DAC. Unfortunately, no general conclusions can be drawn from the above study for lack of any corroborating research.

With regard to the impact of procurement on donor countries' exports, if tying is indeed meant to promote and expand the latter, then it is only relevant to the extent to which it achieves this goal. In other words, it is not only critical to determine whether a tying regime can be effectively imposed on the recipient; it is equally important to find out whether the impact of tying does, in fact, create a net expansion of the donor's exports. Here the discussion focuses on the fungibility concept, that is, to what extent tying results in non-additional export flows. One may assume that a portion of the exports financed by tied aid would have been delivered to the recipient even in the absence of such financing. If tied aid-financed flows are non-additional, the tying regime is, in fact, ineffective from an economic standpoint. This may be true even if tying is "effective" in terms of official definitions.

While the size of fungibility is critical to be able to assess the real impact of tying on the donor's economy, surprisingly few serious studies have tried to grapple with this phenomenon, primarily because such research arouses the criticism that the donor's main concern is self-interest. In addition, however, considerable methodological problems hinder the possibility of arriving at any solid conclusions. If one decides to derive the information from inquiries among the participants, one faces the question of the reliability of non-objective respondents. If, instead, one tries to derive the size of fungibility from *ex post* statistical data, one faces the issue of developing a suitable "antimonde". (For a more detailed discussion of the fungibility effect, see, in Part B, Tying and Comparative Advantage: Fungibility.)

Estimations of tied aid can also vary widely depending upon whether tying is specified for commitments or for disbursements. In the late 1980s the DAC changed its reporting procedures on tying focusing on commitments rather than on disbursements. Although information provided by the new system is somewhat more removed from the actual tying practice, the change was made to facilitate adjustments and corrections based on DAC-donor input (obviously this shift leads to a breach in time series data). The following example may help to illustrate to what extent the size of ODA disbursements can deviate from ODA commitments. In Germany's July 1988 reporting to the DAC, the data for bilateral ODA directly financing imports showed \$1 756 million and \$1 946 million for disbursements and commitments, respectively. The data for disbursements and commitments for aid-in-kind (\$106 million and \$116 million, respectively); ODA not directly financing imports (\$303 million and \$359 million, respectively); and technical co-operation (\$1,535 million and \$1,816 million, respectively) also showed noticeable differences. Overall, commitments exceeded disbursements by approximately 15 per cent (total bilateral aid: \$4,238 million versus \$3,700 million).

One should also distinguish between the tying of total ODA and the tying of bilateral ODA only. Tied aid usually represents a small component of multilateral ODA (see Table 3) and, as a result, the tied percentage of total ODA will be somewhat smaller than that of bilateral ODA only. This distinction also has an impact on the reporting of the tied status of commitments versus disbursements, because multilateral ODA is only reported in gross disbursements. OECD provides information on both tying percentages. The tables which follow represent the most recent information compiled with respect to the tying of ODA.

Table 1 summarizes the size of tied and partially untied ODA of 18 DAC members, excluding EC members. Its size increased considerably during the period 1985-1987, showing an increase of some 40 per cent in current dollars. This shift masks changes with respect to individual countries: US tied aid declined for example while it increased in the cases of France, Germany, Italy and most noticeably, Japan.

Table 2 reflects tying percentages of bilateral ODA commitments with percentages varying widely both among the donors and over the years. Figures range from approximately 10 to almost 100 per cent with relatively low levels of tying in evidence for Sweden, Denmark, Switzerland, and Norway; moderate levels in the cases of Germany, the Netherlands, New Zealand and Japan; and extensive tying of bilateral aid commitments prevalent in the United Kingdom, Italy, the United States, and to a lesser extent France. The results of the table do not, however, permit one to conclude that the degree of tying of bilateral ODA increased structurally during the interval considered.

In fact, official OECD statistics provide no definitive answer to the question whether or not tying has, in practice, increased. A great deal of additional information is needed especially concerning informal tying practices. The experience of aid experts may therefore provide valuable source information. With respect to the European situation, an overview of European country studies in the second half of the 1970s showed their conclusions to be largely unanimous (Stokke, 1984, p. 43): "Tying has been increasingly applied, and more overtly than before, during the second half of the 1970s, and even more so during the 1980s. Also other mechanisms to ensure a growing return flow have been in active use: old mechanisms have been expanded and new ones established. It is not clear, however, whether a similar conclusion can be drawn from the 1980s".

Table 3 reflects commitments of bilateral and multilateral ODA, as well as distinguishing partially untied aid (although the size of the latter is fairly small). As was previously noted, the tying percentages are smaller than the ones presented in Table 2, because multilateral aid commitments have been separated out from total bilateral ODA. A rough guess of total DAC ODA tying calculated in this way, leads one to conclude that the tying element constitutes approximately 40 per cent or less of total ODA rather than 50 per cent reflected in other estimates. The picture may also become relatively positive for certain countries.

Table 1 and Table 2

**TIED AND PARTIALLY UNTIED ODA COMMITMENTS, 1985-1987
(EXCLUDING ODA USED IN ASSOCIATED FINANCING)**

Country	million dollars			percentage		
	1985	1986	1987	1985	1986	1987
Australia	234	261	252	45	49	48
Austria	54	67	35	97	53	28
Belgium	74	239	222	63	75	57
Canada	617	636	795	56	54	48
Denmark	112	165	72	34	34	17
Finland	43	134	182	19	49	82
France	1 617	2 438	2 486	44	48	47
Germany	861	1 151	1 860	36	34	43
Ireland	12	18	18	-	-	-
Italy	800	1 770	1 941	69	76	62
Japan	1 776	1 735	3 203	44	40	44
Netherlands	242	506	733	35	39	43
New Zealand	10	13	23	22	38	45
Norway	98	117	161	30	21	31
Sweden	159	68	40	30	11	10
Switzerland	62	83	116	21	25	25
United Kingdom	471	665	835	69	62	58
United States	5 126	5 420	4 748	59	62	64
Total	12 368	15 486	17 722	48	50	51

Sources: DAC, CRS and Secretariat Estimates.

Table 3
Commitments (excluding administrative costs) Percentages of total ODA of each donor

Countries	Bilateral ODA				Multilateral				Proportion of ODA used for associated financing (e)			
	Of which: United* technical co-op. (a)	"Cash" (b)	United* import financing (c)	Partially untied* (c)	Of which Technical co-op.* (d)	Tied (d)	Of which Technical co-op. (e)	Excluding EEC (e)		Tied EEC (e)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Australia	32.4	27.5	0.7	3.0	-	-	34.7	20.7	23.6	9.3	-	1.8
Austria	1.8	0.2	0.2	0.9	-	-	72.6	27.1	23.9	1.7	-	-
Belgium	25.0	3.3	3.4	41.1	-	-	32.6	19.1	25.6	-	16.8	3.7
Canada (f)	27.6	-	8.8	-	3.9	-	29.5	0.7	33.4	5.6	-	2.1
Denmark	32.6	0.4	2.2	29.9	-	-	21.6	-	37.4	2.1	6.3	-
Finland	9.9	3.7	-	6.2	-	-	49.1	14.2	34.3	6.7	-	-
France	42.2	20.1	8.8	11.0	3.5	3.5	33.6	23.0	13.4	-	7.3	-
Germany	42.2	3.8	18.7	17.1	-	-	33.0	13.5	15.2	-	9.6	-
Ireland (g)	21.5	12.8	-	-	-	-	25.7	24.4	44.7	3.1	5.0	-
Italy	9.5	7.0	1.2	1.2	-	-	61.8	13.7	18.7	0.6	9.3	3.4
Japan	46.9	17.5	-	31.5	16.6	-	11.3	-	25.2	-	-	-
Netherlands	30.5	10.8	12.1	6.5	33.7	11.3	6.4	-	21.8	7.3	0.3	2.8
New Zealand	34.5	14.4	2.3	17.9	-	-	32.6	14.1	31.3	1.6	-	-
Norway	29.8	(1.7)	-	-	1.4	-	21.1	-	44.6	3.1	-	0.7
Sweden (g)	41.6	2.6	-	-	-	-	22.3	13.9	33.8	2.3	-	2.9
Switzerland	46.5	37.1	7.6	1.8	-	-	34.3	17.8	17.6	1.6	-	3.8
United Kingdom (g)	13.1	6.3	0.1	-	0.1	-	42.3	23.7	24.9	0.8	18.7	3.8
United States	26.3	26.3	-	-	36.6	-	16.3	13.5	19.1	1.7	-	-
Total DAC	(33.4)	(14.6)	(4.7)	..	(13.0)	(3.9)	(26.7)	(13.6)	(21.4)	(1.4)	(4.1)	1.0

Notes: a. Fully and freely available for essentially world-wide procurement.

b. Amounts not directly financing imports: budget and balance-of-payments support, local cost financing and debt relief.

c. Contributions available for procurement from donor and substantially all developing countries.

d. Mainly aid tied to procurement in the donor country, but also includes amounts available for procurement in several countries, but not widely enough to qualify as "partially untied".

e. On a disbursement basis.

f. 1986 gross disbursements.

g. Tying status of gross disbursements.

* Compliance with revised reporting instructions remains to be verified.

Source: OECD, DCD/89.1, (1st Revision), June 1989, Table 5, p. 7.

Procurement

Clearly official and informal tying of aid will usually benefit the donor's economic interests via procurement in the donor country. However, there is no *a priori* reason why the donor country could not benefit from some procurement based on the untied part of its own as well as other ODA to the recipient since procurement practices in general reflect the international division of labour and the resulting comparative advantages, but may also be influenced by "piggy-back" effects, economies of scale, information costs and tradition. Moreover, the complementarity of products and services may induce joint tied aid-financed and other procurement in the donor country. The net result is that total procurement will usually exceed the share based on tied aid alone.

Several studies have been carried out to determine the total procurement financed by the donor's aid. For the Netherlands, 78 per cent was revealed for the 1972-1976 period (Louisse, 1979). For the 1976-1981 period, percentages ranged from 91 to 70 per cent as reported in a White Paper issued by the country's Ministry of Foreign Affairs and debated in Parliament in 1981.

For the Federal Republic of Germany, the *London Times* of September 1970, reported that "four-fifths if not more of its official aid comes back in payment for German goods and services". A 1978 study by Grundmann concluded that an average of 77 per cent of bilateral ODA led to procurement from German firms directly in the 1960s and in the first half of the 1970s. A later study by Schumacher, 1981a, revealed a figure of approximately 70 per cent for the second half of the 1970s. May, Schumacher and Malek, 1986 (Table 2-3), reported an average figure of 70 per cent for the period 1978-1984 (63 per cent for capital aid and 81 per cent for technical aid). The same authors revealed (*op. cit.*, p. 31) that if orders financed by multilateral agencies, untied aid from other donors, and the indirectly induced demand for German products by third-party countries are also taken into account, total procurement exceeds the direct costs of the German aid programmes by some 16 per cent.

Similar estimates for the UK made by the Ministry of Foreign and Commonwealth Affairs for the year 1984 uncovered a figure of 74 per cent. May, Schumacher and Malek, 1986 (p. 2), estimated that approximately two-thirds of the bilateral aid expenditures for the period 1978-1984 resulted in procurement in the donor country. They concluded that if orders proceeding from the untied aid of other donors, including OPEC, together with the indirectly induced demand for exports by third-party countries are taken into account, the aggregate demand for both donors' goods and services exceeds the direct costs of their own aid programmes by some 25 per cent.

In Denmark, the Danish Ministry of Foreign Affairs provided an estimate of 68 per cent for the year 1984, in response to questions posed by the Parliament's Financial Commission.

On the basis of these individual country studies, one may conclude that some 70 per cent of bilateral aid of the EC countries has led directly to procurement in the donor countries. This figure is some 20 percentage points higher than procurement based on tied aid alone.

Competitive Bidding Procedures

Clearly, good procurement practices are critical to an effective aid programme both from the donor's and recipient's point of view. According to the DAC, procurement should be viewed as an integral part of the overall process of project selection, design and

implementation. If procurement of aid-financed goods and services from competitive sources is permitted, regardless of whether the development aid is tied, partially untied or untied, ostensibly both the recipient and the donor will reap benefits: the recipient in terms of the price, operation and maintenance of the goods and services acquired and the donor in terms of reinforcing optimal patterns of specialisation. As a result, in 1986 the DAC approved a list of commonly accepted good procurement practices (OECD, 1986 DAC Report), most of which applied to procurement in general, rather than procurement practices related to tied aid alone. Some of these practices were already being followed by most DAC members, others were not. In addition, "minimum conditions for effective international competitive bidding" have been formulated, which recipients are encouraged to apply in appropriate situations.

Most donors leave the major part of the task of carrying out aid-financed procurement to the recipient government (recipient procurement). Some DAC members, like Australia, Belgium, Canada, Finland, France, and Germany retain, at least for part of their aid, the responsibility for procurement (donor procurement); as is also the case for technical co-operation for Italy, Sweden, and the United States.

A review of procurement practices of individual DAC countries reveals the following trends:

- general procurement rules have been or will be published by the international financial institutions and DAC members;
- information on individual supply contracts is usually published, mainly in national newspapers and special magazines or circulars, or via Chambers of Commerce or comparable institutions;
- international lending institutions like the World Bank and the Inter-American Development Bank generally require international competitive bidding (ICB) from their borrowers, whereby eligible suppliers are usually the member countries;
- the application of ICB varies widely among DAC members. It is sometimes called for in cases of associated financing (Australia, Switzerland, the United Kingdom and the United States) or if requested by the recipients (Canada, the United Kingdom). In still other instances, ICB is required for all aid-financed procurement, (as is the case for Germany) or for untied ODA only, (which, for example, Sweden and Japan) require;
- national competitive bidding (NCB) is generally applied if the aid is tied and if the procurement is carried out by the donor; exceptions are usually made for small contracts for which NCB is not required. The size at which the contract is considered small varies considerably among DAC members (ranging from \$1 000 to \$200 000). France and the EC Commission expand the eligible suppliers beyond the national ones to include all enterprises in the Franc zone and the recipient, and to all EC and ACP countries, respectively;
- if competitive bidding is not applied, checks are usually carried out to ensure reasonable prices. The actual rules governing these control procedures are quite strict in some DAC members, while lenient or even non-existent in others. The rules are quite strict, particularly in the United States and Canada. In Canada a "fair price declaration" is always required, if there is no competitive bidding as well as in cases of sole sourcing. In the United States, suppliers are even obliged to certify that prices are reasonable. If audit checks by the Agency for International Development (AID) show overpricing, suppliers are obliged to refund the excess amount;

- direct negotiations, that is, without competition, are generally carried out only when specific circumstances demand it. The precise set of circumstances for which direct negotiations will be invoked depends upon the lending source. For example, the World Bank permits direct negotiations when existing contracts are extended; when there is a need for standardized or proprietary equipment; when delivery is urgent; or when competitive bidding has been unsuccessful. In Germany, direct contracts can be awarded for technical reasons or when competitive distortions exist. In Sweden, the lack of a sufficient number of potential Swedish suppliers can be a reason for direct negotiations. In the United States, direct negotiations are permitted in emergency situations, if procurement would cause unacceptable delays, or would impair the aid programmes for the recipient;
- inspection of goods by the buyer, either before or after delivery, is common commercial practice. A number of private firms have specialised in this field and offer their services to the governments of developing countries;
- rules of origin or of national content are, under tied or partially untied aid, generally applied by DAC members. Their specific forms, again, differ widely among the donors. The main differences concern the minimum national content percentages required and the conditions under which waivers are allowed. The latter are mainly permitted if non-eligible suppliers offer substantially lower prices, or if required for technical reasons.

Most of the donors who allow recipient procurement content themselves with the application of the Minimum Conditions for Effective ICB. These minimum conditions are designed to guarantee "effective international competitive bidding" and relate to the scope of advertising, the size of contracts (intended to prevent contracts from becoming too small for serious competition), pre-qualification of bidders to reach competent suppliers better, bidding documents, the time allowed for the preparation of bids and other bidding procedures, the evaluation and comparison of bids, the contract awards procedures, and its monitoring by independent experts.

In addition, efforts have been made by the donors to increase recipients' administrative capacities. The United Nations Institute for Training and Research (UNITAR) published a training manual on international procurement for officials from LDCs in 1974 which was revised in 1977 and again in 1985 (Westring, 1985). Similarly, the United Nations Conference on Trade and Development (UNCTAD)/General Agreement on Tariffs and Trade (GATT) published a "World Directory of Training Opportunities in Import Management and Procurement Techniques" for import managers in LDCs, which includes an extensive list of training institutions in both OECD and developing countries.

Tying and Bilateral Aid

Partially Untying Practices

In the CRS, six levels of partial tying used to be distinguished in reporting ODA gross disbursements, wherein procurement is limited to:

- a. the reporting and recipient countries;
- b. the reporting country and selected developing countries;
- c. the reporting country and any developing country;

- d. specified developed countries;
- e. specified developed and developing countries; and
- f. others (specify in "notes").

Category c corresponds to what is currently defined as "partially untied" aid according to the Guiding Principles; all the other modalities are now considered tied aid. From 1987 onwards, the tied status of ODA commitments (instead of disbursements) has been reported, although not yet by all member countries. The CRS directives have been revised to reflect the new definitions in the Guiding Principles.

Although some demands have recently been made (notably by Japan) to shift from tied aid to partially untied aid, the percentage of this form of aid is still relatively small, judging from available data. For most countries it is almost negligible. A recent OECD document for general distribution on "Associated Financing and Tied and Partially Untied ODA - DAC member countries' policies and practices" of June 1989, reflecting the 1987 situation, had only the following to say about actual partial untying: Belgium, "a small amount of ODA ... partially untied"; Canada, "6 per cent ... partially untied"; Finland, "5 per cent partially untied"; France, "4 per cent ... partially untied"; Japan, "28 per cent ... partially untied"; Netherlands, "44 per cent ... partially untied"; Norway, "2 per cent ... partially untied"; the United Kingdom, "a small amount partially untied"; and the United States, "13 per cent partially untied".

Although partially untied aid is generally on the rise, corresponding to official donor countries' objectives, this trend does not necessarily favour procurement in LDCs. For example, Japan, a country which generally supports partial untying, has been severely criticised for its protectionist behaviour. A case in point is the Japanese Overseas Economic Co-operation Fund (OECF) which until recently has "tied" the (LDC untied) engineering-consulting services of all projects to Japanese firms. As it is the engineering firm which draws up the detailed engineering specifications, and often manages procurement for the project, Japanese companies seemingly have an advantage in procurement bidding. Indeed with few exceptions there is no evidence that non-Japanese firms have been awarded contracts on big-ticket, high-technology components of capital projects (Preeg, 1989a, pp. 173-85). Similar practices take place in other donor countries as well.

Technical Co-Operation

Technical co-operation expenditures constitute an important part of official bilateral disbursements. According to the 1988 DAC report, net disbursements on technical co-operation amounted to \$7 490 million of a total bilateral ODA for the same year of \$26 214 million. Distribution by donor is illustrated in Table 4.

To get an idea of the emphasis donors put on increasing the stock of human intellectual capital in the recipients, or their capacity for more effective use of their existing factor endowment, one needs to focus on the aid objectives by sector for individual donors. These figures drawn from the *1988 DAC Report*, Statistical annex, table 20, pp. 192-3, demonstrate that improving the social, administrative, and economic infrastructure of recipient countries is heavily emphasized in the aid programmes. It currently accounts for over 50 per cent of ODA, one-fourth of which is earmarked for educational purposes. Commitments to social, administrative and economic infrastructure of total ODA in Austria, Belgium, Finland, Germany, Japan, Norway, Sweden, and the US and in EC multilateral finance, however, is less than 30 per cent.

The terms "technical co-operation" and "technical assistance" are often used indiscriminately. In the DAC reporting system, however, a distinction is made between the two concepts (DAC, *Statistics Reporting Directives*, February 1988a, p. 75 ff.). Technical co-operation is defined as activities whose primary purpose is to improve the level of knowledge, skills, technical know-how or productive attitudes of the LDC population through the supply of teachers, volunteers, experts, education, training, and advice. Technical assistance, on the other hand, refers to the input of labour or expertise provided as part of the implementation of a capital project. These are treated as financial resource flows in DAC statistics, and are sometimes reported separately.

In DAC reporting, however, the above distinction is not always obvious. Recent information about tying of technical co-operation provided in Table 3 shows that the major part of technical co-operation is formally tied. OECD and donor country experts suggested that in practice, the major part of technical co-operation is tied. Not only will technical assistance, as defined above, often be directly tied, it may also induce donor procurement of the accompanying (capital) project, especially if such assistance is employed in the phase of project development.

Associated Financing and Mixed Credits

In the course of the 1970s most donors started programmes in associated financing. During the 1983-1987 period, the DAC dedicated 3-4 per cent of bilateral ODA to such financing (see Table 5).

According to the definition contained in the *DAC Guiding Principles* for associated financing and tied and partially untied official development assistance, AF-transactions bring together in law or in fact two or more of the following forms of assistance: ODA, other official financing with a minimum grant element of at least 25 per cent, officially supported export credits; other official flows or funds with a grant element of less than 25 per cent. (OECD *Press Release*, press/A(87)23). Their main common characteristic is that either the non-concessional or the concessional component or the whole financing package, is in effect tied or partially untied.

In practice, the ODA component of mixed credits should always be considered tied aid. This definition does not affect the definition of ODA nor the modalities of reporting ODA. There are some differences among donors: some donors report only the concessional component as ODA, whereas others report the total package as such.

Because associated financing offers an excellent opportunity for the donor to serve its own export interests with the help of a domestic subsidy, it can easily develop into a protectionist device. The DAC, therefore, made several attempts to prevent associated financing from being misused on a large scale. In 1983, the first DAC guiding principles were formulated for the use of aid in association with export credits and other market funds. DAC guidelines stipulate that associated funding be confined to priority projects and programmes and its application carefully appraised against the development standards and criteria invoked for ODA, and which form part of the recipient country's development programmes. In this way the DAC tried to ensure that procurement would, indeed, be development oriented.

Table 4

TECHNICAL CO-OPERATION EXPENDITURE¹
Official Bilateral Disbursements by Individual Donors

Net Disbursements	\$ million						
Countries	1970	1980	1983	1984	1985	1986	1987
Australia	13	54	99	164	189	176	180
Austria	3	31	38	26	27	39	-
Belgium	51	226	129	99	105	137	-
Canada	41	99	118	102	251	234	-
Denmark	12	105	116	51	48	70	65
Finland	12	33	42	41	54	70	21
France	438	1 825	1 608	1 511	1 521	1 975	2 369
Germany	190	991	834	877	876	1 230	1 535
Ireland	-	5	6	6	7	13	13
Italy	15	55	152	210	267	412	404
Japan	22	278	385	438	422	599	853
Netherlands	38	328	294	268	266	386	543
New Zealand	-	27	14	10	10	14	15
Norway	4	42	40	41	43	57	84
Sweden	21	109	142	108	121	103	185
Switzerland	2	34	31	36	31	60	75
United Kingdom	109	507	345	311	333	404	462
United States	578	734	1 446	1 617	1 464	1 511	1 749
Total DAC	1 537	5 483	5 839	5 916	6 035	7 490	-

Note : 1. Including technical co-operation loans.

Source : OECD, 1988 DAC Report, p. 196.

Table 5

ASSOCIATED FINANCING (AF)/ODA

DAC countries	1983/84	1985	1986	1987
Australia	1	2	1	2
Austria	-	-	-	-
Belgium	1	5	..	+
Canada	10	2	1	1
Denmark	-	6	12	-
Finland	-	-	4	-
France	11	14	10	6
Germany	1	-	-	-
Ireland	-	-	-	-
Italy	11	13	5	10
Japan	1	1	1	+
Netherlands	6	5	2	6
New Zealand	-	-	-	-
Norway	+	-	-	-
Sweden	3	5	9	7
Switzerland	1	12	5	10
United Kingdom	14	3	13	4
United States	-	-	-	-
Total DAC	4	4	3	3

Note : "+" means less than half the smallest unit shown.

Source : OECD Secretariat; OECD, 1985c, p. 246; DAC, CRS and Secretariat estimates.

In addition, DAC guidelines established a figure of in excess of 20 per cent for the grant portion of associated financing. This figure was increased to 25 per cent in 1985, and since 15th July 1988 has been set at 35 per cent for LDCs and 50 per cent for the Least Developed Countries. Precise regulations have also been drawn up with respect to the discount rate used for calculating the concession level, relating it to movements in market interest rates rather than to a fixed percentage. Overall, considerable progress has been made towards improving transparency, and increasing co-operation between aid and export credit agencies, both within national governments and in the OECD (OECD, *DAC Review 1985*, p. 245).

In order to assess how effective the subsidy can be in promoting exports, attempts were made to calculate the "leverage factor", that is, how many export credits could be provided with a given amount of aid. If a small subsidy enables a substantial procurement, the tying element could, in theory surpass the amount of the subsidy itself. Several estimates of the leverage factor have been made. In a study by May, Schumacher and Malek, 1989, total exports based on mixed credits were found to be some five times as large as the subsidised part. A similar result was also reported in the House of Commons Foreign Affairs Committee's Second Report, (Session 1981/82, H.M.S.O. (HC 330) p. 13). Toye and Clark (1986, pp. 298-9), however, clearly indicate that the leverage factor cannot simply be derived by dividing the export contracts' worth by aid allocated through an associated financing scheme for one needs to make adjustments to account for additional subsidies, defaults on contracts, subcontracting activities, and for the fact that some exports would have occurred anyway. They nevertheless conclude that the UK's mixed credit facility, Aid and Trade Provision (ATP), "has a larger proportionate positive impact on the UK's balance of payments than non-ATP bilateral aid of which only about 50 to 60 per cent has been tied" (at least formally).

The June 1989 OECD Report, *Associated Financing and Tied and Partially Untied ODA*, cited previously, provides an overview of the tying component of associated financing for DAC countries (see appendix 2). In one fashion or another, all DAC countries with the exception of Ireland and New Zealand, associate general budget with other funds for aid purposes. Most of the facilities provide for two separate financial transactions with the recipient country, but some combine funds from different sources under a single loan contract. Not all schemes imply the use of ODA, nor that of export credits. Moreover, some countries associate ODA with export credits on a regular basis, while others on an *ad hoc* basis only and that, mainly for "matching" purposes, that is, to support national exporters competing against foreign offers where official financial support is involved.

Whenever budget funds are involved in a financial transaction for a given project in a developing country, the agency administering development/assistance for this country participates, to a varying degree, in project appraisal and decision-making. The bulk of the funds provided are tied to procurement in the donor country, but exceptions for local cost financing frequently occur. In addition, several donors including Australia, Finland, Germany, Italy, Japan, Sweden, Switzerland, the United Kingdom and the United States require, at least in principle, that the suppliers of goods and/or services be chosen in a process of international or national competitive bidding prior to financing.

Other Types of Tying

It can be argued that development aid will, in the long run, benefit the donors' own export interests: for indirectly, it may stimulate economic growth and thus imports as well as more externally-oriented policies in the recipient countries. These indirect effects have in some cases been an important rationale for relating economic aid to growth in trade as a study by Preeg (1989a, p. 175) on US aid to Asia illustrates: "South Korea (now) imports more US farm products in one year than the cumulative total of past US economic assistance to that country". Similar effects may result if aid policies successfully introduce Western consumption patterns in the LDCs, even if, in these cases, aid is not literally tied.

There are other ways of *de facto* tying of aid, even on a short-term basis. The sectorial composition of aid projects can be such that it increases the chances of procurement in the donor country, even if aid is not officially tied. More precisely donors may emphasize support for those sectors in the recipients which require deliveries of goods and services which correspond to their own comparative advantages. In 1986, Jepma and Bartels published one of the few studies to empirically assess the scope of this phenomenon. Total foreign aid of five European donors (Germany, France, the United Kingdom, the Netherlands, and Denmark), to 11 major recipient countries was divided over 18 sectors of destination for the period 1978-1983. The pattern of sectorial distribution of aid was subsequently compared with that of all countries, both for total aid as well as for the tied and untied portions only. These findings were then compared with indicators of the comparative advantages of the individual donor countries, derived from trade statistics. On this basis, the authors hoped to determine whether the sectorial pattern of allocation in general, is designed to support the strong sectors of the donor's economy, and whether there is a significant difference in these patterns between the tied and the untied components of aid packages.

The following major findings were revealed:

- clearly, there exist areas of specialisation among the donors with respect to the particular activities supported in the developing countries (as far as overall ODA is concerned). They mainly seem to reflect the donor countries' comparative advantages. Agriculture provides a clear illustration of this patterning of ODA: Denmark and the Netherlands strongly support activities in this field; Germany, for example, pays it relatively little attention while France and the United Kingdom provide moderate levels of support. The pattern is equally visible in many other sectors: the UK favours extraction industries; Denmark (with its relatively large fertilizer industries) and Germany favour chemicals as well as basic metal industries in the case of the latter.
- the result of a Pearson correlation analysis, applied to the same data, on the sectorial pattern of the tied and untied parts of aid allocation, revealed correlation co-efficients ranging from 0.31 for Germany to 0.64 for the Netherlands. These findings support the hypothesis that some donors more than others try to protect their weak industries through tying, for one would expect low correlation co-efficients if tying is designed to support exports to developing countries of those sectors that would not otherwise be able to successfully penetrate these markets. The fact that Germany ranks lowest may be attributed to this country's official policy of using tying to protect its railroad and ship-building sectors. Denmark, the United Kingdom, and France whose co-efficients fluctuated around the average, take no formal stand in this respect. The relatively high correlation

in the Netherlands reflects the general opinion that tying should not frustrate the pattern of specialisation with regard to the country's comparative advantages. Further empirical evidence on the Netherlands is provided in a study by Van Pelt, 1985.

Apart from the sectorial distribution of aid, the types of activities supported are also significant. Balance-of-payments support, for example, offers much less opportunity for tying than project support. In the case of US aid, certain kinds of balance-of-payments support are associated with overall levels of US imports. Israel, for example, committed itself to import US goods at a level at least as high as US economic assistance (\$1.2 billion for FY 1988). In fact, the US exported \$3.1 billion to Israel in 1987, so that the "tying element" was ineffective. Within the category of project support, again, the possibilities for imposing a tying regime differ widely. Capital project assistance, for example, seems to be a form of aid which can be tied relatively easily, whereas this is much less so in the case of basic human needs projects.

Table 6 clearly illustrates the donors' widely divergent emphases: the large share of aid allocated to programme assistance by Australia and the United States, for example, contrasts sharply with the strong emphasis on economic infrastructure in Japanese ODA.

Some people in the United States feel that their export interests are damaged by their relatively liberal approach towards aid policy, their relatively large share of bop support, and their low share of capital projects especially when compared to the aggressive tied aid credit programmes of other donors. A report on tied aid credit practices transmitted to Congress by the American Exim Bank in April 1989, suggested that the United States may be experiencing only a \$400 million to \$800 million loss in sales each year because of tied aid credits of other donors. It is therefore concluded that there are no "aggregate trends that imply noticeably adverse effects on either US market share or industrial structure" (Exim Bank, Chapter 5, p. 2). In the interim, these figures have been challenged; it has even been suggested that substantially larger figures, ranging from \$2 402 million to \$4 797 million may be produced using the same basic data. (Preeg, 1989b, pp. 1-7).

Capital projects are traditionally relatively large, involving a high proportion of imported capital goods, and a high level of technology as in the fields of energy, telecommunications and transport. In some donor countries, the share of total ODA of these kinds of projects is relatively small as is the case of the United States while in others, for example Japan, such projects tend to dominate the aid picture. If capital projects in the three above-mentioned sectors are expressed as a percentage of total bilateral economic assistance, the following figures are revealed for the years 1985-1986: Japan, 45.8 per cent; Denmark, 33 per cent; Norway, 22.5 per cent; Germany, 20.8 per cent; Italy, 17 per cent; the United Kingdom, 15.4 per cent; Canada, 14 per cent; Sweden, 13.3 per cent; France, 13 per cent; and the United States, 2.3 per cent. (It should be noted, however, that the majority of these kinds of projects, with the exception of telecommunications, are financed through multilateral institutions on the basis of international competitive bidding, at commercial rates). At the time of writing, the size of capital projects financing seemed to show a substantial upward trend, especially in Germany, Italy and Japan. Moreover, some donor countries such as Australia, Canada and the United Kingdom which had not been major supporters of capital projects in the past, are expanding their role in this area. Mixed credits seem to play a major role in financing this increase.

Table 6

AID BY MAJOR PURPOSES (COMMITMENTS), 1987

	Per cent of total										
	Australia	Austria ¹	Belgium ¹	Canada ¹	Denmark	Finland ¹	France ¹	Germany	Ireland	Italy	Japan ¹
Social and administrative infrastructure	27.7	43.8	46.2	15.5	20.6	23.9	42.5	32.1	46.9	21.4	18.5
Education ¹	19.8	38.4	28.6	8.1	3.6	7.7	26.5	19.0	22.0	3.9	8.1
Health & population	1.1	2.3	8.8	2.4	6.8	14.3	4.4	2.4	10.2	8.7	3.7
Planning and public administration	4.6	0.2	2.8	1.0	0.1	1.4	5.2	3.1	5.5	1.7	0.7
Other (including water supply)	2.1	2.9	6.0	4.0	10.2	0.5	6.4	7.6	9.2	7.1	6.0
Economic infrastructure	7.5	30.5	13.9	13.9	15.9	27.7	17.6	26.2	0.4	21.8	37.3
Transport and communication	6.4	2.3	9.9	9.5	13.8	0.0	11.1	15.5	0.4	6.4	22.0
Energy	0.3	27.0	3.4	4.3	-	22.6	2.6	10.6	-	14.2	12.3
Other	0.8	1.2	0.6	0.0	2.1	5.1	3.9	0.1	x	1.2	3.0
Production	10.2	13.9	20.0	27.1	15.5	38.3	16.4	22.7	22.7	26.8	26.6
Agriculture	8.2	3.0	11.7	18.8	10.8	19.7	10.1	10.8	17.2	18.3	14.2
Industry, mining and construction	1.6	9.7	5.2	7.8	4.5	12.5	4.3	9.1	-	8.4	10.9
Trade, banking, tourism	0.4	0.3	2.5	0.5	0.2	1.0	0.1	2.8	-	0.1	0.6
Other	-	0.8	0.6	0.0	-	5.1	1.9	-	-	-	0.9
Multisector	2.5	0.0	1.6	2.8	0.2	2.5	5.9	4.7	-	7.7	1.7
Programme assistance	38.7	0.0	3.5	6.4	18.2	0.0	7.1	4.7	-	5.6	8.3
Debt relief	-	0.2	0.0	0.1	1.6	0.0	6.9	0.8	-	5.7	3.2
Food aid	7.2	7.0	4.0	12.9	-	0.3	1.0	2.9	-	4.2	1.4
Emergency aid (other than food aid)	0.7	4.5	0.3	3.5	-	0.9	0.1	0.7	4.0	4.4	0.1
Administrative expenses	3.8	0.0	5.3	6.6	-	2.8	2.5	1.5	11.0	2.0	2.9
Unspecified	1.7	0.0	5.1	11.2	28.0	3.5	0.1	3.6	15.0	0.4	0.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Of which: technical assistance ¹	34.2	45.3	38.1	13.8	(20.0)	24.4	(46.5)	35.7	100.0	15.7	14.7
Students and trainees	16.0	30.5	2.8	2.3	-	1.8	(6.4)	8.0	-	2.6	3.7
Experts and volunteers	9.5	12.2	19.4	5.3	-	2.0	(39.2)	11.1	-	3.4	6.3
Research	3.7	0.7	0.2	4.1	-	0.3	-	1.9	-	1.7	0.2
Other	5.0	1.8	(15.7)	2.1	-	20.2	(0.9)	14.7	-	7.9	4.5
Memo item:											
Contributions to NGOs (included in above)	0.8	1.7	7.9	13.8	(3.9)	2.3	1.1	-	12.5	2.9	1.6

Table 6 (continued)

	Nether-lands	New Zealand	Norway	Sweden	Switzer-land	United Kingdom ¹	United States ¹	Total DAC ²	Multilateral finance (ODEY)				UN agencies
									Total	EEC	World Bank	UN	
Social and administrative infrastructure	18.9	44.0	39.2	17.3	17.3	26.8	17.5	24.2	19.9	11.3	20.8	27.9	
Education ³	5.0	29.4	10.8	6.7	7.9	12.8	3.8	10.6	4.3	3.8	4.9	2.6	
Health & population	3.3	1.9	11.2	5.8	3.7	4.3	6.9	5.2	7.8	2.6	6.1	19.1	
Planning and public administration	1.2	8.8	x	1.3	1.0	2.3	1.4	2.1	0.5	-	-	4.4	
Other (including water supply)	9.4	3.9	17.1	3.5	4.7	7.4	5.4	6.3	7.3	4.9	9.8	1.8	
Economic infrastructure	17.0	4.8	17.8	10.4	13.9	19.2	3.2	17.2	30.4	16.8	35.0	5.9	
Transport and communication	14.1	2.7	1.6	4.0	4.6	4.6	1.6	9.3	11.3	9.9	12.8	3.8	
Energy	0.7	1.9	15.2	5.6	2.9	6.1	0.7	6.1	18.8	5.8	22.2	-	
Other	2.1	0.2	1.0	0.7	6.3	8.5	0.9	1.8	0.3	1.1	-	2.1	
Production	30.1	13.8	26.7	21.6	24.9	27.2	16.3	21.6	36.6	40.2	36.3	16.6	
Agriculture	23.3	10.9	13.9	12.6	20.2	10.2	11.2	13.2	23.2	24.3	23.3	9.6	
Industry, mining and construction	4.8	1.1	12.8	8.2	1.5	10.4	0.3	5.6	9.3	10.3	8.0	3.8	
Trade, banking, tourism	2.0	1.8	x	0.8	3.2	1.1	3.9	1.9	3.8	5.6	5.0	1.2	
Other	-	-	-	-	-	5.5	0.9	0.8	0.2	-	-	2.0	
Multisector	2.1	0.3	6.4	1.8	3.1	0.8	0.3	2.9	-	-	-	-	
Programme assistance	12.4	24.9	9.6	15.7	15.5	9.4	41.7	17.7	5.4	7	7.5	-	
Debt Relief	1.8	-	-	-	-	4.6	0.5	2.5	-	-	-	-	
Food aid	1.7	1.0	-	0.3	4.7	2.6	12.9	5.7	3.3	13.0	-	20.7	
Emergency aid (other than food aid)	1.6	0.6	0.1	14.8	13.9	3.9	2.3	2.2	2.4	1.4	-	19.6	
Administrative expenses	4.1	-	-	4.0	-	5.5	5.3	3.5	0.2	3.2	-	-	
Unspecified	10.3	10.6	0.2	14.1	6.7	0.0	0.0	2.5	1.8	2.4	0.4	9.3	
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	
Of which: Technical assistance ³	31.8	24.4	(21.0)	18.7	(74.8)	40.7	16.6	24.6					
Students and trainees	1.3	(17.5)	x	x	..	9.3	1.4	3.8					
Experts and volunteers	5.4	6.9	..	4.9	..	11.7	10.7	11.8					
Research	1.2	-	..	4.1	..	2.8	3.0	1.8					
Other	23.9	-	..	9.7	..	16.9	1.5	7.2					
Memo item:													
Contributions to NGOs (included in above)	(8.0)	1.1	15.5	8.5	21.2	2.2	9.0	5.1					

Notes: 1 1985-1986 average. 2 Including students and trainees.

Sources: OECD, 1988 DAC Report, pp. 192-3. 3 Calculated from disbursements data. p Partially united aid.

In April 1988, Japan introduced a policy to promote general untying of consulting services. In addition, the government decided to gradually apply this policy to loans made to upper middle-income countries (starting with FY 1988) as well as to Thailand, the Philippines and Papua New Guinea (beginning in FY 1990). Foreign consultants have also been permitted to play a supporting role to Japanese consulting firms in the procurement of services for the development surveys of the Japan International Co-operation Agency (JICA). In April 1987, the government started untying the engineering consultancy loans to South Korea and Malaysia, and announced it would do the same for the Philippines and Thailand around 1990.

The extent to which Japan applies tying practices more rigorously than others is still heavily debated. Evidence on Japanese protectionism is ambiguous. Due to its industrial structure and consumer preferences, however, one may assume that the level of Japanese manufactured imports is lower than would be the case if its markets were as open as those of other developed countries (Kreinin, 1988, pp. 529-42; Balassa, 1986, pp. 745-90; Lawrence, 1987).

The strictly tied nature of capital projects has led the United States, among others, to propose a general reciprocal untying of capital projects, starting with projects of minimum size and in selected sectors. Untying was also to include the consultancy engineering component. This proposal met with considerable resistance on the part of other donors, however, claiming that they would lose their domestic constituency support.

Tying and Multilateral Aid

It is generally perceived that multilateral aid cannot be tied in the sense of imposing regional restrictions. Indeed, DAC members generally agree that contributions to multilateral programmes should be untied. However, what is practised does not always accord with what is preached or generally perceived. Regional development banks, for example, may restrict the number of countries eligible for procurement in such a way that the condition that procurement be possible in substantially all developing countries is no longer fulfilled. Multilateral aid thus becomes tied aid (see also Table 3).

As illustrated in Table 3, tied percentages of multilateral aid are generally quite small; smaller in any case than those of bilateral aid. Moreover, multilateral institutions tend to apply clear and precise procurement rules, which also favour untying. Thus a shift from bilateral to multilateral aid may be expected to induce some overall movement towards untying (as was also noted in a recent draft study carried out under the auspices of the UNDP/Government of Pakistan). Indeed, such a shift did take place, notably in the 1970s: the average share of ODA contributions to multilateral development agencies as a percentage of total ODA increased from 14.5 per cent in 1970-1971 to 25.7 per cent in 1979-1980.

Maizels and Nissanke in their 1984 study conclude (pp. 879-897) that the trend towards multilateral financing which occurred in the 1970s has contributed to a shift away from what they call "donor interest aid" towards "recipient need aid" supporting one of their main findings, that "bilateral aid allocations are made largely in support of donors' perceived foreign economic, political and security interests. By contrast, aid flows from multilateral sources, as would be expected, are allocated essentially on recipient need criteria" (Maizels and Nissanke, *op. cit.*, p. 891). On the basis of a decomposition analysis applied to aid data for the United States, France, Germany, Japan and the United Kingdom, it was estimated that the \$3.33 billion (1978-80 prices) increase in the real value of "recipient need aid" from

1969-70 to 1978-80 could be explained as much by the shift towards multilateral aid (\$2.16 billion) as by a change in policy direction to focus more on "recipient need aid" than "donor interest aid" (\$1.88 billion); with the reduction in total aid accounting for -\$0.72 billion.

During the 1980s, the share of multilateral aid of total ODA stabilized at about 25 per cent. The trend towards more policy-related lending, a more important role for multilateral agencies in reinforcing the coherence of development programmes and policies, and increased co-financing, have strengthened the position of multilateral institutions. The net result, however, has not meant a larger share of multilateral aid going to all DAC members as a group, although the figures for individual DAC countries may differ as Table 7 illustrates.

Donor Procurement and Multilateral Aid

Even if the countries contributing to multilateral agencies are not greatly involved in the decision-making process regarding procurement financed with multilateral lending, this does not mean that they are totally indifferent to these agencies' procurement practices.

In the first place, a country can make its contribution to the multinational institution dependent on the size of domestic procurement. This practice is considered rather unfashionable, however, and has rarely been applied, because negotiations about the countries' contributions are considered to be something apart. Yet, there have been cases when this rule was broken. Under the pressure of a growing balance-of-payments deficit in the 1960s, the United States Government requested, for example, that its contribution to the second replenishment of funding for the International Development Association (IDA-2) be tied to the amount of American goods and services acquired through IDA loans. It was finally decided that the US contribution would in the first instance be limited to the amount that American suppliers would receive from IDA-connected procurement; the gap in contributions was to be filled, at least temporarily, by other donors. This arrangement lasted until 1971.

A country may make a special contribution to a regional development bank, for example, on the condition that part of the procurement be tied. Such arrangements, however, may oblige the recipient countries to procure goods at elevated prices (see also, in Part C, "Direct Costs of Tying to the Recipient"). An example was a special Canadian contribution to the Asian Development Bank at the end of the 1970s, for the supply of transformers for a dam unit to Pakistan. The bid stipulated a minimum two-thirds Canadian content. The Canadian order was more expensive than two comparable subsequent orders acquired through international competitive bidding by some 50 per cent and 30 per cent, respectively.

Indeed, many donors are very eager to obtain actual procurement figures based on multilateral lending. With respect to this, one usually makes reference to the "juste retour" principle: that procurement in the contributing countries should be more or less proportional to the size of their contribution (after corrections for local cost financing). Although substantial deviations have no direct impact on the size of future contributions, they may lead the donor governments to pressure both local firms and the multilateral institutions to redress the situation. Some quantitative information concerning the "juste retour" practice, is provided below.

Table 7

DAC MEMBERS' ODA CONTRIBUTIONS TO MULTILATERAL DEVELOPMENT AGENCIES AND FUNDS
AS A PERCENTAGE OF TOTAL ODA, GNP AND OF TOTAL DAC MULTILATERAL ODA, 1979-87

	As % of ODA			As % of GNP			As % of total DAC multilateral ODA excluding EEC		
	1979-80 average	1984-85 average	1986-87 average	1979-80 average	1984-85 average	1986-87 average	1979-80 average	1984-85 average	1986-87 average
Australia	26.3	25.1	24.0	0.13	0.12	0.09	2.7	2.8	1.8
Austria	31.2	27.5	24.7	0.07	0.09	0.05	0.7	0.9	0.5
Belgium	13.4 (27.3)	22.5 (39.6)	21.2 (36.6)	0.07 (0.15)	0.13 (0.22)	0.10 (0.18)	1.3	1.5	1.4
Canada	41.3	37.5	35.4	0.19	0.19	0.17	6.8	8.9	6.9
Denmark	37.4 (44.2)	41.8 (49.2)	40.9 (47.2)	0.27 (0.32)	0.34 (0.41)	0.36 (0.42)	2.7	2.7	3.4
Finland	46.2	39.4	39.6	0.10	0.15	0.19	0.7	1.1	1.6
France	8.1 (16.7)	9.2 (17.4)	11.5 (18.6)	0.05 (0.10)	0.07 (0.14)	0.08 (0.14)	4.8	5.2	7.3
Germany	23.6 (35.0)	18.3 (32.8)	18.4 (30.3)	0.10 (0.15)	0.08 (0.15)	0.07 (0.12)	12.8	7.7	8.2
Ireland	28.4 (29.1)	17.6 (56.8)	24.8 (53.9)	0.05 (0.11)	0.04 (0.13)	0.06 (0.13)	0.1	0.1	0.2
Italy	52.4 (88.9)	20.1 (37.0)	23.7 (33.0)	0.07 (0.12)	0.06 (0.12)	0.09 (0.12)	3.9	3.3	6.4
Japan	34.1	38.6	30.5	0.10	0.12	0.09	16.0	22.9	21.6
Netherlands	19.4 (27.2)	23.2 (31.1)	24.4 (32.2)	0.18 (0.26)	0.22 (0.31)	0.24 (0.32)	4.7	4.1	5.1
New Zealand	24.9	20.1	21.6	0.08	0.05	0.06	0.3	0.2	0.2
Norway	41.8	43.1	40.4	0.38	0.44	0.46	3.0	3.5	3.7
Sweden	30.0	30.1	32.1	0.25	0.25	0.28	4.5	3.5	4.3
Switzerland	37.3	24.1	26.5	0.08	0.09	0.08	1.4	1.0	1.4
United Kingdom	23.3 (36.6)	24.0 (44.5)	24.9 (44.1)	0.10 (0.15)	0.08 (0.15)	0.07 (0.13)	7.3	5.2	4.9
United States	28.6	19.2	21.9	0.07	0.05	0.04	26.3	25.4	21.1
Total DAC	25.6 (31.3)	23.6 (28.2)	23.7 (28.2)	0.09 (0.11)	0.08 (0.10)	0.08 (0.10)	100.0	100.0	100.0

Notes: 1 Excluding EEC. Figures including EEC contributions are in brackets.

Source: OECD, 1988 DAC Report, p. 97.