

A Consultation on Tied Aid Issues with CIDA, Policy Branch, and DFAIT, Economic Relations with Developing Countries

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CCIC and the NSI, in cooperation with the Policy Branch of CIDA, organized a consultation with CIDA and DFAIT to hear about progress in discussions now underway on untying aid to the Least Developed Countries (LLDCs) at the Development Assistance Committee (DAC) of the OECD. Participants from interested international NGOs, academic institutions, consultants were invited to an informal discussion of the issues (see the appended list).

Tied aid has been a long-standing concern of the international development community in Canada and abroad and over the years many proposals (including various parliamentary reviews of Canadian aid) have sought to reduce the tying of Canadian aid. As a result of the discussions at the DAC, leading to an agreement and a recommendation to the High Level Meeting (HLM) that untying aid to the LLDCs, have been generally welcomed by NGOs and others in the international development community.

This report will highlight some of the issues under discussion in the DAC process and give some of the perspectives raised at the meeting; from those present on these issues. It is not intended to define a particular consensus of the meeting nor a formal position by CCIC or the NSI. All present, including CIDA and DFAIT representatives, strongly support further initiatives to untying aid provided this leads to more to deepen partnerships with developing countries for effective, efficient and responsive development cooperation. But, as noted during the meeting, "the devil is in the detail".

The framework for the current round of discussions on tied aid in the DAC was initiated by the High Level Meeting (HLM) in April 1998. The Working Party of Financial Experts was mandated to work on a recommendation on untying ODA to LLDCs in order to present a proposed text to the HLM in 1999. The mandate suggested that a number of issues would have to be taken into account:

- donor coordination and partnerships with developing countries;
- effects on the volume and direction of ODA flows;
- capacities of private sector and procurement systems in partner countries;
- maintaining national involvement in donor countries alongside the objective of calling upon partner country expertise.; and
- the different structures and starting points of member countries.

To date, there have been two working sessions in July and September, with a number of informal groups looking at different aspects. NGOs have been closely monitoring the various positions taken by member countries of the OECDs through an initiative (i.e.?) by Actionaid in the UK and through *The Reality of Aid* network.

Evan Due, the representative from CIDA, reported that discussions to date have on the whole been positive. There is broad agreement on the positive benefits of greater untying, but it is also clear that there are major differences on a number of complex issues that still need to be resolved -- what should or should not be included, how to assure transparency and a "level playing field". There is a general will to move forward. Evan Due described a number of these issues and Denise Jacques from DFAIT made some observations from a trade perspective.

- What is under discussion is only bilateral aid to the least developed countries. But, while the scope at this point is very narrow, the principles, mechanisms and exemptions established will be the foundation for future agreements recommendations on untying aid to other developing countries.
- Canadian bilateral aid rules currently allow up to 50% untied for Sub-Saharan Africa and the LLDCs, and 33% for all other developing countries. Food aid is 90% tied to Canadian sources. It was emphasized that these rules are global in application, not country specific, thereby giving a high degree of flexibility to program managers. It was also noted that they apply only to bilateral aid, excluding all forms of multilateral assistance other than food aid and excluding the responsive mechanisms for NGOs, colleges and universities. CIDA has policies in place that put emphasis on utilizing local services and goods and preferential procurement in domestic markets of developing countries (the latter is not recognized by the DAC as untied aid).
- For Canada, and other donors at the table, the primary motivation is better quality programming and development impact arising from further untying aid.
- Transparency and a "level playing field" is another complex issue. Here there is hope that progress can be made.

In current practice there is much confusion and ambiguity among donors about what they should and do report to the DAC as tied aid. Current statistics on tied aid are notoriously inaccurate, lacking common standards, with several countries not having reported to the DAC at all. For example, DAC statistics on Canada suggested that 68.5% of Canadian bilateral aid was tied in 1996, but this figure wrongly included \$159 million spent for refugees in Canada on refugees from developing countries and money channeled to Canadian NGOs through the responsive program. Other donors appear to under-report differently the extent of their tied aid and many rely on technical assistance that is not included notably technical assistance. No one tracks the difference between the intent of commitments and what actually happens in the disbursement. Others, for example the Canadian Association of Independent Consultants (CAIDC), suggest that tied aid should refer to all aid funds that flow into and remain in Canadian organizational

pockets. GreaterFull transparency is essential for the trust necessary to come to an agreement.

Denise Jacques from DFAIT suggested that progress on transparency and procurement rules will take advantage of and borrow from a number of existing workable models, for example the Helsinki consensus rules on procurement for mixed credit loans. There also seems to be agreement that country practices will be subject to review by either a special committee or part of the regular peer review process.

- Tied technical cooperation is both a complex and controversial subject. There is pressure by some to exclude technical assistance altogether and among others there is no agreement on what types of technical services should be "on the table" and subject to untying. It was noted that global economic turmoil may have significantly reduced chances of an agreement in this area, with some members arguing that liberalizing technical services in the face of an economic downturn will alienate current supporters of aid when aid itself may be under pressures of reduced funding.
- Food aid is also likely to be excluded from an agreement. The complexities of donor country subsidies and complex legislation on food exports in other countries make it a highly politicized issue. It was noted that there are already some basic conventions on food aid in place and these will remain. Canadian food aid is tied 90% to Canadian purchases and both CIDA and some NGOs based in Western Canada are subject to strong pressure from farmers to give priority to Canadian grains and food shipments in Canadian food aid programs.
- In order to preserve flexibility and quick responses, there is general agreement that emergency assistance will need to be excluded from the recommendation. emergency assistance is also excluded from the rules on tied aid.
- Based on discussion so far, there is general support for excluding official donor support for NGO programs from any recommendation. Official donor support for NGOs through responsive mechanisms will likely be excluded from any agreement. But NGOs, when they bid on posted bilateral contracts, will be covered by agreed rules for untying aid coming under the recommendation. It is the purpose, size, and geographic target of the bilateral aid program that determines the application of untying rules, not the nature of the implementing agents.
- To avoid high administrative burdens on donors, a threshold will be established below which projects will not be subject to the rules for untying. This threshold will likely be approximately Cdn\$4 million in the first instance. While this could affect how donors structure projects (to avoid untying rules), better disclosure should guard against this abuse.

In theory we should be moving towards low thresholds and no exceptions, but there are both practical and political considerations that will inevitably be taken into account. The final recommendation will not doubt be full of exceptions. While this agreement may be only the

starting point for future negotiations, it is also important to reach a principled agreement on untying that maximizes effective development impact and authentic partnerships.

Participants in the workshop made a number of observations on the report from CIDA and DFAIT:

- Denise from DFAIT reported that repeated attempts to engage the Canadian private sector to get their views surprisingly did not elicit any response. She and others had several hypotheses for this seeming lack of interest. Many Canadian firms may tend to be niche "boutique operations" with little interest or capacity to compete internationally for contracts in the South. (It would be interesting to know whether any Canadians have been able to win any of the untied contracts now posted on the OECD's electronic notification board.) At the World Bank Canadian firms tend to be sub-contractors on large capital projects and their roles are hard to track. It was suggested by several participants that the development community may be over-playing potential opposition from the business community to untying Canadian aid.
- Given public opinion surveys that confirm public support for aid on the basis of humanitarianism, it was suggested that Canadians on the whole would support untying. The majority of Canadians have consistently said that aid is for humanitarian relief and development and not to sustain Canadian jobs and open overseas markets. On the other hand, farmers as noted above have expressed strong views about the sourcing of Canadian food aid.
- What is currently under discussion is not very insignificant to current Canadian aid programs and their quality and impact, given the exclusions and the focus on LLDCs (which are those countries where there is unlikely to be local procurement capacity). Other OECD countries are unlikely to be interested in small Canadian contracts. There are many ways to shape bias a project so that inputs are required in areas where Canada already has a competitive advantage. Most Canadian firms are not interested in the aid program and Canada tends not to produce goods that are put out for procurement. It is only in consulting services that Canadian firms tend to do very well. Evan Due confirmed that only a small number of CIDA projects, likely less than 20 probably around 12, would have been affected if the untying rules likely to emerge from the DAC discussion had been in place in 1996/975 or 1996.
- Several participants suggested that since Canada has very little at stake in the discussions that we should be working at these negotiations to expand the scope of untying as far as possible and push for strong development principles in any consensus that might emerge. It was pointed out that developing countries were not at the table in these discussions, although a meeting with LDCs is planned for December. CIDA also needs to apply its current policies in a consistent manner. While there may be policy priorities for utilizing local resources and strengthening national economies through development programming, it was pointed out that the rules for CIDA contracts limit the allowable markup to 3% for locally hired consultants (whereas the markup on subcontractors hired in Canada can be higher). This is a disincentive for Canadian companies to hire local

consultants; the latter have a very low mark-up for the company and require CIDA approval.

- Accountability and corruption have come up in the DAC discussions as issues that constrain further untying of aid. Some participants in our meeting suggested that corruption does not seem to be a factor relating only to aid that is currently untied. Neither does increased monitoring and transparency necessarily mean less corruption in the allocation of aid resources, witness the recent revelations by the World Bank and their Indonesia program. There is also not evidence that untying aid leads to greater levels of corruption. Corruption cannot be an excuse for tying or untying aid, but the debate on tying does raise questions of transparency that can usefully also address the issue of corruption in *both* developing and donor countries.
- A number of participants stressed the importance of ensuring a preferential procurement process for LDCs in order to maximize domestic spin-offs from development cooperation. Project development must take into account what can be easily available in-country and those goods and services for which there are no domestic sources. Rules for aid untying might usefully only apply to the latter. Another related issue is that of "branch-plants" for northern companies in developing countries gaining preferential access as a domestic source. Perhaps some "rules of origin" may be required.
- The question of the primary motivation for the DAC process on untying aid was raised by several speakers. It was noted that the Canadian public would likely be less supportive if the goal is to transform aid into a form of more liberalized trade, in which there are merely more competitors for contracts from other donor countries. But support would be forthcoming if the intent and practice of aid untying is consistent with the goal of sustainable human development, giving more ownership to Third World countries, helping to build economic and public capacities, which is related to the development of civil society and democracy. A "pro-poor" aid untying policy does not seem to be compatible with a move to a more liberalized and deregulated, kind of "free trade" approach to aid.

In response to a question about which of these directions the Canadian government supports, Evan commented that it is not one or the other. The government's position is firmly rooted in development issues and that the motivation for the DAC as a whole is the partnership and development framework set out in the 1996 "Getting Shaping to the 21st Century: The Contribution of Development Cooperation." . At the same time, procurement rules that reflect transparency and a "level playing field" underpin making progress in untying aid for development purposes.

- It was observed that the motivation and directions chosen for untying will have an impact on NGOs, whether they are excluded or not. If the real purpose is aid as more liberalized trade, then NGOs will be further marginalized from the development process. Development cooperation in this scenario becomes increasingly a global process of development contracting. NGOs cannot compete in this arena. NGOs have a broad mandate. They do not just deliver goods and services; they are engaged in public opinion

building and education to encourage Canadians to be active participants in international inter-cultural dialogue and solidarity. While respecting our Canadian identity, NGOs are contributing to the building of global citizenship. Most of the time the private sector does not include these goals in their work. There is a danger that transforming aid into liberalized trade regime would be at the expense of both the Third World and Canadian participation in development. Evan in response noted that CIDA understood that NGOs are fundamentally different creatures in their relationships with developing countries, although he noted that some do compete for service contracts, which may or may not be covered by the recommendation.

In concluding, at this point in the DAC discussions, the extent of aid untying that will be proposed in the recommendation to the HLM in the spring of 1999 remains very uncertain. There will likely be a tendency to move the discussion back to the level of principles in order to avoid some of the intractable issues that still divide donors. Minimally we need to aim for greater accountability among donors and greater transparency in their aid relationships.

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