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Communication from the Commission to the Council

**THE UNTYING AT COMMUNITY LEVEL OF MEMBER STATES'  
BILATERAL DEVELOPMENT AID TO NON-MEMBER COUNTRIES**

## Summary

The Member States' bilateral aid is still tied to a considerable degree, i.e. the aid is conditional on procurement in the donor country. This practice has long been a subject of controversy. In the early 1970s there were attempts at both OECD and Community level to untie such aid but initial ambitions had to be scaled down and in the end partial solutions emerged that mainly concerned multilateral aid. A recent initiative by the Dutch presidency has rekindled discussions within the Council and the issue of untying aid is once again on the agenda.

The issue of tied aid is especially sensitive since development aid is seen by the Member States as a genuine political choice that is reflected in their budget allocations for development cooperation. Indeed, some Member States argue that the tying of aid is a precondition for aid as far as public opinion is concerned.

At present the amount of aid that would be affected by untying at Community level stands at some \$10 billion, which represents 58% of the Member States' bilateral aid and 0.25% of their GNP. But the situation is not the same everywhere, the Member States' practices varying in relation to the total amount of aid they give, the proportion of multilateral aid within that total and the degree to which bilateral aid is already untied.

The main argument in favour of untying aid at Community level - which would mean that bilaterally-financed contracts would be thrown open to all the Member States - stems from development considerations. The first beneficial effect of the extension of competition to twelve markets would be the likely cost advantages for both the recipient developing countries and the donors themselves. Another effect of the measure would be that donor countries would be less tempted to angle their aid with an eye to their own exports and other considerations often unrelated to local conditions. Lastly, we should not fail to consider the impetus that untying aid at Community level could give to renewed efforts to make all OECD members take similar steps.

Furthermore, a move to untie aid would be timely in view of the completion of the single market, which involves opening up Community markets. In this context, the approach advocated is to consider the tying of bilateral aid as a form of export aid, so that it is covered by Articles 112 and 113 of the EEC Treaty, which call for the harmonization of such aid arrangements.

The practicalities of untying bilateral aid do, however, give rise to a number of questions concerning:

- (i) the scope of such untying: types of flow (official development assistance or extension to other forms of aid?), geographical coverage (developing countries only or extension to Eastern European countries?), the type of tying (sources of supply other than the donor), forms of aid (loans, grants?), different kinds of aid (what about technical cooperation and bilateral food aid?);
- (ii) provision for gradual implementation in terms of the proportion of aid to be untied and the setting of thresholds or adoption of a sectoral approach.

A certain number of the elements mentioned in this communication could also apply to export credits.

The purpose of this communication is to provide the basis for a policy discussion by the Council of the various issues arising from the untying of aid, with a view to examination of the matter, as ministers themselves have requested.

THE UNTYING AT COMMUNITY LEVEL OF MEMBER STATES'  
BILATERAL DEVELOPMENT AID TO NON-MEMBER COUNTRIES

Introduction and history

"Tying" aid, that is, making it conditional on procurement in the donor country, has long been a subject of controversy in international discussions. The first attempts to abolish the practice, i.e. to "untie" aid, were undertaken in the early 1970s - both within the OECD, with a view to allowing procurement in any of the member states of the Development Assistance Committee (DAC), and at Community level, with a view to untying aid only at the level of the Member States. However, neither of these initiatives met with conclusive success.

Within the DAC, hopes of achieving the total abolition of aid-tying had to be abandoned in the light of the monetary situation in 1971 and the uncertainties caused by the oil crisis. Instead, partial solutions were adopted, consisting, on the one hand, of an agreement to untie contributions to multilateral institutions, and, on the other hand, the accession of some DAC members to an agreement aimed at untying bilateral loans to allow procurement in developing countries.

Initiatives at Community level were no more successful. The Commission's proposal to untie aid within the (then six-member) Community, as presented in its first memorandum on a common development policy (1971), encountered insoluble reservations on the part of some Member States. After several years, therefore, no further action was taken on this proposal.

Since that time, the issue of tied aid has taken on a new dimension - for the Community - with the prospect of the completion of the frontier-free single market. With the 1993 deadline in mind, the Dutch presidency therefore reintroduced the subject at an informal meeting of the Council at Apeldoorn (Netherlands) on 6 and 7 July. Since the idea of untying aid met with a generally favourable reception from development ministers, the Commission was asked to draw up a paper examining the issue in detail and proposing practical solutions for the Council meeting on 28 November.

The purpose of this memo is to prepare the ground for a policy debate of the Council on the untying of aid at Community level.

## Background

### The purpose of untying aid

It is not Community aid as such that poses a problem since works, supply and services contracts financed by the EDF or the budget have always been open on equal terms to all the Member States' firms (and also, with some variations, to those of non-member, usually developing, countries).

Member States' bilateral aid, however, is still tied to a considerable degree compared with Community aid or that passing through other multilateral channels, as indeed is that of practically all bilateral donors in the world.

Broadly speaking, the tying of aid consists in making the granting of aid conditional on the purchase of goods and services originating in the donor country. Origin is defined in terms of either the nationality of the firms that may tender or the setting of a "minimum national content".

The severity of the constraints on the sources of supply imposed by tied aid may vary in degree: aid may be linked to goods and services from the donor country alone or from the donor country and certain other countries (which may or may not be developing countries). Often the aid recipient is authorized as a source of procurement. Some Member States sometimes throw contracts open to other developing countries (France, for instance, includes firms from the Franc area as well as French firms for certain forms of financing).

In cases where almost all developing countries are admitted as well as the donor country, aid is judged to be partially untied. It is considered to be untied only in cases where it can be used for procurement in virtually the whole world. This basic criterion can be transposed, *mutatis mutandis*, to Community level, in which case bilaterally-financed contracts would be open to all Member States.

Note finally that in terms of implementation we find a variety of situations. Most donors let the governments of the recipient countries take care of the actual purchasing (recipient procurement). Thus in these cases it is the non-member country, not the Member State, that is the body legally responsible for organizing invitations to tender. Some donors, however, reserve the right to approve the conclusion of contracts and check that the provisions of the financing agreement concerning the award of contracts have been observed. Then again, there are donors which assume the responsibility for procurement procedures themselves, at least for certain types of aid (donor procurement). This is particularly true of aid in kind (food aid, for example).

### Widely varying practices

The issue of tied aid is all the more sensitive because the Member States see development aid as a genuine political choice that is reflected in their budget allocations for development. In this respect, practice is far from standard, as the following figures show.<sup>1</sup>

The Member States' official development assistance (oda) in the form of commitments stood at \$25.7 billion in 1988. Of this total, nearly 60% (\$15 billion) was already untied. This percentage broke down as follows:

- nearly 30% (\$7.4 billion) was multilateral aid, which, by definition, is not tied;
- 30% (\$7.7 billion) was untied bilateral aid.

The amount of tied and partially untied aid that would be subject to untying at Community level is thus in the order of \$10.6 billion, 58% of Member States' total bilateral aid and 0.25% of their GNP. Almost 40% of this amount falls into the category of technical cooperation, namely study grants, experts, teaching materials, and the like.

These are but averages, however, covering widely varying situations. They are based on total oda (which varies from 0.19% to 1.08% of GNP), the size of the multilateral element (between 17% and 64% of total oda) and the extent to which bilateral aid is already untied (which ranges from 8% to 43%).

The proportion of tied or partially tied aid is highest for Italy (88% of bilateral oda), followed by the UK (82%), and the Netherlands (62%).<sup>2</sup> The lowest figure is for Ireland (10%). If, however, the untying of aid required is measured in terms of GNP, the order is different. The Netherlands, which devotes more than 1% of its GNP to development aid, would have to untie an amount equivalent to 0.47% of GNP (more than the total effort of the UK and Ireland), France 0.32% of GNP and Italy 0.31%. Bottom of the list come Ireland, the UK and Belgium.

At first sight, these figures show that the Member States would be differently affected by the untying of aid: those that made a smaller contribution to the granting of aid could, depending on the competitiveness of their firms, win a large share of the contracts financed with the development aid allocations of other Member States.

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1 The figures outlined here are set out in greater detail in the annexed Tables 1 and 2. They are based on notifications to the OECD's Development Assistance Committee (DAC) and thus do not cover the four Member States that are not represented on the Committee (Greece, Luxembourg, Portugal and Spain).

2 The high figure for the Netherlands is mainly explained by the high proportion of partially untied aid, the Netherlands being practically the only Member States to adopt this practice.

Given that some Member States have argued in the past that tying aid was crucial in winning public support for development aid, the prospect of untying bilateral aid must not be allowed to deter donors under pressure of such arguments. Leaving aside certain economic considerations that will be discussed further on, experts' studies have shown that because of the amounts actually at stake, it would be a mistake to think that tying aid has significant macroeconomic effects in terms of employment or the balance of payments of the donor country.

#### Reasons for untying bilateral aid at Community level

The main argument in favour of untying aid at Community level pertains to development considerations.

One of the major criticisms levelled at the tying of aid is that it increases the cost of aid by restricting competition. One primary effect of untying aid at Community level would therefore be to produce cost advantages by widening competition to the 12 national markets. The recipient developing countries - and the donors - would therefore be assured of getting the best value for money for works, supplies and services financed through aid, so that the real value of the aid would be increased and, where it is provided in the form of loans, there would be less pressure to take on additional debt.

By untying aid, the donor country would also be less tempted to angle it with an eye to its own exports, a temptation which can cause a bias in favour of financing that involves a high level of imports or projects designed around capital-intensive solutions, using technology inappropriate to local conditions. Freed from this temptation, aid can be geared to the real needs and capacities of the recipient countries, leading to lower recurrent costs to maintain the projects financed.

On a different level, untying aid can help facilitate joint financing between donors, in this case Member States. This is no small consideration from the point of view of harmonizing development policies within the Community.

These development considerations would carry even more weight if untying aid at Community level were to give an impetus to renewed efforts to make all OECD donor countries take similar steps.

As noted above, the efforts made to this end in the early 1970s were unsuccessful. If untying aid at Community level led to the talks being renewed in the DAC with success, the benefits to developing countries of widening competition and separating aid from export interests would be even greater, extending to all tied bilateral aid by the industrialized countries, of which the Member States account for only around half (48%).

A second, and by no means less important, effect of untying bilateral aid at OECD level would be to remove development aid and other associated public flows from the scope of the "Consensus"<sup>1</sup> reached between the principal exporting countries of the OECD with the aim of curbing distortions of competition caused by the financial terms for credits. The aid would no longer be subject to the restrictions imposed by the Consensus, which are inspired by commercial considerations sometimes far removed from the logic of development. This would also eliminate one factor complicating the frequent renegotiations of the Consensus.

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In addition, a move to untie aid could be timely in view of the efforts being made to complete the internal market, since it involves dismantling barriers within the Community.

#### Legal basis

The approach advocated is to consider the tying of bilateral aid as a form of export aid. The schemes concerned would therefore be covered by the scope of Articles 112 and 113 of the Treaty, which call for their harmonization. This would allow progress towards untying development aid to be made with less risk of a substantial drop in the volume of such aid.

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1 The "Arrangement on guidelines in the field of officially supported export credits", commonly known as the Consensus, has for a number of years covered all aid credits tied to procurement in the donor country.



Only legislation based on these provisions can bring the Member States to apply conditions for awarding contracts to their bilateral aid by specifying in particular:

- freedom to participate for all enterprises and nationals of the Community;
- appropriate publication arrangements;
- measures to eliminate discriminatory practices which might obstruct Community-wide participation;
- measures to ensure that invitations to tender are transparent.

The legislation should also specify its scope (type of aid, geographical coverage, ways of tying aid, form and content of aid) and procedures for phasing it in (e.g. by fixing the proportion of aid to be untied, setting thresholds or adopting a sectoral approach).

This approach does not rule out the application of Articles 92 to 94 EEC in cases where the tying of aid is tantamount to state aid within the meaning of those Articles. It is worth noting, in fact, that in its "Tubemeuse" judgment of 21 March 1990, the Court of Justice considered that Article 112 of the Treaty did not exclude the application of Articles 92 to 94. Article 92 can be applied case by case, and the Commission is currently examining complaints, on the basis of Article 92, by companies which claim that they have been excluded from contracts in third countries by the use of tied development aid operating as an export aid.

With regard to the problem of establishing whether tied aid is covered by Article 30 EEC, it must be pointed out that the existence of Article 92 does not exclude the possibility of applying Article 30 to certain elements of aid (see the "Iannelli", "Tax Advantages for Newspaper Publishers" and "Dupont de Nemours" judgments).

It should be noted that in their present form Community directives on opening up public procurement do not apply to procurement by third countries (recipient procurement). However, it is possible that the Community directives do apply where the contract is awarded by a public body of a Member State acting as agent for a third country. In cases where contracts are awarded within the Community by a public body of a Member State (donor procurement), the directives only apply provided that the international agreement concluded between the donor State and the beneficiary State does not establish procurement procedures other than those provided for in the "public procurement" directives. As a result, the effect of these directives on tied aid is very limited.

#### Practicalities of untying bilateral aid at Community level

In the light of the above, untying Member States' bilateral aid at Community level is an objective worth pursuing for the Community.

However, besides the actual principle of untying aid at Community level, there are a number of other questions to be resolved before proceeding with the measure, in particular practicalities to do with the scope of the untying of aid and provision for its gradual implementation.

Untying bilateral aid in practice involves setting up appropriate instruments, which may extend for example to the use of common general conditions for procurement, as is the practice for interventions financed by the EDF. This aspect of implementation is not discussed in the present document.

#### Scope

##### 1. Types of flows

The idea of untying aid is normally applied to what is termed official development assistance (oda). This term, as used by the OECD's DAC, covers flows in financing or in kind whose principle motive is the development of the recipient country and which comprise a "grant element" of at least 25%. In addition to oda, there are other official

flows (oof) which are not classed as oda by the DAC either because their primary purpose is not development or because their financial conditions are not concessional enough to attain the required grant element. A large proportion of these oof - which amounted for the Member States to around \$3 billion in 1988/89 (bilateral oof only) - are official export credits and therefore covered by the OECD Consensus referred to above. Another part is probably untied by the very nature of the transactions which it finances (bond purchases, etc.).

In as much as some of these bilateral oof are tied to procurement in the donor country, action to untie aid at Community level should cover them in the same way as oda proper.

Likewise, the "aid" component of such facilities as mixed credits, the UK Aid and Trade Provision, etc., used to soften the financial terms of export credits, should not be excluded from untying. Excluding this would amount to untying aid whose consequences in terms of exports were secondary, while leaving tied any aid aimed primarily at trade promotion.

## 2. Geographical coverage

The DAC reserves the terms oda and oof for aid to countries classed by it as developing countries. This does not include the countries of Central and Eastern Europe, with the exception of Albania and Yugoslavia.

It is however obvious that bilateral public flows to these countries should also be untied at Community level.

## 3. Ways of tying aid

As mentioned above, tied aid need not be tied to procurement in the donor country alone. Some other sources of supply, including developing countries, may be allowed. While this intermediate tying - particularly partially untied aid (which allows procurement in almost all developing countries) - has certain advantages over aid tied to procurement in the donor country, and might therefore be treated differently from the point of view of development policy, it has the same disadvantages in terms of dividing up the single market as long as it does not admit all twelve Member States as a possible source of supply.

These forms of intermediate tying should therefore also be included in any action to untie aid at Community level. However, it should be recognized that this would disadvantage developing countries from which procurement is allowed, as they would then be exposed to extra competition from the other Member States.

#### 4. Types of aid

At its first attempt in 1971, the Commission proposed to untie only ODA loans in the first instance. This restriction could be justified again now, both by the extra sacrifice which according to a grant rather than a loan implies for the donor country, and by the extra benefit which the recipient country derives from non-repayable assistance.

Taking into account the present importance of grants in Member States' bilateral programmes<sup>1</sup>, however, confining the operation to loans would significantly reduce its scope and would also have very varied effects on the Member States. Moreover such a distinction according to the financial instrument used does not seem justified if one looks at the question from the point of view of the common commercial policy or the completion of the internal market.

#### 5. Aid content

The aid may be in kind (food aid is a typical case) or in the form of financial allocations. It may serve to finance specific investment projects (project aid) or a variety of activities (programme aid, including sectoral and general import programmes in particular) or technical cooperation. Whatever the case, it is the object of public procurement of either works, supplies or services.

In principle, any such procurement should, if Community aid is untied, be subject to a Community-wide invitation to tender, assuming that it involves exports and that the individual procurement (or the total cost of the operation financed) exceeds a certain threshold below which an international invitation to tender would not be justified on economic grounds.

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<sup>1</sup> In terms of bilateral commitments (1988/89): Ireland 100.0%; Denmark 97.8%; United Kingdom 97.1%; Netherlands 82.7%; Belgium 78.5%; France 69.7%; Italy 63.8%; Germany 57.1%.

There is a problem here with certain types of aid in the form of technical cooperation, which accounts for a large proportion of Member States' tied aid (almost 40% on average). It would seem that at least some forms of technical cooperation (e.g. education and training) should be excluded from any initiative to untie aid, on account of their specific (e.g. linguistic or cultural) requirements. In most cases, technical cooperation does not in practice involve international invitations to tender but procedures involving more limited competition, such as the restricted procedure or direct agreement. However, this approach should be without prejudice to the applicability of the public services directive, which will take effect from 1993 and which will lead to Community-wide competition in the procurement of many kinds of services.

Another question is raised by bilateral food aid, which should be examined to see whether it poses a problem in the context of untying aid at Community level, given the specific circumstances arising from the Common Agricultural Policy.

#### Gradual Implementation

A move to untie Member States' bilateral aid would represent a major innovation. It may therefore be advisable to implement it gradually.

1. One way of implementing it gradually would be to fix the proportion of aid to be untied, increasing the percentage in successive stages according to a timetable to be determined. However, in order to take account of the size of the multilateral element (which is, in effect, untied) this proportion should be defined in relation to the total ODA. The degree to which the total ODA is already untied (see annexed Table 2, column 3) suggests that the initial figure would have to be high (probably around 70 to 80%) to ensure that a maximum number of Member States had to make an additional effort. With such a high starting point, however, it is questionable whether the process could really be termed gradual.
2. Another approach would be to fix a minimum sum for interventions above which an international invitation to tender would be compulsory for bilateral aid. This threshold, fixed at a relatively high level to begin with, would be gradually lowered until it reached a floor below which, for economic reasons, other forms of adjudication involving less competition would be more appropriate.
3. A third tack, which could be combined with the second, would be to adopt a sectoral approach: either defining areas which would gradually be untied, or distinguishing "excluded" sectors which would gradually be integrated into the mechanism of untying aid. Whichever method is adopted, in practice this approach would lead to each Member State protecting its own sensitive sectors first, which would render the exercise meaningless.

TABLE : 1

## TYING STATUS OF ODA, 1988 (\*)

-base : commitments, excluding administrative costs-

US\$ million

	Multilat. ODA	Untied bilat. ODA(a)	Total untied ODA	Tied(b) bilat ODA	Partially untied(c) bilat.ODA	Tied (b) and Partially untied (c) bilateral ODA	Techn. Co-operation Included in col.6	Total ODA
	1	2	3(1+2)	4	5	6(4+5)	7	8(3+6)
B	(292.0)	(190.0)	(482)	(250.0)	(-)	(250.0)	(140.0)	(733.0)
DK	413.0	441.0	854.0	162.0	9.0	171.0	9.0	1025.0
F	1265.0	3130.0	4395.0	2805.0	242.0	3047.0	1816.0	7442.0
D	1878.0	2615.0	4491.0	2160.0	-	2160.0	732.0	6651.0
IRL	34.0	(17.0)	(51.0)	( 2.0)	(-)	(2.0)	-	53.0
I	1546.0	365.0	1911.0	2594.0	-	2594.0	442.0	4505.0
NL	723.0	665.0	1388.0	255.0	814.0	1069.0	306.0	2458.0
UK	1256.0	281.0	1537.0	1329.0	-	1329.0	636.0	2866.0
TOTAL	7405.0	7704.0	15109.0	9557.0	1065.0	10622.0	4081.0	25733.0

(\*) No data are available for Greece, Luxemburg, Portugal and Spain, which are no DAC members.

(a) Fully and freely available for essentially world-wide procurement.

(b) 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".

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

( ) indicates DAC Secretariate estimates.

Source : DAC/OCDE.

TABLE : 2

TYING STATUS OF ODA, 1988 (a)

-base:commitments, excl. administrative costs-

	Multilat. ODA	Untied bilat. ODA(a)	Total untied ODA	Tied (b) and Partly untied (c) bilateral ODA			Techn. Co-operation	Total ODA
	Percent of total ODA			% of Tot. ODA	% of bil. ODA	% of GNP	% of Tied and Partly untied bilat. ODA	percent of GNP
B	(39.9)	(25.9)	(65.8)	(34.1)	(56.8)	(0.16)	(56.0)	(0.48)
DK	40.3	43.0	83.3	16.7	27.9	0.17	5.3	0.99
F	17.0	42.1	59.1	40.0	48.3	0.32	59.6	0.78
D	28.2	39.3	67.5	32.5	45.2	0.18	33.9	0.55
IRL	64.1	(32.1)	(96.2)	(3.8)	(10.5)	(0.01)	(-)	0.19
I	34.3	8.1	42.4	57.6	87.7	0.31	17.0	0.55
NL	29.4	27.1	56.5	43.5	61.6	0.47	28.6	1.08
UK	43.8	9.8	53.6	46.4	82.5	0.16	47.9	0.35
TOTAL	28.8	29.9	58.7	41.3	58.0	0.25	38.4	0.60

(a) No data are available for Greece, Luxemburg, Portugal and Spain, which are no DAC members.

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