

How to spend it

Smart procurement for more effective aid

A report based on six country case studies on procurement, aid untying and using country systems.

By Bodo Ellmers



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Acronyms

| | |
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| AAA | Accra Agenda for Action |
| ACC | Anti Corruption Commission |
| ACP | Africa-Caribbean-Pacific countries |
| ADB | Asian Development Bank |
| CAFTA-DR | Dominican Republic-Central America-United States Free Trade Agreement |
| CPAR | Country Procurement Assessment Review |
| CPIA | Country Policy and Institutional Assessment |
| DAC | Development Assistance Committee (of the OECD) |
| DANIDA | Danish International Development Agency |
| DRET | Development-Related Export Transactions Programme |
| GDP | Gross Domestic Product |
| GIZ | Deutsche Gesellschaft für Internationale Zusammenarbeit |
| GNI | Gross National Income |
| JPP | Joint Procurement Policy |
| IADG | Internationally Agreed Development Goal |
| ICB | International Competitive Bidding |
| ILO | International Labour Organisation |
| LDC | Least Developed Country |
| MAPS | Methodology for Assessing Procurement Systems |
| MDB | Multilateral Development Banks |
| MDG | Millennium Development Goal |
| ODA | Official Development Assistance |
| OECD | Organisation for Economic Cooperation and Development |
| P4P | World Food Program's Purchase for Progress |
| PD | Paris Declaration |
| PEFA | Public Expenditure and Financial Accountability Programme |
| PFM | Public Financial Management |
| SME | Small and Medium Enterprises |
| SPP | Sustainable Public Procurement |
| UN | United Nations |
| UNCITRAL | United Nations Commission for International Trade Law |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |
| WFP | World Food Programme |
| WTO | World Trade Organisation |

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About this study

During the last decade, donors and recipients have made commitments to improving how development aid is delivered. In recent years, Eurodad and other civil society organisations have examined various aspects of how to make this aid more effective, but so far independent research has paid little attention to the agreements made on procurement- the purchasing of goods and services by governments to implement public projects or provide public services such as infrastructure or health and education services- despite the fact that procurement plays a decisive role in determining how aid is spent and who is the ultimate beneficiary of aid.

Commitments on procurement oblige donors and recipient countries alike to make reforms that will increase the chance that more aid goes to companies and individuals in developing countries, rather than to companies from the donor country.

This report assesses the progress made against these commitments and looks at how smarter procurement can make aid more effective to eradicate poverty and promote sustainable development.

Methodology

This report is based on six country case studies and a literature review on procurement and development effectiveness. Each case study is based on interviews with procurement practitioners, experts, civil society activists and watchdogs, and staff of aid agencies.

Where available, databases of awarded contracts were also reviewed. This information was readily available from the World Bank and the Regional Development Banks; but not from all donors or recipient country governments, or the information provided was insufficient to make any meaningful analysis. We assessed the distribution of contract awards to local and foreign firms in order to identify the ultimate beneficiary of their development finance, and what share is retained in the recipient countries. We did this separately for larger (above USD1mn) and smaller contracts in order to identify whether contract size makes a difference.

Procurement, tied aid and the use of country systems: the country case studies

| | | |
|--------------------------|---|---------------|
| Namibia | Targeting Development? | February 2010 |
| Ghana | For whose gain? | April 2010 |
| Uganda | Tapping the potential? | December 2010 |
| Bangladesh | Helping or hindering? | March 2011 |
| Nicaragua | Procurement, tied aid and the use of country systems in Nicaragua | April 2011 |
| Bolivia | Procurement, tied aid and country systems in Bolivia | June 2011 |
| Literature Review | Procurement and Development Effectiveness | December 2009 |

4 Executive summary

The target date for the Millennium Development Goals (MDGs) is quickly approaching and many countries are expected to miss them at current trends, despite some progress in recent years that was facilitated by increasing amounts of aid. Extraordinary efforts are needed to make the most out of every single cent to ensure the best results and a sustainable impact by 2015 and far beyond.

The Paris Declaration and the Accra Agenda for Action (AAA), major aid effectiveness agreements of the international community, were a first attempt to make aid work better for poverty eradication and sustainable development and to deliver on the Global Partnership for Development (MDG8), but little attention has so far been paid to how aid can enable poor people and countries to help themselves, to become independent from aid in the long run.

Key to such success, finds this report, are smarter procurement practices by aid agencies and developing country governments. Development projects are administered by ministries and aid agencies but they rely on inputs from the private sector, for example to contract construction firms to deliver infrastructure works, buy drugs for health programmes, or purchase textbooks for education projects. The exact amount is not officially disclosed, but our calculations suggest that USD 69 billion annually, more than 50% of total official development assistance, is spent on procuring goods and services for development projects from external providers. Procurement practices determine which private firms from which countries receive aid-funded contracts, in turn determining who reaps the benefits of the creation of decent jobs, income opportunities and productive capacities.

How smart are donors' procurement practices?

"Tying aid" to the condition that all purchases are made from firms from donor countries is the least effective form of procurement. It turns aid into boomerang aid: a financial flow that is only channelled to developing countries on the books. Although first agreements to untie aid were signed at the OECD in 2001, more than 10 years ago, about 20% of bilateral aid is still formally tied. Development projects funded with tied aid are also 15 to 40% more expensive.

Furthermore, in reality the majority of formally untied aid contracts from bilateral agencies also go to donor country firms. Two thirds are awarded to firms from OECD countries, and 60% 'in country', to firms from the donor country that funds a project. Multilateral Development Banks (MDB) diversify their supplier base better, but still OECD countries companies' and increasingly companies from emerging economies benefit the most from MDB-funded contracts. Half of the contract value in World Bank funded projects in our case study countries went to foreign firms, and the share increases with the size of a contract. This is a consequence of the World Bank procurement practices that consider international competitive bidding as best practice.

Aid untying in the official sense has obviously been a necessary but not a sufficient condition to untying aid in reality. In order to unleash the full potential of aid to create local capacities,



Our calculations suggest that USD 69 billion annually, more than 50% of total official development assistance, is spent on procuring goods and services for development projects from external providers.

jobs and income, aid must be untied not only on paper but in practice. Donors' procurement practices still favour Northern firms and make it virtually impossible for firms from Least Developed Countries to compete.

One option is to reform donor procurement practices: this report highlights best practice cases where donors really made an effort. The World Food Programme, for instance, sources foodstuffs from smallholders, trying to combine its food assistance programme with rural development. The International Labour Organisation is advising governments and aid agencies on how to use labour-intensive methods in construction projects, aiming to boost job creation and increasing the share of project funding that is translated into additional income for the local poor rather than being spent on imported equipment. Such steps are laudable, but development cooperation is ultimately about assisting developing countries to do things better, which requires more than improving aid agencies. The Accra Agenda for Action consequently obliges donors to give the responsibility for procurement away by using recipient country procurement systems as the first option for spending aid.

Using country systems can change the picture

Using country procurement systems helps strengthen them as scarce aid resources are used to build the capacities of core state functions rather than on expensive and redundant parallel structures set up by aid agencies. It also hands over decision-making power on contract awards to the recipient countries, which creates ownership and improves the chances for local firms to win contracts, in particular if the recipients give preferential treatment to local firms or set aside a share of contracts.

Assessing progress towards the crucial commitment to use country procurement systems is challenging as there is no obligatory reporting on this. Patchy OECD data suggests that there was close to no progress since the Paris Declaration was signed. Donors often argue that they do not use recipient country procurement systems because the systems either lack the capacities or pose important fiduciary risks. We put this argument to the test by comparing the use of country systems with the scores in the World Bank's Country Policy and Institutional Assessment (CPIA) which is widely used to assess the quality of country systems.

Strikingly, our test showed no correlation between donor use of country systems and the CPIA score. This indicates that the constraints for using country systems are to be found on the donor side: a mixture of economic interests, risk aversion and desire for greater public



Development projects funded with tied aid are 15 to 40% more expensive. Furthermore, in reality the majority of formally untied aid contracts from bilateral agencies also go to donor country firms.

recognition by donors (flag flying) are behind the lack of progress made in the use of country systems.

Country Procurement Systems: Strengthened by whom and for what?

Donors' commitments to using country systems were made under the condition that recipients reform and strengthen these systems. According to the Paris Declaration, recipients were supposed to take the lead in such reforms. But the evidence from policy reforms in the case studies conducted for this research shows that donors – and particularly the World Bank and other Multilateral Development Banks – continue to exert a strong influence on procurement policy reform in developing countries.

Procurement reforms pushed by donors in the past decade have strongly pushed towards the greater liberalisation of procurement systems – an approach that serves their economic interest for better access to the government procurement markets of the South. There is no evidence that donors have either given the policy space – or even encouraged – developing countries to shape up procurement policies that are effective for developing their own domestic firms and productive capacities. Neither have developing countries been given the chance to use procurement to promote their social and environmental objectives, as foreseen in the United Nations agreements on sustainable public procurement

The upcoming Fourth High-Level Forum on Aid Effectiveness in Busan (HLF4) in South Korea, will look at aid in the broader context of development. It offers an opportunity to address the unfinished business and also the misguided streams of the aid effectiveness agenda. It is the place for OECD countries to prove that they do take aid effectiveness seriously, and can really change the way that aid is spent.



Donors and particularly the World Bank and other Multilateral Development Banks continue to exert a strong influence on procurement policy reform in developing countries.

Recommendations

Recommendations for bi- and multilateral donors:

- Untie all aid to all countries
- End informal aid tying
- Use country procurement systems as the default option
- Support developing country efforts to strengthen procurement systems
- Give preference to local and regional procurement
- Move towards smart procurement
- Integrate Public Procurement into the EU's Policy Coherence for Development Framework

Recommendations to developing country government:

- Make country procurement systems work
- Make procurement policies and practices smart
- Make procurement transparent and accountable
- Say no to tied aid

Introduction

During the last decade, donors and recipient countries have made important efforts to increase the quantity and quality of development aid. Official development assistance (ODA) has increased from USD 54bn in 2000 to USD 129bn in 2010, although it is still far from the UN target of 0.7% of donor GNI.¹ Theoretically, more aid is now available to reduce income inequalities between North and South and to drive sustainable development in the South. Much progress has been made towards the MDGs, and where effective aid was provided, it played a crucial role in driving that progress, in particular in the areas of health and education.

However, there is still a long way to go. Poverty is still a reality for too many of the world's citizens. Over a billion people are currently living on less than USD 1.25 a day and inequality remains pervasive.² Very few countries managed to graduate from aid dependency over the past decade. Due to the lack of productive capacities and domestic resources, progress against the Millennium Development Goals in Least Developed Countries can only be sustained if donors continue to make funding for health and education systems available. Much remains to be done to make aid a more effective instrument to eradicate poverty, and shift gears towards sustainable and equitable development pathways.

In this past decade, the international community agreed to a range of commitments to address aid effectiveness, laid out in the Paris Declaration (2005) and the Accra Agenda for Action (2008).³ If fully implemented, countries receiving aid will play a stronger role in setting development policies and deciding

how aid is delivered. Better aid should achieve more and better development results.

But despite these international commitments, ineffective practices by donors and recipients continue to constrain the full potential of aid to deliver development outcomes. Many development projects are done for the poor and on behalf of the poor, but not with and through the poor. Much larger shares of ODA could be retained in developing countries and translated into additional income for the poor if donors would change the way they are doing development business.

In practice, this means that for many years aid paid for health, education or infrastructure services for poor people. But poor countries and people did not participate in the provision of these goods and services, often because donors tied their aid to the condition that most of these goods and services that were needed for development projects were bought from providers

Procurement in the aid effectiveness agenda – an overview

OECD DAC 2001

Untying aid

The 2001 Recommendations on Untying ODA to the Least Developed Countries aim to address a major scandal of development cooperation: namely, that aid is provided under the condition that goods or services are bought exclusively from the donor country, excluding Southern companies from business opportunities. "Tied aid" delivers goods and services; however, it halves the development impact of aid as it does not help creating jobs, income or human capacities in the recipient country.

Rome 2003

Harmonization

The first High Level Forum on Aid Effectiveness made commitments to harmonising different donor procedures, including in the area of aid agency procurement.⁶ Harmonizing donor procedures means that recipient governments do not have to become familiar with and process a myriad of different requirements from their various donors. Instead, the donors to a particular country align their practices, reducing the administrative and capacity burden on the recipient country.

An ambitious reform agenda with some severe omissions:

from donor countries. Although the commitments to untying aid have to some extent phased out formal aid tying, a closer look at who gets aid contracts shows that it is still mostly donor country companies and consultants that deliver goods and services paid with aid budgets. The ways in which these goods and services are procured is also part and parcel of the problem.

There is much room for improvement in increasing the participation of the poor in implementing development projects and giving them a chance to find decent jobs, increase their income and build their capacities. Implementing official commitments to untying aid, using developing

country systems and giving preference to local procurement for goods and services paid with aid monies could unleash this unexploited potential. The United Nations highlights that it is necessary to “accelerate growth of government spending on goods and services”⁴ to drive the development of Least Developed Countries. Disbursing aid via the procurement systems of the country that receives aid contributes to that growth. Smart procurement policies and practices contribute to the “technological progress and structural transformation, as well as the generation of productive employment opportunities, which is the key to substantial poverty reduction.”⁵

This report reviews procurement policies and practices of both aid agencies and developing country governments to assess whether they are using procurement in a way that maximises the developmental impact of aid and public spending in developing countries. It assesses the developmental impacts of ongoing reforms which have been triggered by the Paris Declaration and the Accra Agenda for Action, and explores how smart procurement could make aid a more effective instrument to drive poverty eradication and sustainable development.



The United Nations highlights that it is necessary to “accelerate growth of government spending on goods and services” to drive the development of Least Developed Countries.

Paris 2005

Ownership and use of country systems

Over one hundred countries and international organisations signed the Paris Declaration on Aid Effectiveness. The Declaration acknowledges that developing countries must take the driver’s seat in their own development processes. Donors also committed to using developing countries’ procurement systems to the maximum possible extent, under the condition that recipients reformed and strengthened these systems.

Accra 2008

Local and regional procurement

At the Third High-Level Forum on Aid Effectiveness, signatories agreed to use recipient country procurement systems as the first option. This strengthened commitment was necessary because the 2008 Paris Monitoring Survey had found that although many recipient countries had improved their public financial management and procurement systems, donors did not scale up their use of these accordingly.⁷ The Accra Agenda for Action also contains a new commitment to boosting the local economic impact and thus the development effectiveness of aid. This is to promote the use of local and regional procurement, increasing their spending on goods, supplies and works in developing countries.

Although existing aid effectiveness commitments have the potential to make aid more effective for sustainable development, the OECD-DAC’s aid effectiveness agenda lacks explicit commitments to make procurement work better for the poor, and to promote social

and environmentally sustainable development. Such commitments have been made under the umbrella of the United Nations: At the 2002 UN Conference on Environment and Development, the 192 UN Member States committed to move towards Sustainable Public Procurement

(SPP). Sustainable procurement practices take developmental, social and environmental criteria into account and make procurement contribute better to reaching the UN’s development goals.

Part 1

Procurement: a keystone in development

Procurement- the purchasing of goods and services by governments to implement public projects or provide public services such as infrastructure or health and education services- is an important share of economic activity in any country; it is the main component of government spending besides wages. According to the OECD, public procurement accounts for 20% of GNI for OECD countries and 14.5% for developing countries.⁸

In developing countries public procurement is a bigger source of development finance than aid- OECD-DAC donors provided just 0.32% of their GNI in aid in 2010, and only a few post-conflict states receive anything more than 14.5% of their GNI in aid. While domestic resources and tax income are the most important funding source for public procurement, in some developing countries, development aid funds a substantial share of public investment and purchases. This is because donors still prefer to fund, for example, the construction of new hospitals or schools, while relatively lower amounts of aid are channelled for recurrent expenses, such as wages of teachers and doctors.

It is difficult to estimate the share of aid budgets that is used to buy goods and services, and thus is used for public procurement, as all too often donors do not report systematically on the contracts that they have awarded and who has won the bid. Moreover, aid-funded contracts are also awarded directly by developing

country governments, when aid is channelled as budget support or donors use developing country procurement systems.

Procurement is where the money is

According to the OECD, in 2009 bilateral donors spent close to USD 9bn of development aid on procuring goods and services or contract works from the private sector.⁹ However, Austria, Canada, Italy, Ireland, Korea, the Netherlands, Norway, Spain and Switzerland did not report to the OECD. If the percentage for these countries was similar to that of the others (approximately 14%), the total figure would go up to USD 12bn in 2009.¹⁰ Multilateral agencies would add another USD 5bn per year.

As well as donor agencies using ODA directly for development projects, some ODA is injected into recipient country government budgets, and some of this is also used for procurement. According

to the OECD, the 30 recipient countries that took part in the 2008 Paris Monitoring Survey used USD 10.5bn for procurement in 2007.¹¹ For these countries, this is just over 40% of the aid they received.¹² If this percentage were applicable to all recipient countries, it would mean that some USD 52bn of ODA was used for procurement by developing countries.¹³

Although are estimates may deviate from the real figures, they shine light on the sheer amount of aid which is used for procurement either by donors or by recipient countries: roughly over USD 69bn a year.

Smart procurement boosts poverty reduction and sustainable development

Donors committed to increasing their use of recipient country systems under international aid commitments- reducing transaction costs, increasing the recipient country's control over the use of the aid (their ownership), and strengthening developing country institutions.

In return they demanded that developing countries reform their procurement policies and practices. As aid is only a percentage of the monies used for government procurement, the impact of these reforms goes well beyond just aid.

Reforms also go way beyond just enhancing the transparency and accountability of the procedures used for tendering and bidding of goods and services by the government- they ultimately decide in whose hands

money end up- hence the political nature of the issue.

By awarding contracts, governments secure turnover for private firms, and jobs and income for the workers they employ. By guaranteeing predictable demand, companies can make bolder investment decisions, build productive capacities for the future and innovate. Through adequate procurement practices, governments can debar (or blacklist) firms that have been involved in fraud, corruption or which undermine the public interest. They can also strengthen firms which are the most beneficial for the public, by giving preferential treatment (see Box 3 below).

Joseph Stiglitz, the former chief economist of the World Bank, stresses that "government procurement policies have important economic and social roles in developing countries ... Procurement policy might be used to boost domestic industries or encourage development in specific sectors of national interest. Social objectives could also be advanced by preferences for specific groups or communities, especially those that are under-represented in economic standing."¹⁴

However, procurers are often under massive external pressure to ensure "value for money". This, narrowly interpreted, creates strong incentives to award contracts to the cheapest bidder, regardless of the quality and wider developmental and socioeconomic considerations. One World Bank procurement expert interviewed for this research summarized this attitude as "it is often: meet the immediate need first and don't care about the future".

This attitude, while increasing the



According to the OECD, public procurement accounts for 20% of GNI for OECD countries and 14.5% for developing countries.



69bn USD of aid used for procurement each year.

short-term outputs, massively reduces the long term potential impact of goods and services procured by donor agencies and recipient countries using aid monies, which could otherwise be used to foster investment and innovation, enhance labour, social and environmental standards, and can help build local capacities, skills and the adequate socioeconomic fabric to set developing countries on the path

out of poverty. Procurement can be used as a developmental tool or even, as "pro-poor procurement", a tool for "buying social justice", for reducing inequalities and fighting poverty.¹⁵

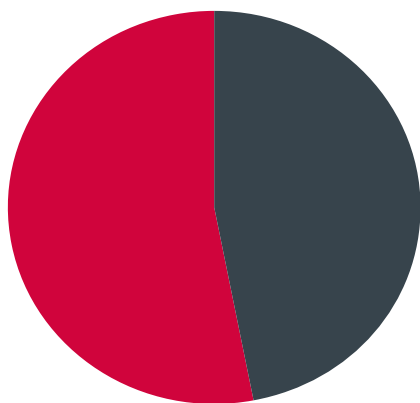
Although smart procurement is more technically challenging than just buying the cheapest offer, some believe that "the ability to navigate the difficult waters of socioeconomic preferences should be a core

competency of state and local public procurement officials."¹⁶ This includes aid agency procurers.

Aid can only play a supportive role, whether it is disbursed through recipient country procurement systems or through aid agencies' parallel procurement systems. However, this role is significant in aid dependent countries where aid accounts for a large share of GDP,

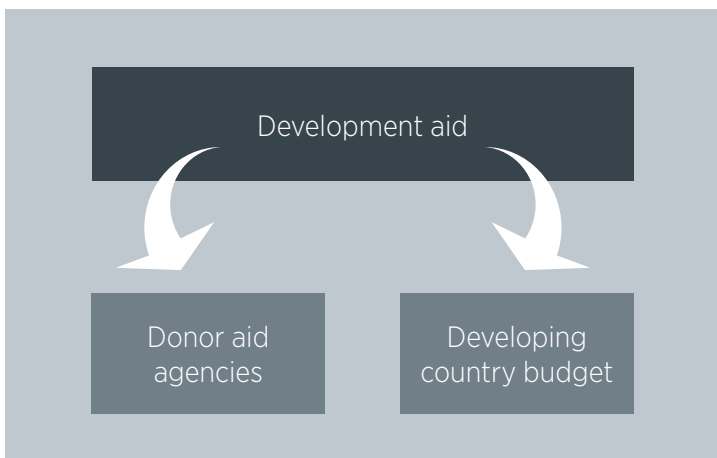
and donors contribute a substantial amount to the government budget. Smart procurement can increase the real value for money of aid, by generating long-lasting and sustainable development impacts. Both parties, donors and recipient country governments, have a role to play to make this happen. The next chapter will explore what donors must do to make procurement a smart developmental tool.

Percentage of aid that is procurement



USD 129bn overall aid in 2010
Over 53% is procurement

How aid is channelled



Targeted procurement: Most common practices

Set asides: With set asides, government contracts are offered exclusively to a group of firms that meet certain criteria. Most common is to limit competition to national firms, or nationally registered firms, but it is also a widely applied practice to set aside a share of contracts for small and medium enterprises, for ethnic minorities or disadvantaged social groups. Some governments have quite exceptional set aside rules, the USA for instance for war veterans, aiming to reintegrate them into the economy upon return home.

Price preferences: This is the most common practice in public procurement. The United Nations Commission

for International Trade Law (UNCITRAL) model law on international public procurement allows for giving price preference to domestic bidders: the price margin is 7.5% for works, and 15% for goods and services.¹⁷ These percentages can be added to bids by domestic firms for comparison with those from foreign firms. The price margins of the UNCITRAL model law are applied by numerous developing countries, and sometimes also by international financial institutions such as the World Bank. Their rationale is to create a level playing field between domestic and foreign bidders, given the fact that the latter are usually more competitive than the former and can submit cheaper bids, because they benefit from a number of advantages such as economies of scale or access to cheaper finance. Free markets

are not necessarily fair markets, and price preference margins are supposed to balance these disadvantages and create the conditions for fair competition between domestic firms from developing countries and the big transnational corporations.

Quality selection: While the price usually is the key criteria for awarding contracts (the contract goes to the bidder who submitted the cheapest offer: lowest-cost-selection), in practice often additional "qualitative" criteria play a role. Quality selection is common for consultancy contracts, but can also be applied to give preference to eco-friendly goods. There are three different ways to consider "quality" in the evaluation of bids. First, a two-stage-selection process ("cost" and "quality" of a bid are evaluated separately).

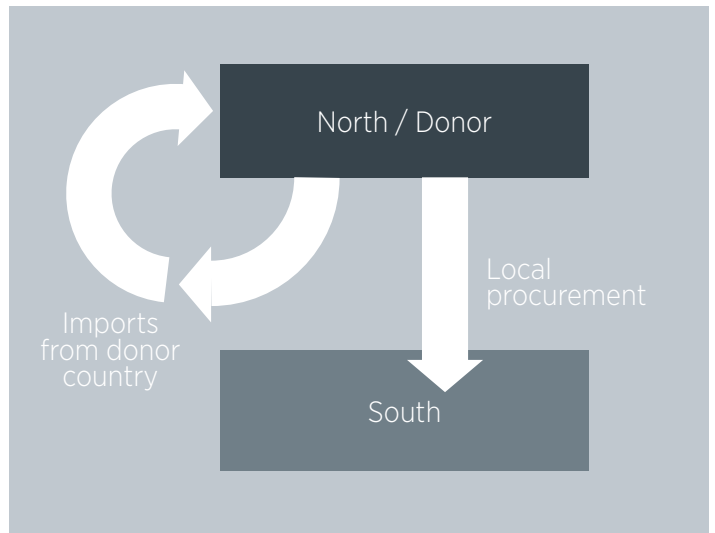
Second, "quality" is translated into monetary values and the price adjusted accordingly. Third, "cost" is translated into points and for "quality" extra points are added.

Debarment: Another option is to exclude certain firms from the procurement market. A widely applied practice, for instance by the Multilateral Development Banks, is to debar firms that have been involved in fraud or corruption cases, thus punishing them for corporate social irresponsibility.¹⁸ The commitment in the Accra Agenda for Action that donors respect corporate social responsibility should also imply that firms registered in tax havens or involved in human rights violations are debarred.

How smart is aid spending?

The Accra Agenda for Action obliges donors to use recipient country procurement systems when disbursing aid, as this has the biggest development impact (see section 1). However, donors are lagging behind on this commitment, and instead continuing to use their own procurement systems. Whilst they are still doing so, it is important that donor procurement practices are improved to ensure that they deliver the highest development impact. This means ensuring that they use local businesses when spending their money on development projects, so that the local economy benefits.

Boomerang aid vs. sustainable aid transfer



Donor procurement:

Most aid contracts go to their own firms

Although donors' procurement policies and practices can take various forms, there are basically three main practices:



Tied aid

Only firms from the donor country are eligible to bid for donors' tenders. Consequently tied aid funds quickly return to or actually never leave the donor country in the first place.



Untied aid

All firms from all countries are eligible; such contracts are usually open to international competitive bidding, which means that the cheapest offer – the most competitive – gets the contract. Larger firms – often from donor countries – which can build on economies of scale or have more resources to compete in open bids, tend to receive a larger share of contracts. Although untied aid has the potential of procuring at cheaper prices, it also has higher transaction costs due to the complex tender and evaluation procedures.



Local procurement

Local procurement: Supplies are purchased by the donor in the project country so contracts are awarded to firms based in the recipient country (including locally registered foreign companies), hence spending more aid funds in recipient countries.

Much aid is still tied

Tying aid has been a common practice in aid for decades. Many donors considered tied aid as a win-win approach- it allowed them to deliver development aid while at the same time promoting businesses opportunities for their own firms in developing countries.

But in practice, tied aid means that aid monies never leave the donor country. Poor people in poor countries may benefit from the good or services procured, but they are deprived from the potential positive externalities of aid spending, such as getting a job or increasing their skills by working in local companies that deliver goods and services procured with aid funds.

In 2001, the OECD-DAC passed the Recommendations to untie aid to the Least Developed Countries,¹⁹ recognising that untied aid could have a more significant impact on the local economy. These recommendations were a major breakthrough in the aid effectiveness agenda. However, they have several shortcomings, as they exclude both food aid and technical assistance. This means that although tying aid is not good for development, much aid is still tied. And progress to genuinely untie aid in the last decade has been minimal at best. According to the OECD, almost a fifth of aid from bilateral donors was tied in 2009 (close to USD 18bn).²⁰

Why tied aid is ineffective

1. Tied aid undermines the recipient country's ownership of the development process.

Ownership is the cornerstone of the aid effectiveness agenda. Realizing ownership is giving the people of developing countries more power as well as responsibility over their own development. However, tied aid disallows developing countries from taking full responsibility of their own development. It puts purchasing decisions in donors' hands instead, often resulting in the purchase of inadequate goods or failed services. The Gilgel Gibe project in Ethiopia is an example of how tied aid decreases the value of aid by providing services which may not have been the most adequate for the country.

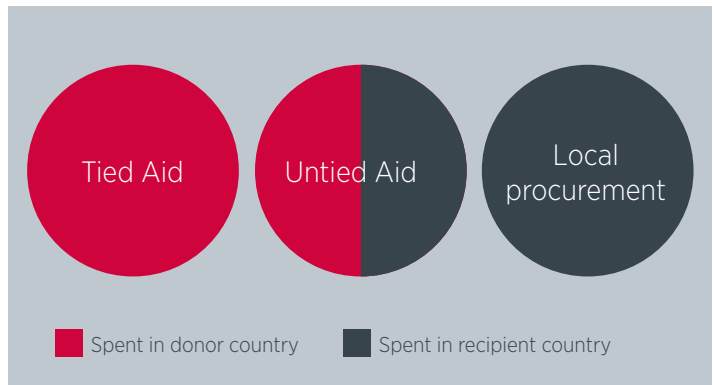
2. Tied aid decreases value for money.

Goods and services from donor countries are often considerably more expensive than their equivalents in developing countries. DAC Recommendations on Untying ODA to the Least Developed Countries (LDCs) showed that tied aid increases costs of supplies by 15% to 40%. This is mainly due to the limited competition, which allows providers to charge monopoly prices, and the higher transport costs when goods need to be delivered from donor countries rather than being purchased locally.²²

3. Tied aid undermines the Right to Development²³ Tied aid contracts awarded to companies in donor countries deprive developing countries from unleashing the full potential of aid as a driver for long-term sustainable development. If goods were procured – to the maximum possible extent – through developing country companies and aid services such as technical assistance to local experts, aid could

help boost the national socio-economic fabric by creating much-needed jobs and income for poor people in poor countries.

The European Commission concluded that aid untying increases transparency, enhances the poverty focus of aid (it delinks aid from donors' commercial interests), and provides cost effective supplies.²⁴



Tied aid increases costs of supplies by 15% to 40%.

The Gilgel Gibe dam: Italian aid supports Italian businesses abroad

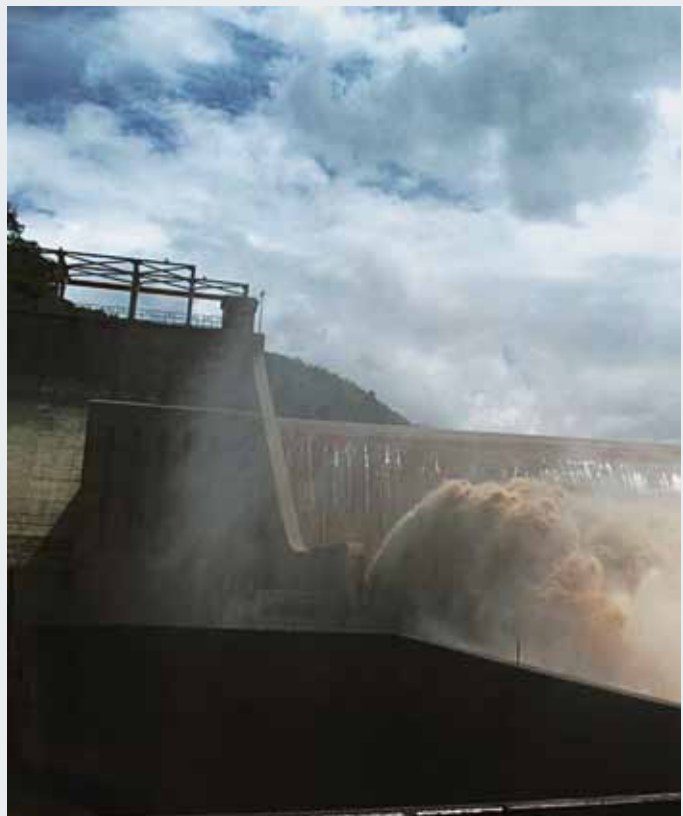
The Gilgel Gibe II is a 25-kilometre long tunnel to exploit a water drop and generate power. In May 2004, the Ethiopian Electric Power Corporation and Salini Costruttori –an Italian company- signed a €490 million deal to build the project, but the project has been surrounded by irregularities since its inception.

In violation of the existing procurement procedures of the Ethiopian Ministry of Finance and Economic Development, as well as Italian law and EU procurement directives, the contract was awarded following direct negotiation between the two companies. Despite this, the Italian Ministry of Foreign Affairs granted Ethiopia a €220 million concessional loan to implement the project –the largest ODA loan ever granted by Italy.

Besides the lack of transparency in choosing the contractors, the lack of an appropriate needs assessment for this project seriously calls into question its development rationale. In February 2004, a few months before the signing of the contract of Gilgel Gibe II, Gilgel Gibe dam (know as a Gilgel Gibe I) became operational. It increased the national generation capacity to 783 megawatts while Ethiopia's peak domestic demand as of January 2006 was only 587 megawatts.

The construction phase also faced problems of its own. Important delays were arguably caused by the lack of adequate feasibility studies. In 2010, more than two years after the original deadline, the project was inaugurated, but ten days later the main tunnel collapsed, and the project now requires costly and lengthy repairs.

Source: The Gilgel Gibe Affair: An analysis of the Gilgel Gibe hydroelectric projects in Ethiopia by CRBM and CEE BankWatch and other sources²¹





Aid untying increases transparency, enhances the poverty focus of aid, it delinks aid from donors' commercial interests, and provides cost effective supplies.

Which countries are still tying their aid?

In 2005 and 2008, donors restated their commitment to untying aid. The Paris Declaration and the Accra Agenda for Action included commitments "to further untie their aid to the maximum extent."²⁵ These agreements have been instrumental in dramatically increasing the share of untied aid from 57% to 86% of bilateral ODA to LDCs between 1999-2001 and 2007-2009 (51% to 79% in all developing countries).²⁶ But despite progress, at least 17% of all bilateral aid was still tied in 2009. This average masks a much worse performance by several bilateral donors such as Greece (67% of its aid was tied in 2009), Austria (54%), Korea (50%), Portugal (39%), Italy (38%), United States (32%), Germany (27%), and Spain (25%).²⁷

However, tied aid culprits in 2009 can also be found among frontrunners of the aid effectiveness agenda. For instance, USD 57 mn of Denmark's tied aid funded several infrastructure projects in Mozambique, Bangladesh, Sri Lanka China and Maldives. And the Netherlands channelled USD 505 mn through the Development-Related Export Transactions Programme (DRET).

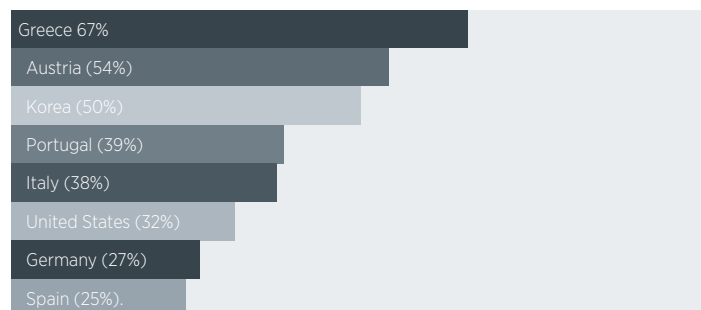
Also in 2009, France bought 37 French trams for Casablanca, Morocco, at a cost of USD 148mn. In addition, USD 90 mn were provided

for maintenance of the tramway in the same year. In Pakistan, France spent USD 98 mn on a wastewater treatment plant and in Vietnam it invested USD 70 mn in a pilot ferry system for Hanoi. Through tied tied, Spain funded a USD 146 mn enlargement of a wind farm in Tunisia. And Portugal provided USD 86 mn to rebuild roads in Cape Verde. All of it was tied aid.

Outside Europe and in the same year, the State Department of the US reported USD 250 mn of tied aid spent on two projects to fight narcotics in Mexico. This is nothing compared with the amount of tied aid- USD 534 mn- spent by the US on the Andean Counterdrug Initiative and other counter drug projects in Colombia. Japan is also building a mass transit system in Jakarta with USD 515 mn of tied aid.²⁸

Despite the OECD-DAC Recommendations and the commitment to untying aid in the AAA, donor countries continue to mislead their own citizens and those of developing countries, by passing off what is essentially state aid to donor country firms, as a genuine contribution to poor countries' effective development. As the European Commission recognises, "untying is not a technical issue. It is a highly political question that touches on the reality of ownership and the neutrality of aid."³⁰

Percentage of aid tied in 2009



Tied technical assistance

When the DAC Recommendations on Untying ODA to the Least Developed Countries were negotiated in 2001, there was strong pressure from some DAC member states to leave technical assistance out of the agreement. Some donor countries have specialised agencies that hold the monopoly for implementing technical assistance, for instance Germany and Belgium. All donors have a certain preference for consultants from their own countries, in particular in sensitive areas of monitoring and supervision of development projects where loyalty ostensibly plays a role. In Accra, however, donors committed to "promote the provision of technical co-operation by local and regional resources, including through South-South co-operation."³¹

Tied technical assistance is costly and all too often inefficient. In countries such as Bangladesh and Uganda, foreign consultants are five times more costly than locals. They receive higher salaries but they also cause higher costs in terms of child allowances, rent and travels or "hardship allowances" for living abroad, that are uniquely granted to foreign staff.²⁹ However, as technical assistance is mostly in-kind aid, all too often the opportunity costs are not fully perceived by recipient country governments.

Overpaid foreign consultants deployed next to underpaid public service officers in ministries may also trigger corruption, highlighted Anu Muhammad, a political activist and university professor in Bangladesh. He states that there is little understanding by public service officers as to why they should be materially so much worse off than the foreign consultants, and there are few opportunities to catch up using legal means.

Moreover, technical assistance has frequently been evaluated the least effective modality of development cooperation. Very few capacity building programs show good results and even fewer sustainable long-term results. Foreign consultants tend to lack knowledge of the local context and culture, and tend to have lower legitimacy among local stakeholders.

Employing foreign consultants is often unavoidable because "all expertise cannot be found in country," says Sylvi Demas, Director for Development Planning in Namibia's National Planning Commission. However, local practitioners such as Charles Businge of ActionAid Uganda think that "there is a deliberate process to keep this niche where expatriates are needed." The usual practice that foreign aid is still largely controlled by foreign staff is looked down on by Southern civil society: "When you give aid, let it be aid, don't attach a hundred people. This is neo-colonialism," added Businge.



Reserved parking for foreign consultants in front of a government building in Kampala/Uganda

“Larger EU contracts almost always go to big international firms because “you must have staff in the company devoted to doing tenders, and only the largest ones can afford this.”

Informal aid tying: Old wine in new skins?

Untying aid is a necessary condition to opening up opportunities for developing country socio-economic actors, such as local firms or technical assistance experts. However, recent research shows that it is not a sufficient condition. An OECD evaluation published in 2010 showed that despite official progress made in untying aid, most contracts awarded by aid agencies were still awarded to donor country firms.³²

How is this possible?

1. Headquarter procurement benefits Northern companies.

The procurement process can be handled by procurement officers in headquarters or by country offices. In exceptional cases it is outsourced to specialised agencies, such as the Crown Agents in the case of the United Kingdom's bilateral aid.³³ Headquarter procurement reduces the chances of developing country companies winning contracts, as it is extremely difficult for a company from a developing country to have the resources to monitor and bid for tenders centrally managed by donors. There is no such thing as a centralised point where a company from, say Uganda, could access all the tenders by all donors in their country.³⁴ Moreover, language is often an additional barrier. Last but not least, larger companies and consultancies

maintain liaison offices at the global hubs of the aid industry such as Washington or Brussels, giving them an edge when contracts are managed centrally. Richer countries' embassies also give support to their countries' firms, a measure most poor countries cannot afford.³⁵

Promoting procurement by country offices increases local companies' chances of accessing aid contracts, thus increasing the local impact of aid. Governments are well aware of the developmental benefits of 'going local' and the AAA encourages donors to "pay more attention to delegating sufficient authority to country offices ... to promote behaviour in line with aid effectiveness principles."³⁶

2. Fragmented donor procurement

Aid agency procurement is regulated by their own country regulations which pay little attention to developmental considerations. Moreover, some developing countries work with a large number of different donors with a myriad of different guidelines. Uganda "partners" with 58 donors, Bangladesh and Ghana with more than 30. The use of different tendering procedures, documents and requirements makes it almost impossible for small companies in recipient countries to successfully bid for contracts, unable to compete for contracts on an equal footing with bigger companies from developed countries.

The director of ActionAid Uganda, Charles Businge, acknowledged that Ugandan companies often "don't know donor procurement guidelines." And Finance and Contracts Officers of the European Commission confirmed that larger EU contracts almost always go to big international firms because "you must have staff in the company devoted to doing tenders, and only the largest ones can afford this." The implications are particularly severe for aid dependent countries where aid constitutes a large share of GDP and thus an equally large share of all potential business opportunities for local firms.

Hardly any efforts have been made to harmonise procurement practices – with almost the only exception being the Multilateral Development Banks, which have developed, for instance, harmonised works contracts³⁷, and the Joint Procurement Policy (JPP) developed by the so-called Nordic+ group of donors.³⁸ Aid agency procurers pointed out the constraints that they have to comply with due to their home countries' procurement laws, which makes harmonisation with other donors difficult unless wide-ranging exemptions are granted when procuring goods and services for a given developing country.

3. Large contracts undermine the chances for small and medium enterprises in poor countries. For instance, the European Commission funded a large roads construction

project in Uganda budgeted at EUR 122 mn, but the contracts were tendered in just three lots of more than EUR 40 mn on average. This size is simply indigestible for most Ugandan construction firms, in particular the SMEs from the construction sector.

In particular the Multilateral Development Banks (MDB) prefer to tender in large lots because these trigger international competition. MDB's procurement regulations imply that for larger contracts, international competitive bidding needs to be the procurement practice. That implies that the market is opened up for the participation of transnational corporations, often to the detriment of business opportunities for local SMEs. Local SMEs do not have the capacity to bid for large contracts. Thus, large contracts are de facto set aside for large foreign firms. The money flows out and does not contribute to strengthening productive capacity in the programme country. International organisations such as the United Nations Conference on Trade and Development (UNCTAD) recommend explicitly tendering in smaller lots in order to increase the development effectiveness of aid-funded procurement.³⁹

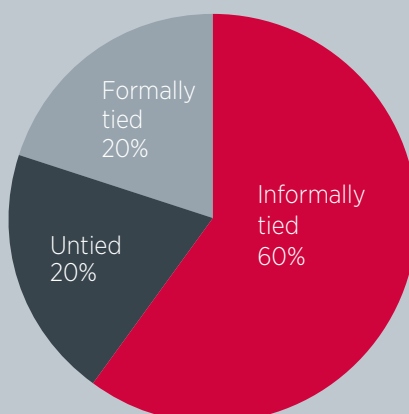
Informal vs. Formal tied aid

60%

of donor aid is informally tied to using donor firms

20%

of donor aid is formally tied to using donor firms





De facto tied aid, despite different in nature, does not differ much in terms of results from formal tied aid: it decreases value for money, and deprives developing countries from positive aid externalities.

4. Restrictive conditions and eligibility criteria. Aid agencies have restrictive eligibility criteria in place. EuropeAid, for instance, gives preference to experienced large bidders by requiring the company to have completed a certain number of projects of the same nature over the past years. Such requirements naturally penalise infant industries and de facto exclude them from the procurement market. Other restrictive criteria include having access to a certain and high amount of credit, or having had a high turnover over the past years. This usually means that only companies with good access to credit markets can successfully bid

for this type of project, effectively ruling out most companies in developing countries.

While such criteria try to pre-select bidders in order to ensure quality and actual delivery, they are obviously inadequate from a developmental perspective. The aim of development cooperation is not only to ensure optimal project management, but also to use development aid to build local capacities. The latter is fully dismissed by EU's eligibility criteria which cannot expect developing country companies and other socio-economic actors to have the same experience and access to credit as

European ones.

5. Donors do little to level the playing field. Very few donors make efforts to increase the share of contracts awarded to poorer country firms and exploit the double dividend that buying local could have. Multilateral Development Banks (MDBs) are one step ahead as they allow practices such as using price preference margins to support national companies. For instance, the World Bank and the Asian Development Bank (ADB) allow a 7.5% preference margin for works and 15% for supplies in competitive bidding. However, MDBs evaluate the

price of foreign bids net of import tariffs and duties, which may be higher than the price preferences they grant to local firms. Bilateral donors rarely use set asides or price preferences to promote local industries. Some, for example the Swedish SIDA, explicitly ban them. The European Union (European Development Fund) has price preferences for firms from the Africa-Caribbean-Pacific (ACP) countries, but EU Finance and Contracts Officers interviewed for this study confirm that in practice they are rarely granted.

DAC donors: geographical distribution of contracts awarded in 2007

| Donor | Total contracts awarded | | Within donor country | | | | Other OECD and non-DAC countries | | Developing countries (excl. LDCs) | | LDCs | |
|------------------|-------------------------|---------------|----------------------|---------------|-------------------------------------|--------------------------------------|----------------------------------|--------------|-----------------------------------|--------------|-----------------|--------------|
| | No of contracts | US\$ mn | No of contracts | US\$ mn | As % of total contracts awarded (n) | As % total contracts awarded (value) | No of contracts | US\$ mn | No of contracts | US\$ mn | No of contracts | US\$ mn |
| Australia | 12 | 100.5 | 10 | 96.3 | 83.3 | 95.8 | 0 | 0.0 | 1 | 1.4 | 1 | 2.8 |
| Austria (2) | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Belgium | 5 | 18.2 | 1 | 2.8 | 20.0 | 15.4 | 0 | 0.0 | 2 | 2.1 | 2 | 13.3 |
| Canada | 1 | 16.1 | 1 | 16.1 | 100.0 | 100.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Denmark (3) | 6 | 6.5 | 5 | 6.5 | 83.3 | 100.0 | 1 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Finland | 3 | 5.5 | 3 | 5.5 | 100.0 | 100.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| France | 66 | 350.3 | 16 | 57.4 | 24.2 | 16.4 | 7 | 119.7 | 32 | 134.3 | 11 | 38.9 |
| Germany | 52 | 171.8 | 29 | 75.9 | 55.8 | 44.2 | 3 | 6.7 | 4 | 6.4 | 16 | 82.9 |
| Greece (4) | 0 | 0.0 | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Ireland (2) | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Italy (5) | 0 | 0.0 | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Japan (6) | 23 | .. | 20 | .. | 87.0 | .. | 2 | .. | 0 | .. | 1 | .. |
| Luxembourg | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Netherlands | 1 | 4.0 | 1 | 4.0 | 100.0 | 100.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| New Zealand | 7 | 10.5 | 6 | 9.1 | 85.7 | 86.7 | 1 | 1.4 | 0 | 0.0 | 0 | 0.0 |
| Norway | 1 | 6.0 | 0 | 0.0 | 0.0 | 0.0 | 0 | 0.0 | 1 | 6.0 | 0 | 0.0 |
| Portugal | 1 | 1.4 | 0 | 0.0 | 0.0 | 0.0 | 0 | 0.0 | 1 | 1.4 | 0 | 0.0 |
| Spain (4) | 0 | 0.0 | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Sweden (4) | 0 | 0.0 | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Switzerland (2) | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| UK | 54 | 293.7 | 44 | 258.4 | 81.5 | 88.0 | 4 | 13.3 | 4 | 12.6 | 2 | 9.3 |
| USA | 95 | 1917.0 | 65 | 1207.4 | 68.4 | 63.0 | 6 | 20.2 | 20 | 650.2 | 4 | 39.2 |
| Total DAC | 327 | 2901.3 | 201 | 1739.4 | 61.5 | 60.0 | 24 | 161.2 | 65 | 814.3 | 37 | 186.4 |

Source: Clay, E. J. et al (2010): Untying Aid: Is it working?, p. 17

Notes:

1. This table does not include information on small contracts (below SDR 700,000)
2. No contract award information provided.
3. Two contracts for Denmark did not include project amounts.
4. No contracts from Greece, Spain and Sweden were reported above the SDR 700,000 threshold.
5. No contracts awarded pertaining 2007 ex ante notifications.
6. No contract amounts have been provided.



In 2008, 67% of the World Bank-financed contract amounts went to firms from just ten countries.

Donor firms profit most from aid contracts

Even when open and competitive bidding is used in donors' procurement, most contracts are awarded to companies from their own countries.

2010 research commissioned by the OECD, entitled "Untying Aid. Is it working?" shows that 60% of contracts "are awarded within the donor country" and that "it would seem reasonable to infer that an even higher proportion of all contracts, including those that are not reported, are awarded within the donor country."⁴⁰ It is reasonable to think that some contracts may go to donor country firms when goods or services are not available in recipient countries. However, such a disproportionate distribution of contracts suggests that donor procurement practices continue to favour donor country firms.

While not explicitly tied, this so-called de facto tied aid, despite different in nature, does not differ much in terms of results from formal tied aid: it decreases value for money, and deprives developing countries from positive aid externalities.

Eurodad had no access to figures of the contracts awarded to local and foreign firms by donors in the country case studies researched for this project. Unfortunately, very few donors disclose information in ways which are accessible and meaningful for civil society monitoring. However, existing research by the World Bank reveals that less than 20% of all aid to the Solomon Islands was spent locally.⁴¹ In Afghanistan, a study conducted by the Peace Dividend Trust found that in 2006 only 37.6% of reported ODA was spent locally and actually entered the economy. And this was already a large increase compared to previous years. It was boosted by the UN's "Afghanistan First Initiative" that aims to maximize local procurement.⁴² The Afghanistan study found that the decisive factor to determine how much money is spent locally is in fact the choice of aid modality. Aid modalities that used the country procurement system performed much better: 80% of budget support was spent locally while the ratio for aid through

international organisations was only 15%.⁴³

Eurodad assessed the distribution of World Bank-funded contracts in local and foreign beneficiaries. The results differ dramatically across case study countries. In Nicaragua 72% of contract value went to local firms while in Uganda this share was only 18%, resulting in very little job creation and income opportunities for the Ugandans, and capacity-building for Ugandan firms. In comparison, in the EU cross-border procurement is much lower: EU governments, who fund procurement mainly from their domestic income rather than from foreign loans that come with procurement conditions, award only 1.6% of public contracts to firms from other EU Member States. More than 98% of contracts in EU Member States go to local firms. This proves that, using donor money disbursed under donor conditions leads to substantial outflows compared to domestically funded public procurement.⁴⁴

It is reasonable to think that Multilateral Development Bank (MDB) operations are influenced by the balance of power in their decision-making bodies, where donor countries hold a majority of voting rights. Therefore in practice, MDB procurers systematically opt for international competitive bidding which increases the likelihood for the most competitive firms from higher-income countries to win contracts – to the detriment of SMEs from the borrower countries who – ironically – bear the responsibility to generate profits and tax income from their investments to be able to repay the loans.

The ultimate destination and beneficiary of a large share of World Bank loans are industrialised and emerging economies which can increase their exports to World Bank borrower countries through such loans. In 2008, 67% of the World Bank-financed contract amounts went to firms from just ten countries: China, Germany, India, Italy, United Kingdom, Argentina, Russia, Turkey, Indonesia and France.⁴⁵ This is a consequence of the World Bank procurement practices that consider international competitive bidding as best practice.⁴⁶

In order to unleash the full potential of aid to create local capacities, jobs and income, aid must be untied on paper and in practice. The latter requires a better mutual understanding between donors and recipients of what effective aid means. As pointed out by UNCTAD, there seems to be a "major difference in perception between donor and recipient countries about what untying means. For the donors, it is matter of meeting legal and administrative requirements. For the recipients, untying is understood to be the transferring of responsibility

for planning and managing funds from donors to recipients, and it should offer local businesses an opportunity to compete successfully for contracts."⁴⁷

In order to turn formally untied aid into a pot of money that socio-economic actors in developing countries can fully tap into, donors must either remove constraints in aid agency procurement to ensure greater access to contracts by poor country companies, or simply procure through recipient country systems.

Distribution of World Bank contracts in case study countries (from January 2000 until February 2011)

| Country | Local Procurement in % of contract value | | |
|------------------------|--|-------------------------|-------------------------|
| | All contracts | Contracts above USD 1mn | Contracts below USD 1mn |
| Nicaragua | 72 | 64 | 83 |
| Bolivia | 63 | 57 | 80 |
| Bangladesh | 58 | 51 | 75 |
| Ghana | 43 | 33 | 67 |
| Uganda | 18 | 11 | 53 |
| Namibia | N/A | N/A | N/A |
| Country average | 51 | 43 | 72 |

Source: Calculations by Eurodad based on World Bank contract awards database



In order to unleash the full potential of aid to create local capacities, jobs and income, aid must be untied on paper and in practice.

Procurement through country systems

The benefits of using country systems

Using developing country procurement systems could do away with many of the controversial procurement practices currently used by donors. Not by chance, in the Accra Agenda for Action, donors made a commitment to “use country systems as the first option for aid programmes in support of activities managed by the public sector”⁴⁸ to make aid more effective.

It is also the prerequisite for better domestic accountability because only the developing countries’ own institutions and systems can be monitored and controlled by their citizens, auditors and

parliamentarians – donor systems are beyond their sphere of control. Improved country systems, in their turn, improve the transparency and accountability of all public spending beyond aid.

To what extent do donors use country procurement systems?

Donors are sorely lagging behind in the implementation of their commitments to increase the use of country systems. Official figures suggest that no progress was made between 2005 and 2007. Across countries, it is fragmented. Table 3 shows the use of country procurement systems in the case study countries researched for this report as well as a few other countries examined in previous Eurodad research. The figures show that only Bangladesh, Nicaragua and countries with very low scores

in 2005 are showing significant increases, while in Mali and Uganda, the use of country systems is actually decreasing.

Most recent and country-disaggregated data on the use of country systems will not be available until the 2011 Paris Monitoring Survey is published, but the case studies conducted for this research did not find evidence of substantive progress in donors fulfilling their commitments to use country procurement systems as the first option. Out of all the countries explored in the country case studies, only one positive example stood out: the Danish International Development Agency (DANIDA) in Bangladesh conducted an assessment of the procurement system together with the UN Development Programme (UNDP) Procurement Capacity Development Centre and scaled up their use afterwards, while implementing some safeguards.⁵⁰ While this is most welcome, the uniqueness of the case confirms how progress on this front is sorely lagging behind. The exception just goes to highlight the rule.

Even more worryingly, a number of European countries such as Germany and the Netherlands have recently reduced budget support in favour of project aid. Budget support is the only aid modality that naturally uses country systems, hence the impact of this decision on future figures regarding progress on the implementation of country systems commitments.

Why donors aren’t using country procurement systems as the first option

Donors often argue that they do not use recipient country procurement systems because these systems either lack the capacities or pose important fiduciary risks. The first argument was mentioned, for instance, by the German Gesellschaft für Internationale Zusammenarbeit (GIZ) and UNDP in Namibia. The second by the US’s Millennium Challenge Account and Japan, in Namibia and Uganda respectively.

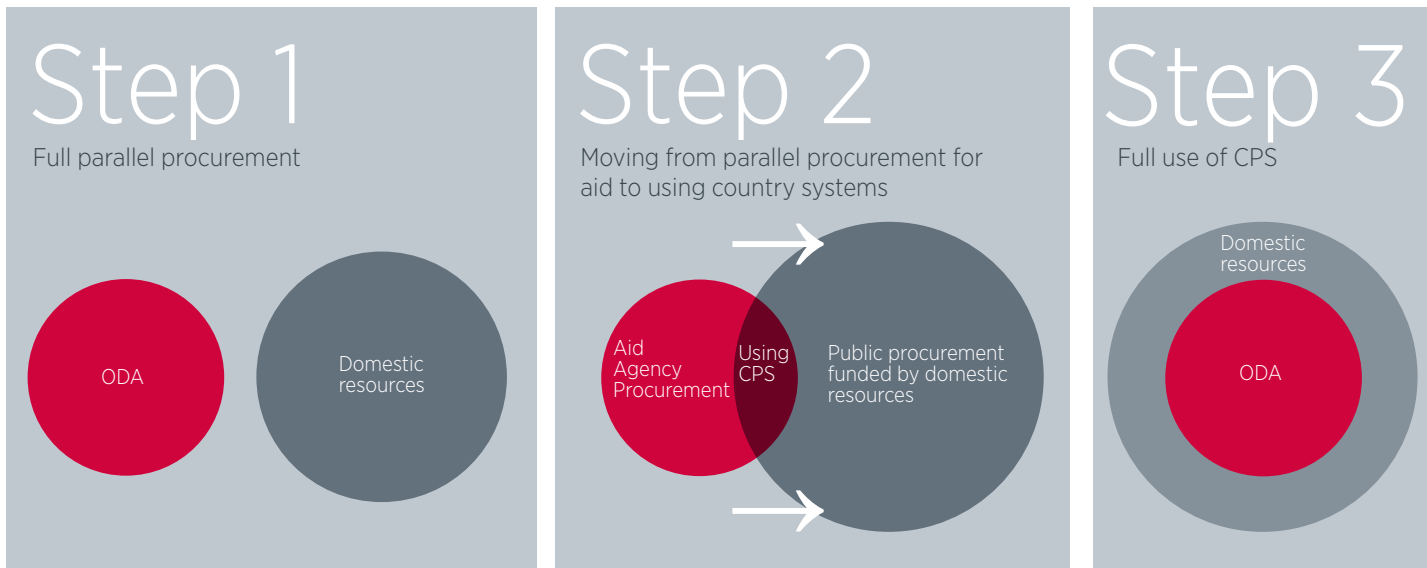
This suggests that better country systems should encourage donors to use them more and more often. Eurodad put this argument to the test by comparing the use of country systems with the scores in the World Bank’s Country Policy and Institutional Assessment (CPIA) which measures, among other aspects, the quality of public financial systems. Despite shortcomings of the World Bank’s CPIA methodology, it is the Paris Declaration’s proxy for the quality of country systems. Figure 1 compares these figures with the use of country procurement systems in case study countries and a few other countries assessed in previous Eurodad reports.⁵¹

Strikingly our test showed no correlation between the donors’ use of country systems and the CPIA score. Despite scoring highly in the quality of their country systems, neither Ghana, Mali nor Bolivia have managed to persuade donors to use their systems and do away with the myriad of parallel systems and implementation units. However, despite lower scores in Bangladesh, Mozambique and Sierra Leone, donors use these country’s systems

Using country systems:

- improves the likelihood that local businesses will profit from aid
- gives the developing country more of a say on how the aid is used
- reduces transaction costs by doing away with the donors’ numerous parallel implementation units which populate the aid industry with the so-called “project aid bombardment”⁴⁹.

Using country procurement systems (CPS)



to a larger extent. When proper risks management systems are in place, using country systems may be a good investment for the future, and it may help to strengthen them. However, the current situation begs the question of why countries with good systems are treated differently by donors.

There are also important inconsistencies in the evolution of the use of country procurement systems in time (see table 3 in the previous section). For instance, the use of procurement systems in Mali decreased from 45% to 35% between 2005 and 2007, while its CPIA score remained stable (3.6 in 2005 and 3.5 in 2007). This is even more illustrative in the case of Uganda, where the use of country procurement systems decreased from 54% to 37% in the same period of time, while the CPIA score remained constant at 3.3.

Last but not least, different donors use the country procurement systems in a given country to a very different extent. In Bangladesh, for instance, 99% of Danish aid to the government

used the country system. The value was 0% for Canada, USA and the European Commission. Since all donors face the same system with the same level of functionality and accountability, it is impossible that their decision to use it or not is determined solely by its quality. If the quality of country procurement systems is not the main factor driving donors' decisions on the use of country procurement systems, what are the reasons at play?

Some bilateral donors have extremely low tolerance to fiduciary risks which makes it very difficult for them to use country systems. USAID sources indicate that 15 to 20 years ago, 60% of their aid was channelled through country systems. This has been reduced to currently 10% due to the focus on risk avoidance.⁵² There is however no reason to think that recipient country systems were more functional or accountable than they are today. The reasons why EU donors have cut budget support may be diverse, but in Tanzania, for instance, these cuts respond to the lack of visibility and the desire of

some smaller budget support donors to report specific results, attributable to their own interventions, in order to gain public recognition.⁵³

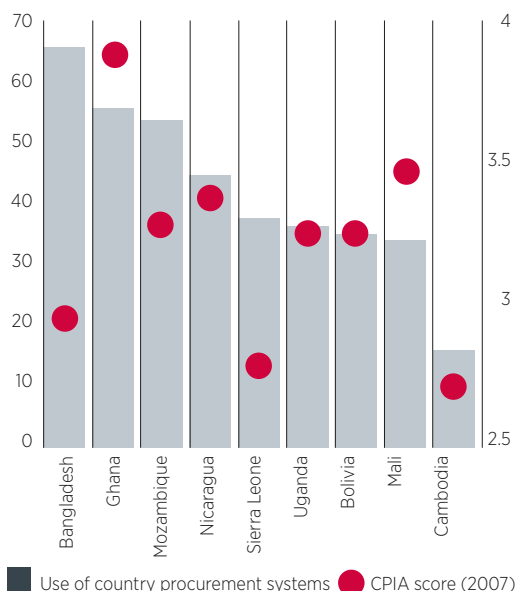
Attempts by the World Bank to increase the use of country systems have been blocked by major shareholders and strongly lobbied against by OECD countries' business associations – as shown by their comments made to the World Bank's consultation on the revision of its procurement guidelines.⁵⁴

A mixture of economic interests, accountability concerns and desire for greater public recognition by donors (flag flying) could be telling reasons behind the lack of progress made in the use of country systems. Political and commercial interests by donors and rich country corporate lobbies could be seriously jeopardising much-needed progress in the aid effectiveness agenda, which could turn procurement into a powerful policy tool to boost the capacities of private companies and other socio-economic actors in poorer countries.

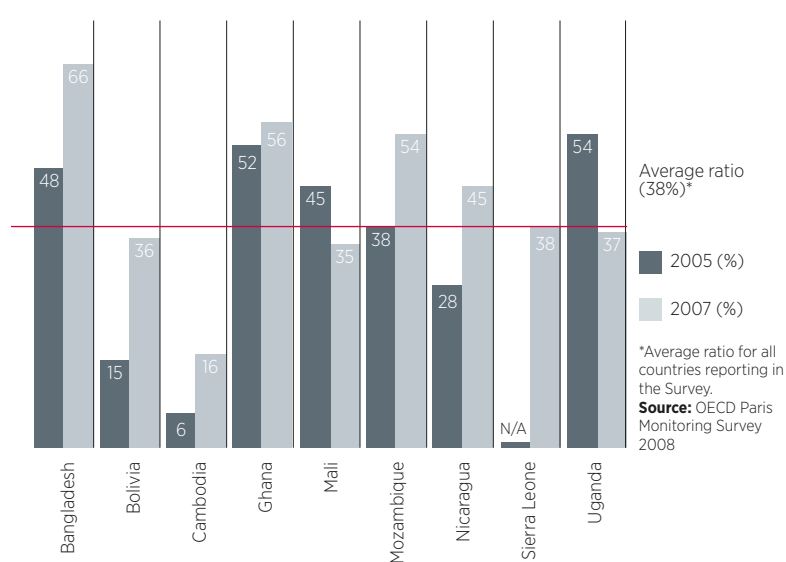


Budget support is the only aid modality that naturally uses country systems.

Use of country procurement systems and CPIA score



Use of country procurement systems (indicator 5b)



Country Procurement Systems: Strengthened by whom and for what?

Smart procurement has the potential to make a long lasting impact on the fight against poverty and inequality. This is why donors agreed in the Paris Declaration and the Accra Agenda for Action to “progressively rely on partner country systems for procurement when the country has implemented mutually agreed standards and processes”⁵⁵ and to “support (developing country) reforms (where needed) by providing capacity development assistance.” In their turn, recipient countries would “lead in defining reform programmes and priorities.”⁵⁶

Procurement reforms are highly political

Procurement policies and practices are politically sensitive as they influence who gets public contracts and who profits from public spending. They do determine how aid monies are spent; but well beyond aid, they shape the spending of developing country public budgets and taxpayers’ money. Government procurement is a contested agenda item in trade negotiations, with rich countries pushing for opening up the government procurement markets

in the South for their transnational corporations. Opening up Southern government procurement markets is a political aim of Northern countries and thus a donor interest: The European Union’s “Global Europe” Strategy, for instance, states that: “Public procurement is an area of significant untapped potential for EU exporters. EU companies ... face discriminatory practices in almost all our trading partners, which effectively close off exporting opportunities.” Consequently, the European Union is looking for “a sharper focus on market opening and stronger rules in new trade areas of

economic importance to us notably ... government procurement.”⁵⁷

Developing countries have refused to sign the World Trade Organization’s (WTO) Government Procurement Agreement that liberalises public procurement through equal treatment for foreign and domestic firms because they wanted to keep the policy space to use procurement for the development of domestic industries. However, the WTO is not the only channel through which donors countries can pursue trade liberalisation aims. The World Bank states that in an unpublished paper procurement reforms should: “contribute significantly to the trade objectives, through greater openness. By adopting Bank-equivalent policies for all public procurement, countries will be less likely to use such procurement inappropriately for purposes of domestic protection... The Bank aims to ensure that there is a fair and level playing field for foreign firms to participate under procurement processes that are expected to attract international competition.”⁵⁸

Increased competition through liberalisation of procurement markets can reduce the costs and increase “value for money” of development projects and public service delivery. This argument is often highlighted by MDBs. On the other hand, liberalisation may substantially reduce the share of public contracts that goes to local firms, and lead to spending a substantial share of scarce domestic resources on imports rather than domestically produced goods. If ownership is crucial to making aid more effective, so is defining the policies that influence how hard-won taxpayers’ money is spent in poorer countries. Therefore, it is key that developing country governments and not foreign actors take the lead in designing procurement reforms and engage a broad range of stakeholders to shape up policies for making procurement policies and systems accountable to citizens and effective for development.

However, evidence from policy reforms in the case studies conducted for this research shows that donors – and particularly the World Bank and other Multilateral Development Banks – continue to exert a strong influence on procurement policy reform in developing countries by:

- Attaching policy conditions to their aid and loans;
- Providing donor-driven technical assistance;
- Conducting diagnostics of procurement systems;
- Using trade negotiations to constrain developing countries’ policy space to decide their own pathways out of poverty.

Procurement reforms are donor-led

1. Policy conditions applied by donors influence procurement policy reform in developing countries. These reforms are often portrayed by the World Bank and other MDBs as good governance and transparency reforms. Transparency is one of the dimensions that need to be addressed in public procurement policies to make them unleash the full potential to contribute to equitable development. But procurement policy reforms advocated by the World Bank and other MDBs have all too often pushed for increased liberalisation of procurement systems.

As a general rule, the World Bank imposes the condition that World Bank procurement guidelines are followed for all larger tenders, i.e. international competitive bidding is obligatory. Procurement liberalization is often also a condition for disbursement of development loans. For instance, the World Bank’s Country Assistance Strategy 2006-2009 for Bangladesh reads: “Investments in peak power capacity expansion and complementary transmission facilities are planned, jointly with the ADB, subject to the Government’s committing to a fully open and competitive procurement process. Support for the government’s small-scale power program is also envisaged, subject to the same condition.”⁵⁹

The country case studies conducted show that the Regional Development Banks also attach procurement conditionality to development loans. In Bolivia, the Inter-American Development Bank (IADB) required to give all qualified bidders from Member States of the bank the



If ownership is crucial to making aid more effective, so is defining the policies that influence how hard-won taxpayers’ money is spent in poorer countries.



Procurement reforms pushed by donors in the past decade have strongly pushed towards the greater liberalisation of procurement systems.

opportunity to compete on equal terms in the procurement process.

2. Technical assistance is another channel through which donors influence reforms in developing country procurement systems. In Ghana, World Bank technical assistance played a crucial role in the reform process that took place a few years ago. In theory, consultants hired to help in the reform were supposed to be accountable to the Government – who was directly responsible for supervising and paying them – but as they recognised, the practice was somewhat different: “90% of our efforts are responding to donors’ demands”.⁶⁰ Bangladesh has the largest public procurement reform project funded and designed by the World Bank. The institutional and legal reforms that were promoted and implemented under that project followed one-to-one the recommendations made in a Country Procurement Assessment Review which was conducted in 2002 – by the World Bank. Anu Muhammad, a Bangladeshi aid watcher interviewed for the country case study, highlighted that “there are very few policies in country that have been drafted without the guidance of consultants, and without satisfying donors’ needs.”

This results in procurement systems aligned with “international best practices” as defined by the World Bank and other donors, rather than to the needs of individual developing countries. International best practices often fail to respond to the specific needs of a given country. For instance, the post-apartheid state Namibia uses targeted procurement to overcome ethnic inequities inherited from the Apartheid-era-similar measures could play a role in uplifting other marginalised groups such as minorities, women, or simply the poorest of the poor.

3. Diagnostic reviews have also exerted external influence on the ways procurement policy reforms have been conducted. Although the Paris Declaration states that “partner countries and donors jointly commit to work together to establish mutually agreed frameworks that provide reliable assessments of performance, transparency and accountability of country systems,”

in reality, diagnostic tools have been developed primarily by the World Bank, with some influence from other MDBs and bilateral donors. Southern governments, parliamentarians and civil society have hardly had a say. Diagnostic tools for procurement systems have been developed by the “Joint OECD/DAC-World Bank Procurement Round Table Initiative”, which is now the OECD/DAC Task Force on Procurement.⁶¹ Only after the Accra High-Level Forum has this Task Force been partly opened for participation of and scrutiny by non-governmental actors. Beforehand, it operated in a fully opaque and unaccountable fashion.

The World Bank’s Country Policy and Institutional Assessments (CPIA) and Country Procurement Assessment Reviews (CPAR) have been mostly used as diagnostic tools. Since 2005, a number of additional tools have been developed, in particular the Public Expenditure and Financial Accountability (PEFA) Program and the Methodology for Assessing Procurement Systems (MAPS). These tools still promote the opening of developing countries’ government procurement markets through giving higher scores to liberal procurement policies (see Box on diagnostic tools). Only Bangladesh has developed its own methodology for assessing country procurement systems, although the Paris Declaration makes clear that it is the role of developing countries to “carry out diagnostic reviews that provide reliable assessments of country systems and procedures.”⁶²

In practice, assessments are conducted with the financial support of donors and very often by external consultants. Even in Namibia, a country where the MDBs are largely absent, a PEFA Assessment was conducted, by a consultant funded by the European Union. The Government of Namibia found the results inadequate, refused to accept publication of the results and ended up conducting its own interviews with African peers in order to inform the procurement system reform plans. The case of Namibia, however, is an exception. In Bolivia, donors made clear that the possibility of using budget support depended on achieving good MAPS score,

Diagnostic tools to assess procurement practices: What do they measure?

Diagnostic tools to assess Public Financial Management (PFM) mushroomed in the 2000s along with the debt relief initiatives and the launch of the aid effectiveness agenda. As binding conditionalities was reduced from the mid-2000s, they became an instrument to influence policy reform in developing countries in softer ways. Donors use diagnostic tools to decide on aid modalities, e.g. whether they give budget support or project aid. Recipients are therefore put under pressure to reform their PFM and procurement systems along the lines determined by such diagnostic tools’ indicators if they want more effective aid.

The assessment below shows how these tools tend to give higher scores to liberalised procurement systems and larger tender sizes, which are all too often more likely to benefit donor companies rather than guarantee the highest and best impact of aid in poorer countries.

Country Policy and Institutional Assessment (CPIA)

scores the quality of developing countries’ policy and institutional framework, including indicators in the Paris Declaration to measure progress on PFM systems. The tool was designed by the World Bank and has been strongly criticised for being biased toward rewarding liberalised trade and financial sector policies.⁶³

Country Procurement Assessment Reviews (CPAR)

are intended to assess the efficiency, transparency, and integrity of a country’s entire procurement system and the risk it may pose to the use of World Bank funds.⁶⁴ The case studies conducted by Eurodad showed that the CPARs became the blueprint for the public procurement reform programs funded, designed, and often implemented by World Bank staff or consultants, who often even act as ghost-writers for the procurement laws which determine how public funds in poor countries are spent. The results were that country procurement systems completely aligned with those of donors. “In fact the system we are using is the donor system,” responded one government

official in Uganda. This view was shared by donor representatives who confirmed that “they are very close to the World Bank system.”

Methodology for Assessing Procurement Systems (MAPS)

is the newest tool for assessing procurement systems. It was developed by the OECD Task Force on Procurement. MAPS is supposed to align developing countries procurement systems with “internationally agreed good practices,” including liberalised procurement markets, and large tendering lots (indicator 1b). To receive the highest score, developing countries are required to limit domestic price preferences, and to phase out requirements for foreign firms to partner in joint ventures with local firms. Such requirements are however widely acknowledged as a suitable mechanism to facilitate technology transfer. The MAPS toolbox does not include indicators to assess the social, environmental or poverty impacts of procurement.⁶⁵

Public Expenditure and Financial Accountability (PEFA)

Program was established by the World Bank, International Monetary Fund (IMF), the European Commission and four European governments.⁶⁶ The procurement indicators contained in the PEFA “focus on the quality and transparency of the procurement regulatory framework in terms of establishing the use of open and fair competition as the preferred procurement method.”⁶⁷ Therefore, liberalised procurement systems receive higher scores.

PEFA is the only diagnostic tool which makes an attempt to implement aid effectiveness commitments on mutual accountability, as it assesses the performance of recipients as well as of donors. Regarding the latter, it contains indicators on predictability of budget support, financial information provided by donors and the proportion of aid that is channelled through country systems.

Country procurement systems in our six case study countries

This table outlines the main characteristics of the contemporary procurement systems in the case study countries. Reforms have largely been determined by donor conditions and diagnostics, technical assistance, and free-trade agreements. For instance, in the early 2000s, World Bank CPARs influenced procurement legislation in Bangladesh, Bolivia, Ghana, Nicaragua and Uganda. MAPS is currently being used in Bolivia and Nicaragua.

All case study countries now have a legal framework, which at least in the case of Bangladesh,

Ghana and Uganda, was substantially influenced by World Bank assessments and technical assistance. In case study countries that lead the reform process, procurement institutions are usually integrated in ministries, while those with substantial World Bank influence have erected separate and independent institutions.

Only Namibia's procurement system is largely free from foreign influence and thus deviates tremendously from the "international best practice" as defined by the OECD and the World Bank, in particular in the

area of preferential treatment. Namibia has relatively complex preference schemes that not only support domestic industries, but also certain targets groups within these, namely SMEs, firms based in underdeveloped areas, and firms owned by formerly disadvantaged groups which include in the Namibian definition: black people, women and people with disabilities. Nicaragua fully removed preference schemes due to the Central American Free-Trade Agreement. Countries in which foreign influence was strong usually stick to the price preference caps determined by the United Nations Commission

for International Trade Law (UNCITRAL) model law, which is formally a UN model law but has been largely determined by World Bank inputs and expertise. Uganda does have price preference and reservation schemes in its legislation but does not apply them in practice.

No country assessed uses debarment systematically for other reasons than fraud and corruption, e.g. for excluding firms based in tax havens or that violated human rights and core labour standards from the government procurement market.

| Country | Legislative framework | Key institutions | Anti-corruption initiative | Preferential treatment |
|-------------------|---|--|---|--|
| Bangladesh | Bangladesh Public Procurement Law Public Procurement Rules Public Procurement Regulations | Central Procurement Technical Unit Consultative Committee Review Panel | Anti Corruption Commission | Price preference may be granted to domestic bidders: 15% for supplies and 7.5% for works |
| Bolivia | Supreme Decree 181 | Ministry of Economy and Public Finance | Ministry of Transparency and Fight Against Corruption Comptroller's Office | Under certain tendering procedures, a margin of preference of up to 25% can be applied for the use of national products, up to 5% for Bolivian companies (more than 51% of shares) and up to 20% for MSMEs, small farmers and similar. |
| Ghana | Central Procurement Technical Unit | Public Procurement Authority Appeals and Complaints Panel | Serious Fraud Office | A procurement entity may grant a margin of preference for the benefit of tenders for work by domestic contractors or for the benefit of tenders for domestically produced goods or for the benefit of domestic suppliers of services. |
| Namibia | The Tender Board of Namibia Act (Act 16/1996)* Tender Board Regulations and the Tender Board of Namibia Code of Procedure | Tender Board | The Anti-Corruption Act (No. 8 of 2003) created the Anti-Corruption Commission (ACC). To a lesser extent, the Ombudsman and the Auditor-General | Price preferences can be granted for: a) Goods produced, manufactured or assembled in Namibia. b) Bona fide Namibian small scale industries. c) Tenderers located in communal areas or underdeveloped areas. d) Bona fide Namibian tenderers implementing Affirmative Action policies. |
| Nicaragua | State Procurement Law (Ley N° 323)*, reformed by Law 349 Municipal Procurement Law (Ley N° 622)* Anteproyecto de Ley de Contrataciones Administrativas del Sector Público | Directorate General of State Procurement Central Procurement Units | The Public Ethics Office. It administers the Efficiency and Transparency in Public Procurement and Contracting Programme. The General | Originally yes, but removed by Law 349 |
| Uganda | Public Procurement and Disposal of Assets Act (Act 1/2003) | Public Procurement and Disposal of Assets Authority (PPDA) Central Government Procurement Disposal Entities (PDEs) Local governments have their own PDEs | National Anti Corruption Strategy 2008-2013 ⁶⁸ The Directorate of Ethics and Integrity (coordinates) Inspectorate of Government (main authority) PPDA | Preference schemes may apply to all competitive procurement methods. Two types: - procurement bodies can add a margin to the evaluated price of non-local bidders during the evaluation of bids. - reservation schemes: only members of a target group or community are eligible |

Elaborated by Eurodad based on information from the case studies and national authorities

regardless of the suitability of this assessment tool to Bolivian country procurement system reform needs. The case study from Nicaragua also shows how developing countries are forced to align their procurement systems with those of donors following the results of the diagnostic tools if donors are to increase the use of the country procurement systems.

4. Trade agreements can also influence how procurement systems work in developing countries. Developing countries have refused to sign the WTO's Government Procurement Agreement, which liberalises public procurement in the North. However, regional and bilateral agreements increasingly play a role. The case study from Nicaragua provides evidence on how the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) compels signatory countries to use international competitive bidding. It grants firms from all parties equal access to tendering, provided the amount of the contracts is above a certain threshold (USD 70,000 for supply and service contracts and USD 7.8mn for works).⁶⁹ These measures also push for greater liberalisation of procurement policies which may create further imbalances in the playing field that is characterised by very unequal capacities of developing

and developed country firms.

Procurement reforms are not yet effective for development

Procurement reforms pushed by donors in the past decade have strongly pushed towards the greater liberalisation of procurement systems. However, there is no evidence that donors have either given the policy space – or even encouraged – developing countries to shape up procurement policies that are effective for developing domestic firms and productive capacities in developing countries. This strategy deprives poorer countries from cashing a double dividend on aid, by using aid and other public expenditure to create jobs, generating additional income sources for the poor, or strengthening local capacity building.

Procurement policy reforms in the countries where Eurodad conducted research favoured the liberalisation of procurement markets and the use of international competitive bidding (ICB). Most procurement laws or regulations in the case study countries allow national authorities to apply small margins for preference for local companies. However, in practice, larger contracts that are

the only ones that may attract the attention of foreign companies are often excluded. In Bolivia, for instance, margins of preference exist, but they do not apply if bilateral agreements with donors suggest a different procedure. Also relevant is the case of Nicaragua, where the original version of the current national procurement law (Law 323) was reformed three months after entering into force, to remove existing margins of preference.

In many cases, reforms conducted did not necessarily result in more effective procurement systems. The case study in Uganda found that although many reforms were intended to promote greater efficiency and accountability, they actually resulted in high bureaucratic requirements and time-consuming and burdensome procurement processes. The Public Procurement and Disposal of Public Assets Authority found that the average duration of a procurement cycle ranges from 43 days for direct procurement to 180 days for open competitive bidding. Procurement thus became a bottleneck for the implementation of development projects.

In none of the countries assessed were procurement officers trained in managing socioeconomic preference

systems, and only in the case of a DANIDA-funded workshop in Uganda did sustainable procurement practices feature in the training. The poverty, social and environmental impacts of procurement have largely been forgotten in the reform process so far.

Much aid money has been spent on public financial management system reforms, which include the procurement system reforms, since the Paris Declaration was signed. ODA disbursements to the PFM sector have increased more than three-fold since 2005 and reached USD 644.5 mn in 2008. However, making procurement systems fit for promoting developmental, social and environmental aims played a minor consideration in donor-driven reform programmes. A donor representative interviewed in Uganda stressed that the reform agenda should not be overloaded: “maybe it is not the right time to be so sophisticated, the system needs to be robust first”. Driven by self-interests, donors set the priority on improving fiduciary accountability, access for international firms, and short-sighted “value for money” through increased competition. The chance to develop conventional procurement systems in line with most-modern sustainable public has been missed.⁷⁰ It is left for the coming generation of reforms.



No country assessed uses debarment systematically for other reasons than fraud and corruption.



In none of the countries assessed were procurement officers trained in managing socioeconomic preference systems.

Part 4

Transforming aid: A stimulus package for the world's poor

The main purpose of official development assistance is to boost poverty eradication and drive sustainable development as agreed in the United Nation's Internationally Agreed Development Goals. In the case of European aid, this objective is legally enshrined in the Lisbon Treaty and the 2005 European Consensus on Development which state that "the primary and overarching objective of EU development cooperation is the eradication of poverty in the context of sustainable development."⁷¹

Fighting poverty, promoting sustainable development, and safeguarding human rights are the overriding criteria that should guide European donors in the ways that they deliver development aid.

In the past decade, EU aid commitments have played a crucial role in scaling up aid (albeit still insufficiently). However, they have fallen short of ensuring that aid spending has the highest possible impact on poverty eradication and other socioeconomic and environmental objectives. The question of how aid can directly contribute to poverty eradication through creating decent jobs and new income opportunities, and building productive capacities while at the same time protecting the environment, has so far been a minor consideration for donors in the EU and elsewhere.

Value for money reconsidered

ODA is a scarce resource and by no means sufficient to drive development and eradicate poverty worldwide. It can however have enormous catalyser effects if spent most effectively. Donors and recipients can make the most of aid by spending every euro twice. In other words, when aid is spent on local supplies and employment for development projects, it can have enormous multiplier and leverage effects. It creates jobs and income locally, and creates demand for the products offered by local firms.⁷² The International Labour Organisation (ILO) has calculated that each additional Euro of income for local workers leads to a multiplier effect of between 1.5 and 2.8 in low-income countries, which suggests that mainstreaming labour-based



Donors and recipients can make the most of aid by spending every euro twice. When aid is spent on local supplies and employment for development projects, it can have enormous multiplier and leverage effects.

Pro-poor procurement in practice: the infrastructure and food sectors

Pro-poor procurement techniques are particularly well-suited to the infrastructure sector. In this sector, labour-based techniques can also be up to 50% cheaper than equipment based projects.⁷⁴ But most importantly, the ILO has calculated that labour-based construction projects generate up to 20 times more jobs. In turn, up to 50-60% of project budget is transformed into wages for local workers (compared to 5-10% in equipment-based projects where most of the budget goes to machines supplied by transnational corporations). Creating local jobs has additional multiplier effects for the local economy, as the workers spend most of their income locally on goods and services for themselves and their families.⁷⁵

In Nicaragua, the Pro Empleo house construction projects spent

almost two thirds of the total budget on wage payments and the purchase of local materials.⁷⁶ In Namibia, labour-based projects tend to use large and experienced contractors to provide heavy equipment and deal with finances, but these are obliged to work with small and medium enterprises from the project region that employ local staff. As a general rule, 50% of the contract volume goes to the main contractor and 50% to SMEs. The Namibian Roads Construction Authority also provides training to small construction firms, where the latter learn how to draft tender documents, and how to access financing from the Namibian Development Bank.

Unfortunately, the European Commission and most MDBs primarily use international competitive bidding procurement practices, award contracts on the basis of lowest-cost selection and do not consider the poverty and social impacts of their procurement practices. As a result, most contracts go to foreign firms that work with capital-intensive

methods, and most of the budget is spent on foreign technical equipment and expertise, missing the opportunity to create high impact aid by using more local labour and paying more local wages.

The World Food Program's Purchase for Progress (P4P) shows how pro-poor procurement can also be successfully used in the agriculture sector. In twenty-one pilot countries, the P4P purchases food directly from farmers' organisations aiming to increase the share of locally sourced foodstuffs. Through forward contracting and procurement guarantees, it creates reliable demand for smallholder farmers. The programme also provides training for farmers on post harvest handling, helps creating market collection points and supports the construction of feeder roads to link these collection points with wider markets. In Uganda, the programme is supposed to benefit 48,000 farmers according to the WFP's own estimations.⁷⁷

Home-Grown School Feeding (HGSF) Programs are another example: These buy the foodstuffs they need from smallholder farmers. School feeding is an extra incentive for children to actually attend school and improve their education. Good nutrition improves their health. Moreover, buying the foodstuffs from smallholders, who are often the parents of these children, increases their family income. HGSF programs were first applied in Brazil on a large scale, in particular through the Fome Zero (Zero Hunger) programme. They are now increasingly applied all over Africa.

Despite the success of these programmes, dealing with a large number of providers poses a number of procurement management challenges, which is the main reason why aid agencies used to work with bigger agribusinesses in the past. However, the International Food Policy Research Institute (IFPRI) finds that engaging smallholders in cooperatives offers the opportunity to address the challenges.⁷⁸

methods in development projects should be a priority.

Smart procurement can promote economic growth, boost local demand and investment and help build a vital private sector in developing countries. What follows are three key ways that procurement can be conducted to benefit the poor and other marginalised groups, so that it can directly contribute to poverty eradication and greater social justice.



Pro-poor procurement has a double dividend for poverty eradication: while poor people profit from the outputs of development projects in their region, e.g. a new road or school they can use, they also profit from the new work and income opportunities that these projects generate.

1. Pro-poor procurement

Pro-poor procurement can increase the share of aid (or public spending) that goes to the poor and help develop their capacities. For instance, it can promote the use of labour-intensive supplies and methods and create jobs for the poorest sectors of society.

Pro-poor procurement has a double dividend for poverty eradication: while poor people profit from the outputs of development projects in their region, e.g. a new road or school they can use, they also profit from the new work and income opportunities that these projects generate. The ILO estimates that just the infrastructure investments currently funded by the EU and the World Bank could create one million additional jobs in Sub-Saharan Africa if contractors were obliged to apply labour-based methods.⁷³

Although the benefits of pro-poor procurement are uncontested, it is rarely applied in practice. Officers in aid agencies responsible for public procurement pointed out project management challenges, such as pressure to get the job done. For project managers it is often simply quicker and easier to deal with large and experienced contractors that they know, which constrains the use of pro-poor and sustainable procurement techniques. They cause additional workload and may be more time-consuming.

Such practices have been mainly tested in the infrastructure sector, but another example from the agriculture sector is to procure foodstuffs preferably from smallholders rather than from big agribusiness.

2. Promoting decent work, social inclusion and environmental sustainability.

Governments and aid agencies can use their substantial purchasing power to motivate their client firms to adopt desirable social and environmental outcomes. They can require contractors to comply with labour and environmental standards, and can use procurement to the benefit of marginalised groups, including women.

Setting high labour standards has the double effect of generating decent work, but also prevents cut-throat competition in the procurement process, by preventing that most contracts go to firms that can submit

cheaper bids because they save costs through reducing wages. Trade unions consulted during the course of Eurodad's research in Namibia were concerned about foreign companies frequently outcompeting local firms for government construction contracts because they do not pay the minimum wages and do not comply with labour standards.

There are examples where procurement is actively used to promote labour rights. The US-American Living Wage Law provides a good example of this approach, by obliging contractors to pay workers a wage sufficient to support themselves and their families, and to provide health benefits.⁷⁹ More recently, advocacy by trade unions has succeeded in getting MDBs to put an end to wage



Road construction in Ghana

dumping in development projects. The standard work contracts now oblige contractors to pay at least the minimal wages or, in case they are not established in the programme country, wages which are not lower than the general level of wages observed locally.⁸⁰

Procurement rules can also help overcoming income and social inequality by setting aside contracts to target marginalised groups, gender inequality or uplift disadvantaged ethnic groups. In the USA, for instance, the Federal Acquisition Streamlining Act of 1994 established a 5% procurement target for women-owned businesses.⁸¹ Post-Apartheid States such as South Africa and Namibia have integrated public procurement within their Black Economic Empowerment policies, and give preference to firms that are owned by black citizens.⁸²

Governments can also use their purchasing power to promote environmental goals. They can create incentives to produce environmentally sustainable products, use sustainable production techniques and even promote environmental innovations. In 2002, the United Nations' World Summit on Sustainable Development called on "relevant authorities at all levels to ... promote public procurement policies that encourage development and diffusion of environmentally sound goods and services."⁸³ In Europe, the Commission "calls on public procurement to ... support the shift towards a resource efficient and low-carbon economy, e.g. by encouraging wider use of green public procurement"⁸⁴, a shift that is already foreseen in the current legal framework, the EU Procurement Directives.⁸⁵ The shift towards green public procurement was also pushed in fiscal stimulus packages during the financial crisis which aimed at promoting a green transformation of the economy.

Green public procurement is just as important for developing

countries, which are suffering the worst consequences of the climate crisis. A UN case study on sustainable procurement argues that "weaknesses of Indonesian public procurement ... could also be seen as opportunity, since a conventional procurement system can be developed in parallel with sustainable procurement."⁸⁶ But making procurement systems fit for sustainable development does not feature high in the donor agenda which currently focuses on costs, accountability, and market access for their corporations.

However, this may be an unwarranted dilemma. Dismissing important considerations of labour, social justice and the environment when developing procurement systems, may be short-sighted: it could be a missed opportunity to make aid monies and public spending in developing countries deliver not only goods, but to generate positive externalities for the local economy and society. Much more can be done to make procurement work for the poor and the marginalised, doubling the impact of aid.

3. Driving private sector development, innovation and inclusive growth.

The willingness of private firms to invest largely depends on the future demand for their goods and services. A long-term and predictable commitment to purchase by governments and donors can create such demand and therefore boost investment in productive capacities. However, giving preference to local and regional procurement as the first option is not a common practice. Donors' practices of formal and informal aid tying may limit the possibility to use aid to boost the local socio-economic fabric.

Aid agencies and developing country governments could promote private sector development by granting price preferences to local bidders,



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Much more can be done to make procurement work for the poor and the marginalised, doubling the impact of aid.

or setting aside a share of contracts, in particular for SMEs. Promoting SME development through targeted procurement is usual practice in most developed countries, including the EU, which regards SMEs "as the backbone of the EU economy, and they have a huge potential for job creation, growth and innovation."⁸⁷ The European Commission identified easy access to procurement markets as a key driver for SME development in the recent revision of the EU Procurement Directives. However, SMEs are also the backbone of the world's poorest countries' economies; therefore, similar considerations that the European Commission is taking in the revision of the EU procurement directives at home, should be applied in developing countries.

A study conducted by the OECD in three East African countries finds that "small, medium and

microenterprises (SMMEs) have been marginalised as suppliers to the government", and notes that the main reason "seems to be lack of a coherent, transparent, accountable and participatory procurement policy in the three countries." The study criticises that, unlike in South Africa "where the government has explicitly taken SMMEs on board in its procurement policy," other African countries do not have "specific affirmative programmes in favour of SMMEs."⁸⁸ Eurodad's case study research in Uganda confirms that so far no such programme has been put in place. These considerations were dismissed in all diagnostic tools assessing procurement, including the World Bank's, and consequently did not feature in the resulting reform programmes. South Africa designed and drove the reforms itself and has in course turned procurement into a tool for local development.⁸⁹

Conclusions and recommendations

Procurement is a keystone in development finance

Almost half of all official development aid (ODA) is used to procure goods and services for development programmes. The sheer amount of money spent by donors or by developing country governments makes their procurement practices key to ensuring that aid delivers the best development results.

Donors' procurement practices decide the ultimate beneficiary and the ultimate destination of aid flows. They determine aid's distributional and developmental impact, distinguish real aid from boomerang aid, and sustainable North-South transfers from reverse flows. If well targeted, procurement can yield a double dividend for poverty eradication and sustainable development.

Procurement will be on the agenda of the Fourth High-Level Forum on Aid Effectiveness in November 2011 which is supposed to adopt a Ministerial Declaration on Procurement. It already features strongly in international aid effectiveness agreements, the Paris Declaration and the Accra Agenda for Action. Donors committed to making further progress on untying aid, to using country procurement systems as the first option, and to giving preference to local and regional procurement. Recipient countries committed to take the lead in strengthening country procurement systems. A full implementation of these commitments would make aid significantly more effective for development.

How smart is aid spending?

According to the OECD, almost 80 percent of bilateral ODA is now untied. Aid untying is essential for smart procurement, as it is a prerequisite to ensuring more aid is spent locally, creating more jobs and income. However, this change has not proven sufficient to ensuring that substantially more aid is actually injected into recipient countries' economies.

The OECD's own research has proven that when bilateral donors procure, almost two thirds of the contracts are awarded to transnational corporations and foreign consultants, rather than to developing countries' firms. Three fifths of contracts are awarded 'in country', which proves that donors still favour their national firms. Multilateral donors' procurement is less distorted by economic interests, but half of World Bank-funded contracts in our case study countries went to foreign firms - in extreme cases such as Uganda the share is more than 80%. In particular larger contracts are being awarded to Northern firms.

Donors do little to level the playing field to make it easier for firms from recipient countries to compete. Many of their procurement practices de facto exclude Southern firms from the large aid procurement market and impede their access to business opportunities and to enhancing their capacities. These practices include tendering large contracts that SMEs cannot digest, headquarter-conducted procurement, and restrictive eligibility criteria.

Using country procurement systems

Using developing countries' procurement systems would help improve procurement results and boost the local economic impact of aid. Aid that uses country procurement systems is several times more likely to be spent locally than, for example, aid to international organisations. Moreover, using country systems is the prerequisite for ownership and domestic accountability because the decision-making power over contract awards is handed over to the recipient side.

However, donors have overall made almost no progress in using country systems, although the performance of different donors does vary. Donors interviewed stated that they do not use country systems because the latter are either not functional or not accountable. But data for different donors in different recipient countries suggests that a donor's willingness to use country systems is not dependent on the system's accountability or quality, and neither does this willingness increase with the system's quality. Ghana and Nicaragua have 'better' country systems than Bangladesh (as measured by the CPIA), but donors use them less. In Uganda, the share of aid that used the country system decreased since 2005 while its quality (CPIA score) did not change.

Whether country systems are used is often arbitrarily decided by donors. Some donors face legal or institutional constraints to use country systems - notably the USA and the World Bank. Others may be constrained by risk aversion, the desire to stay in the drivers' seat in order to have attributable results,

or simply to keep control over the procurement process for promoting economic interests. Best practice examples such as the Danish DANIDA in Bangladesh, who scaled up their use of country systems to 99% of their portfolio after assessing and removing constraints, show that improvements are possible if there is the necessary will and effort to do so.

Country Procurement Systems: Strengthened by whom and for what?

In the Paris Declaration and the AAA, recipient countries committed to strengthening their procurement systems, and donors committed to supporting to this. Shortcomings within these systems are supposed to be identified by joint assessments that apply mutually agreed diagnostic tools. With this, the aid effectiveness agenda expanded far beyond aid: Country procurement systems determine how all public monies are spent, regardless of whether the finances come from foreign donors through aid or from local citizens through taxes. On average, public procurement accounts for 15% of GDP in developing countries, therefore only a small share is aid-funded.

The optimal procurement policy differs from country to country. The key determinant is obviously the stage of development and the competitiveness of local industries. However, there are also country-specific factors. For instance, the post-apartheid state of Namibia uses public procurement as a policy tool for social justice, with its Black Economic Empowerment policy. International organisations such as the World Bank and the



Procurement rules can also help overcoming income and social inequality by setting aside contracts to target marginalised groups, gender inequality or uplift disadvantaged ethnic groups.

OECD, however, currently promote an inflexible “international best practice” model within their mandate to strengthen public procurement systems given by the Paris Declaration and the AAA.

The most widely applied diagnostic tools for procurement systems are not mutually agreed, but have largely been developed by donors. They include indicators on liberalisation and thus give better scores to more liberalised procurement systems. Thus, they include ‘soft’ economic policy conditionalities. International competitive bidding is considered best practice. Thus, they de facto measure how easy it is for transnational corporations to access developing countries’ procurement markets, which may be to the detriment of the development of the easily out-competed domestic industry. What they do not assess is to what extent country procurement systems are fit to promote a nation’s respective developmental and socioeconomic aims – smart procurement.

The extent of ownership or foreign influence in procurement policy and practice reform varies tremendously from country to country. In some countries, the donor diagnostics,

in particular the World Bank CPAR and CPIA, became the blueprint for reforms and recommendations and were translated one-to-one in reforms. We found almost no foreign influence in Namibia, but much influence in Ghana, Uganda and Bangladesh, exercised in particular by the World Bank. We found that the stronger the foreign influence, the more “liberal” the outcome of procurement policy and practice reforms. Strong foreign influence therefore reduces policy space to use public monies in the national interest for promoting domestic industries, among others.

The liberalisation of government procurement was rejected by developing countries in WTO negotiations. With the aid effectiveness agenda it sneaked in through the backdoor. The increased financial outflows that resulted from more contract awards to foreign firms may outdo the benefits of more effective aid.

Transforming aid: A stimulus package for the world’s poor

Procurement is by far the most important economic activity under direct control of governments. It should be more effectively used

to drive poverty eradication and accelerate progress towards the internationally agreed development goals. To ensure this, the United Nations have developed the “Sustainable Public Procurement” (SPP) approach under the UN’s Sustainable Development process. SPP takes developmental, social and environmental criteria into account. UN Member States are obliged to report on implementation progress at the 2012 World Summit on Sustainable Development.

In particular the UN organisations already promote such alternative approaches to procurement. The World Food Programme tries to source more foodstuffs from smallholder farmers, the ILO promotes labour-based construction projects that create income opportunities for the local poor in project areas. We could not find much evidence that the SPP approach is promoted by other donors’ current activities to help strengthen public procurement systems in developing countries. Just one workshop in Uganda organised by DANIDA included an SPP training module.

Neither does SPP feature highly in donors’ own parallel procurement at

the country level. No bilateral donor systematically gives preference to local procurement. Multilateral development banks and European Commission (EDF) guidelines allow for price preferences for domestic bidders. Social and environmental criteria feature in some bi- and multilateral donor guidelines. Interviewees however confirm that neither the price preferences nor the social and environmental criteria are systematically applied, monitored or enforced. Much more can and needs to be done to fully exploit the potential of targeted and well-regulated procurement, which can yield a double dividend on scarce aid resources.

The way ahead

Upcoming World Conferences offer the opportunity to drive further change. Key moments are in particular the Fourth High-Level Forum on Aid Effectiveness in Busan, the regular meetings of the UN Development Cooperation Forum, and the 2012 UNCSD conference in Rio de Janeiro. On top of clear international agreements, there is a need for real change on the ground, for pro-poor and sustainable procurement practices by donors and developing countries.

Recommendations for bi- and multilateral donors:

Untie all aid to all countries

Untying aid is the prerequisite for using country systems and local procurement, and therefore for development effective procurement. The 2001/2008 DAC Recommendations on Untying Aid should be enhanced to explicitly cover all aid modalities in all countries. Tied aid should not be accounted fully as ODA because it does not promote economic development and welfare, which is a prerequisite for ODA.

End informal aid tying

Donors should end all practices that de facto exclude Southern firms from competing. This means creating smaller packages, sized to be manageable by local firms, advertising all tenders locally in local languages, preferably in one joint database per recipient country, and removing unnecessarily restrictive eligibility criteria, among other measures.

Use country procurement systems as the default option

Using recipient country procurement systems is the best way to ensure

recipient ownership of aid, to pave the way for domestic accountability, and to increase the share of aid that is spent and retained in developing countries. Country systems should be used in all cases where the domestic accountability of recipient country governments to their citizens is satisfactory in their self-assessment.

Support developing country efforts to strengthen procurement systems

Donors should fund developing countries' own capacity building plans. Technical assistance for capacity building should be sourced by developing countries themselves. Institutions that are affected by conflicts of interest should not be eligible to carry out diagnostics of or provide technical assistance for procurement reform programs. This applies in particular to the multilateral development banks.

Give preference to local and regional procurement

Buying local is the best way to exploit the double dividend of aid and maximize its effectiveness. Only local procurement creates jobs and local income and kick-starts virtuous cycles of economic development in developing countries. Donors should

provide obligatory explanations when they award contracts back to the North.

Move towards smart procurement

ODA should make full use of smart procurement for eradicating poverty, reducing inequalities and inequities, and promoting sustainable development. Smart procurement must become a key qualification for all procurement officers of all aid agencies. Training and procurement directives need to be adjusted accordingly.

Integrate Public Procurement into the EU's Policy Coherence for Development Framework

Public procurement accounts for 16% of GNI in the EU or almost 40 times the amount provided by EU member states as ODA. It should become a separate chapter of the EU's Policy Coherence for Development Framework. The ongoing modernisation of EU procurement policy should include reforms towards sustainable public procurement practices.

Recommendations to developing country government:

Make country procurement systems work

Invest in and increase the capacities of the public procurement systems and officers. Developing countries should develop their own capacity building plans. Public procurement is a key area of sovereignty: in case donors attach conditions or offer only biased advice, necessary reforms should preferably be funded by domestic resources.

Make procurement policies and practices smart

Governments should consult with parliaments and citizens on which policies and practices are best for making procurement fit for development, and reform their procurement laws and regulations accordingly.

Make procurement transparent and accountable

The procurement process should be transparent throughout the entire procurement cycle, from publishing

tender documents to disclosing information on contract awards and evaluation criteria online. The accountability work of parliaments and civil society watchdogs must not be restricted.

Say no to tied aid

Developing countries should systematically assess the real value of all grants and loans provided by donors, taking into account the long-term pecuniary and political costs of tied aid, in particular of tied technical assistance.

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