

Purchasing Power

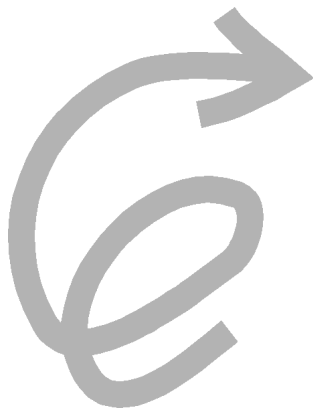


Aid untying, targeted procurement and poverty reduction

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Summary

Given the enormity of the task, it is vital that all resources directed towards poverty eradication are used as effectively as possible. Yet too often, international aid is abused in favour of supporting the interests of particular domestic companies over the needs of poor people, resulting in distorted and ineffective aid programmes at significantly higher costs. Or it is used to provide technical expertise from companies located in rich countries that may be inappropriate and is almost always unsustainable.

This report suggests a workable alternative which, if properly implemented, could increase the impact of aid on poverty reduction, enhance Southern ownership of development and bolster self-reliance.

Purchasing Power: aid untying, targeted procurement and poverty reduction proposes significantly reforming the way that international development aid is spent. The core of this proposal is that donor governments should ensure that the purchases they make as part of their aid spending – on goods or services – should support developing countries’ efforts to become self-sufficient and build their own national private sector and technical capacities. Using the purchasing power associated with aid spending together with strategically-oriented aid inputs, donor governments can:

- help build private sector capacities by promoting a graduated exposure of local firms to the international marketplace, by increasing the proportion of goods and services sourced locally (nationally and regionally) via targeted /affirmative procurement
- enhance the skills-base and expertise of local companies and consultancies through a range of joint venture schemes such as mentoring, partnerships and sub-contracting
- seek to influence the development of the private sector in developing countries towards labour-intensive strategies and the use of appropriate technologies within a framework which values workers’ rights and which maximises the spin-off impact on poverty by promoting economic growth that benefits all
- strongly influence developing country government procurement so that it is steered towards promoting social and economic development objectives.

Purchasing Power highlights some of the innovations in the area of targeted or affirmative procurement as well as how some countries seek to use procurement as a demand-level resource to support economic and social goals. The report seeks to identify how this learning can be translated to aid and government procurement more generally.

The report addresses a number of issues that need to be tackled in this context. The first is the problem of aid tying. The majority of aid spending on goods and services currently takes place in donor countries, either because it is a specific condition of aid giving or because it is informally tied to donor companies. As long as aid tying continues, the prospect of using aid procurement to support development is extremely limited. *Purchasing Power* reviews the case against aid tying and outlines the legal case against the practice at the EU level. The report proposes that aid donors should end all aid tying within two years.

Purchasing Power warns that the pursuit of economic liberalisation should not be allowed to dominate the agenda on this issue. Aid untying without directing aid procurement and contracting towards supporting poverty eradication efforts will mean that developing country companies will simply not be able to compete on a level playing field with Northern business for aid contracts. The report contends that without measures to actively use aid procurement and contracting to boost developing country producers and consultants, many of the damaging aspects of aid tying – such as over-reliance on Northern companies, ‘know-how’, technologies and spare parts – will be retained. *Purchasing Power* proposes that any future agreement to untie aid must be combined with an equal commitment to using aid purchasing to build local capacities and boost local ownership of development. Without any such commitment, a major opportunity to expand the effectiveness and long-term impact of aid will be missed.

The report highlights the need to redefine the concept of ‘value for money’. The challenge for donors, we argue, is to use their purchasing power to pursue social objectives without compromising the fundamental tenets of procurement. This means rethinking the definition of ‘value for money’ to encompass the central role that procurement and contracting can play in economic and social development. As argued by the European Commission

in its 1998 communique on public procurement, “the best value for money objective in public procurement does not exclude taking environmental, social and consumer protection considerations into account”. In a world of highly constrained development resources, ‘development impacts’ should not be measured in terms of individual projects, but in terms of the wider benefits that spread from development interventions to the wider society. *Purchasing Power* points to the important role that reformed systems of donor aid procurement could play as a catalyst and a ‘learning zone’ for much broader transformations in government procurement and contracting in developing countries in the future. If applied to public procurement more generally, models of pro-poor procurement that could be developed through reformed donor aid purchasing could represent an invaluable asset in the wider fight against poverty.

The report is released to coincide with an official complaint to the European Commission, made by over 40 European-based NGOs, that Member States’ use of tied aid is illegal under EC law. Given the failure of political will by the international community to address the problem of tied aid adequately, this complaint marks a first stage in seeking to use legal avenues to end the practice of aid tying.

Purchasing Power should be read as an input into initiating dialogue between interested parties and a call for further research on the issue of targeted procurement and using purchasing and contracting to support development objectives. Purchasing Power should also serve as a potent reminder to the international donor community that they need to act decisively to end the practice of aid tying once and for all, rather than simply promoting trading opportunities for domestic companies.

The report makes a number of recommendations including:

Donor Governments should:

- eliminate all forms of aid tying in the next two years. DAC donors must now seek to recast the current efforts to untie aid to least developed countries into a new and re-invigorated process to press for full untying. They also need to recognise that aid untying without concomitant commitments to use aid procurement as a resource for development and poverty reduction will retain many of the damaging components of tied aid. Instead, a firm commitment by donors to an agreed set of guidelines outlining best practice on pro-poor procurement and contracting must be agreed as an integral component of any deal on aid untying. The legal complaint by NGOs could help to put pressure on some of those countries that have been less willing to untie to now do so.
- put much greater efforts into the development of best practice, pilot studies, learning from other donors and governments and a process to agree guidelines to guide donor actions on capacity building using procurement/contracting as a demand led input.
- invest resources in overhauling their procurement systems and practices. Part of this investment should be used to considerably enhance local procurement capacities. This investment should seek to train procurement staff in creatively using the demand created by procurement to support development. As part of re-examining procurement practices, donors should undertake a formal review of existing contracts with procurement agencies to see if they are appropriate vehicles for using procurement as a development resource.
- seek to bring together support for local business and entrepreneur development with aid procurement as part of a coherent package for supporting Small and Medium Enterprise (SME) development.
- bring together support given to reforming recipient government procurement systems with the learning and best practice developed through strategic aid procurement. Donors should consider enabling recipient governments to use aid procurement as a way of leveraging wider change in the strategic and transparent use of procurement.
- rethink and re-examine the concept of ‘value for money in procurement’ so that strategic policy objectives can transparently be accounted for in purchasing decisions.
- promote joint ventures, mentoring and partnerships between Northern and Southern consultancies and ensure that such ventures promote positive learning and capacity building for the Southern partner.
- change their contracting procedures to ensure that learning and capacity building are emphasised in their technical cooperation programmes.

- undertake surveys of local and regionally based consultants who are able to give good quality advice and assistance on donor aid projects and non-project initiatives.
- agree that by 2005 over 90 per cent of all technical cooperation contracts must involve Southern consultancies and that the overriding aim of all technical cooperation must be capacity building.
- seek to build-in targeted/ affirmative procurement into existing support for improving the effectiveness and transparency of government procurement systems. Reformed aid procurement could in some instances provide a model for improving government procurement more widely; in other cases aid and government procurement could be brought together into a single system.
- ensure that any moves to put government procurement on the agenda of the WTO as a staging post towards full liberalisation should be resisted. The focus of the existing WTO working group on procurement should remain on enhancing transparency in government procurement only as long as these are not used as a compliance burden.
- UNCTAD, UNDP, the World Bank, the DAC and other relevant international institutions should consider how government procurement can be reformed to support the development of national capacities and poverty reduction by adapting best practice developed in aid procurement.
- Developing Countries should resist being drawn into signing any agreement in procurement that could undermine their ability to use procurement to support development and other social and economic objectives. National treatment for foreign firms in government procurement must also be resisted. Developing countries should insist on classifying government procurement as a development issue under the auspices of the WTO.

Introduction

Despite major advances in some development indicators over the last three decades, poverty and social exclusion in developing countries remain perhaps the most significant blight on humankind as we enter the next millennium. Abject poverty destroys the lives of billions of people world-wide, and the gap between rich and poor is continuing to widen.

Not only is poverty increasingly entrenched, the processes that cause and maintain it are increasingly complex. The forces of globalisation are proceeding apace, benefiting some but leaving behind many more. In the process, the pursuit of growth, efficiency and profit as end-results in themselves too often push aside efforts to promote equity, human security and the eradication of poverty. Meanwhile, global resources for development and poverty eradication are dwindling. Rich countries now spend little more than a quarter of one per cent of their wealth on aid to developing countries.

Aid resources remain a pivotal and important resource for development and an important test of Northern governments' commitment to poverty eradication – a test which most developed nations currently fail. Without official development assistance, many poor countries would struggle to survive. It is therefore incumbent on the donor community to ensure that sufficient resources are being directed towards poverty reduction and that these resources are spent as effectively as possible.

This report argues that the effectiveness and poverty focus of donor aid is very seriously undermined by aid tying – the practice by which donors continue to tie their aid finances to the provision of goods and services from companies based in their own countries. As argued in the first section of this report, aid tying results in inefficient and wasteful procurement practices, it biases aid away from poverty reduction and sustainable development in recipient countries, and it unfairly supports Northern companies and commercial interests to the detriment of local commercial participation in and ownership of development programmes in the South. Untying therefore represents an essential first step towards improving the effectiveness and quality of development aid.

But untying aid alone is not enough. *Purchasing Power* argues that donor governments should be doing much

more to improve and expand the development and poverty-reduction impacts of their aid programmes. Significant improvements in aid spending can only come about if donors embark now on reforming their systems of aid procurement. Instead of unfairly supporting commercial interests in the North and reinforcing Southern dependence on Northern development inputs through aid tying, aid procurement can and should be directed to play a direct role in assisting commercial and wider development in the South, and in enhancing local ownership of development projects.

Drawing on a growing body of international learning and discussion on public procurement and its role in development, we argue that donors should be working now to establish a new pro-poor and pro-development aid procurement regime to replace aid tying. The second section of *Purchasing Power* argues that donors, governments should ensure that the purchase of goods and services through their aid programmes genuinely supports developing countries' efforts to build their own national private sector and technical capacities, and genuinely strengthens local ownership of and participation in development initiatives.

In a world of highly constrained development resources, development 'impacts' should not be measured simply in terms of the outcome of individual projects, but in terms of the wider benefits that spread from particular development interventions to the broader society. In the final section, *Purchasing Power* points to the important role that reformed systems of donor aid procurement could play as a catalyst and 'learning zone' for much broader transformations in government procurement and contracting in developing countries in the future with, potentially, far greater long-term impacts on development and poverty reduction than could ever be achieved through aid spending alone. Government procurement currently accounts for 20 per cent of global GDP and, for many countries, far outstrips foreign investment in terms of national GDP. African continent public procurement contracts, for example, amount to over \$50 billion a year. If applied to public procurement more generally, models of pro-poor procurement that could be developed through reformed donor aid purchasing could represent an invaluable asset in the wider fight against poverty.

Tackling key challenges to procurement reform

Purchasing Power highlights three key challenges, in addition to aid tying, that need to be tackled in any effort to establish aid procurement and wider government procurement as an effective demand-level resource to support economic and social goals. First is the concept of ‘value for money’ which currently holds sway in procurement policy. The definitions used for value for money can have a very important influence over the extent to which wider policy objectives are taken into account in purchasing decisions. Narrow definitions of value for money – which regard cost as the key determinant – cannot provide a basis for treating procurement as a vehicle for pursuing social or economic objectives.

The task for governments, we argue, is to use their purchasing power to pursue social objectives without compromising the fundamental tenets of procurement, including value for money. The challenge, therefore, is to reorient and rethink the ‘value for money’ concept to encompass the role that procurement and contracting can play in the pursuit of wider policy objectives, such as economic and social development. As argued by the European Commission in its 1998 communiqué on public procurement, “the best value for money objective in public procurement does not exclude taking environmental, social and consumer protection considerations into account” (Commission of the European Communities, 1998, p.25).

A second key challenge is concern over the issue of corruption. Transparency International has argued, for instance, that “fewer activities create greater temptations or offer more opportunities for corruption than public procurement” (TI source book, chapter 12, no date). Undoubtedly, corruption can severely undermine development efforts and is an issue of grave concern to Southern civil society. Fighting corruption and increasing transparency in government procurement represent the main focus of work on public procurement pursued by the World Bank and WTO over recent years. *Purchasing Power* argues that the development of pro-development procurement systems, the pursuit of transparency and the fight against corruption in procurement should go hand-in-hand, precisely because any effective system of development-focused procurement could not function but on the basis of maximum transparency and

accountability. As Yash Tandon, Director of The International South Group Network comments, “There is everything to be said in favour of ensuring that there is transparency in procurement policies and practices, even if, at the end of the day, a procuring agency decides that it wishes to purchase the needed goods or services only from just one supplier, provided that it is done transparently and for good reasons” (Tandon, 1999, p.6).

A third potential challenge is raised by the possibility of the WTO agenda on government procurement extending from the WTO’s current work on transparency in procurement into negotiations for the wholesale international liberalisation of government procurement markets. The possible opening up of government procurement to international competition has been pursued particularly forcefully by the European Union in the run-up to the WTO’s 1999 Ministerial meeting in Seattle. The EU would like to see foreign procurement markets prised open for greater access by European companies.

Purchasing Power argues that the international liberalisation of government procurement would only bring gains for powerful commercial interests in the North, since it is almost exclusively Northern and transnational companies that are ready and waiting to move in to exploit new procurement markets abroad. Developing countries would be the losers, with governments probably losing any chance that they currently have of building and improving their procurement regimes to better support local commercial and social development. There is no good reason why liberalising government procurement would necessarily help to reduce corruption and rent-seeking. Indeed, rapid liberalisation would only increase the administrative load on already overstretched government departments in the South, and thus undermine effective institution- and capacity-building in this area. Transparency and institution-building in government procurement, we argue, should be kept entirely separate from the issue of liberalisation, and developing country governments should resist any pressure for an expansion of WTO interest in this area.

I. The case against aid tying

ActionAid published a report in April 1998, *In Whose Benefit? The Case Against Tied Aid*, which set out in detail the problems posed by aid tying, including the skewing of programme priorities by commercial considerations to the detriment of sustainable development and poverty reduction impacts. Donor countries, academics, NGOs and recipient countries have long recognised that aid tying significantly reduces and distorts the effectiveness and direction of aid flows and that it should be reformed. In 1990, for example, the US Commerce Department noted that:

“aid tying is not an ideal practice. In principle, aid that is untied is more efficient because the recipient is allowed to import from the most suitable and cost effective suppliers. Experience also suggests that tied aid can lead to inefficient and wasteful procurement practices, sometimes with relatively low development impact. Biases can be created favouring aid-giving for those economic sectors absorbing capital equipment and for relatively more industrialised developing countries, to the detriment of others”

(International Trade Administration, 1990, p.31).

BOX i

Latest figures on aid tying

A significant proportion of donor aid resources are provided on the basis that they are used by developing countries to buy goods (such as medical supplies or water pumps for example) or services (such as consultancy contracts) from the donor country. Quantifying the amount of aid that is subject to these conditions is notoriously difficult, particularly since the official reported figures now exclude technical cooperation (TC), despite TC remaining effectively tied to donor country companies. The OECD's Development Assistance Committee (DAC) figures on the extent of aid tying are very unreliable because of poor and/or inconsistent reporting by DAC member states. This makes any comparison between countries extremely difficult.

Percentage tying status of total ODA for selected Development Assistance Committee donors in 1996, excluding technical co-operation and administration costs

DAC Member	% bilateral aid untied	% Partially tied bilateral aid	% bilateral tied aid (excl. TC)
Austria	60.6	—	39.4
Belgium	49.9	20.3	29.7
Canada	31.5	—	68.5
Denmark	61.3	—	38.7
Finland	60.2	13.6	26.2
France	38.7	26.7	34.5
Germany	60.0	—	40.0
Italy	45.6	—	54.4
Japan	98.9	1.1	—
Netherlands	82.2	4.8	13.0
Norway	88.5	—	11.5
Portugal	100.0	—	—
Spain	—	—	100.0
Sweden	64.0	—	36.0
Switzerland	92.9	—	7.1
UK	86.1	—	13.9
United States	28.4	—	71.6
Total DAC	69.7	3.1	22.1

From Table 23(A50), *Development Co-operation. Efforts and Policies of the Members of the Development Assistance Committee, 1998 Report*, Development Assistance Committee, OECD, 1999 Edition.

The OECD's Development Assistance Committee (DAC) has also called for an end to aid tying, arguing that 'tied aid credits may substitute for financing on market terms and may also fund projects of dubious development benefit... [and in] an era of very tight aid budgets, there is also concern that the use of tied aid credits diverts aid away from countries... most in need of aid' (DAC, 1996, p.74).

A recent African Finance Ministers meeting in Ethiopia highlighted the need to address aid dependency, one of the key problems caused by aid tying. In their final communiqué, the Finance Ministers stressed the importance of "improved African ownership and commitment to aid funded projects and programmes, the need for strengthening institutional aid delivery mechanisms, the importance of a strategic vision of aid-funded activities" (All Africa News Agency, 1999).

Despite wide recognition of the case against aid tying, and despite progressive international economic liberalisation in other areas, aid tying is not likely to be simply and easily cast aside. Some Northern governments, under pressure from certain key companies and/or sectors that benefit from the practice, are likely to try to maintain aid tying as a form of domestic commercial protectionism. A report for the US Congress by the US Export-Import Bank in 1989 revealed the extent of US industry interest in aid tying (International Economic Policy and Trade of the House Committee on Foreign Affairs, 1989, p.42 & p.100). The report cites a case in which an American company lost out on an \$8 million contract to install a cellular communications system in China. The US company lost the contract, it was reported, because of a "substantial amount of grant assistance" from the Swedish government (Rosefsky, 1993, p.438). The £8m contract had an estimated \$80 million of follow up business to 1995 reflecting, the Congress report complained, "an even greater loss for the US company."

BOX ii

The links between aid and trade promotion

The links between aid and trade promotion were dealt with at great length in the UK investigation surrounding the Pergau Dam affair (Foreign Affairs Committee, Third report, 1994). As a result of this inquiry, the Labour Government decided when it came into office that it would abolish the notorious Aid and Trade Provision (ATP) programme (a tied aid credit fund, jointly managed by the then Overseas Development Administration and the Department for Trade and Industry, designed to provide finance for sound development projects which were also of commercial importance to Britain) – although existing contracts were to be honoured, which means that considerable ATP spending continues to come out of the aid budget. Other donor governments continue to use ATP-type support from their aid budgets to support domestic companies.

Amidst a row over a visit to China in December 1998, Clare Short, the UK's International Development Minister, insisted that she did not consider it her Department's role to promote British exports. Earlier in 1998, the Minister stated that "tied aid is all about doing things for the wrong reasons with Western economies. Instead of looking for the best possible development, they are looking for what they can get in return for aid. We believe that should be ended and is undesirable. Aid should be untied". (quoted in *The Herald* 13.03.98) Nevertheless, the UK Government continues to tie its aid, and the UK aid programme therefore continues to offer British companies an unfair competitive advantage over companies from other countries, and particularly from the poorest.

Over the last 18 months a number of development NGOs, including ActionAid, have strived hard to encourage donor governments to end the practice of aid tying. Despite this pressure, and the efforts of some donor countries to see the agreement go through, an OECD Development Assistance Committee initiative to abolish aid tying to the world's Least Developed Countries (LLDCs) failed at a Ministerial level meeting in May 1999. This was largely a result of a small number of donor governments digging in their heels over aid reform.

This report calls on the donor community to rapidly abolish all forms of aid tying by the end of the year 2000.

To this end, ActionAid and a large number of European NGOs are calling on the European Commission to investigate the practice of aid tying, since it clearly falls foul of EC Treaty law.

BOX iii

The legal case against aid tying

In 1997¹ European Union Member States provided over \$26 billion in development aid – over half of global overseas development assistance. Available figures indicate that over 50 per cent of this aid is tied to products and services from donor country companies. This means that at least \$13 billion a year of EU Member States' bilateral aid is used to provide protectionist assistance to EU companies.

In 1991, in response to a European Parliamentary Question (Written questions No. 1140/91 OJ 1991 C259/31 & No. 1106/90, OJ 1991 C98/11) Sir Leon Brittan, then EU Competition Commissioner, indicated that 'tied development aid' should be treated as a type of 'state aid'. As such, tied development aid should be bound by EC Treaty law as it affects state aids.

The practice of aid tying violates a number of articles of EC law. Yet the European Commission, charged with upholding European law, has taken no formal action to explore and eliminate the practice among EU Member States.

In September 1999, over forty European-based NGOs wrote to the President of the European Commission, Romano Prodi, urging the Commission to initiate proceedings, under Article 226 of the EC Treaty, to bring about changes in the relevant national tied aid rules or law. The NGOs suggested that, if necessary, a ruling be sought from the European Court of Justice. This letter set out the key areas of EC law that apply to tied aid:

- Although adopted as part of the development aid policies of the Member States, tied aid rules nonetheless fall within the scope of EC law because they affect trade in goods and services, and, although not addressed directly under the provisions of the EC Treaty, can only be implemented by the Member States if EC law is not thereby infringed.
- The nature of tied aid rules is to insulate one national market against competitive forces elsewhere in the European Union. They clearly have discriminatory effects *vis-à-vis* the undertakings of Member States other than the donor state, because they give rise to procurement processes conducted either by procurement agents in the donor state on behalf of the donor government or the government of the recipient state from which many EU firms will be excluded.

- Tied aid rules are a form of state aid in that they grant advantages to national firms in the competitive process, and as such are subject to Articles 87–88 EC. The effect on firms in Member States other than the donor state means that there is an impact on interstate trade. In any event, the Court's case law has acknowledged that the distortion of trade between the Union and third countries may also affect interstate trade. The duty of the Commission is to keep under review forms of state aid to determine whether they are compatible with the common market. In addition, Member States must notify new aids to the Commission, and must not apply those aids until the Commission has undertaken a review. It is clear that in not treating tied aid correctly as state aid, and applying the rules in Articles 87 and 88 EC, both the Commission and the Member States are neglecting their duties under EC law.
- As discriminatory public procurement rules, we submit that tied aid rules *also* breach Articles 28 and 49 EC guaranteeing the free movement of goods and services, as a result of their effects on interstate trade. They partition off national markets and favour national suppliers. They are not saved by the exceptions in Articles 30 and 46, because none of the relevant exceptions apply.

The NGOs will continue to put pressure on the EC to investigate tied aid as soon as possible. However, they recognise that the current Commission mechanisms for combating serious infringements of Community law in the area of free trade and public procurement are inefficient. In its 1996 Green Paper on public procurement in the EU, the European Commission admitted that, in the area of public procurement, 'there is still a major problem of non-compliance' by Member States (European Commission, 1996, p.5). According to the Economist Intelligence Unit, 'public procurement law is the most flagrantly violated category of EU law, both by member states which do not implement the procurement directives, and by contracting authorities who fail to notify their tenders' (Economist Intelligence Unit, 1998, p.73). If the threat of investigation by the Commission does not put pressure on EU Member States (and through them on other aid donors) to untie aid rapidly then further legal action may be necessary to enforce Member States' compliance with EC law. NGOs intend to keep open different options for pursuing full untying through legal channels under review.

¹ Latest available figures

BOX iv

Case Studies on tied aid I

Swedish Tied Aid to India

This example shows some of the distortions that using tied aid can generate in donor aid programmes.

In his study of Swedish aid to India Sten Folke of the Centre for Development Research (Copenhagen) points to a large turnkey hydro-electric project supported through Swedish and British aid in Uri in Kashmir which was funded in the 1990s (Folke, 1998). This project, which at one stage employed 350 Swedes, used tied aid loans and grants in part to benefit Swedish firms. The project ran into severe managerial problems and huge cost overruns with most of the contracts going to some of the largest Swedish firms. Swedish commentators have questioned the commercial viability of the project and the extent to which it qualified as an aid project under DAC criteria for development assistance. Folke suggests that this project is far removed from having a positive impact on poverty reduction.

Case Study of power projects funded through tied aid

This example demonstrates the problems associated with aid tying caused by pressure from donors for their own countries' technologies to be used in development programmes that they fund.

A 1992 World Bank study (ODA, 1992) evaluated a number of multi-donor funded diesel power projects in Indonesia. The study found that the plants were characterised by "low production, low revenues, high costs and short engine lifetimes. Few were financially viable... many unscheduled power cuts occurred, and unacceptable voltage cuts were common". The study concluded that "donor policies and procedures" were a major contributing factor for their failure. Aid tying "resulted in non standardisation in many plants... resulting in inefficiencies". Furthermore, "fuel and lubricant consumption was often high, partly because of poor maintenance in turn partly the result of non-standardisation". A later World Bank report (World Bank, 1998) remarks that "tied aid reduces the value of that assistance by about 25 per cent".

1.1 Contracting for the poor? Aid tying and technical cooperation

Much of the discussion in this report focuses on increasing the use of local companies in donor procurement and sourcing. Changes in the aid industry over the last decade mean that a far greater proportion of aid is spent on technical assistance than on goods. Over 25 per cent of donor aid from OECD countries was given in the form of technical co-operation in 1996 (DAC report 1999). The vast majority of technical co-operation is provided by technical experts and consultants based in the donor country (or if not the donor country, then other developed countries).

Reforming technical cooperation to better reflect development needs is critical to improving the effectiveness of aid spending. One of the reforms that would help to increase Southern ownership of development, make advice and know-how more relevant to local realities and which help to increase Southern capacities is to channel more contracts towards Southern consultants using a form of targeted procurement. Building a vibrant, competitive, and competent local consultancy sector is important for supporting poverty reduction and for decreasing reliance on Northern expertise.

A report by Christian Aid on British aid to India (van Diesen, 1998) found widespread criticism of DFID-funded projects because of the over-reliance on European consultants providing technical assistance. In interviews conducted for the report, the reliance on European consultants was questioned and many interviewees felt that, given the rich human resource base in India, greater efforts could be made by DFID to encourage the use of local consultants. One of the interviewees quoted in the report highlighted some of the problems associated with foreign technical assistance:

"Too many consultancies are short term. While the expertise is not an issue, they do not spend enough time with us to truly understand the local situation. And because of time constraints, the emphasis is on getting the job done, not on learning or on sharing information"
(van Diesen, 1998, p.14).

The report suggests that a roster of local consultants is maintained – a suggestion that DFID has since acted on – and that "all major consultancies should include a clear capacity-building plan and that creative ways to produce synergy between local and external expertise should be identified" (*Ibid.*)

Technical assistance is clearly a requirement for many aid-funded initiatives and it is inevitable that much of

this know-how and expertise will be provided by companies based in donor countries. Nevertheless, much has been written about the problems and failures associated with technical co-operation, particularly in the Africa context. A paper by Ellen Johnson Sirleaf in the *Development Journal*, for instance, outlines many of the problems associated with technical assistance. Quoting the UNDP's National Technical Cooperation Assessments, she concludes that:

“most technical cooperation projects in Africa are often not aimed at the highest priority needs; they too often are a substitute for local staff with little or no skills transfer; they are often too ambitious and complex relative to local management capacity; and they feature hurriedly designed components with low priority to capacity building and institutional development objectives”
(Johnson Sirleaf, 1996, p.2).

She continues her analysis of the weaknesses of technical assistance by arguing that the expatriate/local counterpart model has lately been discredited as a model of cooperation.

A 1996 report from the African Governors of the World Bank, *Partnership for Capacity Building in Africa: Strategy and Programme of Action*, highlights many of the problems raised by technical cooperation:

- Technical assistance has tended to substitute for missing, or limited, capacity in African countries, while contributing little to developing existing local capacity or building new capacity. It has sometimes increased, rather than reduced, dependency on external support.
- Technical assistance has been ‘supply-driven’, reflecting the World Bank’s and other donors’ own concerns, rather than country needs.
- Technical assistance is often treated as a free good by recipient countries, undercutting incentives to use it effectively.
- Remuneration scales for technical experts have an invidious effect on morale among public servants earning regular public sector pay.
- The impact of technical assistance has been constrained by a failure of donor co-ordination. Different donors pursue their own agenda and frequently provide overlapping, and even conflicting, forms of support (World Bank, 1996).

Through lack of capacity and initiative, governments have failed to control technical assistance management, which has remained firmly with the donors. As a result, technical assistance tends to serve the short-term interests of specific donors rather than the long term interests of the client country.

The Governors were of the view that the massive resources currently devoted, with little apparent beneficial impact, to technical assistance in Africa should henceforth be used to fund “innovative capacity-building approaches” which will yield palpable results. They recommended the following changes:

- treating the preparation and implementation of every project it finances as an opportunity for capacity building. This means helping countries develop the capacity to prepare projects for themselves.
- judging the merit of every proposed project in terms of its likely contribution to capacity building.
- revamping its internal incentive and reward structures in a way that recognises staff who pay attention to capacity building, and downgrades the importance of meeting internal bureaucratic benchmarks such as completion of appraisal reports.

Clearly the consultancy and technical advice sector in many developing countries is small and it is often not possible to seek local consultants to provide technical assistance. However, donors still rely too heavily on donor country consultants rather than using aid contracting as a resource to help build the capacities of local consultants and expertise.

In recent years many Northern-based consultants have worked with locally-based consultants, primarily to provide local knowledge of conditions as well as making bids more attractive to funding agencies, but there is little evidence to suggest that these joint ventures have been designed to build sustainable Southern capacities. Indeed, many Northern-based contractors seem to have used Southern consultants to undertake many of the basic data collection roles and to help make their bids to international donors more attractive.

If donor agencies could build the appropriate incentives and accountability into their contractual arrangements with consultants, expanded subcontracting and joint ventures could offer a way of building sustainable capacity among Southern consultants. Subcontracting to an external contractor introduces the local company to the disciplines typical in international consultancy arrangements, including contracts, terms of reference, budgets, deadlines, invoicing and submitting accounts and duties of care. Splitting consultancy contracts into component parts can also help to encourage the establishment of a local consultancy sector. Clearly, a sensitive approach will need to be adopted so as not to encourage civil servants and academics out of their current jobs and into highly paid consultancies. Decisions on which local consultants are encouraged to apply for consultancy contracts, through some of the methodologies devised under targeted procurement, should be made locally.

BOX v

Who benefits from tied aid?

Many Northern-based and transnational companies benefit from aid-funded contracts for goods and services, as demonstrated in the various case-study examples of tied aid projects cited in this report. Identifying precisely which companies receive the greatest amount and proportion of contracts is not easy, however. In the UK, for example, five DFID-appointed procurement agents handle goods procurement, the biggest among them being the privatised Crown Agents. The Crown Agents are unable to provide information to the public on which companies receive the greatest number and amount of orders. The vociferous support for aid tying from one of the UK's principal construction trade associations, the Export Group for the Construction Industries, suggests that some powerful construction companies have benefited from aid-tying in the UK.

A recent UK Parliamentary Answer indicated which companies won the greatest share of technical cooperation consultancy contracts from the UK aid programme in 1989/99 (Hansard 08/06/99). British companies receiving some of the highest value consultancy contracts in that year were:

1. **Population Services International** for an £11m project providing contraceptive social marketing advice in Nigeria.
2. **Hunting Technical Services** – a subsidiary of Hunting PLC, the oil and defence company. Specialists in natural resource development and environmental management. £9m project and a £3.3m projects in 1998/99.
3. **The British Council** for various projects in education and health including our education training programme in Uganda (£2.4m) and support for primary health systems in Nigeria (£2.6m). The British Council received the biggest number of DFID contracts in 1998/99: 78 contracts compared to 48 for the company receiving the second largest number of contracts (Natural Resources International Ltd). The British Council has a specific remit to support UK publishing and media industries with overseas clients. In their website section on Partnerships and Competition, the British Council outline their strategy to support

publishing: "we use Britain's skills and resources to respond to local educational needs and to stimulate opportunities for UK-based publishing." The British Council choose only British books and media for inclusion in their exhibitions which often then form the basis for materials procurement within aid funding.

4. **Arthur Anderson** to provide advice on the privatisation of the Indian power sector (£5m)
5. **Maxwell Stamp PLC.** an economics consultancy won a DFID contract worth £3.9m.
6. **Helm Corporation,** a Northern Ireland based economic and financial consultancy, won a contract worth £2.9m
7. **National Economic Research Associates** – £2.7m project to support the Haryana Electricity Regulation Commission in India as part of the privatisation of the Indian power sector. NERA is an economic consulting firm.
8. **LTS International** won a contract worth over £2.3m for a forestry project.²

The twenty companies listed as receiving the largest number of technical cooperation contracts included the two big management consultants, PricewaterhouseCoopers and KPMG, alongside the British Council and a number of university departments and institutes.³

DFID's consultancy process takes place through limited competition (unless there are reasons for not doing so) and have a prime objective 'to obtain the best value for money' (DFID leaflet: Consultancy services for DFID). The competition is usually restricted to between four and six consultants who are chosen by DFID from their existing database. The overwhelming majority of consultancy contracts go to UK-based companies, including Anderson Consulting and KPMG. This is an example of where a major opportunity to help support indigenous and/or fledgling consultancies in developing countries and thereby promote local ownership of development is being overlooked. Northern-dominated technical cooperation, the category of aid that encompasses the majority of these consultancy contracts, is increasingly criticised as an ineffective and unsustainable development input (see below for further discussion of TC).

² Hansard, 8 June 1999, Written Answers, cols. 239-241. Note that the Parliamentary Answer printed in Hansard only listed the companies and size of the individual contracts awarded. Where possible, ActionAid has matched the details provided in the Parliamentary Answer with specific contracts awarded.

³ *Ibid.*

1.2 Untying to increase commercial competition in the North, or untying for social good?

Renewed interest in aid untying over the last few years has been driven, at least in part, by some donor governments' interest in opening up the 'aid procurement market' to greater access by their own countries' companies. In the EU, some Member States are also keen to re-examine aid tying because of its

contravention of EC law and fears that they may face legal action by a disgruntled company.

Untying aid and allowing competitive tender for most aid funded contracts would clearly bring some benefits in terms of efficiency in aid spending. Goods and services could be bought at more competitive rates, helping to eliminate some of the distortions that have resulted in 30 per cent higher prices for aid-procured goods than available on the open market.

BOX vi

The UK Government's efforts to contract locally

Despite British aid remaining tied to UK products and services, the UK's Department for International Development (DFID) is increasingly seeking to contract local consultants and other businesses to provide services and goods for projects funded by the UK aid programme. DFID recently appointed a procurement officer in India to identify suitable local consultants who can be encouraged to bid for DFID contracts, and to make some effort to build local capacities.

In a speech in April 1999, Clare Short outlined how DFID is helping to support the local private sector. The South African construction industry is constrained by a shortage of local subcontractors with the necessary skills to work on major projects. "My Department is providing training subsidies – on a competitive basis – to enable established construction companies to develop the technical and managerial skills of emerging contractors" (Short, 1999).

Purchasing Power argues that using aid contracting as a lever for social development goals can help complement this type of support. In the same speech, Short outlined how DFID aim to help create a demand for new products and services to improve financial services to the poor by promoting joint ventures. *Purchasing Power* argues that carefully targeted aid procurement and contracting can itself help to build the capacity of local firms to participate in wider national and international competitive tendering in the public and private sectors; and can help to foster joint initiatives and partnerships between local, donor-country and international businesses.

Building schools in Andhra Pradesh – "Vidyalayam"

In 1994/95, the Education Secretary of Andhra Pradesh challenged DFID Field Managers to come up with ideas for using funds for a school building project in ways that would not only produce new school buildings, but would also help to build local

capacity to respond more effectively to regional infrastructure needs. The result was a project known as "Vidyalayam", meaning school in Sanskrit.

Vidyalayam was an experiment in reintroducing long-forgotten but locally-developed construction technologies, which are both cost-effective and environmentally-friendly. A consortium of local consultants, helped by the state Panchayati Raj Engineering Department, were contracted to build a series of prototype school buildings. The entire project did not involve a single non-Indian consultant or agency, all innovations were locally conceived and planned, and implemented by a local workforce, including designers, supervisors, contractors and masons. The result was a series of buildings based on local concepts, and many with forms derived from vernacular architecture. In the second phase, districts, community participation in decision-making and construction management was also promoted.

The *Vidyalayam* experience was subsequently disseminated on a large scale using a variety of film and print media, also developed by local consultants. This went a long way in spreading the use of cost-effective technologies in the 'next generation' national and state education programmes, as well as geographically and to other sectors, particularly health. Under the Health Sector Reforms Programme, DFID is facilitating the Government of Orissa in constructing three cost-effective prototypes designed, constructed and supervised by an Indian consultant and implemented by the state-owned Infrastructure Development Corporation.

Vidyalayam was recently evaluated through a national agency and this has helped to disseminate learning from the project among interested government departments. A State Resource Group on Construction is now engaged in studying these buildings over a 10–15 year time-frame to evaluate their structural and design performance, along with lifetime upkeep and maintenance costs. (source: unpublished DFID communication, 1999)

Allowing more open competition for aid-funded procurement and contracting will help to increase the relative value of aid by several billion dollars.

However, untying aid without due consideration to what replaces the tied aid regime is not, in itself, enough to ensure real improvements in the development impact of donor aid spending. Any regime which allows Northern companies to maintain a strangle-hold over aid contracts and which therefore fails to involve and build the capacities of Southern producers and consultants can only reinforce Southern dependence on Northern-based companies, consultants and expertise. If untied only for the sake of liberalising procurement markets, donor aid programmes will continue to undermine developing countries' prospects for self-reliance and their efforts to achieve more sustainable poverty reduction. Thus, untying aid merely to enhance commercial 'value for money' and increase competition among Northern companies to lucrative aid contracts, could mean that a major opportunity to enhance the impact of aid on poverty will be overlooked.

ActionAid believes that donors need to do a lot more to reform aid procurement and contracting so that real progress is made towards increasing the involvement, and build the capacities of, Southern producers and consultants. This would enhance self-reliance and Southern ownership of development processes, while also breathing life directly into the development of the commercial sector in recipient countries. As Joseph Stiglitz, Senior Vice President and Chief Economist of the World Bank, insisted in a lecture entitled *Towards a new paradigm for development: strategies, policies, and processes* in October 1998, that the benefit of investing in development projects is "not just the direct returns from the project". He argued that "we, and developing country governments, need to focus on leveraging – on identifying areas where... limited actions can have a large-scale effects, and where absence of requisite action... can have disastrous effects". It is also imperative to recognise that "key ingredients in a successful development strategy are ownership and participation":

"we have seen again and again that ownership is essential for successful transformation: policies that are imposed from outside may be grudgingly accepted on a superficial basis, but will rarely be implemented as intended. But to achieve the desired ownership and transformation, the process that leads to that strategy must be participatory"
(Stiglitz, 1998).

BOX vii

Danish Assistance to the Ghanaian agricultural sector

This example shows some of the problems associated with providing equipment and advice from donor countries.

In Ghana the agricultural sector accounts for 70 per cent of merchandise exports and absorbs 66 per cent of the labour force. Maize, the country's second most important food crop after cassava, is grown both as a staple and as a cash crop in all regions. Due to traders' limited storage capacity within the country, farmers must store their grain themselves until there is a ready market for grain. However, higher grain prices later on in the season are offset by grain losses due to the farmers' poor grain-drying and storage facilities.

At the end of the 1980s, Denmark's official overseas development agency, Danida, introduced a project involving the supply of five grain-drying and storage centres to Ghana tied to Danish firms. The contract was signed in September 1988 by the Danish firm Kongskilde Maskinfabrik, a subsidiary of Kongskilde, and Ghana's State Grain Company, GFDC. Total project costs equalled 42.2 million DKK.

A long lag-time between signing the contract and the commissioning of equipment meant that some of the basic conditions upon which the project rested changed. By the time the facilities were up and running in 1990, the role of the GFDC in the maize processing, storage and distribution sectors had been reduced, rather than expanded, as had been anticipated by the project planners. This was partly due to a lack of working capital, the abolition of a government minimum pricing scheme, and reduced plans to store grain for Ghana's food security. Thus project plans, which were drawn up in Denmark since there was no Danida representative in Ghana during the planning stages, set a target for maize handling that was 3–4 times more than was needed. The planners had placed some of the units in areas with limited maize production, which they anticipated would expand, but this never occurred. According to a 1993 Danida evaluation: "The facilities provided under the Danida scheme were designed and constructed for a situation which does not exist any longer... The role and position of GFDC will not revert back to what it was in the 1980s meaning there is no use for them now, and alternative modes of operating the units must be found." Figures indicate that less than 10 per cent

Studies on tied aid II

of the installed capacity is now in use and three of the five units have not been used at all during the last two growing seasons. The Evaluation report concludes: "At the time of evaluation the main beneficiary is therefore the Danish supplier of the units, and thus... Danish industry" (*Danida, 1993*)

DFID funded health project in Malawi

This example demonstrates the range of problems associated with aid tying and how local procurement can often be more cost effective. It also demonstrates that reform of procurement procedures and contracting agencies needs to be addressed by individual donors.

Established in 1987, Banja La Mtsogolo (BLM) was the first non-governmental organisation in Malawi to contribute to national family planning services, working in every region of the country to help protect couples from unwanted pregnancy and helping to prevent and treat sexually-transmitted diseases. In 1996, BLM was contracted to help run an ODA-funded family planning and primary health project in Malawi. Crown Agents sub-contracted all the procurement to Balfour Williamson (BW), a smaller UK-based procurement agency. According to BLM's Programme Director, many problems were encountered because of aid-tying. These included significantly increased project costs, particularly relating to shipping. BLM requested on several occasions, but with little success, to be allowed to procure locally, particularly regarding such items as pregnancy tests, which were available from within Malawi and from neighbouring countries.

To make matters worse, the delivery of goods and equipment was frequently late, erratic, inefficient, and inconsistent, and prices extravagant. According to BLM's Programme Director, prices for the supplies and equipment were high due to the preference of specific suppliers, and quality of support was poor due to lack of competition. On more than one occasion, the procurement agents purchased goods, such as pregnancy test kits, a month away from their expiry date to cut costs, meaning that they had expired by the time they arrived in Malawi. BW also provided different goods than those that were requested by BLM. In one instance, BLM requested old-fashioned theatre beds that local medical staff knew how to use, but instead BW sent expensive modern theatre beds which couldn't be used and therefore had to be sent back. Delays affected implementation of some of the project's core activities – new clinics opened late or failed to provide family planning services because important equipment

had not arrived. Transportation difficulties and delays also resulted in serious damage to supplies, such as heat-damage from goods being stuck for months in port in Dar Es Salaam. A study carried out by BLM indicated that at least £2 million could have been saved on the project in the space of a year if it had been allowed to buy goods from within the southern Africa region.

Working with a new procurement agent, efforts have been made more recently to overcome many of the procurement problems experienced during the first few years of the project, including, importantly, expanding the range of goods procured from within Malawi or neighbouring countries, including South Africa.

Japanese supply of Maize to Malawi

In the mid-1990s, aid amounting to 300 million Yen was granted for Malawi for the purchase of maize by the Japanese companies Matsui and Mitsubishi exclusively from Argentina. As it turned out, only 79 million Yen was actually used to purchase food; over 200 million Yen was spent on transport and insurance. As a consequence, only 3,000 metric tonnes of maize was purchased. According to sources from Malawi's Ministry of Finance, if the same money had been used to purchase the maize from within the southern Africa region, at least 10,000 metric tonnes of maize would have been bought. Moreover, some money would have been saved which could have been used for the poverty alleviation programme to assist the poor in Malawi (*Chilowa, 1999*).

Spanish Aid to Nicaragua: The Managua-Masaya Highway

Spain gave Nicaragua \$30 million in aid for reconstruction post-Hurricane Mitch. According to a local NGO, ACAN-EFE, \$16 million of the promised \$30 million would be spent on widening 31.5km of the highway between Managua, Masaya and Granada in the south-east of the country. Hurricane Mitch never affected this part of the highway – the development was clearly oriented towards tourism. The Nicaraguan government was looking for a financier for the project for some time. (*From Algunos Proyectos Financiados por le FAD en Nicaragua by Intermon/Oxfam, Spain*).

Directing aid procurement and contracting creatively to strengthen Southern ownership of development and to help build Southern commercial capacities should be regarded as a central objective of donor aid programmes. Aid procurement should not be separated from the mainstream of development practice, but should be treated as an integral part of development strategies, helping to reinforce and support national development objectives. In this regard, aid procurement, like government procurement more generally, can be used to support very specific objectives included in national poverty reduction strategies, such as supporting particular indigenous groups or the involvement of women in economic activities. Reformed aid procurement and contracting can also be used to promote reforms of developing country government procurement to support development goals. Thus reformed aid procurement and contracting could become an important vehicle for leveraging wider sustainable social and commercial development.

Enhancing Southern ownership and maximising the benefits to poverty reduction from aid expenditures must now be the main thrust behind any process to untie aid. The principal objectives of aid untying should be to increasing Southern ownership of development strategies, to increase the involvement of local and regional consultants and producers, and to foster broad-based and locally-focused economic growth that benefits the poor and reduces the dependency of developing countries on Northern-based companies and consultants. Aid untying should, therefore, represent a stepping stone towards improved aid effectiveness, and not be seen as an end-point in itself.

2. Pursuing social development through reformed aid procurement and contracting

The task for aid donors is to use their purchasing power to pursue social objectives without compromising the fundamental tenets of procurement. Clearly it is not desirable to place such wider policy objectives, such as social development, artificially above other considerations such as value for money. However, the challenge is to reorient and rethink the 'value for money' concept to encompass the important positive and negative impacts that procurement and contracting

can have on social development. As discussed below, the South African Government's Public Sector Procurement Reform initiative provides some useful learning on how some new concepts, such as affirmative procurement policy and life cycle costing, are beginning to extend the concept of value for money considerations. Donor governments should be open and prepared to learn from these experiences and with a view to reforming their own procurement practices.

BOX viii

Community participation in procurement

In recent years, the World Bank has increasingly recognised that community participation in development projects is critical to ensuring project sustainability and ownership. Mirroring NGOs' own experience, the World Bank found that participation helps to increase access to disadvantaged groups, enhances community motivation, encourages self-reliance through skill transfer, helps build local institutions and better targets benefits upon those who need them most. A key constraint identified by the Bank in enhancing community participation in development projects was the procurement and disbursement policies it relied on which were designed to facilitate the supply of goods and services by large contractors and suppliers. The existing guidelines on procurement were found inadequate and inflexible. In 1995, the Bank produced two reports which (World Bank, 1995) proposed methodologies to involve communities in the procurement of goods, works and services. Increasing the participation and ownership of local communities in project procurement is not without its difficulties. These include how to involve commercially unsophisticated communities in competitive bidding and other economic issues; how to pay recurrent costs to community groups, often in scattered locations; how to ensure timely disbursement of funds; difficulties in ensuring accountability; and the often bureaucratic procedures of the Bank or the recipient government.

Experience in confronting these difficulties has led to a number of innovations defined to overcome these difficulties. These include: establishing unit costs to control and monitor procurement contacts; certification of works completed before payment; the

development of implementation manuals; standard designs and contracts to facilitate capacity building.

While the overwhelming proportion of Bank-funded procurement and contracting takes place through International Competitive Bidding (ICB) procedures, allowances are now made in Bank procurement manuals to involve local communities in development projects where community participation is critical.

Local Shopping

The Bolivia Social Investment Fund introduced a method of procurement that is followed by many other Bank-financed projects. The agencies that propose sub-projects on behalf of the community are in charge of procurement. In the case of civil works contracts such an agency is required to obtain quotes from three different contractors. In making the final selection, the Fund compares these quotes against a schedule of standard prices that has been established for contracts covering various types of sub-projects. If all the quotes are above the reference price, the agency is requested to renegotiate. If the negotiations fail to lower the price, the Fund assesses the need to revise its standard prices.

Use of Vouchers

The Zambia Social Recovery Projects finances a series of small and locally generated sub-projects in health, nutrition, education and economic structure. Communities are provided with vouchers which they exchange for goods and materials required for implementing sub-projects at specified retail outlets. This eliminates the need for disbursement of funds to communities an advantage where banking channels for transfer of funds is not available.

Using procurement and contracting to support development efforts rather than reinforce the systemic processes that cause poverty in the first place is an under-explored area of inquiry. *Purchasing Power* makes some initial suggestions, using experience and best practice illustrated by case studies in related areas, of how aid procurement and contracting could be used to foster local economic development and pro-poor broad based economic growth.

These include new ways of working for Northern companies and for the contracting processes that donors employ to help build the capacities of Southern companies for the benefit of poverty reduction. We offer some initial suggestions as to how this new methodology could help build forms of economic activity which maximise the benefits to poor people.

The case-study material presented below demonstrates that **the pursuit of social development objectives through aid procurement and contracting need not involve more than marginally increased costs of the goods and services purchased**. Indeed, the evidence presented in this report from the public and private sectors show that increased costs are marginal. Indeed, cost savings can be made through, for example, local procurement where the costs of transportation may be negligible. Nor will reformed procurement practices mean that goods or services provided are of lower standards or quality. The standards of goods and services provided by companies in developing countries can be improved significantly through opening up opportunities for local companies to compete for contracts globally, both in the public and private sectors. Targeted or affirmative procurement can also help to tackle corruption rather than reinforce the forces that create it in the first place.

BOX ix

Balancing 'value for money', transparency and

Most aid procurement, like other areas of donor government procurement, is carried out on the basis of a standardised set of practices and assumptions that have been well-established for many years. Procurement, whether by public and private enterprises, should adhere to the principles of sound financial management, competition and fairness. Most procurement policies are designed to fulfil three central objectives:

- 'value for money'
- probity and transparency
- wider policy objectives (such as social policy or commercial development)

Bad practice, such as corruption or overcharging, is likely to occur when contractors fail to achieve an appropriate balance between these objectives. These three core elements of procurement practice are rarely accorded equal weight, however. Among donors, 'value for money' (VFM) usually outweighs probity/transparency; and probity/transparency tends to be seen as more important than wider policy objectives.

The accepted definition of 'value for money' is likely to have a very important influence on the way that wider policy objectives are taken into account in purchasing decisions. Narrow definitions of value for money – which regard cost as the key determinant – cannot provide the basis for using procurement as a vehicle for pursuing social or economic objectives.

In the UK, HM Treasury provides considerable detail on the factors that need to be taken into account in assessing value for money, such as indirect costs, running costs, costs associated with administration, investment, recyclability, disposal, risk factors etc. The clearest example of where contractors may take account of wider policy objectives is where there is a concern not to procure goods whose production has caused environmental damage. Costs associated with 'green' procurement will sometimes be higher than if environmental factors were not taken into account. The Treasury suggest that a decision to proceed with higher-cost 'green' procurement can be justified if "Ministers have decided collectively as a matter of policy that the government as a matter of policy that the government should not

wider policy objectives in procurement policies

buy a particular substance or material on the grounds that it is harmful to the environment" (HM Treasury, 1999, p.5).

This suggests that, in the UK at least, wider policy objectives can override basic cost issues. Just as the UK's Department for the Environment, Transport and the Regions (DETR) is allowed the space to pursue 'green' procurement, we argue that social development and poverty reduction criteria should be allowed to outweigh lowest cost determinants in DFID's aid procurement, and in other government departments' procurement policies. This would require a review of the current government definition of 'value for money' in procurement so that it can take account of the positive and negative social impacts of procurement decisions.

In its 1998 communiqué on public procurement, the European Commission states that "the best value for money objective in public procurement does not exclude taking environmental, social and consumer protection considerations into account". The Commission goes on to argue that:-

"Contracting authorities and entities can therefore be called upon to implement the various aspects of social policy in awarding contracts, public purchases in practice constituting a significant means of influencing the behaviour of economic operators"
(Commission of the European Communities, 1998, p.26).

Sipho Shezi, South Africa's Director General of the National Department of Public Works, argued in a presentation to the 9th International Public Procurement Association Conference in Copenhagen in June 1998:

"Provided that the procurement policy and systems put in place have measurable targets, that the process is verifiable and auditable and that the process is transparent and takes place within a competitive bidding environment, [procurement] could contribute to the development of growing enterprises from developing countries participating equitably in the global economy"
(Shezi, 1998, p.11).

2.1 Private sector development and poverty reduction: addressing the 'missing middle' in developing economies

In its report, *DAC Orientations for Development Cooperation in Support of Private Sector Development*, the OECD's Development Assistance Committee states that:

"private sector development has to take place on a massive scale throughout the economy, and consequently donors have to organise themselves and their actions to leverage scarce aid resources to achieve this end... Aid efforts must work in harmony with market forces to create conditions that will trigger private initiative. New approaches to development assistance that address these factors will change the way donors organise themselves to carry out this work and the scope and method of designing and implementing related assistance efforts... Private sector development also calls for concerted efforts among donors to adopt closely co-ordinated approaches to public enterprise support, subsidies, investment incentives and end-user interest rates"
(DAC, 1994, p.2).

Aid procurement can provide a resource to help create a business environment which, through a mixture of demand and supply side initiatives, can help build the capacities of developing country producers and consultants and assist their transition into becoming internationally competitive. In a paper published in the journal of the South African Institution of Civil Engineering, Watermeyer, Gounden, Letchmiah and Shezi have argued that:

"development contracts can be used to facilitate the successive introduction of labour, transport, materials, plant and finance to community based/developing enterprises in structures programmes. Certainly, the associated contractual arrangements will permit such enterprises through the execution of contracts to establish themselves and to acquire the necessary skills required in respect of materials supply, materials management and construction management"
(Watermeyer, Gounden, Letchmiah, Shezi, 1998, p.8).

One of the principal ways in which procurement can be transformed to assist social development objectives is through targeted support to the local private sector – particularly micro, small and medium sized enterprises (SMEs) in developing countries.

BOX x

Assistance by state government agencies in Ceara State, Brazil to small enterprise associations is a good example of 'demand driven' procurement in which the state buys from SMEs while also providing technical assistance. The project began as part of an emergency employment-generating public works programme in response to a serious drought in 1987-88. The state authorities directed that materials and tools for the works programme be purchased from small producers in the drought-stricken areas. In addition, some customary purchases of goods such as school furniture, grain silos and construction and repair of public buildings were transferred to small enterprises.

Two agencies which had already worked closely in previous small producer support programmes were responsible for the procurement programme – the State Department of Industry and Commerce (SIC) purchased the goods and services, while the Brazilian Small Enterprise Assistance Service (SEBRAE) provided technical assistance to enable their clients to reach the production standards required. The contracting procedure differs in one crucial respect from most other such programmes: if the purchasing state government departments are unhappy with the quality of the goods, they are under no obligation to accept them. This innovation has proved of central importance to the scheme's success.

The scheme works as follows – a state government department – such as agriculture, education or health - contracts with the SIC for the provision of goods or services. SIC then makes a contract with SEBRAE to provide necessary technical assistance to small producer associations, paying SEBRAE a five per cent commission on the value of completed contracts. SEBRAE in turn contracts with associations – where none exist in specific subsectors, it encourages their formation. SEBRAE advances 50 per cent of the value of the contract to the commissioned association. (This mimics the way that large private concerns habitually sub-contract to small producers in Brazil, providing them with substantial working capital for commissioned work.)

A system of product warranties has been established by the scheme. Each item produced carries the name of the producer and if it proves defective, it is returned for repair or replacement. If the producer has closed down in the interim, the association is responsible for all necessary work. The association is also responsible if a particular producer does not deliver on schedule.

Public sector procurement in Ceara State, Brazil

These arrangements bring four important factors into play. First, they create a healthy distance between the two sets of government actors – SIC/SEBRAE – and the purchasing departments. Second, they make SEBRAE's income dependent on the quality of the work of their clients. Third, by working with associations, the habitual problem of trying to work with many individual enterprises is overcome. And fourth, small producers are encouraged to work closely and co-operatively together: better performing firms have an interest in encouraging laggards to improve the quality of their products.

The initial impact of the project was sufficiently great that when the drought ended, the programme was continued. In the three-year period from 1989–91, the state government directed \$15 million (30 per cent of its total expenditure on goods and services) through the scheme. This gave rise to the expansion or opening of dozens of small brick-making operations, woodwork shops, stone quarries and lime-burners.

In the face of political pressures, the benefits of the scheme have tended in recent years to become dispersed and diluted, as contracts have been spread over the huge area covered by the state. Only in the case of woodworking have efforts been sufficiently concentrated to enable the emergence of a cluster of small producers, permitting a significant leap in their collective efficiency.

At the outset of the scheme, the district of Sao Joao do Aruaru boasted only four small sawmills, each employing three workers. An initial order for 300 wooden wheelbarrows was met with assistance from SEBRAE. These not only proved more popular than the metal wheelbarrows provided by the previous large-scale producer but also cost 30 per cent less. Within two years, the small-scale woodworkers had successfully met orders for an additional 2,000 wheelbarrows, 3,000 school desks and 100 tables as well as handles for hoes and backhoes and barrels for the distribution of water. By 1992, they were supplying 40 per cent of the state's needs for school furniture, amounting to 90,000 pieces annually, and had displaced the two large furniture-making plants in southern Brazil.

Five years after the first order for 300 wheelbarrows, the number of small sawmills had increased from four to 42, each mill now employing an average of nine permanent workers. An additional four to seven temporary additional workers felled trees, cut them into lumber and transported the lumber to the mills. All in all, this added up to a total of around 1,000 persons employed

directly or indirectly by the mills, more than ten per cent of the total population of the district. More than half the mills increased their productivity by acquiring powered equipment they did not have before.

The new skills, equipment and confidence that were gained through participation in the programme was used by small producers to break into new private sector markets – furniture for summer homes and hotels – where they have now become permanently ensconced. Indeed, five years after the programme's start, these markets account for 70 per cent of their sales. In addition, an order for 20,000 school desks has also been awarded by a neighbouring state.

Backward and forward linkages to firms in other sectors have developed in almost textbook fashion and with remarkable spontaneity. Local firms moved into the repair and then the production of equipment, initially for sawmilling and then for sugar cane and cassava mills and for cheese-making businesses. A private bus company opened up a local service, five storeowners bought trucks for transporting logs, a new hardwood supplier started operations and the Bank of Brazil opened a branch in the district. The flurry of new manufacturing activity also led to a spurt in housing construction and a new brick-making business opened, employing 20 people. The association of wood-workers itself is now an important provider of skills to its members, organising night schools in co-operation with the local authorities.

Finally, the programme has had a significant impact on the quality of service provided to small producers by SEBRAE. With a vested interest in the performance of its clients, its activities have naturally become more driven by their real needs. Five years after the launch of the initiative, commissions account for 15 per cent of the agency's income. According to The Enterprise Research Institute, this project demonstrated that targeted procurement coupled with training helped to make improvements in the SME sector sustainable and has resulted in "an increased in SMEs winning competitive open-bidding" (The Enterprise Research Institute, 1998, p.17).

The development of a vibrant national private sector has long been recognised as a critical component of development and poverty reduction strategies. The motivations for strengthening the local private sector include promoting economic efficiency and welfare. As Fiona Kam points out, "private enterprise will be the main source of government revenue through corporation tax, VAT and PAYE, from which infrastructure, healthcare, water, sanitation and education will be financed" (Rural Investment Overseas Ltd, 1999, p.19). Donors already target some of their existing aid resources at building the capacities and enhancing the prospects of small, medium and micro enterprises (see box).⁴ However, the potential for using aid procurement and contracting as a demand-side instrument of policy to achieve social development objectives has not yet received the attention it deserves.

Facilitating the development of this sector of economic activity is important because:

- **SMEs can foster broad-based economic growth:** SMEs help to promote the economic development of a country by generating wealth and employment. A vibrant private sector can contribute to broad-based economic growth and provide opportunities for a larger section of society and assist in income distribution by passing the benefits of growth to more people.
- **SMEs can directly or indirectly contribute to poverty reduction:** Micro-enterprises and SMEs enhance the involvement of poorer or marginalised sections of societies in the economy through direct ownership or through job creation. According to RIO, 'between 1985 and 1990, experience in the UK suggests between 75% to 85% of all new jobs were created in the SME sector' (RIO Ltd, 1999 p.20). Thus, helping SMEs development can directly or indirectly contribute to poverty reduction. Furthermore, the creation of new businesses and entrepreneurial opportunities will create new jobs for poor people. Increased financial resources for poor people can help tackle other problems faced by developing countries such as rural-urban migration and food security.

⁴ Meanwhile, donors have increased direct or indirect assistance to SMEs in developing countries, in recognition of the fact that such activity benefits poverty reduction. The International Labour Organisation estimate that donor support for SME development in Africa rose from £0.3m in 1992-93 to £10.1m in 1996-97 (*International Labour Office Business development services for SMEs*, p6). The same study shows that World Bank commitments to micro-enterprise rose from \$8.2m in the period 1978-89 to a planned figure of \$100m in 1997-2001. This assistance has primarily been focused on providing a range of inputs designed to fill identified gaps undermining the development of the sector.

- **SME growth maintains resources locally:** Economic growth in the SME sector can help to recycle revenues and profits back into the local economic system thereby benefiting other producers through backward linkages.
- **SME development can strengthen civil society:** SME development can help foster institutions which promote participation by new stakeholder entrepreneurs in the economic, social and political systems of a country thus strengthening civil society and improving governance. Furthermore, involvement in the private sector can help productive decision making and confidence furthering participatory development and governance.
- **SMEs can increase economic flexibility:** SMEs can increase the flexibility of a national economy by being more responsive and adaptable to changes in economic circumstances. This is particularly important given that many developing country economies depend on a narrow band of exports for their economic survival. Private sector development also helps to stimulate improved use of material; and human resources and helps create government revenues to tackle social and environmental problems. Improved business linkages and integration will help to improve a country's economic performance.
- **SMEs can address the problem of the 'missing middle':** The growth of small enterprises into medium enterprises is viewed by many as a key component of economic health. In many countries, particularly in Africa, this graduation does not occur, leading to a so called 'missing middle' of medium-sized enterprises. Examining why this graduation does not occur can help improve the policy environment for businesses to flourish.

ActionAid argues that donor countries should develop new and creative ways of using existing procurement and contracting opportunities to help protect the development of the national and local private sector, to create sustainable jobs, and to increase wealth and broad-based economic growth. Most developing countries, particularly the poorest countries, currently do not have the full range of domestic companies with the international business experience and expertise to compete effectively on the open market. Unless specific assistance is given, then aid contracting and procurement will help to maintain this lack of experience and exposure. Increasing the use of donor aid procurement to build Southern private sector capacities remains an under-explored area of research and practice.

2.2 Aid procurement and SME development

Many governments seek mechanisms to enhance the involvement of domestic SMEs in their own government procurement programmes (see boxes). These range from the straightforward provision of information to SMEs about contracts and bidding procedures, through to 'affirmative' procurement programmes, such as that pursued by the South African government (discussed below). Whatever mechanisms they apply, governments widely recognise both the importance of the SME sector and how the procurement process can help support wider policy objectives. In its 1998 Communication on public procurement, for example, the European Commission states that it is possible for public administrations to 'lay down as a condition of execution of public contracts, compliance with obligations of a social character, aimed for example at promoting the employment of women or encouraging the protection of certain disadvantaged groups' (Commission of the European Communities, 1998, p.28). A 1990 EC communiqué on promoting SME participation through procurement (Commission of the European Communities, 1990, p.7) highlights the role of governments and the Commission in aiding SME involvement in government procurement. The report suggests that SME involvement in public procurement can be increased though removing the legal and fiscal framework inhibiting participation, providing assistance to and simplifying bidding, promoting subcontracting, guarantee schemes and performance binds, rapid payment procedures, and notification. The report concludes by calling for additional research and pilot programmes aimed at promoting SME involvement in procurement.

Donor approaches to local private sector development have changed considerably over the last 20 years. In the 1970s and 1980s, support focused on the provision of external training, technology transfers and financial services for local businesses. These services were widened during the 1980s to include a range of other support mechanisms including counselling, networking and clustering, the facilitation of market access and the provision of information. The widespread interest in the delivery of financial services through savings and micro-credit facilities led to a greater focus on the sustainability of business services. In the early part of this decade, the experiences of providing financial services to local business were translated into a number of best practice guidelines which could be widely replicated 'leading to improved levels of impact, sustainability and cost effectiveness' (International Labour Organisation, 1997, p.5). Best practice in the area of non-financial services, however, has not been so well developed.

Some governments have concentrated on facilitating the participation of SMEs through the provision of information (particularly on-line) and keeping bidding costs to a minimum. The European Union's 'Electronic Public Procurement System for Europe' (ELPRO) is an example of seeking to increase SME participation through on-line bidding procedures (The Enterprise Research Institute, 1998, p.12). The United States and Japan have gone further by steering government procurement actively to help SME participation. In the US, procurement policy is used to assist small enterprises in a number of ways. The Small Business Administration (SBA) negotiates compliance targets with federal governments and also enters into contracts that it then subcontracts to small businesses. 'Set-asides' are also used to target procurement towards social disadvantaged or minority SMEs. In addition, the US Government has used widespread on-line information dissemination to aid SMEs in winning procurement contracts.

While there is continuing debate about the advantages of using set-asides and targeted procurement, there is no doubt that it has enhanced SME involvement in public procurement contracts: "Without specific set-aides for SMEs", the Enterprise Research Institute concluded that "the evidence indicates that larger companies obtain the lion's share of contracts" (The Enterprise Research Institute, 1998, p.14).

Considerable advances in supporting local involvement in aid-financed procurement can be achieved through increased access to information and the simplification of tender documents, alongside training and other supply side initiatives. In addition targeted or affirmative procurement which creates the demand for certain goods or services can help fulfil agreed socio-economic objectives such as developing the local private sector. Targeted strategic aid procurement should enable donor and recipient governments to use procurement to achieve socio-economic objectives without compromising fairness, probity, transparency, competition, efficiency and value for money. The mix of supply and demand side aid interventions could work as a powerful instrument to support development objectives.

Sourcing aid-funded goods and services from SMEs in recipient countries, or from larger organisations which subcontract local SMEs, holds considerable potential for loosening the demand-side constraint which has held back SME growth. As Jonathan Dawson argues, insufficient demand "consistently appears as a core constraint in studies into the growth potential of SMEs" (Dawson, 1999, p.3). Experience in a number of countries demonstrates that with the right incentives and appropriate forms of assistance, SMEs are able to "make the qualitative leap necessary to supply large-scale formal sector

clients of the kind required to increase involvement in aid-funded business" (*Ibid.*). There is, of course, considerable debate about how useful procurement can be as a public policy tool to achieve social development objectives, particularly if other key aspects of procurement and contracting – probity/transparency and value for money – are compromised. Examples of using procurement to support social/political goals provide mixed results. As the Strategic Procurement Systems paper on using procurement as an instrument of social policy said:

"the use of procurement as an instrument of policy is not without controversy and questions have been raised regarding its legitimacy and effectiveness. Certainly, many attempts to promote an industry or sector within an industry have failed, particularly where policies have been championed in an uncompetitive environment, isolated from national and international competition"

(Strategic Procurement Systems, undated, p.2).

Nevertheless, there are sufficient examples, both from the public sector and the private sector, where procurement has been used as an instrument of policy, to identify some of the key problems and potential solutions associated with targeted procurement. Recent experience in South Africa, for example, suggests that 'affirmative' procurement (discussed below) may be more effective than set-asides. Taken together, examples of best practice should begin to provide the basis for establishing a range of guiding principles to support the development of donor practice in this area. Aid procurement offers an important opportunity to experiment with a range of practices to identify what works and what does not. This report seeks to identify some of these problems and offers, in some areas, tentative ideas on how these problems could be tackled.

There is clearly a need to bring together learning and experience as well as commissioning new research in the area of procurement as a resource for social policy. As the paper prepared by the Enterprise Research Institute says, "experimentation with innovative pilot projects which try out alternative approaches should yield a great deal of useful information which could provide indications of what works and what does not" (The Enterprise Research Institute, 1998, p.39).

BOX xi

Promoting SME growth: lessons from the private sector

Case study research demonstrates that governments in general and donor agencies in particular, lag behind some of the innovative and creative uses of procurement adopted by the private sector. There is much to be learned from the private sector approaches to the involvement of the local business sector both in developing and developed countries. This section reviews some of the issues to emerge from this experience which is applicable to aid procurement and contracting.

Some examples of where large companies have sought to facilitate the development of local business include Anglo-American, San Miguel and Courts (Rural Investment Overseas Ltd, 1999, p.7):

Anglo American Corporation (AAC), based in South Africa, established a Small and Medium Enterprise Initiative in 1989:

- contracting services to and purchasing goods and services from small businesses;
- offering advisory services to these businesses; and
- acquiring minority equity stakes in emerging enterprises through an investment company.

In 1996 the initiative facilitated business transaction with a value of £37 million for 201 emerging businesses employing some 3,700 people. The cumulative value of business placed through the initiative since its inception totals £115 million, ranging from food and cleaning services, to the production of equipment, conveyors, bricks and household materials for mineworkers.

San Miguel from the Philippines has had a long tradition in corporate philanthropy and social investment. In recent years it has focused on building partnerships with local communities based on more sustainable forms of engagement driven by its business units.

An example is an initiative targeted at small-scale corn farmers. The San Miguel Food Group is a major chicken producer, and corn feed represents about 60 per cent of its production costs. In the past, Filipino farmers have been unable to compete with foreign imports from Thailand. Since 1993, San Miguel has worked with the government, and with several NGOs to provide:

- training for the farmers aimed at increasing their productivity and quality;
- institution building aimed at improving their ability to negotiate and deal with traders;
- access to credit and other key inputs such as organic fertilisers and hybrids; and

- access to markets via corn marketing contracts signed by San Miguel with some 30 farmer groups.

There has been a range of mutual benefits. The small-scale farmers have been empowered, both economically and politically, with better organising power and access to jobs, finance, material resources, and reliable markets. San Miguel has saved about £100,000 since the programme; it is now sourcing better quality corn; it has measurably better relationships with local community groups, and a growing reputation for working with small scale farmers which is a valuable asset, given that some 70 per cent of San Miguel's beer drinkers are farmers.

Courts PLC, provides another interesting example of backward linkages. Courts established itself in Guyana in 1993, taking over a furniture and electrical retail chain. Courts' buyers scoured Guyana for affordable furniture for the mass market, and found little available that met their quality and price requirements. The only two major factories manufactured exclusively for export and the remaining workshops made individual pieces in small quantities. Courts realised it would have to help the furniture industry in a fundamental way. It launched a Furniture Investment Programme to provide training in all aspects of furniture manufacturing, from forestry to finishing. Expert volunteer advisers for British and Canadian agencies (BESO and CESO) provided training. Courts gave workshops guaranteed orders, to allow them to borrow money from banks and expand their operations. Within two years there were 50 furniture makers in the programme, over half of whom had under 20 employees, and they subsequently doubled employment to 750 people. New lines of furniture are being sold through Courts stores. Courts introduced awards to reward improvement and design competitions to encourage new talent.

The lessons of sub-contracting and co-operation

Many Northern companies operating in developing countries are increasingly interested and involved in co-operating with local partners. Local suppliers can offer certain advantages such as knowledge of local conditions and markets, lower transportation costs, quicker deliveries. Despite the increasing interest, backward linkages between foreign controlled firms and local firms have not been well developed in many developing countries.

Some developing countries have sought to legislate for enhancing backward linkages by, for example, imposing import restrictions or by legislating for local content requirements. These forms of protectionism are increasingly anachronistic because of the potential for economic inefficiencies and deteriorating management and technological skills. In some cases this has led to some

international concerns paying higher prices for lower quality products bought locally. In poor developing countries however, rapid liberalisation can be counter-productive. The pressures exerted on companies from global competition in countries with poorly developed market economies can be disastrous.

Using aid procurement as a 'hothouse' method of building up the capacities of local businesses to become viable competitors on the international market sets out an alternative path for developing countries between overly-protectionist policies on the one hand and rapid liberalisation on the other.

The benefits of local sourcing

The experience of many large companies in building links with smaller companies offers a considerable amount of learning to reforming aid procurement and contracting. Direct business linkages include local joint venture partners, suppliers, contractors, distributors, retailers, franchisees, licensees, agents and other service providers. These linkages help to build managerial, organisational and technical capacities among partner organisations; help local companies to reach quality standards and delivery times appropriate for competing on the international market; build support services through backward linkages; and develop a solid business base to expand economic growth.

Many developing countries are keen to increase so-called backward linkages where foreign direct investment is seen as an instrument for improving the products and services of local suppliers, generating enhanced economic activity and transferring technological and management skills to these countries. This will help to increase the capacities of local suppliers and producers to compete on the international market.

Companies, too, see clear advantages from local sourcing and out-sourcing non-core activities to local producers and suppliers. These advantages are developed through training and sharing best practice along the supply chain.

However, reorienting aid procurement towards support of development objectives is not simply a case of massively increasing local sourcing. Indeed, transferring procurement opportunities to Southern-based suppliers holds significant dangers and could further undermine the development of the private sector in developing countries unless it is carefully managed.

2.3 Pursuing targeted social development goals through targeted and 'affirmative' procurement: the South Africa model

Pro-development aid procurement need not be limited to initiatives that aim generally to support and enhance private sector development and build local ownership of development in recipient countries. 'affirmative' procurement initiatives pursued by the South Africa government over recent years demonstrate how more particular social development goals – such as women's employment – can be successfully pursued through targeted procurement policies.

Targeted procurement has been developed in South Africa to provide employment and business opportunities for marginalised individuals and communities. It enables procurement to be linked to the achievement of social objectives in a "fair, transparent, equitable, competitive and cost effective manner" (Strategic Procurement Systems, undated, p.3). The process seeks to target specific enterprises that do not have all the necessary resources, capacity or expertise to perform contracts in their own rights.

Small contracts falling below an agreed value threshold are afforded direct preferences to targeted suppliers to 'tip the scales' in their direction. Larger contracts require tenders to compete on product and process criteria. The tender includes resource specifications to define social objectives and these make up the social deliverables of a particular contract. Tenderers are expected to define how they intend to meet the social objectives of a particular procurement contract. Contracts are awarded on the basis of a balance between price and deliverables in respect of targeted groups. Targeted enterprises take part in the process as prime contractors, joint venture partners, subcontractors, service providers or suppliers.

In South Africa targeted or affirmative procurement has been used to target small and medium enterprises – including individuals – in certain areas. The objective of this programme is to support the development of small, medium and micro enterprises owned and operated by "previously disadvantaged persons" (Watermeyer, Gounden, Letchmiah, Shezi, 1998, p.20) through affirmative action.

In a pilot study to see whether affirmative procurement could be adapted to construction projects in 1996/97, a study concluded,

“procurement, depending upon how it is structured, can be successfully used as an instrument of policy. Targeted procurement, an innovative form of

procurement which links procurement to social policy, can present government with an attractive opportunity for correcting skewed distributions of wealth in a nation, and addressing poverty alleviation and job creation”

(Strategic Procurement Systems, undated, p.5).

The scheme is based on a point scoring system. Development objective points are awarded to tenderers who exceed minimum goals in terms of resource specifications to one or more of five issues. This helps to minimise the premium payable for incorporating socio-economic objectives. Development objective points can also be awarded to enterprises on the basis of whether companies have the status as an Affirmative Business Enterprises or the amount of ‘Women Equity Ownership’ within an enterprise. “This system of tender adjudication replaces the practice of awarding the tender to the lowest priced offer, as it permits resource based/scio-economic objective offers to be considered together with the financial offer” (Watermeyer, Gounden, Letchmiah, Shezi, 1998, p.9). The paper goes on to argue that the use of a development objective/price mechanism:

- enables tenderers to use their skill, knowledge, and creativity in arriving at a favourable mix between economic and development objectives.
- penalises those persons who fall outside the targeted groups or who offer to meet certain socio-economic objectives to only a limited degree but does not preclude them from tendering (i.e. engaging in economic activity) in a meaningful manner.
- prevents those who fall within a targeted group from presenting grossly uncompetitive tender prices as the reward for compliance with socio-economic objectives will be outweighed by the loss of points incurred through uncompetitive tender prices (*Ibid*).

One of the ways in which micro and SMEs have been brought into government procurement activities is through a process the South Africans call ‘unbundling’ – essentially a way of breaking contracts down into the smallest practicable parts and then encouraging joint ventures between contractors.

The change in contracting has required companies, particularly long established ones, to change their working methods. For example, there is a lower reliance on capital intensive technologies and a much greater reliance on labour. *Targeted Procurement: A means by which socio-economic objectives can be raised through engineering and construction works contracts* concludes, “the potential of Targeted Procurement to be used beyond South Africa’s borders in developing countries is significant. All developing countries have a need for resource based construction in order to grow their economies. The methodology

for Targeted Procurement... can be readily utilised in other countries without any substantial modifications being affected” (Watermeyer, Gounden, Letchmiah, Shezi, 1998, p.21). The report highlights a Namibian Government Green paper published in 1997 which sets out a policy on labour based works where the objective is to “improve living standards in a sustainable way through increasing income generation and employment opportunities where technically and economically feasible for the poor and marginalised sectors of Namibian society in a focused and targeted manner” (*Ibid*).

2.4 Aid procurement and ethical purchasing

Considerable progress has been made by many institutions and companies in recent years to ensure that the purchases that they make do not harm the environment and, in some cases, positively support environmental concerns. An example of how purchasing can be used to enhance the environment is cases in which profits made from the sale of recycled paper are used to plant trees.

Indeed, environmentally conscious public procurement is now a feature of many Northern governments’ purchasing policies. In 1996 the OECD adopted a recommendation on ‘greening Public Procurement’. In the UK, the Treasury and the Department of the Environment, Transport and the Regions (DETR) jointly produced guidelines in 1999 for spending departments called “environmental issues in purchasing”, which explains how environmental issues should be dealt with in government procurement. The guidance note recognises that:

“although the aim [of procurement] must be to achieve value for money, not to further other policy aims, it should not be overlooked that legitimate requirements laid down by Government purchasers can have an influence in assisting the development and use of goods and services which are less harmful to the environment” (HM Treasury, 1999, p.2).

Agenda 21, agreed at the Earth Summit in 1992, proposed a strategy for procurement which takes into account environmental protection and conservation of resources criteria alongside the more traditional procurement requirements of quality, price, delivery, stability of supply etc. In 1994 the Danish government announced that it was adopting a policy of environmentally-friendly public procurement policies. The size of the Danish procurement programme is such that its policy is thought to have a significant ‘demonstration’ effect on the behaviours of companies and citizens in Denmark as well as the suppliers outside.

A growing body of work is now also being developed on ‘ethical’ purchasing and trade, where principled criteria, such as human rights issues, are taken into consideration with the other issues underpinning purchasing decisions, such as value for money. Like environmental purchasing, ethical purchasing is concerned with the way that buying can be used to directly or indirectly influence the supply chain, helping to address issues such as labour standards, child labour and health and safety issues. In the North, many companies have responded to these issues, which have emerged both from NGO campaigns and in the behaviours of the buying public, by developing or adopting voluntary codes of conduct to help regulate and seek compliance with supplier relationships (see for example the Ethical Trading Initiative in the UK – a partnership of NGOs, high street companies and DFID).

The South African Government’s experience of reforming its procurement practices suggests “the use of procurement as a regulatory tool to enforce existing legal obligations or to encourage standards of behaviour beyond those required by the law has the potential to make substantial impact” (Strategic Procurement Systems, undated, p.1). This requires aid donors and governments to alter their tendering and contracting procedures to either ensure compliance with national law on minimum wage levels or on worker conditions or to set new standards for employees rights and entitlements. Clearly, developing new levels of employment conditions will need to be integrated with other policy measures. Nevertheless, procurement offers an incentive for local companies to address workers rights and conditions as a core component of their business practices.

Further research is required on how this learning can be applied to aid and wider government procurement for the benefit of sustainable development and poverty reduction. However, it is clear that certain elements of the ethical purchasing methodology could be quite readily adapted to aid procurement practices.

The partnership approach adopted by many companies between private sector purchasers and producers offers a potential blueprint for the approach that *Purchasing Power* advocates. Under such a scenario, **donor agencies would work through intermediaries to help actively build capacities of private sector companies and, through this relationship, also address issues such as labour standards and workers rights. Donors can use their purchasing power to encourage the development of the local private sector on an ethical basis.** However, such power must be used carefully and sensitively, so as not to add on additional unsustainable costs or

burdens which would reduce the operational and development capacity of local companies.

2.5 Challenges to increased aid procurement from the local private sector

In order to meet the challenge of reforming aid procurement towards social development goals, donors will need to address some of the difficulties that would be involved in reforming their aid procurement from the local private sector.

These difficulties include:

1. **The need to ensure the production of appropriate standards and quality of the goods by the local private sector.** The abilities of local SMEs to produce goods or provide services to an acceptable standard is a potential constraint to enhancing their involvement in aid funded contracts. SMEs may be unable to meet rigorous standards on delivery, bulk production, quality of products and consistency. This constraint mainly arises from the lack of exposure of local companies to international competition and standards as well as lack of investment in management and technologies. Furthermore, the lack of legal framework may make it extremely difficult for donor agencies to seek legal recourse. These constraints are the result of low levels of modern technology, lack of skilled labour, low working capital, restricted access to technical or market information, and restricted access to global markets. There is a concern that the products and services offered by local companies are uncompetitive and of lower quality than that available elsewhere. These concerns extends to claims that local suppliers are unwilling to adapt to meet the standards expected. This has led, in certain countries to foreign companies operating in economic ‘enclaves’ that have little connection with the economy of the country where an operation is based.
2. **Bureaucratic barriers that may prevent local SME involvement in aid-funded contracts.** Complex tendering information and access is a significant constraint to SME involvement in procurement contracts. Furthermore, delays in payments for services rendered can act as a significant barrier to SME involvement.
3. **Aid procurement and contracting based on development projects may not provide the continuing level of demand required by fledgling SMEs.**⁵

⁵ Note that a number of further constraints, and proposals for overcoming these constraints, are listed by the European Commission in its 1990 Commission Communication, *Promoting SME Participation in Public Procurement in the Community*.

The case studies presented in this report suggest that these constraints can be overcome. As Dawson notes, “given the appropriate mix of technical support and operational flexibility, procurement and contracting policy can indeed be used as highly effective weapons in the war on poverty” (Dawson, 1999, p.20).

Some of the key lessons that emerge of relevance for the donor community in developing a new pro-poor procurement regime are:

- Successful programmes must be based on an economic rather than a philanthropic framework. Procuring goods and services from companies on the basis of charity is not a viable or sustainable business practice. The contracting or procurement agency is best placed to provide the technical know-how geared to the specific needs of the SME under contract. It has the best knowledge of the product it requires as well as the economic incentive to provide the most efficient form of training and mentoring. Where more than one SME is contracted, then an important lesson is that market mechanisms to promote the efficient and cost effective use of mentoring and training are required, such as fees for market linkages, or the provision of subsidies for a limited period.
- Mechanisms need to be put in place which protect the procuring authority (or larger partner company) from poor quality or sub-standard work. These mechanisms may include business contracts or, in more informal settings, an agreement whereby buyers are free to purchase goods which conform to an acceptable standard. The Ceara case goes further than this by placing obligations on the producers by ensuring that clients are under no obligation to purchase sub-standard goods. Second, every item carries a warranty which obliges the producer to undertake repairs as necessary; and third that, if a business ceases trading then the producers association is responsible for honouring the warranty.
- Lack of capital is a constraint to SME involvement in procurement. This can be largely remedied through recourse to credit provision, the provision of equipment on a hire/purchase basis.
- Producer associations are an important factor that need to be considered because of their role in underwriting warranty schemes, as negotiators of contracts which can then be allocated to its membership, for the delivery of technical assistance and know-how and for bargaining power with clients.
- Purchasing agencies can seek to develop organisations which conform to agreed conditions integrated to workers’ rights and recognition of unions and other factors, which maximise the impact of the SME sector on poverty reduction (without unduly adding to costs). Buyers can also seek to reduce the vulnerability of SMEs by helping them diversify their client base.
- Inevitably, the purchase of goods and services from local producers will require donor agencies to put in place new procedures and mechanisms in their dealings with SMEs which take into account the constraints faced by the sector. This will require a significant rethink in donor agencies on how procurement takes place and by whom. Inevitably, it will also require donor governments to invest significantly more resources in the procurement activities so that they can be readily accessible by local SMEs. Donor agencies will also need to invest in their procurement processes in other ways such as surveys of existing SMEs etc.
- Donors should seek to use the demand they create sensitively and creatively so as to build up sustainable capacities among SMEs. This will involve reorienting current aid procurement practices from a centralised model to one which seeks to improve understanding of local conditions, local producers and consultants and local constraints as well as developing improved local analysis of the potential positive (and negative) impacts of using procurement as a demand-led investment in development.

3. Aid procurement and its links to wider government procurement in developing countries

Aid procurement and contracting currently takes place largely in isolation from recipient government procurement with little integration between the two processes. Donors rightly use existing aid resources to help reform and increase the efficiency of government procurement processes and help set up new procurement procedures. However, there is little interaction between aid and recipient procurement.

Unlike foreign investment, government procurement and contracting takes place in all countries. It is estimated that government procurement makes up to 20 per cent of global GDP (Transparency International, undated) and higher in some countries. African continent public procurement contracts, for example, amount to over \$50 billion a year. Reorienting this expenditure in the pursuit of development goals could be an invaluable asset in the fight against poverty.

Purchasing Power makes the case that, like aid procurement, existing government procurement programmes can be reoriented and re-focused to enhance the prospects of local and regional producers, manufacturing and consultants within a pro-poor framework. As the President of the African Development Bank commented last year, “an efficient public procurement system is vital to the advancement of our states and is a concrete expression of our commitments to making the best possible use of our public resources.” (Kabbaj, 1998)

A reformed aid procurement and contracting process which seeks to use the demand created by procurement to support development objectives, has the potential to act as a model or a ‘learning zone’ for influencing the direction and use of government procurement more generally in developing countries. For example, best practice developed in aid procurement on integrating social objectives into the tendering and implementation of procurement could provide the models to help to recipient governments refocus their procurement towards development objectives. Increased transparency is a critical element of any reform of government procurement. Lessons learned here could also help enhance the transparency of existing government procurement programmes.

Using aid and government procurement creatively can also help to influence the quality of economic growth. Contracting procedures could, as the South African experience demonstrates, place the emphasis on labour intensive rather than capital/technology intensive

processes. This helps to create greater employment using one of the key resources that developing countries have in abundance. Furthermore, it reduces reliance on expensive foreign technologies. The creation of ‘good’ jobs, the greater involvement of people in the productive process and a focus on local economic development which retains assets and capital in the locality could help to ensure that economic growth benefits the overwhelming majority of the population.

The active use of government procurement as a development resource and as a tool to set the tone for national economic growth is a relatively new area that requires further investigation and research. Nevertheless, it seems to offer great opportunities to focus existing resources on enhancing their impact on poverty reduction. As argued by Joseph Stiglitz,

“Part of the government’s role as a catalyst is to undertake projects that can lead to social learning – that is, projects from which the country can draw widely applicable lessons.”
(Stiglitz, 1998)

Purchasing Power makes the case that, on the basis that additional resources are required by many developing countries to help overcome poverty, then it may be possible, using models developed in aid procurement, to reorient and refocus existing government procurement practices in the South to enhance the growth of local and regional producers, manufacturing and consultants within a pro-poor framework.

Clearly not all procurement could be targeted towards achieving development goals but unless action is taken to view procurement and contracting as a potential development resource then a significant opportunity will be missed to promote poverty reduction.

3.1 Transparency and accountability in procurement and the WTO agenda to liberalise government procurement

Any discussion of government procurement as a vehicle for pursuing social policy objectives inevitably raises the question of corruption. Transparency International argues that “fewer activities create greater temptations or offer more opportunities for corruption than public procurement”. (REF) Undoubtedly, corruption can severely undermine development efforts and it is an issue of grave concern to Southern civil society.

Fighting corruption and increasing transparency in government procurement represent the main focus of work on public procurement pursued by the World Bank and WTO over recent years. *Purchasing Power* argues that the development of pro-development procurement systems, the pursuit of transparency and the fight against corruption in procurement, should go hand-in-hand, precisely because any effective system of development-focused procurement could not function *except* on the basis of maximum transparency and accountability. As Yash Tandon comments,

“There is everything to be said in favour of ensuring that there is transparency in procurement policies and practices, even if, at the end of the day, a procuring agency decides that it wishes to purchase the needed goods or services only from just one supplier, provided that it is done transparently and for good reasons.”

(Tandon, 1999, p.6).

A further potential challenge to pursuing a social development agenda in public procurement is raised by the possibility of the WTO’s work on government procurement extending from its current focus on transparency in procurement, into negotiations for the wholesale international liberalisation of government procurement markets. The possible opening up of government procurement to international competition has been pursued particularly forcefully by the European Union in the run-up to the WTO’s 1999 Ministerial meeting in Seattle. The EU would like to see foreign procurement markets prised open for greater access by European companies.

Purchasing Power argues that the international liberalisation of government procurement would only bring gains for powerful commercial interests in the North, since it is almost exclusively Northern and transnational companies that are ready and waiting to move in to exploit new procurement markets abroad. Developing countries would be the losers, with governments probably losing any chance that they

currently have of building and improving their procurement regimes to better support local commercial and social development. There is no good reason why liberalising government procurement would necessarily help to reduce corruption and rent-seeking. Indeed, rapid liberalisation would only increase the administrative load on already overstretched government departments in the South, and thus undermine effective institution- and capacity-building in this area. Transparency and institution-building in government procurement, we argue, should be kept entirely separate from the issue of liberalisation, and developing country governments should resist any pressure for an expansion of WTO interest in this area.

This report argues for a reformed and re-invigorated aid and government procurement process that seeks to address social and economic objectives within the context of a highly transparent process and a reworked definition of value for money. A transparent process which makes purchasing decisions open and accountable, which offers a clear basis on which individual decisions are reached and which includes a review mechanism, should be an integral part of the procurement process.

4. Policy Recommendations

On tied aid

Donor governments should:

- eliminate all forms of aid tying by the end of the year 2000. DAC donors must now seek to recast the current efforts to untie aid to LLDCs into a new and re-invigorated process to press for full untying in light of the legal pressure now facing them. If donor countries as a group fail to make rapid progress, then like-minded countries should agree to untie all forms of aid as quickly as possible. This is likely to pressure recalcitrant donor countries to untie their own aid programmes.
- recognise that aid untying without concomitant commitments to use aid procurement as a resource for development and poverty reduction will retain many of the damaging components of tied aid. Untying on the basis of increasing competition between Northern contractors only will not tackle the underlying problems associated with tied aid. Donor commitments to Southern capacity building and resourcing must go beyond rhetoric. Instead, a firm commitment by donors to an agreed set of guidelines outlining best practice on pro-poor procurement and contracting must be agreed as an integral component of any deal on aid untying. 'Procurement in support of development' must be the principle driving force behind untying efforts.
- at the EU level, donor government should press for urgent action by the European Commission to follow up the NGO complaint on aid tying. European donor countries should help facilitate the Commission's investigation and urge donor countries who have the greatest problems in pursuing aid untying to now accept that progress has to be made.
- donor governments should put much greater efforts, research and political will into developing a new vision for procurement and contracting which supports development. This effort should include the development of best practice, pilot studies, learning from other donors and governments and a process to agree guidelines to guide donor actions on capacity building using procurement/contracting as a demand-led input.
- donors who continue to argue that not all aid should be included in any agreement should be exposed by other donors and NGOs for seeking to maintain the use of aid as a domestic subsidy either directly or indirectly. There are no convincing reasons for any aid to be tied to donor country

goods and services. It is hypocritical for donors to continue to use aid resources as a commercial subsidy.

- resist intensive lobbying by those private sector firms who benefit directly from aid tying. Donors should use aid untying as one way of increasing the knowledge, understanding and commitment of their publics to poverty eradication.

The Development Assistance Committee should:

- seek to encourage donors to re-invigorate efforts to untie aid and recast discussions on aid untying towards pro-poor procurement rather than liberalisation per se. New discussions must be based on utilising procurement as a development resource and untying all aid.
- take a lead in developing guidelines that describe best practice on using aid procurement as a development resource.
- develop mechanisms to ensure that informal tying and other forms of rent-seeking to not continue to distort aid spending.

The European Commission should:

- speedily investigate the legal complaint submitted by NGOs on aid tying. The Commission must also use the investigation to place pressure on European donors to seek agreement with all OECD donors to fully untie aid.
- take a lead role in arguing for aid procurement and contracting to support rather than undermine development efforts and ensure that its own aid programmes support the development of local capacities for poverty reduction rather than undermine them.

On procurement:

Donor governments should:

- undertake further research and learning to develop best practice to use the power of procurement and purchasing to support national poverty reduction objectives by building local capacities in the private sector to meet development needs. This learning should be shared with other donor agencies.
- invest resources in overhauling their procurement systems and practices. Part of this investment should be used to considerably enhance local procurement capacities. This investment should seek to train procurement staff in creatively using the demand created by procurement to support development. Likewise, development project implementors should be trained to consider how procurement could help support project. Investment should also be made into full surveys of local and regional procurement capacities. These surveys should be in-depth and consider both the existing capacities for local and regional sourcing and the potential for using procurement demand to help build local capacities. Procurement professionals should be encouraged to develop strategic skills in utilising procurement for development and donor agencies and should be encouraged to regard procurement as a component of the development process rather than as a technical support function.
- as part of re-examining procurement practices, undertake a formal review of existing contracts with procurement agencies to see if they are appropriate vehicles for using procurement as a development resource. Alternatives must be developed which incentivise and increase the scope for procurement to be used strategically such as using local procurement agents or undertaking more procurement in-house. Procurement must take place on market terms and not
- seek to bring together support for local business and entrepreneur development with aid procurement as part of a coherent package for supporting SME development.
- seek to learn from South African and World Bank experience of incentivising the participation of local communities in the procurement required for development
- bring together support given to reforming recipient government procurement systems with the learning and best practice developed through strategic aid procurement. Donors should consider enabling recipient governments to use aid procurement as a way of leveraging wider change in the strategic and transparent use of procurement.

Donor governments, Finance Ministries and the OECD should:

- rethink and re-examine the concept of ‘value for money in procurement’ so that strategic policy objectives can transparently be accounted for in purchasing decisions.

Recipient governments should:

- seek to reform existing procurement processes to take into account the need for transparency and the potential for strategically using procurement to support national poverty reduction goals.

NGOs should:

- reform their own procurement processes in line with the recommendations made in this report.

On technical cooperation contracting and consultancies:

Donor governments should:

- promote joint ventures, mentoring and partnerships between Northern and Southern consultancies and ensure that such ventures promote positive learning and capacity building for the Southern partner. Donors should fully evaluate the qualitative impact of joint ventures on capacity building and consider measures that will incentivise cross learning as well as measures that penalise consultants who do not put adequate emphasis on learning.
- change contracting procedures to ensure that learning and capacity building are emphasised in their technical cooperation programmes. Contacts must also be reviewed to ensure that they emphasise consultants' responsibility for the advice and know-how they impart and that the poverty reduction framework under which they are expected to operate and be accountable for.
- undertake surveys of local and regionally-based consultants who are able to give good quality advice and assistance on donor aid projects and non-project initiatives.
- agree that by 2005 over 90 per cent of all technical cooperation contracts must involve Southern consultancies and that the overriding aim of all technical cooperation must be capacity building.

Private sector companies should:

- seek to find new mechanisms for working with and building the capacities of local consultancies. Northern-based consultancies should ensure that partnerships with local companies should be genuinely capacity building.

On government procurement:

Donor governments and international organisations should:

- seek to build-in targeted/affirmative procurement into existing support for improving the effectiveness and transparency of government procurement systems. Reformed aid procurement could in some instances provide a model for improving government procurement more widely; in other cases aid and government procurement could be brought together into a single system.
- ensure that any moves to put government procurement on the agenda of the WTO as a staging post towards full liberalisation should be resisted. The focus of the existing WTO working group on procurement should remain on enhancing transparency in government procurement only as long as these are not used as a compliance burden. UNCTAD, UNDP, the World Bank, the DAC and other relevant international institutions should consider how government procurement can be reformed to support the development of national capacities and poverty reduction by adapting best practice developed in aid procurement.

Developing Countries should:

- resist being drawn into signing any agreement in procurement that could undermine their ability to use procurement to support development and other social and economic objectives. National treatment for foreign firms in government procurement must also be resisted. Developing countries should insist on classifying government procurement as a development issue under the auspices of the WTO.

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Annexes

Case-studies of pro-development procurement

The following case studies demonstrate many of the challenges faced in government and private sector procurement and some of the creative solutions that have been identified. The case studies were researched by Jonathan Dawson and Fiona Kam as part of the work commissioned by ActionAid for this report.

I. Manicaland Business Linkages Programme (MBLP), Zimbabwe⁶

Located in eastern Zimbabwe, the Manicaland Business Linkages Programme has the dual aims of creating a strong and diverse small enterprise sector in the project area; and developing a model for MSE assistance that is replicable elsewhere. It does this through:

- i. facilitating the development of linkages between producers of different sizes through the dissemination of information on linkage opportunities;
- ii. encouraging cost-effective capacity-building for MSEs based on 'buyer mentoring'; and
- iii. facilitating the access of client enterprises to credit (rather than providing credit itself).

The programme promotes business linkages through a number of different activities:

- *linkages identification workshops* for buyers and suppliers, usually with a sub-sectoral focus;
- *buyer open houses* give small groups of potential suppliers a chance to visit buyers who are seeking linkage partners. Potential suppliers observe the production process, inspect samples, or attend presentations with a view to identifying linkage opportunities and initiating negotiations with prospective partners;
- *supply capacity audits* assess the ability of an enterprise to supply specific goods or services in terms of their productive or managerial capacity. Such audits often serve to identify a specific need for supplier capacity-building; and

- *feasibility studies* to examine the merits of specific linkage proposals and to outline the conditions under which it could be profitable for a supplier to enter into a linkage agreement.

Having facilitated the development of linkages, the next key step in the process is strengthening the capacity of the suppliers (generally MSEs) to enable them to achieve the standards of quality and punctuality of delivery required. As a general rule, MBLP does not do this itself: rather it promotes a local culture of 'buyer mentoring', believing that it is the buyers of the goods and services in question that are best placed to deliver the technical assistance necessary.

MBLP does have a budget to buy in training or other assistance from outside agencies. However, it tends to use this to leverage contributions from others, particularly the buyers and suppliers who stand to benefit from the services provided.

While the programme is too young to have generated solid impact data, early indications are most encouraging. Between its inception in 1996 and mid-1988, the programme facilitated the formation of 139 linkages. Of these, the majority (67 per cent) involved a few large timber and wood products companies. Construction companies were also well represented, with horticulture, tourism and furniture-making of more marginal significance.

There is evidence of increased capacity and employment among small supplier enterprises as a result of the scheme. To date, existing linkages appear to be withstanding the sharp downturn currently afflicting the Zimbabwean economy. There has been only one closure among the 139 linkages created to date. There is also evidence of widespread acceptance of linkages as a profitable and efficient way of doing business: it is now accepted policy, mandated at the highest company levels. Finally, and crucially, the concept of buyer mentoring appears to have become widely accepted among contracting companies as providing good value for money. Mentoring in the form of training is usually precisely targeted at a specific current need, a recognised characteristic of successful and cost-effective training.

⁶ Drawn from Grierson, Mead and Kakora, 1999

There are also encouraging signs that the programme may, in the longer-run, be financially self-sustaining: “When business linkages become standard practice, the costs of generating them (information) and sustaining them (capacity-building and buyer mentoring) are largely borne by the buyers and suppliers themselves” (Grierson, Mead and Kakora 1999, p.6).

In drawing their conclusions from the experience of the programme to date, the authors of the paper from which this case study is drawn (Ibid.) arrive at two key lessons learned:

- *“the driving force must be economic.* An attitude of charity on the part of the buyer, or of entitlement on the part of the supplier, can alter the focus, diminish the degree of win-win motivation and potential, and hinder the emergence of the understanding that business linkages are a commercially rewarding business practice; and
- *cost-effectiveness is a key part of the equation.* There is no likely source of long-term external support for linkages ‘projects’. Therefore, limited resources must be used carefully and efficiently. In general, this means avoiding costly ‘integrated’ approaches and placing stress on providing only the bare minimum of useful and necessary assistance”.

II. Sarvodaya/Rural Enterprise Development Services (REDS), Sri Lanka⁷

Sarvodaya is the largest NGO in Sri Lanka and has programmes of social and economic assistance to over 2,500 groups covering most parts of the country. One of the largest of its programmes is Sarvodaya Economic Enterprise Development Services (SEEDS) and it, in turn, comprises three units, one of which is Rural Enterprise Development Services (REDS). REDS provides technical assistance to enterprises established by Sarvodaya group members in the form of training, technology development and dissemination and on-site counselling. Some of these services are delivered by REDS staff members, but more commonly, they draw on private or public sector expertise or a combination of the two.

The way REDS works is well illustrated by its promotional efforts in the field of milk production. It has worked closely over a number of years with the Veterinary Department in the development of demonstration and training programmes for dairy farmers. Formal training workshops and occasional

mobile clinics are held, involving extension officers from both REDS and the Veterinary Department.

In parallel, the Veterinary Department helps train selected Sarvodaya group members in artificial insemination and simple animal care techniques. The trainees purchase semen from the Veterinary Department and provide insemination services for a fee. The private milk-purchasing agency, Milco, also provides training to selected group members in the testing and grading of milk according to fat content. These trainees collect, test and grade the milk daily and then store it for collection by the company.

The delivery of services by the private sector – buyer mentoring – is an important and growing feature of REDS work. Various fruit and vegetable distributors, including several serving the international market, provide training in production and storage techniques as well as providing a final market outlet. The private sector Smallholders’ Tea Development Authority has helped with the establishment of Sarvodaya members’ tea nurseries. Several dealers in handicrafts provide market information and advice on the production of craft items, including brassware, wood-carving and leather-working and purchase high quality produce. The international company Singer Ltd. provides trainers for REDS’ courses on dress making and bridal wear and also buys the best-made items produced by group members.

The motivation for private sector participation in these various programmes is not primarily philanthropic. In most cases, the improved capacity of the producers translates directly into increased profits, both for the producers themselves and the companies that market their produce. As a consequence of this mutuality of interest, REDS is often able to withdraw slowly, leaving a direct, unmediated linkage between group members and the large companies they work with.

In the financial year 1996/97, the income accruing to Sarvodaya group members as a result of the business linkages created by REDS totalled over US\$475,000. The REDS business plan for 1997-2000 foresaw a substantial increase in the scale of its linkage activities.

III. Proyectos de Fomento, Chile⁸

Proyectos de Fomento, one of the programmes of Chile’s official small enterprise support agency, SERCOTEC, was established in 1990 with the aim of promoting clustering and networking between MSEs. The programme is based on a number of assumptions:

⁷ Drawn from Jeans and Ruthven 1996; and REDS 1998

⁸ Drawn from Humphreys and Schmitz 1996

i) that one of the principal problems facing MSEs is isolation; ii) that dynamic clusters can have a positive social and economic development on those areas where they are concentrated; and iii) that co-operation between private and public sectors is required if clusters are to be successfully promoted.

There are three stages to the development of programme initiatives (PROFOs) at the local level. First, SERCOTEC establishes contact with a small number of producers active in a specific subsector (usually between 10 and 30) and, following an analysis of their problems and opportunities, seeks agreement with them that a basis for ongoing collaboration exists. A manager is then appointed, with the initial task of acting as an interface between client enterprises and service providers. In this capacity he is able to act as a two-way conduit between local service providers and client enterprises – promoting services and acting as a channel for client feedback.

The manager also facilitates networking and co-operation between client enterprises through exchange visits, group workshops, joint approaches to process and product improvement and so on. The aim of this is to promote collective competitive advantage, so that the economic muscle of individual firms is increased through membership of effective networks within the cluster.

The final element of the PROFO process is the transfer of the initiative to local associations and other institutions. The manager is appointed only for a period of three years. If client enterprises wish to perpetuate the post, they must organise and fund it themselves. The benefits, it is hoped, will be sufficient for private initiative alone to sustain it.

Early results from the PROFO initiative have exceeded SERCOTEC's expectations. Some 16 PROFOs had been established by mid-1993, of which several had already made significant progress in increasing market share, moving into new markets both in Chile and abroad, and in developing sub-contracting relationships with large companies. In three cases, groups of small metal-working firms had been able to improve their performance sufficiently to begin supplying the state mining corporation, providing inputs, which had previously been imported or manufactured in Santiago.

SERCOTEC was sufficiently encouraged by these results to develop a PROFO programme specifically directed at small firms wishing to enter export markets. Under this initiative, SERCOTEC pays for 70 per cent of the costs of a manager for the first three years and also subsidises the hiring of consultants to

provide specific assistance.

A recent evaluation identified significant progress among participating enterprises on four fronts:

- improved business organisation and management – adopting improved planning practices, better specifications of roles and functions and adoption of modern marketing strategies;
- improved human resource development, including better access to management and worker training;
- improved access to enterprise support agencies – mainly technological institutions, advisers, consultants and development funds; and
- significant growth in employment generation.

The evaluation concluded: “Last but not least, the cost-benefit analysis suggests that the programme is ‘socially profitable’ and does not involve massive government budget spending, which is more than offset by the increased revenue thanks to the tax generated by the companies involved.” (Benavente 1998).

IV. UNIDO's Sub-contracting and Partnership Exchanges (SPX)⁹

Convinced that sub-contracting offers a key route towards the development of healthy integrated economies and a strong small enterprise sector, UNIDO promotes the model of Sub-contracting and Partnership Exchanges (SPXs). SPXs are technical information, promotion and match-making centres for industrial sub-contracting and partnership agreements between main contractors, suppliers and sub-contractors. They are non-profit manufacturers' associations enjoying full-autonomy, but generally sponsored or supported by public authorities and private associations.

SPXs perform a number of functions:

- the collection, analysis, storage and dissemination of information on the existing production capabilities of MSEs seeking to develop sub-contracting relationships;
- attracting and identifying sub-contracting inquiries and offers from large-scale international and domestic companies; and
- assisting potential sub-contractors to successfully negotiate agreements with large-scale clients. Assistance provided to the MSEs includes technical support (product design and development); quality management, standards and certification; marketing strategies (including participation in

⁹ Drawn from Garrigos-Soliva 1999; and de Crombrughe and Montes 1999

international fairs); facilitation of improved access to credit; business management; legal advice; and human resource development. Such advice is provided either through buyer mentoring, by the SPX team itself or by relevant specialised institutes.

Since the programme's inception in 1984, a total of 54 SPXs have been established in 30 countries, of which 45 are currently operational. In addition, regional networks of SPXs have been created in Latin America and the Middle East. The total number of companies currently registered with SPXs exceeds 15,000.

Several case studies illustrate the kinds of roles that SPXs perform. In Monterrey, Mexico, the SPX facilitated the development of sub-contacting agreements between a large-scale Mexican plastics manufacturer, four small manufacturing companies and a raw materials supplier. The sub-contracts involved the production of 16,000 glass fibre bases for public lavatories. The agreement included the transfer of technology and expertise, by way of training, from the buyer to the small contractors. The sub-contractors employed 15 new workers, increased their production by 30 per cent and, as a result of the improved quality of their goods, were able to move into new domestic markets.

The SPX in Medellin, Colombia put a transport vehicle manufacturer in touch with a small-scale producer of metallic pieces, SIMSA Ent. An Italian technician was employed to work with SIMSA and a German expert was engaged as a consultant to help upgrade its processes to the standards necessary to fulfil the contract. An initial contract worth US\$25,000 was signed and satisfactorily delivered. SIMSA continues to work for the larger contracting company and has since further diversified its product and client base. Meanwhile, the transport company is able to source locally a number of goods which previously it was obliged to import.

A survey conducted in 1994 indicated that on average 80 per cent of companies registered with SPXs were consulted at least once in the previous year; and that 40 per cent of these consultations resulted in a signed contract. A similar study in 1997 found that 66 per cent of registered companies had concluded a sub-contacting agreement in the preceding year.

V. The Body Shop's Community Trade Programme¹⁰

This programme sources natural ingredients and accessory items for Body Shop retail outlets from

disadvantaged communities around the world, the great majority in the South. The core criteria for the selection of partner communities are that:

- organisations already exist that represent the disadvantaged;
- the producer groups in question have limited opportunities, limited resources, limited access to education, limited health care and limited outlets for their goods;
- trade with the Body Shop will benefit directly the producers of the goods;
- trade is commercially viable; and
- the Body's Shop's standards for environmental and animal protection are met.

Goods sourced through the Community Trade Programme include cocoa beans from Ghana, hand-made paper products from Nepal, jute products from Bangladesh, hand-woven hair accessories and woven boxes from the Philippines, sesame seed oil from Nicaragua, loofahs from Honduras, honey and other bee products from Zambia and various handicrafts from India.

The technical assistance provided by the Programme varies according to the opportunities and needs of each individual partner group, but can include:

- the introduction of new products;
- product enhancement and quality control;
- the development of diversified marketing strategies;
- health and safety; and
- maintaining environmental standards.

Technical assistance is delivered either by the Community Trade Programme team (comprising seven staff members), experts elsewhere within the Body Shop group or external consultants.

In addition to supplying the Body Shop, the Programme sets a high priority on the development of other marketing outlets so as to reduce the vulnerability of partner groups to a loss of Body Shop business. For example, the managing director of Get Paper Industries (GPI), a Nepalese supplier of hand-made paper products, was funded by the Programme to visit various trade fairs and potential clients in Britain. GPI moved from being a small business with near total reliance on the Body Shop to having 16 other large customers and six shops in Nepal.

The programme has grown rapidly in recent years: from 11 partner community groups in 1994/95 to 19 in 1995/96 and 22 in 1996/97. The value of raw materials and accessories purchased from these groups rose

¹⁰ Drawn from unpublished case study material provided by the Body Shop

from £826,425 in 1992/93 to nearly £2 million in 1996/97.

VI. Labour-based roads in Ghana¹¹

Following years of neglect, Ghana's feeder road network (a total length of 21,000 kilometres) had by the early 1980s fallen into a state of serious disrepair. This was a particularly serious problem in the cocoa growing areas of the country, where large quantities of the valuable export crop were effectively 'locked up' for months at a time due to the poor condition of the roads. Transport costs often accounted for up to 70 per cent of the marketing costs of agricultural produce.

A pilot project with technical assistance from the International Labour Office (ILO) was launched in 1984 to address the problem. The project adopted an innovative approach based on a three pronged strategy:

- i. the introduction of an employment-intensive technology in an environment that had previously been geared towards the building and maintaining of feeder roads by heavy equipment;
- ii. the development of a specialised category of small-scale contractors capable of implementing labour-based methods; and
- iii. strengthening the institutional capacity of the Department of Feeder Roads (DFR) to transform it from an implementing agency into the role of facilitator, manager and supervisor.

Changes in the conventional approach to road building and maintenance took a number of forms:

- new technologies were identified and field tested (although, since a similar programme had already been running for a number of years in Kenya, technology identification did not prove difficult);
- international procurement of light equipment and hand tools was made through a local bank. These were made available to the contractors through a hire-purchase system;
- contractors were identified and provided with training in the new methods;
- productivity-linked payment schemes, standards of fair working practices and involvement of worker associations were agreed on with contractors;
- village-based road committees were established to co-ordinate construction and maintenance activities with the contractors;
- unit rates were established for different labour-based activities;

- work was packaged into small contracts;
- competition for work between contractors was encouraged;
- mechanical back-up facilities for the maintenance and repair of the equipment was put in place through training of private sector artisans and mechanics;
- DFR was geared up for rapid payment of contractors; and
- technical and managerial support was provided to DFR to help it evolve into its new role.

Field trials were followed by the awarding of trial contracts of five kilometres' rehabilitation works to the trained contractors. These were closely supervised by DFR staff and ILO technical advisers. Upon successful completion of these contracts, full-scale contracts of 20 kilometres of road rehabilitation were awarded, using on average 150 paid local manual workers and a set of light equipment.

By 1996, 93 companies had been trained, of which 54 had received loans for equipment sets. Between 1987 and 1995, a total of 1,395 kilometres of feeder road were rehabilitated with 3,700 culverts installed. During this same period, the programme created some 4.4 million workdays of temporary employment which, at a daily wage rate of approximately US\$1, also injected US\$4.4 million into the local economy in the form of direct cash wages.

VII. WISPECO Ltd., South Africa¹²

The South African construction company, WISPECO, concluded that it would be more economical to transport its steel window frames in kits to the townships and outsource their assembly there through backyard welders than to do the assembly in-house. This was because a truckload of completely assembled windows could carry only one fifth the number of units as a truckload of window kits alone. The ability to tap into the market of smaller-volume clients, in turn, opened up the township market to WISPECO in a way that would not have been feasible if the corporation were to have continued producing in-house windows for this relatively fragmented market.

Considerable training was provided by WISPECO to its new sub-contractors, in the fields of production techniques and business management. After some time, the welding artisans association, NISDA, approached WISPECO with a request to provide further training for its members to go beyond assembly and welding to production of the frames themselves, including the bending of steel. This would,

¹¹ Drawn from Miles, de Veen and Clifton 1997; and Bentall 1995

¹² Drawn From Tendler 1994

of course, have taken the production process – and profits – further out of the hands of WISPECO and the company, consequently, refused. In response, NISDA has actively sought out alternative advanced training courses through various formal sector associations of steel product manufacturers and their research and development institutes.

The case study carries two important lessons. First, WISPECO's approach, which involved the transfer of significant quality enhancement to the welders, has endowed them with permanent and transferable skills. This has enabled them to improve the quality and range of their products, including metal beds, tables and chairs and burglar bars. The WISPECO tutoring, moreover, has itself provided the welders with the sophistication and confidence to go out in the world of formal sector institutions to seek further and more advanced assistance.

Second, the role of the association was key in giving the welders some bargaining power in their relationship with a monopsonistic client. This has enabled them to further improve their skills, enhance the quality and range of their products and diversify their client base.

Technology transfer

Often suppliers of capital equipment to developing country clients also provide an element of technology transfer. The closer both equipment and technology supplied are to the needs of the client, the better the success of the project.

Worldaware award winners provide two examples of good practice.

In 1989 ABB Transportation (a subsidiary of the Swedish-Swiss engineering multinational ABB) added a new dimension to their business in the developing world. In addition to supplying new railway stock, they started to offer a complete maintenance and refurbishment service on-site. This would reduce the foreign exchange spending of the client, often a government railway service.

ABB's focus is on doing the maximum possible locally by training the clients' railway personnel to the level where they can continue to maintain their rolling stock unaided. Having done this in Kenya and Tanzania by training tradesmen and artisans, ABB is now extending training to management level, to give its clients a maintenance culture. It has been estimated that 20-30 per cent of locomotives in many African countries are out of service at any one time, for lack of spares and maintenance. A working locomotive can pay off its capital cost in a year, so proper

maintenance can have a significant financial impact.

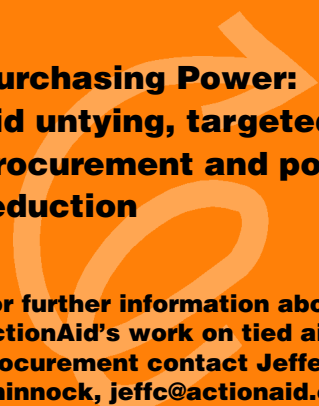
Avon Technical Services, a subsidiary of specialist tyre manufactures Avon (who supply Rolls Royce and Aston Martin amongst others), have been dedicated to the transfer of tyre making technology to developing countries for over 20 years. It provides the know-how for setting up tyre factories, and in 1993 were advising clients in Pakistan, Sri Lanka, India, Malaysia, and China. Tyres are designed to meet local conditions: road surface condition, temperature, typical load carrying practices. Over the years ATS partners in developing countries have become self supporting manufacturing bases offering large scale employment locally, on average 700 people in a factory, some of it highly skilled.

VIII. Training for printers in Ghana

Ghana is the third largest African importer of printed matter, and continental Africa imported US\$500 million printed products in 1996.¹³ Under the Ghanaian Education Reform programme, the government is planning an initiative to foster active private sector involvement in the implementation of a sustainable book production and distribution policy for school textbooks. The World Bank and DFID have pledged US\$50 Million and £7 million respectively for the printing of textbooks. This programme has generated interest from major international publishing houses and suppliers, as well as the local printing industry. The local industry faces problems of poor productivity, indifferent quality, unreliable delivery and lacks the ability to respond to customers needs.

In order to enable the local printing industry to compete, EMPRETEC has identified the need to train print operatives to improve their skills. With assistance from two BESO volunteers (who are training coordinators with the British Printing Industries Federation), they are putting together a new programme for practical training that will be linked to National Vocational Qualification (NVQ) certification. The Ghana Printers and Paper Converters Association is to be trained to be the NVQ accreditation body, and EMPRETEC will be the training organisation training trainers drawn from local industry. The training will include on-the-job training, and lectures spread over a year in different areas eg: different printing techniques, improving quality, lithography, bookbinding, pre-press. The programme (to be submitted to DFID) is estimated to cost about £330,000 and be wholly Ghanaian run by the fourth year.

¹³ Source: International Trade Centre report 17/8/98



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