



DNA Economics

THEMATIC STUDY

THE DEVELOPMENTAL EFFECTIVENESS OF UNTIED AID: EVALUATION OF THE
IMPLEMENTATION OF THE PARIS DECLARATION AND OF THE 2001 DAC
RECOMMENDATION ON UNTYING ODA TO THE LDCS

SOUTH AFRICA COUNTRY STUDY

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Executive Summary

Introduction

In the 2008 Phase I study, *The Developmental Effectiveness of Untied Aid*, it was found that aid to LDCs is now overwhelmingly untied (excluding exempt categories, technical co-operation and food aid). However, it was also found that there existed very little formal analysis of both the donor practices in partner countries and the actual consequences of untying aid at a country level. The Phase II study is in response to the proposals of the Working Party on Aid Effectiveness and the Development Assistance Committee (DAC) Network on Development Evaluation and the reporting requirement in the 2001 DAC Recommendation on untying ODA to LDCs.

Phase II of the project is intended to provide evidence-based conclusions about the implications of untying aid and its impact on aid effectiveness in selected case-study countries, for presentation to the DAC by December 2009. This report provides the results of the South Africa Country Study.

This study aims to highlight key issues through a short statistical and econometric review of the available data and through the assessment of three project case studies. The focus of the case studies was on the procurement practices of the donors, governmental executing agencies and implementing agents, that may have a significant impact on how goods and services are purchased, with implications for aid effectiveness.

The three projects selected as case studies were:

- a health sector project funded by DFID
- a health sector project funded by the EU
- a water sector project funded by the Association of Netherlands Municipalities (VNG) International.

Statistical and econometric analysis

ODA in South Africa has increased progressively and diversified since 1994/95, when official aid was first used to support national policy development. Yet total ODA commitments as a percentage of GDP remain very small, at less than 0.4% in 2007. ODA commitments have primarily been in the form of grants, and most aid has been from bilateral donors. The United States and the E.U. are South Africa's largest donor partners, respectively contributing 29.5% and 20.6% of total bilateral ODA to South Africa between 2005 and 2007.

As a non-LDC, South Africa was not originally covered by the DAC 2001 recommendations, but ODA commitments reported as untied have shown a general upward trend since 2001 (though there remain inconsistencies between donor reporting of untied aid and studies commissioned by the South African Government). A large proportion of donor ODA to South Africa is in the form of technical co-operation, and the tying status of much of this kind of ODA is not reported to the DAC. Projects where there was no reporting on project type accounted for 39% of total ODA between 2005 and 2007. In South Africa, almost all Government officials expressed concern about the use of technical co-operation as a means to tie aid to home country consultants.

The aim of the econometric analysis is to determine whether ODA, the tying status and the different forms in which aid is provided (loans and grants) have any discernible impact on aggregate donor export flows at the country level, in this case to South Africa. The overall results suggest that ODA in general, and grants in particular, may have some trade distorting effect through the donor-recipient relationship, though the South African analysis is not conclusive.

Aid modalities and tying

Most donors in South Africa still make use of the traditional project approach. The apparent low usage of country systems is supported by analysis in the South African 2006 Survey on the Paris Declaration: less than half of all ODA made use of South Africa's financial or procurement systems. Based on information in Quist et al (2008), just 7% of total donor funds received by South Africa in the 2007/2008 financial year was in the form of budget support, and only three donors have used the budget support modality between 2005 and 2008 (the E.U., Netherlands and Ireland). Countries such as Japan, the United States, the UK and Germany, that report a high percentage of total ODA as untied (80%, 45%, 100% and 72% respectively for 2006¹), make very low usage of South African procurement systems (based on the 2006 Survey on the Paris Declaration). In these cases, the possibility of *de facto* tying is more likely. In the country report on the 2008 Evaluation of the Implementation of the Paris Declaration, some reasons given by donors for not using South Africa's systems include concern that the use of country systems delays the quick implementation of projects and that donor HQs have directed local staff not to use local systems.

Table 1: Donor use of country systems, 2005

	Aid disbursed (US\$ Mn)	Public financial management systems	Procurement systems
Australia	1	0%	20%
Austria	0	–	–
Belgium	6	75%	75%
Canada	0	100%	100%
Denmark	14	37%	75%
European Commission	139	42%	42%
Finland	9	85%	85%
France	1	2%	7%
Germany	21	33%	33%
Global Fund	10	67%	100%
Ireland	8	100%	100%
Italy	3	33%	0%
Japan	15	0%	0%
Netherlands	22	100%	100%
New Zealand	0	100%	100%

¹ Based on Clay et al (2008).

Norway	8	100%	100%
Sweden	7	42%	42%
Switzerland	0	88%	88%
UK	41	0%	29%
United Nations	2	81%	0%
United States	43	0%	4%
Total	351	38%	44%

Source: 2006 Survey on Monitoring the Paris Declaration: South Africa Country Chapter
Percentage figures reflect the baseline ratios for each donor.

Project analysis

Three donor projects were used as case studies for the South African analysis: two from the health sector (both relating to HIV/AIDS); and one from the water and sanitation sector. All three projects were similar in that they largely involved the procurement of services (especially relating to consulting services) rather than goods, yet all three projects had different contracting, funding and procurement procedures. This gave the opportunity to contrast the projects and to provide a more holistic view of the way untied aid works in South Africa. The three case study projects are summarised as follows:

1. The Rapid Response Health Fund (RRHF) was established in late 2008 as the fifth output of the Multi-sectoral HIV and AIDS Support Programme (MSP), funded by DFID. The RRHF was initiated during high level talks between South African and UK Government officials. At a meeting between the UK Secretary of State and the newly appointed South African Health Minister, it was agreed that a health fund would be made available to the Minister in order to rapidly improve HIV/AIDS policy and delivery in South Africa and to assist with any unexpected problems that may arise. GBP 15,000,000 has been committed to the one-year programme, which runs from 2008 to 2009. The head contract was managed by HLSP, the local subsidiary of a British company, who had been awarded the management of the MSP under a framework contract.
2. The Extended Partnerships for the Delivery of Primary Health Care including HIV and AIDS Programme (EPDPHCP) is an E.U. funded programme that began in 2001. The programme aims to contribute to more accessible and affordable primary health care in South Africa by partnering with NPOs. The programme has evolved over the period both by expanding delivery of services from five to all nine of South Africa's provinces and by moving from E.U. to local systems and procedures. For the period 2001 – 2006, the E.U. committed 25,000,000 Euros. In the period 2007 – 2010 the E.U. has committed a further 45,000,000 Euros. The contracting agency for the EPDPHCP is the South African Government, through the National Department of Health.
3. The Storm-water Drainage and Sanitation project was implemented in 2005 through the municipal twinning arrangement between Buffalo City Municipality (South Africa) and the City of Leiden (Netherlands), and was funded through the City of Leiden by VNG International. VNG International is funded by, among others, the Netherlands Ministries of Foreign Affairs and Home Affairs, the European Union, the World Bank and various United Nations agencies. For the 2009-2010 the budget application was 566,815 Euros of which 297,000

Euros was provided by Leiden in the form of technical assistance. VNG International requires that the contracting agency is a Dutch organisation; as such Leiden is seen as the contracting agency. However, Buffalo City is largely responsible for the management and execution of the storm-water project.

These three projects raise two very different sets of concerns:

- Firstly, the use of framework contracts can effectively exclude smaller and less experienced South African firms from participating in lucrative head contracts. For example, the RRHF contract was awarded to a UK-owned company, which already held a framework contract with DFID. This may have been necessary for expediency reasons, but it did effectively exclude South African health companies from tendering for this specific contract.
- Secondly, there is some evidence that the high level of technical assistance and cooperation agreements in South Africa makes ODA less transparent and increases the potential for tying. For example, in the case of the Buffalo City storm-water project, a significant amount of budget assistance was in the form of technical assistance from Leiden and for travel and accommodation of both Leiden and Buffalo City officials. Buffalo City was also required to counter-fund a substantial amount for the procurement of consulting services relating to the project, with this counter-funding amount believed to be substantially more than the financial contribution by VNG.

Cost and developmental effectiveness

In the actual procurement of goods and services for all three projects, there is little evidence of implicit or *de facto* tying by donors, with all three projects making extensive use of local suppliers for both services and works contracts. The extent to which this has contributed to new or sustainable domestic capacity is less clear.

For the RRHF, the use of local consultants and companies certainly raises the potential for domestic capacity development, but many of the consultants contracted were already highly-sought with specialised skills. The EPDPHCP has a much clearer development impact and has explicitly contributed to the establishment of technical and administrative capacity within the national and provincial health departments. The Buffalo City storm-water project has used a South African consortium for the major consulting work and local (based in the municipality) works companies for the minimal construction activities. This would have had positive spin-offs within the local community. However from a budget perspective, technical assistance provided by Leiden and travel and accommodation accounts for over half the total international funding. The fact that Buffalo City has counter-funded over half the actual amount spent on the procurement of works and services (outside of travel and accommodation) reduces the potential benefit of aid provided. In addition, it is not clear that the twinning arrangement (i.e. information and knowledge exchange) has been used efficiently and VNG International's actual contribution to long-lasting capacity and infrastructure development may be small.

Cost-effectiveness is often cited as a key reason for the untying of aid. Assessing the cost-effectiveness of consulting services is very difficult given the varying degrees of quality and specialisation. Professional fees are difficult to compare and are usually treated as commercially

sensitive. This study has revealed four issues that donors need to consider in an untied environment in general, and specifically, when local systems and procedures are used:

- local rules and guidelines for consulting rates may differ from the international norm;
- preferential procurement policies may raise the cost of certain goods and services;
- the administrative burden of local procurement may be higher or more time consuming; and
- a lack of competition in some domestic markets may contribute to premium rates on certain skills.

Conclusion

South Africa is exceptional as a recipient of aid, largely because, in general, it is not very dependent on aid as a revenue stream, and also because it has the necessary institutions and capacity to coordinate donor activities and manage donor funds. This is confirmed by the econometric results: donor flows impose no significant distortions on the South African economy. The presumption is that this should, in practise, contribute to the more effective and efficient use of ODA. The case studies reveal three reasons why this is not always the case.

- Firstly, in two of the three cases, there remains some evidence of *de facto* tying, with source country consultants or companies brought in to do work that could potentially be done domestically.
- Secondly, although a large proportion of reported ODA is untied, the risk of un-reporting may increase in more developed countries. This is largely because in countries like South Africa, a reasonably large proportion of overall ODA is provided as ad hoc or short-term technical cooperation. This form of assistance is generally less transparent than more conventional long-term development projects.
- Thirdly, in an untied environment, donors are more likely to make use of recipient country procedures. The case studies show that the use of recipient country procurement systems enables Governments to pursue domestic policy priorities and improve alignment. But in some instances, this can raise the cost and diminish the effectiveness of specific donor programmes.

In the case of South Africa, it would appear that untying has contributed to improvements in the alignment and development effectiveness of aid. Moreover, although donors are minor funders in South Africa, they can play a critical role in deploying technical and financial resources, quickly. The examples explored in this report highlight the significant contribution made by just three projects: rescuing various national HIV/AIDS programmes; providing high-level advice to a new Cabinet Minister; and protecting an impoverished community from severe flooding. Could more have been achieved if these donors had adopted a more open procurement process; or made greater use of the South African system? Certainly, alignment and development effectiveness could be further enhanced; but these gains might be partially offset by the intended (policy-related) and unintended (inefficiencies) costs of alternative procurement procedures.

List of Acronyms

ACP	African, Caribbean and Pacific Group of States
BCM	Buffalo City Municipality
BEE	Black Economic Empowerment
CSP	Country Strategy Paper
CRS	Creditor Reporting System
DAC	Development Assistance Committee
DANIDA	Danish International Development Assistance
DBSA	Development Bank of Southern Africa
DEAT	Department of Environmental Affairs and Tourism (South Africa)
DFID	Department for International Development (UK)
DPLG	Department of Provincial and Local Government (South Africa)
DPSA	Department of Public Service and Administration
EDF	European Development Fund
EPDPHCP	Expanded Partnerships for the Delivery of Primary Health Care including HIV and AIDS Programme
GBS	General budget support
GSSC	Gauteng Shared Service Centre
HDI	Historically Disadvantaged Individual
HRC	Human Resources Council
IDC	Department for International Development Co-operation (South Africa)
IST	Integrated Support Teams
LDC	Least Developed Countries
MACH	Ministerial Advisory Committee on Health
MDG	Millennium Development Goals
MIP	Multi-Annual Indicative Programme
MSP	Multi-sectoral HIV and AIDS Support Programme
NGO	Non-governmental Organisation
NPO	Not for Profit Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OJE.U.	Official Journal of the European Union
PBA	Programme Based Approach
PMTCT	Preventing Mother to Child Transmission of HIV

PPP	Public-Private Partnerships
PRAG	Practical guide to contract procedures for EC external actions
RDP	Reconstruction and Development Programme
RRHF	Rapid Response Health Fund
SADC	Southern African Development Community
SANAC	South African National AIDS Council
SBS	Sector Budget Support
SPSP	Sector Policy Support Programme
TTT	Technical Task Teams
UMIC	Upper Middle Income Country
VNG	Vereniging van Nederlandse Gemeenten (Association of Netherlands Municipalities)

1 INTRODUCTION

1.1 Background and approach

The purpose of this thematic study on untied aid is to provide the Development Assistance Committee (DAC) and the 2009 High Level Meeting, as well as the wider development community, with a comprehensive assessment of current donor policies and practices regarding the tying status of aid and an assessment of the effects of the untying status on aid effectiveness². This follows from the 2001 DAC Recommendation to untie aid to the Least Developed Countries (LDCs) and the 2005 Paris Declaration, which included untying as an indicator on donor alignment.

In 2008, Phase I of the study on the developmental effectiveness of untied aid was completed and provided both a qualitative and statistical overview of aid from DAC countries. Conclusions from Phase I of the study include that, from a donor point of view, aid to LDCs is now overwhelmingly untied (excluding exempt categories, technical co-operation and food aid). However, it was also found that there existed very little formal analysis of both the donor practices in partner countries and also the actual consequences of untying at a country level.

Phase II of the project is intended to be an exploratory study providing provisional but evidence-based conclusions about the implications of untying aid and its impact on aid effectiveness in selected case-study countries. This report provides the results of the South African case study. The aim is to provide a benchmark against which further moves towards untying aid can be measured and assessment can be made of how best the possibilities opened up by untying aid can be exploited. In particular the study focuses on two broad issues:

- The patterns of aid provision and usage associated with untying, focusing on disbursement and procurement practices in South Africa. The objective is to identify aid modalities that, coupled with institutional arrangements, procurement guidelines and other conditions, are associated with genuine untying and where these conditions might effectively lead to *de facto* tying of aid.
- The tendering for and sourcing of goods and services procured by aid beneficiaries in South Africa with untied funds. Understanding how untied aid is used to procure goods and services allows for an assessment of the trade impact, developmental effectiveness and cost-effectiveness of untied aid.

The study has primarily made use of the following methods:

² The thematic study on the developmental effectiveness of untied aid also forms part of the OECD's overall evaluation of the Paris Declaration, which can be accessed online at:

http://www.oecd.org/document/60/0,3343,en_21571361_34047972_38242748_1_1_1_1,00.html

South Africa is one six countries taking part in the thematic study on untied aid. The other five are Zambia, also in the Southern African Development Community (SADC) region, Ghana and Burkina Faso in West Africa and Laos and Vietnam in South-East Asia.

- A short statistical review of the available data to identify the status and trends in aid flows to South Africa. The data used was based largely on the information provided by donors to the Organisation for Economic Co-operation and Development's (OECD's) Creditor Reporting System (CRS) database.
- Econometric analysis has been included to provide a more quantitative assessment of the impact of untying and the choice of aid instrument on trade between South Africa and its main donor partners.
- Three donor projects were identified, purposively selected and analysed from the point of disbursement to the sourcing of goods. This allowed for both qualitative and quantitative evidence, albeit limited to the donors who funded the projects, on the practical nature of untied aid in South Africa. The focus of the case studies was on both the international procurement practices of the donors as well as local agreements that may have a significant impact on how goods and services are purchased. For one of the three projects, a 'ground-truthing' exercise was performed and a site visit held to identify the extent to which the explicit intentions in design and implementation phases of the project were borne out at the beneficiary level.

1.2 South Africa as a case study

From an aid point of view South Africa is unique in a number of ways. First, compared to many other developing countries, particularly in Sub-Saharan Africa, South Africa, in general, relies very little on donor funding. Second, the use of aid for capacity building initiatives and assistance of a technical nature, as opposed to the development of infrastructure, is much more pronounced in South Africa. This is largely a reflection of the fact that South Africa is relatively more developed, both in an institutional and infrastructure sense, than most other aid recipients. Third, the South African Government plays a very active role in overall aid management to ensure that there is a strong sense of ownership and control. Considering this, the study has focused on three projects where the sourcing of services, rather than goods, has been extensive and where issues relating to the process rather than *de facto* tying are likely to emerge. For these reasons the South African case study provides an interesting point of reference against which donor and recipient roles can be compared in other partner countries.

While the Phase II study has chosen to focus especially on the water and sanitation sector, in South Africa, the emphasis is instead on health. This is partly because the health sector is the predominant focus of aid in South Africa, as well as the fact that almost all water and sanitation programmes identified in South Africa receive aid through budget support, an aid modality that was considered inappropriate in attempting to evaluate the realities of untying practices³. The study in South Africa therefore provides a snapshot assessment of aid in an untied environment by analysing two projects from the health sector and one from the water and sanitation sector. This provides for comparability between different projects in South Africa, as well as some comparability with the other country studies.

³Budget support is by definition untied and, in addition, there has been a recent evaluation of partner country practices and experiences with budget support. The thematic study will take account of the findings of that evaluation and compliment it by focusing on other modalities such as pooled funding and more conventional project-approach funding.

The study in South Africa was initiated through a meeting with the National Treasury's Department for International Development Co-operation (IDC), the official aid co-ordinating body in South Africa. This ensured Government involvement in and awareness of the study and assisted in identifying and contacting relevant donors for participation in the project. In general, the donor response to the study has been poor, possibly reflecting the strong role played by the Government in co-ordinating aid relations and therefore studies (a role that in many developing countries, is often performed by the donors themselves), and the low importance of aid in South Africa relative to other developing countries. Additionally some donors expressed "evaluation fatigue". In contrast, Government departments have generally been more responsive to the study, showing a high level of willingness to participate and provide both quantitative and qualitative information.

A questionnaire was developed, seeking information on donor projects in, and aid modalities used by donors in South Africa. This, along with an introductory letter from the IDC was sent to the five donors prioritised by the Government (USAID, the E.U., Sweden, the UK's Department for International Development (DFID) and the Netherlands), of which four responded (the E.U., Sweden, DFID and the Netherlands). However, only Sweden, DFID and the Netherlands have provided information on aid modalities used in South Africa.

A joint meeting with the IDC resulted in the final selection of the two health sector projects and one water sector project, funded by DFID, the E.U. and Association of Netherlands Municipalities (VNG) International respectively. The VNG International project, as the only water and sanitation project included in the South African case study, was selected for the ground-truthing exercise.

Other Government Departments and agencies that were consulted and participated in this study include the following:

- Various National Departments, including the Department of Science and Technology, the Department of Environmental Affairs and Tourism and the Department of Provincial and Local Government. These departments provided assistance at the initial levels of the study, helping to identify potential projects;
- The National Department of Health, specifically the E.U. compliance office;
- The Gauteng Provincial Department of Health; and
- Buffalo City Municipality.

2 THE SOUTH AFRICAN CONTEXT

South Africa is classified as an Upper Middle Income Country (UMIC) with a GDP per capita of US\$ 5,693 in 2008⁴, and according to the 2007 Mid-Term Country Report on the Millennium Development Goals (MDGs), is well on its way to achieving many of the MDGs by 2015. Persistent high levels of income inequality and the prevalence of HIV/AIDS are the main obstacles to South Africa achieving the MDGs. Since the first democratic elections in 1994, South Africa has seen consistent and

⁴ Based on data from the IMF's World Economic Outlook, April 2009.

reasonably strong real GDP growth, at an average rate of 3.5% up until end-2008. The country has well developed infrastructure and institutions, and this, coupled with a large and reasonably diversified economy, has resulted in a limited reliance on aid assistance. Official Development Assistance (ODA) commitments as a percentage of GDP measured less than 0.4% in 2007⁵. Nevertheless, given South Africa's recent political history, its economic importance in the region and high levels of income inequality and the HIV/AIDS epidemic, many donors continue to play an active role in the country.

Prior to 1994, official aid to South Africa was practically non-existent, though many donors made substantial contributions to non-Governmental organisations (NGOs) and various anti-Apartheid organisations within and outside of South Africa. This all changed in 1994 and between 1995 and 2007, total ODA commitments to South Africa amounted to US\$ 7.8 billion, with aid increasing at an average nominal rate of 8.3% for this period. South Africa's dependence on aid has however remained consistently muted, at 0.2% to 0.4% of GDP and only 1% to 2% of total public expenditure⁶ between 1995 and 2007.

Historically, South Africa's largest donor partners have been the USA, the UK and the E.U. These three donors' aid commitments collectively account for 51% of all DAC bilateral and multilateral ODA to South Africa between 1995 and 2007. Given that these three economies are in the midst of a severe recession, it is likely that aid from these countries will stagnate or decline over the next few years. This, in itself, will not pose a major fiscal challenge for South Africa,

Well developed budget and financial management systems coupled with South Africa's low dependence on aid have enabled the South African Government to assert a strong degree of aid ownership, at least at the national level. The National Treasury's IDC, responsible for co-ordinating aid at a national level, deems ownership of ODA "a strong and non-negotiable priority"⁷.

The IDC's Draft ODA Policy Framework and Guidelines closely resemble the principles of the Paris Declaration. Strong emphasis is placed on ownership and alignment of ODA:

Ownership. The IDC's Policy Framework emphasises that donor projects must be anchored in one of the three spheres of Government (national, provincial or municipal). Furthermore, the conceptualisation and design of ODA is declared as a Government responsibility and there is a stated preference for Government entities to implement and manage ODA projects.

Alignment. ODA must be aligned to overall Government priorities and integrated into a specific Government planning framework (i.e. developed on plan); financial management and reporting should meet South African Government requirements; procurement should follow Government rules and

⁵ Based on data from the IMF's World Economic Outlook, April 2009 and the OECD's CRS Aid Activity Database.

⁶ Based on total Government expenditure (calendar year) and ZAR/US\$ exchange rates from the South African Reserve Bank (SARB).

⁷ Draft ODA Policy Framework and Guidelines, 2007, IDC.

procedures, including Black Economic Empowerment (BEE); and monitoring and evaluation should be done by Government or under its control. Moreover, the Government seeks to use ODA for innovative and capacity-building projects, rather than as an additional source of Government finance.

A number of issues regarding the management of ODA in South Africa, especially relating to the Paris Declaration, were identified in the 2008 Country Study on the Evaluation of Paris Declaration⁸:

- There is concern among donors that South Africa's strong ownership may potentially have a negative impact on donors' roles in some areas of the Paris Declaration. Ownership of aid is considered highly uneven across the different levels of Government.
- Tied aid remains common in South Africa, particularly among certain donors.
- Donors have expressed frustration with the lack of a national co-ordination forum, and harmonisation among donor groups continues without leadership from the South African Government.
- Information on aid flows are poor and unclear, suggesting that greater effort could be made to ensure that both the South African Government and donor partners should account more effectively for ODA and thereby ensure greater transparency.

While South Africa has a strong record on ownership of aid, issues surrounding Alignment, Harmonisation and Mutual Accountability still need to be addressed and improved if aid in South Africa is to meet the principles of the Paris Declaration. Additionally, the South African Government, through the IDC, has indicated that untying, as defined by the DAC⁹, is too narrow in scope and should be extended to include the use of partner systems. The IDC contends that procurement and the procedures (and systems) used in procurement are closely linked, with the choice of procedure (e.g. donor versus partner) often directly impacting on the source of goods and the effectiveness of aid. This ultimately implies that increased alignment (both through use of country systems and untying aid) may have a positive impact on aid effectiveness.

3 ODA TO SOUTH AFRICA

ODA in South Africa has increased progressively and diversified since 1994/95, when official aid was first used to support national policy development. ODA commitments have primarily been in the form of grants, and most aid has been from bilateral donors, who have contributed 97% of ODA to South Africa between 1995 and 2007. Multilateral ODA commitments are dominated by the Global Fund which has committed 79% of total multilateral funding to South Africa. Bilateral loans have made up a small portion of bilateral aid, averaging 11% of total bilateral commitments between 1995 and 2007 and, as can be seen in Table 1, there has been no clear trend in the movement from grants to loans or vice versa.

⁸ The country study formed part of the overall OECD evaluation of the Paris Declaration, Phase I of which was presented to the High Level Forum in Accra in 2008. South Africa was one of eight countries that took part in the evaluation.

⁹ Untied ODA is officially defined as "loans or grants which are freely and fully available to finance procurement from substantially all developing countries and from OECD countries" (OECD DAC, 1987). Thus, a donor can have fully untied aid but still make use only of donor systems.

Table 1 ODA Commitments (US\$ Millions)

	Total ODA	Bilateral ODA	Multilateral ODA	Bilateral Grants	Bilateral Loans	Bilateral loans as a share of Bilateral ODA
1995	394	394	-	374	20	5%
1996	549	549	-	432	117	21%
1997	386	386	-	385	1	0%
1998	555	555	-	385	170	31%
1999	370	367	3	366	1	0%
2000	379	378	1	366	12	3%
2001	435	432	4	401	31	7%
2002	524	520	5	472	48	9%
2003	646	594	52	594	-	0%
2004	615	588	28	529	59	10%
2005	893	877	16	758	118	13%
2006	841	833	8	675	158	19%
2007	1,012	903	108	793	110	12%

Source: OECD Creditor Reporting System (CRS) Aid Activities Database
Equity investments are not included

Table 2 shows the commitments made by donors between 2005 and 2007. Here again it is clear that the United States and the E.U. are South Africa's largest donor partners. ODA commitments in the form of loans and grants from the UK have declined and been replaced by equity investment, with equity investments by the UK contributing almost half of all of this kind of ODA. But overall equity investment commitments accounted for just 4% of total bilateral donor ODA to South Africa for this period.

It is interesting to note that although most countries have phased out loans as a form of ODA, France and Germany continue to make significant use of this instrument in South Africa. Loans from France contributed 87% of its total ODA commitments to South Africa between 2005 and 2007; and about 81% of its total ODA since 1995. Loan commitments to South Africa between 1995 and 2007 have come from only four countries: France (65%), Germany (20%), Japan (14%) and Norway (1%).

Table 2 ODA Commitments by Donor, 2005-7 (US\$ Millions)

	Grants	Loans	Equity Investments	Total ODA	% of Total Bilateral ODA
United States	803	-	-	803	29.5%
EC	560	-	-	560	20.6%
France	51	330	-	381	14.0%
Germany	129	56	29	214	7.9%
Netherlands	194	-	-	194	7.1%
UK	39	-	54	93	3.4%
Denmark	76	-	-	76	2.8%

Belgium	67	-	-	67	2.5%
Ireland	54	-	-	54	2.0%
Norway	52	-	0	52	1.9%
Canada	47	-	-	47	1.7%
Finland	29	-	9	39	1.4%
Switzerland	17	-	18	34	1.2%
Sweden	34	-	-	34	1.2%
Japan	28	-	-	28	1.0%
Italy	20	-	-	20	0.7%
Australia	7	-	-	7	0.3%
Austria	6	-	-	6	0.2%
New Zealand	4	-	-	4	0.1%
Luxembourg	4	-	-	4	0.1%
Greece	3	-	-	3	0.1%
Spain	2	-	-	2	0.1%
Portugal	1	-	-	1	0.0%
Total	2,226	386	111	2,723	100%

Source: OECD Creditor Reporting System (CRS) Aid Activities Database

Table 3 indicates that the population sector received the largest amount of committed ODA between 2005 and 2007, though this is slightly misleading. Of the US\$ 896 million committed to the population sector, US\$ 889 million has been committed to the control, prevention and treatment of HIV/AIDS, a highly important health issue in South Africa. With one of the highest HIV/AIDS infection rates in the world, it is not surprising that the Health and HIV/AIDS sectors combined explain 37% of total ODA commitments from 2005 to 2007. Despite the fact that ODA as a percentage of total public expenditure was less than 2% in 2007, donor commitments to HIV/AIDS programmes contributed just over 52% of South Africa's total HIV/AIDS spending¹⁰. It is clear that ODA commitments to South Africa between 2005 and 2007 have been skewed towards a small number of sectors, reflecting South Africa's overall low reliance on ODA and the strategic need (or Government direction) to target aid at a few important social issues where ODA will have the greatest impact.

¹⁰ Based on the South African Government's (2008) Progress Report on Declaration of Commitment on HIV and AIDS. The information reflects actual expenditure on HIV/AIDS programmes in 2007 (excluding Governmental HIV/AIDS Workplace programmes), with the exception of the US President's Emergency Plan for AIDS Relief (PEPFAR) programme which reflects commitments for 2007. If US PEPFAR commitments was replaced with actual US disbursements for HIV/AIDS programmes in 2007 (taken from the OECD CRS Aid Activities Database), ODA expenditure as a percentage of South Africa's total HIV/AIDS spending would remain substantial at approximately 40% of total.

Table 3 ODA Commitments by Sector, 2005-7 (US\$ Millions)

	Grants	Loans	Total	% of Total ODA
Population	896	-	896	32.6%
Other Social Infrastructure and Services	198	155	353	12.9%
Education	243	-	243	8.9%
Government and Civil Society	234	-	234	8.5%
Water and Sanitation	177	50	227	8.3%
Other	92	55	147	5.4%
Business and Other Services	84	62	146	5.3%
Health	113	-	113	4.1%
Industry	86	-	86	3.1%
Banking and Financial Services	9	56	65	2.4%
General Environmental Protection	61	-	61	2.2%
Agriculture	57	-	57	2.1%
Energy	21	8	29	1.1%
Administrative costs	25	-	25	0.9%
Communications	14	-	14	0.5%
Unspecified	12	-	12	0.4%
Food Aid/Food Security Assistance	9	-	9	0.3%
Support to NGOs	7	-	7	0.3%
Conflict Resolution, Peace and Security	7	-	7	0.3%
Trade Policy and Regulations	6	-	6	0.2%
Emergency Response	4	-	4	0.1%
Tourism	2	-	2	0.1%
Transport and Storage	1	-	1	0.0%
Forestry	1	-	1	0.0%
General Budget Support	0	-	0	0.0%
Construction	0	-	0	0.0%
Disaster Prevention	0	-	0	0.0%
Fishing	0	-	0	0.0%
Mineral Resources	0	-	0	0.0%
Refugees in Donor Countries	0	-	0	0.0%
Other Commodity Assistance	-	-	-	0.0%
Reconstruction Relief and Rehabilitation	-	-	-	0.0%
Total	2,359	386	2,745	100%

Source: OECD Creditor Reporting System (CRS) Aid Activities Database
Includes both Bilateral and Multilateral ODA.
Equity investments are not included.

As a non-LDC South Africa was not originally covered by the DAC 2001 recommendations but, as Table 4 shows, ODA commitments reported as untied have shown a general upward trend since 2001. This would suggest that donors have generally accepted the approach towards untying aid,

and not only for LDC countries. The level of unreported aid since 2004 has declined dramatically and this may also have resulted from the Paris Declaration in 2005, which requires better reporting on aid untying as a specific indicator on donor aid alignment. However donor reporting on the untying of aid (to the CRS) is inconsistent with the South African 2006 Survey on Monitoring the Paris Declaration¹¹. The survey indicated that OECD data covering 63% of commitments to South Africa in 2004 showed that 97% of aid was untied. Yet a 2006 independent baseline study found that only as much as 30% of aid was untied¹². Clearly there is a need for better reporting or a more consistent definition on the status of ODA in South Africa.

Table 4 ODA, Tying status (US\$ Millions)

	Commitment	Tied	Untied	Partially Untied	Unreported
1995	397	28%	35%	15%	22%
1996	554	26%	44%	20%	10%
1997	404	25%	33%	26%	16%
1998	563	18%	40%	20%	22%
1999	393	3%	33%	32%	32%
2000	386	3%	34%	16%	47%
2001	467	4%	43%	24%	30%
2002	524	1%	51%	24%	24%
2003	652	1%	45%	26%	28%
2004	615	3%	38%	29%	30%
2005	940	11%	63%	21%	5%
2006	879	19%	60%	18%	3%
2007	1,037	2%	65%	21%	12%

Source: OECD Creditor Reporting System (CRS) Aid Activities Database
Includes both Bilateral and Multilateral ODA and includes equity investments.

A large proportion of donor ODA to South Africa is in the form of technical co-operation, and the tying status of much of this kind of ODA is not reported to the DAC. This is reflected in Table 5. Projects where there was no reporting on project type accounted for 39% of total ODA between 2005 and 2007. Nevertheless, it is clear that technical co-operation to South Africa is high, with freestanding technical co-operation projects accounting for 30% of total ODA commitments to South Africa for 2005 – 2007.

¹¹ The 2006 Survey on Monitoring the Paris Declaration was undertaken in 34 countries and is an OECD initiative. South Africa did not participate in the 2008 Survey.

¹² This study was cited in the 2006 Aid Effectiveness Review (South Africa), a review by the World Bank which contributed to the 2006 Survey on Monitoring the Paris Declaration. The study cited was co-funded by the National Treasury's IDC and the EC

Table 5 ODA and Technical Co-operation, 2005-7 (US\$ Millions)

	Commitment	Projects without TC	Freestanding TC projects	Projects with some TC	Not reported
Grants	2,359	29%	35%	1%	36%
Loans	386	24%	0%	14%	62%
Total	2,745	28%	30%	3%	39%

Source: OECD Creditor Reporting System (CRS) Aid Activities Database

Includes both Bilateral and Multilateral ODA but excludes equity investments.

"Projects without TC" reflects aid for which donors either reported the absence of a free-standing TC component or for which they did not report at all (there may therefore be an underreporting of TC).

"Free standing TC projects" show projects where only TC was reported (thus there may be projects that have only a partial TC component but other aspects of the project have not been reported).

"Not reported" indicates projects for which there has been no reporting on project type (TC, Investment Project, Support Programme).

A significant proportion of the ODA that is not reported is likely to include a high proportion of technical cooperation, and this may explain the difference between the OECD data and the results of South Africa's independent analysis. This is supported by qualitative evidence. Technical co-operation is often tied to the donor country, especially for project managers and head consultants. In South Africa, almost all Government officials expressed concern about the use of technical co-operation as a means to tie aid to home country consultants.

4 ECONOMETRIC ANALYSIS¹³

4.1 Introduction

This section investigates whether there is any evidence that bilateral aid and associated tying practices are trade distorting, extending the basic gravity model for this purpose. The aim is to understand whether ODA, the tying status and the different forms in which aid is provided (loans and grants) have any discernible impact on aggregate donor export flows at the country level, in this case to South Africa. The six countries are deliberately paired according to trading region: South Africa results are therefore compared against those of Zambia.

4.2 Methodology

There could be several reasons why ODA could lead to an increase in the donor's exports. The most obvious explanation is that aid is formally tied to exports from the donor country (direct effect); by definition tied aid results in trade dependency. However, there are several ways for a donor to effectively tie aid without a formal tying agreement. Therefore, *de facto* tying by covert restrictions on sourcing can also generate increased trade with the recipient. There are other indirect effects that might lead to a positive correlation between ODA and donor's exports. Aid might have a macroeconomic impact in the recipient countries; higher rates of economic growth and structural economic reforms such as trade liberalization might indirectly impact on a donor's exports. Moreover, aid flows could result in an increase in trade with the donor, reflecting the goodwill of the recipient

¹³ This section is based largely on work done by Luisa Natali (ODI, United Kingdom), with the full econometric analysis provided in Annex 4.

towards the donor. Finally, the aid relationship might facilitate trade between the donor and the recipient, increasing the recipient's proclivity to procure goods from the donor (reinforcing commercial ties).

The basic idea is to consider whether there is any trade distorting effects of aid at an aggregated level by examining whether bilateral aid from a particular donor to a recipient country affects trade between that donor and recipient pair differently to aid from other donors. It could also be that certain aid instruments impact differently on trade flows; it might therefore be important to disaggregate ODA into loans and grants while still distinguishing aid instruments based on the origin of the flows. The gravity approach was selected (against other approaches such as Granger causality or the Tajoli methodology) based on the approach's flexibility and the fact that it is solidly based in empirical literature. A factor that was also considered when selecting the gravity approach was the limited number of observations in the dataset. The basic gravity model was extended, with the regression used in analysis as follows:

$$\ln(Exp_{it}) = \alpha + \beta_1 \ln(Y_{it}) + \beta_2 \ln(Ypc_{it}) + \beta_3 \ln(Dist_{it}) + \beta_4 \ln(ComL_{it}) + \beta_5 \ln(FDI_{it}) + \beta_6 \ln(Im pR_{it}) + \delta_1 \ln(ODA_{it}) + \delta_2 \ln(ODA_{All-it}) + \varepsilon_{it}$$

The dependent variable Exp_i represents the export flows from country i to the recipient country. Y_i and Ypc_i measure respectively the GDP and GDP per capita of donor country i . ODA_i is the country i 's ODA to the recipient country whereas ODA_{All-i} represents ODA the recipient country receives from all the bilateral donors other than country i . FDI_i stands for foreign direct investments to the recipient country. $Dist_i$ stands for the distance between the exporting and the recipient country whereas $ComL_i$ is a dummy indicating whether the donor country and recipient share a common official language.

$ImpR_i$ stands for import residuals. There might be a number of unmeasured influences that affect both aid and exports in the model. The omission of variables representing such influences (either difficult to measure, such as political ties and other implicit relationships between the donor and the recipient, or simply underlying relationships not identified as potential determinants) could lead to over-estimating the explanatory power of foreign aid, which could be proxying for several of these omitted variables. In order to overcome this problem an OLS regression is run on imports from the recipient to the donor and then the residuals from this regression are included in the original equations.

The basic equation was extended in three ways: the tying status of ODA was included, ODA was disaggregated between loans and grants and an EC variable (EC disbursements) included to explore the effect that the ACP-E.U. relationship may have on exports from E.U. countries. These equations were estimated using a random effects model.

4.3 Data

Empirical estimation includes 21 DAC donor countries to South Africa with observations only covering the years 2002-2006 because of data quality issues and availability. The bilateral trade data is from the IMF Direction of Trade Statistics database, ODA data is taken from the OECD CRS database and FDI comes from the OECD International Direct Investment Statistics. The analysis uses aid disbursements and not commitments because trade effects are expected to follow actual

disbursements. Data on the tying status of aid, however, is not available in disbursement form. Therefore, a proxy for the tying status is computed by applying the share of tied commitments to total commitments (average of the previous two years) and then assuming the tied share in disbursed aid to be the same. Data for GDP and GDP per capita are taken from the World Development Indicators (WDI) Online database. All nominal variables (exports, FDI, GDP and GDP per capita) are deflated into 2000 constant US dollars using DAC deflators. Data for distance and common language dummy are taken from the CEPII Distance Database.

4.4 Results

The results for South Africa are presented in Table 6. In line with expectations the size of the donor economy is an important determinant of bilateral exports, with the parameter estimate indicating that a 1% increase in GDP is associated with around a 0.9% rise in exports for donor country i . FDI has a positive influence on bilateral exports toward the host country with a 1% increase in FDI resulting in a 0.065% increase in exports from the FDI-originating country. Besides the potential macroeconomic impact of FDI; patterns of intra-firm trade within multi-national enterprises (MNE) and investment incentives can generate a strong link between FDI and exports¹⁴. Aggregated aid flows, from the donor or from other bilateral donors, do not have any statistically significant impact on donor exports. This result is not unexpected for a country such as South Africa which receives low level of aid and has a limited number of active donors: ODA commitments as a percentage of GDP measured less than 0.4% in 2007.

Table 6 Econometric results for South Africa

<i>Dependent variable: Exports</i>	ODA	Tying status	Loans and grants	EC variable
GDP _{<i>i</i>}	0.970***	0.940***	0.915***	0.897***
GDP per capita _{<i>i</i>}	0.699	0.546	0.167	-0.009
ODA _{<i>i</i>}	0.016	0.038		
ODA _{All-<i>i</i>}	0.209	0.17		
Distance _{<i>i</i>}	-1.585	-1.373	-1.186	-1.115
Common language _{<i>i</i>}	0.269	0.222	0.085	0.044
FDI _{<i>i</i>}	0.050***	0.056***	0.058***	0.065***
Import residual _{<i>i</i>}	0.259***	0.266***	0.238**	0.267***
Tying status % _{<i>i</i>}		0.272	0.449**	0.513**
Grants _{<i>i</i>}			0.110**	0.136***
Grants _{All-<i>i</i>}			0.131	0.335
Loans _{<i>i</i>}			-0.008	-0.01
Loans _{All-<i>i</i>}			0.014***	0.012**

¹⁴ An example of the impact of investment incentives on the FDI-Trade relationship is South Africa's Automotive Development Programme (ADP), previously known as the Motor Industry Development Plan (MIDP). Investment and export incentives are given to motor manufacturers that assemble and export motor vehicles from South Africa, resulting in European countries investing heavily in South Africa and importing both parts and vehicles from their home countries.

EC disbursements				-0.005
Constant	-89.307**	-108.111**	-159.716***	-187.165***
<i>N</i>	76	75	75	75
<i>N_g</i>	21	21	21	21
r^2_w	0.795	0.789	0.8	0.792
r^2_o	0.823	0.83	0.84	0.851
r^2_b	0.803	0.813	0.829	0.842

All variables are in natural logarithms (except Common language and Tying status).

All regressions include a time trend not reported.

Legend: * significance at 10 percent **significance at 5 percent *** significance at 1 percent.

Data covers the period 2002-2006.

The import residuals variable, which is used to control for underlying relationships between the donor and the recipient countries (and not specified in the model), is highly significant and positive in all specifications, implying that special relationships and other implicit variables between trading partners exist and impact significantly on the exports level from donor countries to South Africa. This result suggests the existence of a complex reciprocal relationship between South African and respective donors. The direction of the relationship between formally tied aid and exports is as expected but not at all robust: the estimated tying status variable is positive but not always significant. An issue not examined in this analysis is the effect of technical assistance and other services provided by donors, an issue which is particularly relevant for South Africa, where a large proportion of ODA is provided in the form of services. Because the analysis has been restricted to trade in goods, the model may underestimate the extent to which donor ODA impacts on exports from the donor country to South Africa. Unfortunately data restrictions prevent a thorough and conclusive analysis that includes exports of services.

When aid is disaggregated in terms loans and grants, grants from the donor country are found to be positively associated with donors' exports; a 1% increase in grants from the donor country causes a 0.136% increase in exports to South Africa. This suggests that grants may have a trade distorting effect and may reflect some combination of *de facto* tying or a more indirect effect where donor grants improve goodwill and therefore the recipient's proclivity to procure goods from the donor.

Significantly ODA in the form of loans does not seem to have a trade distorting effect, since loans from donor *i* do not significantly impact on exports from that country. ODA in the form of loans is seen to have a general macroeconomic impact though, with a 1% increase in loans from all other donors resulting in a 0.014% increase in exports from donor country *i*. Other potential influences are found to be wholly insignificant: disbursements from the EC, distance and common language, and the level of development of donor countries, measured by their income per capita level, has no impact on bilateral export flows.

It is interesting to compare results for South Africa, an upper middle income country, with those obtained for Zambia (Table 7), a least developed and relatively aid dependent country in the same trading area, the Southern African Development Community (SADC).

Table 7 Econometric results for Zambia

<i>Dependent variable:</i> <i>Exports</i>	ODA	Tying status	Loans and grants	EC variable
GDP _i	0.751***	0.855***	0.750***	0.771***
GDP per capita _i	0.873	0.709	0.458	0.731
ODA _i	0.091	0.03		
ODA _{All-i}	-0.055	-0.064		
Distance _i	-0.24	-0.238	-0.677	1.934
Common language _i	0.15	0.145	0.164	0.094
Import residual _i	-0.063	-0.027	0.019	0.028
Tying status % _i		0.408	0.714*	0.911**
Grants _i			0.165***	0.135**
Grants _{All-i}			0.192	0.164
Loans _i			0.009	0.005
Loans _{All-i}			0.006	0.005
Export credits _i				0.002
EC disbursements _i				0.089**
Constant	-299.202***	-315.955***	-64.238	-98.109
<i>N</i>	118	116	95	95
<i>N_g</i>	21	21	21	21
<i>r²_w</i>	0.312	0.317	0.183	0.188
<i>r²_o</i>	0.578	0.549	0.665	0.753
<i>r²_b</i>	0.606	0.579	0.744	0.802

All variables are in natural logarithms (except Common language and Tying status).

All regressions include a time trend not reported.

Legend: * significance at 10 percent **significance at 5 percent *** significance at 1 percent.

Data covers the period 2002-2006.

The results are quite similar for the two countries notwithstanding some differences in the basis of the computations. GDP plays a significant role in explaining exports. It was expected that ODA levels might be more strongly associated with higher donor exports to Zambia given its aid dependency but this is not found to be the case at either the aggregate level or the disaggregated level. For the last specification there is an indication that formal tied aid is associated with higher bilateral export flows, with the coefficient for the tying status variable significant at the 5% level. Similar to the South African results, grants seem to have a trade distorting effect, with a 1% increase in grants from donor *i* increasing exports from that country to Zambia by 0.165%. FDI has a positive influence on bilateral exports toward the host country for the South African results; such relationship could not be explored for Zambia due to data unavailability.

There are two striking differences between the South African and the Zambian results. In the case of Zambia, a full ACP member, EC disbursements are found to be positively associated with export flows from E.U. member states. Also in the Zambian case, import residuals are not significant. The comparison suggests that a different set of relationships are being captured for the two countries. Whereas there could be a complex net of reciprocal relationships between South Africa and trading

partners, in Zambia the absence of any significant underlying relationship may indicate a more aid dependent relationship.

Overall, while there is some indication of a definitive relationship between ODA and trade the results are not very robust or conclusive, pointing to the fact that better data may improve overall results for both countries.

5 AID MODALITIES AND TYING

The extent to which different aid modalities are used in South Africa by donors is difficult to quantify. Only three donors responded to the questionnaire, with South Africa's two biggest donors, the E.U. and the U.S., providing no response. In addition, the IDC has been unable to furnish information on aid modalities in South Africa for this study. Some conclusions may be drawn by comparing the donor disbursements to South Africa with official records of South Africa's RDP fund account and complimenting this analysis with data received from the donors.

For all aid where a Governmental department is the contracting agent, it is a legal requirement that donor funds are transferred into the National Treasury's RDP Fund Account, from which funds are further disbursed to the relevant Government department. While a direct comparison between this fund account and total donor disbursements should be made with caution, it can provide some insight into donor funding preferences and the modalities used. In 2007, the RDP account received just 21 per cent of the total ODA distributed to South Africa.

Table 8: ODA Disbursements and the RDP Fund Account (US\$ Millions)

Year	2004	2005	2006	2007
ODA disbursed	434.0	634.3	782.2	844.7
Technical Co-operation (T.C.)	144.8	220.0	302.6	167.7
ODA disbursed (excluding Technical Co-operation)	289.2	414.1	479.6	677.0
Financial Year	2004/05	2005/06	2006/07	2007/08
RDP Fund Account – Funds Received	145.1	132.9	184.7	173.4

CRS Aid Activity Database, RDP Annual Financial Statements.

ODA excludes Equity Investments, but reflects funds from DAC bilateral countries and Multilaterals.

RDP Fund amounts have been converted into US\$ using South African Reserve Bank (SARB) average annual exchange rates.

The Financial Year for the RDP Fund account runs from April to March.

Table 8 shows the amount of ODA disbursed as reported by donors (to the Aid Activity Database) and the funds received by the South African Government (as reported in the RDP account). Three possible conclusions can be drawn from this comparison:

1. Data based on donor reporting to the CRS database indicates that a large portion of donor funding is in the form of technical co-operation. For the period 2004 – 2007, 31% of donor funding went towards technical co-operation. The potential underreporting of technical co-operation to the CRS is not known, implying that technical co-operation could form a much larger percentage of ODA. Technical co-operation is often cited as being tied to the donor country, either through formal rules and regulations or through less formal practices and specifications.

2. The use of Government institutions as the contracting agent is limited. The apparent low alignment of ODA may either be because donors have a preference for use of their own (or private) systems or because donors spending priorities are different from those of the South African Government (e.g. until recently, on HIV/AIDS).
3. Use of Government financial and procurement systems may be low. While this does not lead to the conclusion of tying by donors, funds not managed by a Government institution are more likely to follow non-Governmental procedures and procurement (either donor or private) and the possibility of *de facto* tying practices increases. In the country report on the 2008 Evaluation of the Implementation of the Paris Declaration, two key reasons given by donors for not using South Africa's systems is that it delays the quick implementation of projects, and that donor HQs have directed local staff not to use local systems.

In terms of aid modalities Table 9 indicates that donors in South Africa still makes predominant use of the traditional project approach, with none of the three donors using a pooled or hybrid approach. With the exception of the Netherlands, budget support (either general budget support (GBS) or sector budget support (SBS)) does not seem to be a common approach to providing ODA to South Africa. Based on information in Quist et al (2008), of total donor funds received by South Africa in the 2007/2008 financial year it is estimated that only 7% was through budget support, and only three donors have used a budget support modality between 2005 and 2008, the E.U., Netherlands and Ireland¹⁵. Quist et al (2008) also indicates the donors' view that given the way SBS is implemented it is more accurate to define SBS as project / programme support. This is supported by evidence in the E.U. case study (which employs SBS as an aid delivery modality for a sector programme) and by officials from the Netherlands embassy, who indicate that budget support provided in South Africa is not "on budget" (in that the support is not explicitly included in Government budgets), but is rather "on plan" for specific programmes.

Table 9 Aid modalities for selected donors

	DFID	Netherlands ¹	Sweden
	2008/2009	2005 - 2009	2007
	US\$ Million	Euro Million	US\$ Million
Total disbursements	49.7	212.99	19.1
Budgetary support (GBS and SBS)		33%	
Projects using partner country procurement system (CPS)	10%		6%
Projects using non-Government partner procedures – NGOs and private commercial organizations	33%		69%
Pooled funding arrangement according to CPS or lead agency procedures			
Project funding involving agency's own procurement at country office level			2%

¹⁵ Quist et al (2008) indicate that total Budget Support for the 2007/2008 financial year amounted to ZAR 279,653,297 with total donor disbursements for that year amounting to approximately ZAR 4 billion.

Project funding involving agency's own procurement through HQ	57%		23%
Hybrid project	0%	0%	0%

Source: Information provided by donors

¹The Embassy of Netherlands was not able to provide a breakdown of ODA disbursements by country systems, own systems or private organisations / NGO systems.

The apparent low usage of country systems is supported by Table 10, which is taken from the South African 2006 Survey on the Paris Declaration. Overall, less than half of all ODA made use of South Africa's financial or procurement systems. This result is distorted by the fact that South Africa's three largest donor partners (the E.U., USA and UK), prefer to use their own systems and procedures, smaller donors make substantial or absolute use of the RDP account. Donors that made predominant use of South African procurement systems (baseline ratio for procurement systems is greater than 50%) accounted for only 21% of total disbursement in 2005.

Table 10 Donor use of country systems, 2005

	Aid disbursed (US\$ Mn)	Public financial management systems	Procurement systems
Australia	1	0%	20%
Austria	0	--	--
Belgium	6	75%	75%
Canada	0	100%	100%
Denmark	14	37%	75%
European Commission	139	42%	42%
Finland	9	85%	85%
France	1	2%	7%
Germany	21	33%	33%
Global Fund	10	67%	100%
Ireland	8	100%	100%
Italy	3	33%	0%
Japan	15	0%	0%
Netherlands	22	100%	100%
New Zealand	0	100%	100%
Norway	8	100%	100%
Sweden	7	42%	42%
Switzerland	0	88%	88%
UK	41	0%	29%
United Nations	2	81%	0%
United States	43	0%	4%
Total	351	38%	44%

Source: 2006 Survey on Monitoring the Paris Declaration: South Africa Country Chapter
Percentage figures reflect the baseline ratios for each donor.

Despite a high baseline ratio for the use of South African public financial management systems for the United Nations, none of its aid was channelled through South Africa's procurement systems. France,

which primarily contributes ODA in the form of loans (67% of ODA disbursed in 2005 through loans¹⁶) is also a low user of South African systems, and may imply that loans are primarily implemented through donor systems. Countries such as Japan, the United States, the UK and Germany also have very low baseline ratios. It is interesting to note that despite these countries reporting a significant percentage of total ODA as untied (80%, 45%, 100% and 72% respectively for 2006¹⁷); very low usage of South African procurement systems is made. While this does not immediately imply *de facto* tying, the use of donor over partner systems raises this possibility. The low usage of South Africa's procurement systems is consistent with the qualitative evidence retrieved in this study.

It is also important to note differences in the understanding of the term "tying". From the OECD perspective, and the internationally accepted definition, tying refers to the principle of securing procurement of goods and services by the partner country from the donor country. However for many South African Government officials, the principle of tying often refers to the procedures and processes used in aid programmes. The focus is therefore on the alignment and ownership of aid with country systems over and above the procurement and sourcing of goods and services. An example of this is the E.U. aid model, cited by some Government officials as particularly tied. This perception relates largely to the EC requirement that unless certain eligibility criteria are met and a budget support aid modality (see Box 1) is used, E.U. aid is, for the most part, governed by the E.U.'s Practical Guide to Contract Procedures for EC external actions (commonly referred to as PRAG). Under these guidelines E.U. aid to South Africa is only partially tied to the E.U. states; the state who is a beneficiary of assistance and developing countries as specified by the OECD's DAC¹⁸. However, in South Africa, the fact that E.U. imposes its own rules and conditions on how ODA is spent is in itself seen as problematic. In such cases, the use of donor country procurement systems is sometimes synonymous with tying.

Box 1 The E.U. Sector Programme and Budget Support¹⁹

The E.U. defines a sector programme as a programme that is progressively developed as a result of following a sector approach. A sector approach will have the same features as a programme-based approach:

¹⁶ Based on data from the OECD CRS Aid Activities Database.

¹⁷ Based on Clay et al (2008).

¹⁸ Assistance from the E.U. is classified as being either from the EC's general budget or from the EDF. The two different financing sources have different rules on eligibility and under these guidelines, aid from the EDF is partially untied in that procurement is open to all ACP states, member states of the E.U. and the state that is being financed. South Africa's aid is financed through the general budget, according to a parliamentary decision passed in 2006. Because South Africa only has qualified membership of the Cotonou Agreement and has a special framework for relations with the E.U. (through the Trade, Development and Cooperation Agreement) unlike other ACP states it does not have access to funding from the EDF. Between 2000 and 2006 South Africa was financed through the European Programme for Reconstruction and Development in South Africa (EPRD). At the end of 2006 this was replaced with a general thematic and geographic financing instrument that provides aid to South Africa for the period 2007 – 2013.

¹⁹ The description of the Sector Programme is based on the EuropeAid's Guidelines No 2: Support to Sector Programmes.

- Leadership by the host country;
- A single programme and budget framework;
- A formalised process of donor co-ordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement; and
- Efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation.

The key difference is that a sector approach functions at a given sector level. In addition, key principles for sector approaches are that they be led by the partner Government and that they improve public sector performance in terms of service delivery and in terms of efficient and effective use of resources. The E.U. supports sector programmes through the Sector Policy Support Programme (SPSP), with three predominant aid delivery methods used:

- The EC procurement and grant award procedures relevant to that region when implementing the programme;
- Budget support, specifically defined as sector budget support (SBS), but operating in the same way as general budget support, with funding transferred to the recipient country's treasury account and the Government's financial management, procurement rules and processes used. This is used by the EC as a results-based approach, linking disbursement of variable tranches to the achievement of targets for agreed indicators; and
- Common pool funds. Funds from various donors are pooled and ad hoc procedures for disbursement, procurement and sourcing agreed to by both the donor and Government, are used.

The use of budget support for sector programmes is encouraged and favoured by the EC. However three rigorous criteria are set for eligibility with regards to the use of budget support: a well defined sectoral policy; that there is a credible and relevant programme to improve public financial management; and that the programme is operating within a stable macroeconomic policy framework.

These three criteria are evaluated through the assessment of the seven key areas of the sector approach: 1) Sector Policy; 2) Sector budget and Medium-Term Expenditure Framework; 3) Sector Coordination framework; 4) Institutional Capacity; 5) Performance Monitoring; 6) Macro-economic policy and 7) Legal and Institutional framework surrounding Public Finance Management.

Under E.U. guidelines, for projects to make use of recipient country procedures through budget support, the above criteria must first be met.

While recipient country Governments are encouraged and expected to take leadership of E.U. sector programmes, the aid delivery method used by the E.U. is often a source of frustration for recipient Governments. As seen in Box 1, a sector programme can only be implemented using South African systems and procedures if the SBS aid delivery method is used. The move from the use of E.U. procurement and grant award procedures to SBS has been described in South Africa as highly onerous, often duplicating existing assessment mechanisms, with the assessment requirements for SBS aid delivery hindering the use of South African systems.

A distinction should also be made here between direct budget support (in the financing sense) and budget support as an aid delivery modality. The preference in South Africa for E.U. delivery through a SBS modality is a result of the fact that this is the only way (under E.U. guidelines) that South African systems and procedures can be used. E.U. aid through SBS is not likely to directly support a sector budget, but is more likely to support a programme within a sector, with the aid effectively ring-fenced for this programme i.e. be earmarked specifically for that programme.

6 PROJECT ANALYSIS

Three donor projects were used as case studies for the South African analysis: two from the health sector (both relating to HIV/AIDS); and one from the water and sanitation sector. All three projects were similar in that they largely involved the procurement of services (especially relating to consulting services) rather than goods, yet all three projects had different contracting, funding and procurement procedures. This provided the study with the ability to contrast the projects and provide a more holistic view of the way untied aid works in South Africa.

The Rapid Response Health Fund (RRHF) was established in late 2008 as the fifth output of the Multi-sectoral HIV and AIDS Support Programme (MSP), funded by DFID. The programme was set up to provide “fast and flexible” aid to support the needs of a new Minister of Health, relating especially to HIV/AIDS policy. GBP 15,000,000 has been committed to the one-year programme, which runs from 2008 to 2009.

The Storm-water Drainage and Sanitation project was implemented in 2005 through the municipal twinning arrangement between Buffalo City Municipality (South Africa) and the City of Leiden (Netherlands), and was funded through the City of Leiden by VNG (Association of Netherlands Municipalities) International. The project focuses on the improvement of Storm-water management policies in Buffalo City as well as the improvement of local residents’ living conditions through the implementation of this policy. The project is primarily a vehicle for the building of capacity through information and knowledge exchange between the two municipalities but also contains an element of investment or infrastructure funding. VNG International is funded by, among others, the Netherlands Ministries of Foreign Affairs and Home Affairs, the European Union, the World Bank and various United Nations agencies. For 2009-2010 the budget application was 566,815 Euros of which 297,000 Euros was to be provided by Leiden in the form of technical assistance. However, due to VNG’s funding shortages the project budget has been reduced to 436,366 Euros. The technical assistance amount provided in this adjusted budget is not known.

The Extended Partnerships for the Delivery of Primary Health Care including HIV and AIDS Programme (EPDPHCP) is an E.U. funded programme that began in 2001. The programme aims to contribute to more accessible and affordable primary health care in South Africa by partnering with NPOs. The programme has evolved over the period both by expanding delivery of services from five to all nine of South Africa’s provinces and by moving from E.U. to local systems and procedures. For the period 2001 – 2006, the E.U. committed 25,000,000 Euros. In the period 2007 – 2010 the E.U. has committed a further 45,000,000 Euros.

6.1 Project Initiation

The projects were initiated either by the South African Government or through a joint process with donors, although in different formats. The RRHF was conceived during high level talks between South African and UK Government officials. At a meeting between the UK Secretary of State and the newly appointed South African Health Minister, it was agreed that a health fund would be made available to the Minister in order to rapidly improve HIV/AIDS policy and delivery in South Africa and to assist with any unexpected problems that may arise. Attention was drawn to the fact that the project required

quick initiation and setting up in order to avoid any delays in moving South Africa's response to the HIV/AIDS pandemic forward.

The EPDPHCP, in contrast, was initiated through a more regular process, with the E.U. highlighting the possibilities of Public-Private partnerships (PPPs) in its Country Strategy Paper (CSP) and Multi-Annual Indicative Programme (MIP) and consulting with the South African Government on the needs of the health sector.

Leiden City and Buffalo City Municipality have a long-term relationship with formal ties between the two municipalities established in 1998. The partnership agreement between the two municipalities was renewed in 2002. The Storm-water Drainage project was initiated by Buffalo City Municipality as a result of severe flooding that occurred in one of the municipality's districts. An investigation by Buffalo City Municipality concluded the need for storm-water by laws and the implementation of a storm-water policy and Buffalo City requested Leiden's assistance in resolving these problems. Leiden officials and water experts visited Buffalo Municipality to determine the extent to which they could cooperate, resulting in the initiation of the project.

6.2 Contracting and Administrative Arrangements

The three projects have very different contracting arrangements with the donor. Only the EPDPHCP programme has a Government department as the contracting and managing agent (the National Department of Health). Thus it is only for this programme that donor funds flow through the Treasury's RDP Fund Account and onwards to the National Department of Health's expenditure accounts.

The RRHF is managed by HLSP, a subsidiary of a British consultancy firm, specialising in the health sector and a member of an international consultancy, the Mott MacDonald Group. HLSP has been contracted to manage the MSP (and the RRHF, since it is an output of the MSP) through a framework contract that it was awarded by DFID in 2006. For this framework contract (which was over the E.U. threshold of GBP 90,319), DFID followed its standard procurement procedures. Advertising was placed in the Official Journal of the European Union (OJEU) and DFID's Procurement Group (PrG) was responsible for managing the competitive bidding process. The framework contract required HLSP to manage DFID's existing Health Resource Centre (HRC) and had additional call-off provisions that allowed DFID to contract HLSP for additional work without the need for further tendering. Under these call-off provisions, DFID contracted HLSP to take over the management of the MSP in 2008 from the incumbent contractors, who were not meeting expected performance criteria.

Approximately 18% of the RRHF expenditure is budgeted to go to HLSP for management of the project and for technical assistance provided by HLSP to the project. While DFID's procurement procedures are considered to be fully untied, the use of an external contractor whose parent company is British and who received 18% of the total RRHF funding (a part of which included technical assistance) was viewed with some suspicion within the South African Government. While not implying explicit tying, the Government was concerned that the procurement process for the RRHF was not open to local competition and that a significant percentage of the cost was transferred to a UK-owned consultancy. DFID's view is that the fee is appropriate to cover the cost of the full technical assistance provided by HLSP; and that it was necessary to make use of the framework contract in

order to implement a “fast and flexible” fund as requested by the Minister of Health. With the MSP and HSLP already in place, this was the most appropriate and quickest solution. In such situations, DFID acknowledges that it is often expedient to search “within one’s own network” and make use of trusted and pre-qualified expertise. In practise, this can lead to large and international companies (that hold framework contracts) being favoured for head contracts in local work, regardless of the availability of local expertise in a specific area.

The use of framework contracts, especially by the E.U. is a contentious issue in South Africa. In terms of E.U. guidelines, the procurement of framework contracts is partially tied to E.U. states and developing or ACP countries²⁰, but the predominant perception in South Africa is that such contracts are almost always awarded to European firms, which are larger (both from a financial, balance sheet and company size perspective) and have better international recognition. Because of this, and the generalised reference terms in framework contracts, it is felt that smaller South African firms cannot effectively compete. It follows that through these framework contracts, South African firms are often excluded from smaller scale work at the national (South African) level, because there is no transparent tender process within the consortia that hold these contracts.

It is also worth noting that the management cost of the RRHF is not significantly different from the management cost of the EPDPHCP. For the RRHF, HLSP has been awarded 18% (ZAR 39,000,000 of a total annual budget of ZAR 222,000,000) of the total funding for management, administration and technical assistance. For the EPDPHCP, the effective management cost (measured as the cost of employing staff at a national and provincial level, these staff largely responsible for the management and administration of the programme) is approximately 15% of the total budget for 2008/09 (ZAR 29,110,000 of a total annual budget of ZAR193,600,000). While the projects differ in scope (with the RRHF likely to be more technically complex and the EPDPHCP likely to be more administratively complex) it is clear that the RRHF project’s management cost (which includes technical assistance) is not significantly different to the EPDPHCP. The key difference between the management contract of the two projects (and potentially a reason for the National Treasury raising objections to the RRHF management fee) may be that for the RRHF management is contracted out to a UK-owned company, while for the EPDPHCP the management of the programme takes place internally as a functioning part of Government.

VNG International requires that a Dutch Municipality is appointed as the contracting agency. Thus in the Storm-water project, the City of Leiden acts as the contracting agency, and funds are then transferred from the City of Leiden to Buffalo City Municipality for specific expenditure purposes.

6.3 Systems and procedures

6.3.1 Project systems

As the contracting agent HLSP is responsible for the management of the RRHF. However the systems and procedures used are reasonably flexible and HLSP uses a mix of its own, the National

²⁰ The distinction between developing or ACP states depends on whether funding is from the E.U.’s general budget or EDF.

Department of Health's and DFID's systems to administer and manage the programme. Budgets and outputs are agreed on through dialogue between all three stakeholders. The use of different procedures has been determined by the circumstances, the urgency of the requests and from who the requests are made.

The EPDPHCP has gone through rapid evolution in terms of the systems and procedures used in implementing the programme. From inception in 2001 through to 2007, the EPDPHCP followed the E.U.'s programme-based approach (PBA). The contracting agent (the South African Government, specifically the National and Provincial Departments of Health) adopted the E.U.'s systems and procedures for financial management and procurement under a decentralised approach²¹. After a successful review of the seven key assessment areas, in 2007 the EPDPHCP was converted into a sector policy support programme (SPSP), using a budget support aid modality. While the financing method was relatively unchanged (the only significant change was the disbursement of aid in tranches) and the objectives of the programme remained in place (i.e. the funding does not provide direct sector budget support), the switch to a budget support aid modality allowed the department to apply South African Government financial systems and procurement procedures to implement the programme.

While the City of Leiden is the contracting agent for the storm-water project, the money received and spent by Buffalo City largely follows its own financial systems and procedures. There are additional reporting and auditing requirements for projects financed by VNG International. VNG International provides limited funding for infrastructure and investment costs. This funding is currently limited to 50% of the projected investment costs per year, up to a maximum of 45,000 Euros. The remaining 50% is to be counter-funded either by the Dutch or local municipality, as long as this co-financing is not funded, directly or indirectly, by the Netherlands Ministry of Foreign Affairs. A large portion of the project budget is in the form of technical assistance provided by the Dutch municipality, though VNG International financially reimburses Leiden for only a small portion of the technical assistance provided. The remainder of the budget is made up of travel and accommodation costs.

6.3.2 Local procurement

In the procurement of goods and services for all three projects, there is little evidence of implicit or *de facto* tying by donors. For the EPDPCHP, during its implementation as a PBA, the programme used the E.U. PRAG guidelines for local level procurement. Furthermore, to enable local companies to participate, the programme estimates were kept below the ceiling for local procurement, as agreed to in the financing agreement. Under this system advertising is required to be done through the local Government's official journal or through any suitable local media. When the EPDPHCP graduated to a SPSP, South African procurement policies and guidelines were implemented, including the use of South Africa's preferential procurement policy. Under South African procurement guidelines provincial departments are free to follow their own procurement processes (as long as they comply with national

²¹ Under E.U. guidelines, a programme is decentralised if the contracting agent is not an E.U. body. Under a decentralised approach the contracting agent will follow a combination of *ex-ante* approval and *ex-post* controls imposed by the E.U. when managing the programme.

policy). For example, the Gauteng Province has implemented a centralised procurement system, with all provincial procurement taking place through the Gauteng Shared Service Centre (GSSC). The Gauteng Department of Health therefore procures goods and services through this central system. The EPDPHCP expenditure has largely been on the transfer of funds to not for profit organisations (NPOs) for the provision of basic-health care services. Consulting and technical services have been procured for the provision of training (of both staff and NPOs), skills audits, the development of frameworks and guidelines and the provision of workshops to increase capacity within the programme. There has been small expenditure on goods, mainly in support of the management and administrative needs of the programme.

Box 2 South Africa's Preferential Procurement Policy

In 2000 South Africa passed the Preferential Procurement Policy Framework Act, which legislated the framework for the implementation of a preferential procurement policy. This policy was designed to allow state organs to give preference to South Africans who had “been historically disadvantaged by unfair discrimination on the basis of race, gender or disability” due to Apartheid. In addition, the policy aims to use Government procurement to contribute towards:

- The promotion of South African owned enterprises;
- The promotion of export oriented production to create jobs and the creation of new jobs or the intensification of labour absorption;
- The promotion of Small, Medium and Micro Enterprises (SMMEs); and
- The promotion of enterprises at a localised level.

The policy is implemented through a points systems which gives preference to companies that can meet the above goals. It does not exclude foreign firms from competing alone or as partners with South African firms. The number of points awarded to each of these criteria can differ by provincial or local Government, but the total amount of preference is limited to 10% of the total scoring for large tenders (those of R500 000 or more) and 20% for smaller ones (between R30 000 and R500 000).

The table below shows the premium tender applicants can receive, depending on the preference points they can claim.

Price premium under the preferential system

Points	Premium				
	0	5	10	15	20
80/20 System (R30,000 – R500,000)	0%	6%	13%	19%	25%
90/10 System (> R500,000)	0%	6%	11%		

The breakdown between the price and technical aspects of the tender vary between departments and levels of Government, and where the technical aspect of the product procured is important (e.g. service procurement) it is likely that the technical component is larger than price in the evaluation. However, for standardised goods where the technical aspect matters less, price is likely to be the biggest and sometimes component in evaluation. In such cases, under the 80/20 system, an applicant can charge a price premium of up to 25% and still be awarded the contract. Under the 90/10 system, a maximum of 10 preference points can be awarded and this would allow a maximum price premium of 11% on the evaluation.

The RRHF's procurement was, for the most part, ad hoc and determined by the National Ministry of Health in collaboration with DFID. The largest amount of the RRHF's budget has been spent on providing direct funding support to state organisations at the request of the Health Ministry. This

included providing ARVs to the Free State province Health Department to avert a cessation in treatment²². Funding was also provided to the South African National Blood Services and the National Health Laboratory Service, which were in financial distress and unable to meet payment demands, with funding transferred from HLSP to these organisations to ensure that they were able to pay overdue bills and continue operating until the financial year-end. This is followed by expenditure on a wide range of consultants appointed to advise the new Minister of Health. These consultants were, by and large, selected by senior officials in the Health Ministry, and their preference was for consultants of South African nationality. Thus, while there was no prescribed procurement methodology, the aid provided through the RRHF to fund these consultants was not tied to DFID or HLSP.

The RRHF also provided funding for the procurement of a media consultancy to manage the World AIDS Day campaign. Again, no specific procurement process was followed due to time constraints (the contract was awarded in October 2008 with the World AIDS Day campaign taking place on 1st December 2008), with HLSP requested to invite South African media organisations to express their interest to the South African National AIDS Council (SANAC). The selection process was managed by SANAC and chaired by an independent member of the Development Bank of Southern Africa (DBSA). Funding for the preventing of mother to child transmission of HIV (PMTCT) mobilisation campaigns was also provided by the RRHF, with the organisations selected by SANAC and the Health Ministry. There is therefore no evidence to suggest that RRHF procurement was tied in any way.

For the Storm-water project, Buffalo City Municipality's preferential procurement policy was used (as outlined in Box 2). Tender advertisements are placed locally, through Government notice boards, websites or through the local media. The project has provided some counter-funding for basic works contracts and for the procurement of consultants to develop the storm-water management plan, though this has been small relative to this cost of the consultants. While an exact amount could not be provided, it is estimated that only R1,500,000 of the total cost of R5,790,000 for the consultant contract has been funded using VNG funding with the remainder funded by Buffalo City Municipality.

7 COST AND DEVELOPMENTAL EFFECTIVENESS

It is beyond the scope of this once-off country study to measure the impact of untying on aid and developmental effectiveness. This would require much more evidence over a much longer time period. But the information and insights from the three projects described in this case study may shed some light on the extent to which untied ODA in South Africa might contribute towards the development of local capacity; and the impact that this may have on the costs of goods and services procured. These two dimensions of Aid effectiveness are considered below.

²² HLSP made payment on behalf of the Free State Department of Health for a "once-off" emergency supply of ARV drugs, at the Department's request and procured from the Department's preferred supplier, using Government procurement procedures.

7.1 Developmental Effectiveness

For all three projects, almost all goods and services have been procured and sourced locally. The extent to which this has contributed to new or sustainable domestic capacity is less clear. HLSP has provided a list of the nationalities of all consultants used in the implementation of the RRHF, shown in Annex 1. From this list it is clear that the consultants have been almost exclusively South African, with very little time used by British consultants. 68 of the 69 consultants that were contracted under the RRHF were South African, and of the organisations contracted 100% were South African. While the perception from the South African Government is that the project has been managed by a British firm, the project management team for the project is largely South African, with only 2 non-South Africans out of the 17-member management team. Though this points to some positive developmental impact in terms of capacity building for South Africa, there are also significant gains to HLSP (a British subsidiary) in terms of track-record, networks and corporate profit.

Management at both the National and Provincial (Gauteng) units of the EPDPHCP indicate that the programme has made use of South African consultants, NPOs and academic institutions. Technical assistance (in terms of management and administration) for this project has been contracted locally by the respective National and Provincial Health Departments and forms part of the respective Government departments' operations. This, along with the fact that the programme includes skills development for health departments, implies that there is likely to be a long-term benefit to the capacity of Government.

A 'ground-truthing' exercise was undertaken for the storm-water project in Buffalo Municipality in order to provide a better understanding of the project's outcome and developmental impact. South African companies have been used for the bulk of the services (outside of the technical assistance provided by Leiden) and in the case of works contracts the companies were small, local enterprises. The intangible nature of the work and the fact that the plan was at a very early stage of implementation made it difficult to assess the developmental impact of many of the services provided to the project. Interviews with Buffalo City officials paint a mixed picture of the efficacy of the municipal partnership programme. Some see the twinning arrangement as a highly effective way of sharing information, with Leiden officials and consultants providing information that is both beneficial and not found in South Africa. Others argue bi-lateral travel provides only a small benefit and that the travel itself is largely seen as a reward and a beneficial by-product of the partnership programme. Given these contrasting views, and the fact that the information exchange component accounted for over 70% of the total project budget in 2009 (see Table 11), the developmental impact of the twinning arrangement is in itself questionable. In addition, while actual counter-funding by Buffalo City could not be provided by Buffalo City Municipality officials²³, it was suggested that less than one-third of the cost of the consultants contracted to develop a storm-water management plan was provided by VNG International, with Buffalo City Municipality counter-funding the rest. For this project, VNG International's contribution to long-lasting capacity and infrastructure development is likely to be small.

²³ Buffalo Municipality has not been able to detail exact counter-funding amounts for the storm-water project. It is estimated that the total expenditure on the project has amounted to ZAR 1,708,776 for the period 2006 – 2008, while Buffalo City Municipality has budgeted a counter-funding amount of ZAR 4,000,000 for the 2009/2010 financial year.

Table 11 Storm-water project - information exchange budget (Amounts in Euros)

	2007	2008	2009	2010
Travel and accommodation	45,511	39,484	45,798	44,773
Of which for:				
Leiden officials	28,376	28,511	22,716	24,353
Buffalo City Officials	17,135	13,673	23,082	20,420
Leiden technical assistance	82,600	121,900	164,800	155,800
Total budget for information exchange	128,111	161,384	210,598	200,573
Total project budget	203,978	242,654	288,323	278,497
Information exchange as percentage of total budget	63%	67%	73%	72%

Source: Project budget applications provided by Buffalo City Municipality

Clearly all three projects have procured extensively from the recipient country. The extent to which the use of local goods and services has built capacity is however less clear. Qualitative evidence suggests that the EPDPHCP has built capacity within the Government through the use of local South Africans for technical assistance while for the Storm-water project the use of local companies for the two small-scale construction works is likely to have had a positive impact on capacity at those firms. For the RRHF, while there is evidence of a positive impact on capacity, the potential for capacity development through procurement of local consultants is likely to have been lower since many of the consultants contracted were already highly-sought with specialised skills. For example, the financial consultants used in the project to support the Health Ministry were largely from a single multinational consulting company.

7.2 Cost-effectiveness

Cost-effectiveness of aid is often cited as a key reason for the untying of aid. Assessing the cost-effectiveness of consulting services is very difficult given the varying degrees of quality and specialisation and the commercially sensitive nature of consulting services. While the same can be said of many goods, the costing of consulting services is especially difficult because there is usually no transparent market price against which consultants can be assessed. This study has revealed four ways in which the cost-effectiveness of untied aid may be impacted: local rules and guidelines for consulting rates may differ from the international norm; preferential procurement policies may raise the cost of certain goods and services; the administrative burden of local procurement may be higher or more time consuming; and a lack of competition in some domestic markets may contribute to premium rates on certain skills.

In contracting domestic consultants for the RRHF's advisory team for the Health Ministry, HLSP was required by the Government to use South Africa's Department of Public Service Administration (DPSA) external consultant rates as a benchmark. The DPSA consultant rates vary for level of specialisation, the inclusion of overheads, whether the consultant is contracted through a company (in which case there is a mark-up) and the length of the contract period. For confidentiality reasons, HLSP was not able to provide exact consulting rates charged to the project, but it was able to indicate the average DPSA levels used for contracting consultants.

In terms of the DPSA guidelines, consultants' fees are benchmarked against the grading levels of the South African civil service. Levels 6 to 10 are considered administrative or secretarial staff, levels 10 to 13 are considered relevant for technical staff, and levels 13 to 16 are considered relevant for specialist consultants or directors. In most cases, HLSP issued contracts at levels 12 – 14 (with very few at higher and lower levels). Contract terms varied with some allowing the inclusion of “all overheads” and some “partial overheads”, and some permitting “mark-up” and others not.

Table 12 DPSA consultant rates, hourly in ZAR

South Africa, DPSA short-term rates				
	All overheads		Partial Overheads	
	Mark-up	No Mark-up	Mark-up	No Mark-up
16	2,557	1,969	2,199	1,687
15	1,957	1,507	1,683	1,291
14	1,647	1,268	1,416	1,087
13	1,348	1,038	1,160	890
12	725	558	624	479
11	612	471	527	404

Source: DPSA Consultant Rates, 2009.

Table 12 shows the benchmark DPSA rates that HLSP used as a basis for contracting local consultants. Table 13 shows the average rates generally used by DFID for the contracting of experienced consultants in South Africa. Danish International Development Assistance (DANIDA) standard consulting rates in South Africa have also been provided for comparative purposes.

Table 13 Donor consultant rates, hourly in ZAR

DANIDA (includes overheads)				DFID (includes overheads)	
	Junior	Medium	Top-of-the-top	Type	Rate
Local	657	986	1,315	Local	684
Local expatriate	657	1,191	1,479	Regional	941
				International	1,027
				Highly specialised	1,198

Source: DANIDA and DFID

Rates have been converted to ZAR using the average exchange rates for the period Jan – Jun 2009. For DFID rates were converted from daily to hourly (assuming an 8-hour day).

The medium rate used by the RRHF (level 13) corresponds to a Director-level position in the South African Government, which is probably best compared to the DFID regional rate and the DANIDA medium band. DPSA's “all overheads” and “mark-up” rates are used in this comparison as DANIDA and DFID rates include a margin for overheads and profit. Under these assumptions, the relative costs of the three different consulting guidelines are shown in Table 14.

Table 14 Cost-effectiveness of DPSA consulting rates

DPSA 13 th Band	DANIDA		DFID	
Rate	Rate	Relative cost	Rate	Relative cost
Mark-up (ZAR 1,348)	986	37%	941	43%

From this analysis, it would appear that the use of South African Government consulting rates (rather than DFID's South African rates) may not be cost-effective. The rates, which HLSP were directed to use by the Health Ministry, are as much as 43% higher than the corresponding donor rates. This suggests that in certain circumstances, when aid is untied and Government procurement guidelines are used, donors may pay a higher cost than what they would normally incur for the same service. South African consultants are generally aware and accepting of the different rates that they can charge donors, relative to those that they can receive from the Government.

The use of preference policies to encourage wider participation in the procurement process is not unique to South Africa. The E.U.'s 2008 PRAG give a price preference to ACP country firms of 10% for works contracts of less than 5,000,000 Euros and 15% for supply contracts²⁴. South Africa's own preference policy gives up to 25% preference for contracts lower than R500,000 and up to 11% preference for contracts greater than R500,000. Procurement of aid through preferential policies has the inevitable impact of raising costs and, in South Africa, the difference on some large contracts can be substantial. These additional costs need to be weighed against the developmental benefits of local involvement and capacity building.

The use of local systems may also have other unintended consequences, leading to uncompetitive tender results. In the Storm-water project, Buffalo City issued tenders for three contracts: one major services contract and two fairly minor construction contracts. The response to all three tenders was very low, with the large services contract receiving only one bid (which was accepted) and the works contracts receiving two tenders each. The services contract, specifically, was large enough at the outset (the only bid was initially priced at R2,078,505 though increased to R5,790,918 as changes to the reference terms were made) to attract a wider number of bidders at a national level and potentially, at an international level. The lack of competitive bidding for this contract was likely the combined result of low levels of capacity in the region, the Government's preferential procurement requirements, and the fact that the tenders were advertised only at the local level only. Thus, in circumstances where local procedures are used and where local capacity is limited; there is further potential for cost-inefficiencies.

The time efficiency of aid is also an important consideration for both donor and recipient countries. There are conflicting views around the use of South African systems and procedures to disburse ODA. Government officials managing the EPDPHCP have commented on severe delays experienced in implementing certain aspects of the PRAG. For example, in the case of the PBA, any procurement over 5,000 Euros (the limit during the first phase of the EPDPHCP programme where *ex-ante* controls

²⁴ This preference is giving when aid is financed from the EDF.

were in place) required approval from the E.U. office in South Africa before the good or service could actually be purchased. This resulted in delays of up to 3 months and hampered implementation. The same officials greatly appreciated the single tender procurement procedure provided for under the PRAG (which allows for sole procurement under certain financial thresholds), as this dramatically simplified procurement for small tender amounts and provided significant reductions in time wasted on procurement. While unrelated to the three case studies, during the ground-truthing exercise (taken for the storm-water project) officials at Buffalo City have mentioned that the Swedish procurement process was much quicker than the South African process and was preferred because of this.

The over-riding perception of donors is that the South African system of procurement can cause significant delays, and this is to some extent supported by project co-ordinators in the South African Government and the available literature.²⁵

Under the RRHF, the use of an external agent (in HLSP) to manage the programme has undeniably given it the ability to react quickly. Because the agent was effectively unburdened from the use of either donor or Government systems, it was able to greatly reduce the time that would normally have been taken in the disbursement of funds and the procurement of services. This was probably the greatest contribution of the RRHF to Government. For many projects there is clearly an implied trade-off between time-effectiveness (and efficiency) and the principle of alignment. As highlighted in the 2008 country report on the Evaluation of the Implementation of the Paris Declaration, “the use of country procurement systems may not always be appropriate” and “the appropriate degree of flexibility required for alignment within the South African context needs to be determined”.

8 CONCLUSION

This report considers the tying status of aid and provides an assessment of the effects of untying, in South Africa, with reference to three specific donor projects. South Africa is exceptional as a recipient of aid, largely because, in general, it is not very dependent on aid as a revenue stream, and also because it has the necessary institutions and capacity to coordinate donor activities and manage donor funds. This is confirmed by the econometric results: donor flows impose no significant distortions on the South African economy. The presumption, reflected for example in the PD is that this should, in practise, contribute to the more effective and efficient use of ODA. The case studies reveal that this is not always the case; and for three main reasons.

²⁵ The Public Expenditure and Financial Accountability (PEFA) assessment (the PEFA assessment focuses specifically on budget formulation and execution and therefore partially assesses the procurement system) was completed in September 2008 (see Quist et al (2008)). South Africa received a very good overall score in the assessment, though the report assessed only the public financial management (PFM) system of South Africa’s central Government (thereby excluding roughly 65% of public sector PFM activity and the more problematic lower tiers of Government). In addition, while the overall PEFA assessment score was very good, South Africa’s score for procurement (namely “Competition, value for money and controls in procurement”) received a very low grade. It should also be noted that donor practices also received a very low score in the PEFA assessment. An older assessment of South Africa’s procurement system, which took place in 2001 (see The World Bank (2003)), indicated significant deficiencies in South Africa’s procurement system, some of which have since been addressed.

Firstly, in two of the three cases, there remains some evidence of tying, with source country consultants or companies brought in to do work that could potentially be done domestically. A large portion of the funding for the storm water project (direct from VNG International and indirect co-funding from the City of Leiden) went to support the time and travel of Leiden Government officials; and Buffalo City Municipality incurred costs of their own in implementing this twinning agreement. The DFID-funded RRHF programme was linked to an existing framework contract, which happened to be held by a UK-based consultancy. The use of the framework contract was important to deliver the necessary services at the level and speed required by the South Africa Minister of Health, but it did preclude independent South African companies from competing for the head contract to deliver this work. At a more general level, the common use of framework contracts by donors, and especially the E.U., seems to favour large, established international firms with experience of that donor; over and above new and domestic entrants.

Secondly, although a large proportion of reported ODA is untied, the risk of non-reporting may increase in more developed countries. This is largely because in countries like South Africa, a reasonably large proportion of overall ODA is provided as ad hoc or short-term technical cooperation. This form of assistance is generally less transparent than more conventional long-term development projects. There is also some evidence provided in the case studies that some forms of technical assistance, such as twinning, cooperation or partnership arrangements, are easily susceptible to *de facto* tying. An independent study co-funded by the South African Treasury suggests that as much as 30% of aid to South Africa, in 2006, was still tied.

Thirdly, in an untied environment, donors are more likely to make use of recipient country procedures. The case studies show that the use of recipient country procurement systems enables Governments to pursue domestic policy priorities and improve alignment. But in some instances, this can raise the cost and diminish the effectiveness of specific donor programmes. South Africa's preferential procurement policy (where the use of South African, and in particular historically disadvantaged individuals (HDIs), is legislatively encouraged), introduces an element of reverse-tying. This limits competition, permits a price premium on procurement and generally raises the cost of services provided. In addition, the consulting rates used by the South African Government, are sometimes higher than those that would be paid by international donors. Local procurement systems can also result in delays in procuring both goods and services.

The debate over the role of Government procurement to support local industry and black economic empowerment transcends the issue of untying (ODA flows are a very small part of overall Government expenditure and the South African historical context is important and unique). But in an untied environment, and where donors are expected to make wider use of domestic procurement procedures and systems, donors do need to take cognisance of how their funds are likely to be spent and continue to evaluate the implications that this may have on the cost, speed and quality of delivery.

Existing research suggests that it is still too early to determine the potential long-term benefits and costs of South Africa's preferential procurement policy²⁶.

In the case of South Africa, it would therefore appear that untying has contributed to improvements in the alignment and development effectiveness of aid. Moreover, although donors are minor funders in South Africa²⁷, they can play a critical role in deploying technical and financial resources, quickly. The examples explored here highlight the significant contribution made by just three projects in rescuing various national HIV/AIDS programmes; providing high-level advice to a new cabinet Minister; and protecting an impoverished community from severe flooding. Could more have been achieved if these donors had adopted a more open procurement process; or made greater use of the South African system? Certainly, alignment and development effectiveness could be further enhanced; but these gains might be partially offset by the intended (policy-related) and unintended (inefficiencies) costs of alternative procurement procedures.

²⁶ For more on this see Andrews (2008), Acemoglu et al (2007). For more general assessments of Black Economic Empowerment see Empowerdex (2005) and Mohamed and Roberts (2006).

²⁷ It should be noted that while, in general, ODA is a fraction of public expenditure, certain sectors such as the Health, and particularly the HIV/AIDS sectors, depend heavily on ODA as seen previously in this report.

ANNEXES TO SOUTH AFRICAN REPORT

Annex 1: Rapid Response Health Fund case study

1. Background

The Rapid Response Health Fund (RRHF) was established in November 2008 as the fifth output of the Multi-sectoral HIV and AIDS Support Programme (MSP). The MSP was established in 2004, the purpose of the programme being to contribute to the strengthening of South Africa's response to HIV and AIDS.

The RRHF is distinctive from other programmes both in its initiation and implementation. South Africa appointed a new health minister in September 2008 who committed to a quick and active response to the HIV/AIDS pandemic in South Africa. Following high level talks, DFID offered assistance to the minister in the form of a health fund that would be specifically designed to provide both fast and flexible aid in order to support the new health minister's needs in revitalising South Africa's HIV/AIDS policy implementation and respond to unexpected challenges that may arise in the early stages of her tenure.

2. Objectives, Scope and Method of Investigation

The case study was selected based on the unique circumstances surrounding the programme's initiation and implementation, with the RRHF able to provide an interesting contrast to more traditional untied aid programmes. The study focuses on the sourcing and procurement for various aspects of the programme, focusing particularly on the procurement of consulting services used in the programme. The investigation has relied primarily on information provided by DFID and the contracting agent, HLSP, in the form of progress reports, interviews and procurement guidelines documents.

3. Contracting, Funding and Administrative arrangements

The project has been financed by DFID, who has committed to providing an estimated GBP 15,000,000 to the RRHF, which will run from November 2008 to October 2009. HLSP has been contracted to run and administer the programme, with HLSP's management fee including aspects of technical assistance. HLSP's total cost (including the provision of technical assistance) is budgeted at roughly GBP 2,630,000 (approximately 18% of the total amount committed to the project).

HLSP acts as the contracting agent for all aspects of the programme, with DFID retrospectively reimbursing HLSP on a monthly basis for expenditure incurred on the programme. The period between the incurring of expenditure (by HLSP) and disbursement of funds (by DFID) is generally two months. While there is no contractual relationship between the National Department of Health and HLSP the budget and outputs are agreed on through dialogue between all three parties i.e. DFID, the National Department of Health and HLSP. The National Department of Health also performs some administrative functions such as signing off on timesheets and reports. In terms of HLSP's contract with DFID, HLSP is responsible for providing both progress reports and accounting information on the programme to DFID.

4. Project structure

The essential aim of the programme is to provide support to the new health minister in order to invigorate what was seen as a weakening HIV/AIDS policy. In addition the programme was designed to address concerns that the new Minister of Health may face within the broader Health policy framework. The project was required to be both fast and flexible, allowing for both rapid disbursement of funds and the ability for the programme to adapt to any needs that may be raised by the health ministry. At approximately the half-way stage, the programme has focused on six key areas:

Strengthening the South African National AIDS Council (SANAC). The staffing and improvement of SANAC, with the aim to strengthening its abilities and building its capacity, was identified as one of the core requirements by the Health Ministry in mounting an effective HIV/AIDS campaign. HLSP has responded by providing both technical and administrative assistance in filling vacant positions at SANAC and assisting in SANAC's funding application in the Round 9 Global Fund application. HLSP also provided the use of an internally developed "audit tool" to assist in the identification of SANAC's strengths and weaknesses, with the audit carried out by an HLSP consultant.

HIV/AIDS communication and mobilisation campaigns. The RRHF provided funding support to two primary communication and mobilisation campaigns, the 2008 World AIDS Day campaign and the Integrated Prevention of Mother-to-Child Transmission of HIV (PMTCT) Acceleration Plan. The 2008 World AIDS Day campaign was a SANAC initiative aiming to communicate the treatability and prevention of HIV/AIDS. Communication mediums included television, press, radio and mobile phones. The PMTCT Accelerated Plan is a joint programme by the National Department of Health and SANAC that looks to mobilise women to access PMTCT services and synchronising this mobilisation with the improvement in the quality of PMTCT services available.

Addressing of Service Delivery Challenges. The biggest budgeted portion of the RRHF has focused on addressing various delivery challenges, largely financial, faced by different Government-related health organisations. The RRHF provided direct aid to the National Health Laboratory Services (NHLS) and the South African National Blood Service (SANBS) in order to assist with the organisations' cash flow and budget problems and ensure that both the NHLS and the SANBS were able to continue with service delivery related to the provision of ARTs. The RRHF also provided a "once-off" payment for the procurement of ART drugs on behalf of the Free State Provincial Department of Health, which was unable to purchase the treatment due to budget overspends. Finally, HLSP contracted a specialist at the request of the National Department of Health in order to co-ordinate efforts to respond to the cholera outbreak in South Africa.

Support for a ministerial review of the health system. The RRHF has provided funding and technical assistance for the establishment of a Ministerial Advisory Committee on Health (MACH) with six sub-committees, called Technical Task Teams (TTTs), and Integrated Support Teams (ISTs) to advise the MACH. The purpose of the MACH is to provide technical support and advice to the Minister of Health in health-related matters ranging from the health workforce to the financial standing of provincial and national departments.

Strengthening Civil Society. One of the aims of the RRHF is to ensure that civil society organisations are capable of effectively monitoring and evaluating the NSP. As a result, the RRHF funded an inaugural symposium that brought together the private sector, SANAC and civil society organisations in order to reach agreement on how to effectively monitor the NSP. At the request of the Minister of Health, the RRHF has made funding available for organisations to support the monitoring and evaluation of the NSP at the national, provincial and district levels.

Providing direct ministerial support. The RRHF has provided direct support to the Health Ministry, including providing funding for a speech writer, special advisors and an audit. The RRHF provided joint-funding with the US Centres for Disease Control (CDC) to support a workshop to model the annual costs of ART for South Africa, with HLSP providing Technical Assistance to the workshop.

Table 1 RRHF Draft Budget & Expenditure (Amounts in ZAR)

Activity	Total Budget	Expenditure			Funds remaining
		Nov 08 - April 09	May 09 - Oct 09	Total	
Minister Support	2,455,100	380,500	2,074,600	2,455,100	-
Advisors	20,500	20,500	-	20,500	-
Auditor General Audit	1,800,000	-	1,800,000	1,800,000	-
Speech Writing	134,600	60,000	74,600	134,600	-
Support to Deputy Minister	500,000	300,000	200,000	500,000	-
Strengthening SANAC	10,176,375	161,000	10,015,375	10,176,375	-
Secretariat	10,000,000	-	10,000,000	10,000,000	-
Private Sector Conference	176,375	161,000	15,375	176,375	-
Communication Campaigns	28,866,869	11,516,869	15,380,000	26,896,869	1,970,000
World AIDS Day	11,366,869	11,366,869	-	11,366,869	-
PMTCT Communication and Media Campaign	17,500,000	150,000	15,380,000	15,530,000	1,970,000
M&E for Private Sector Response	9,500,000	-	8,010,000	8,010,000	1,490,000
Provincial Visits	700,000	13,000	687,000	700,000	-
Ministerial review of health system	52,400,000	7,000,000	32,400,000	39,400,000	13,000,000
Integrated Support Teams	22,400,000	5,000,000	17,400,000	22,400,000	-
MACH & TTTs	30,000,000	2,000,000	15,000,000	17,000,000	13,000,000
Donor Harmonisation	700,000	-	700,000	700,000	-
Service Delivery Challenges	78,500,000	69,343,000	3,686,000	73,029,000	5,471,000
Laboratory and Blood Bank Accounts		69,000,000	-	69,000,000	
ART Service Delivery Challenges		-	3,300,000	3,300,000	
Infectious Disease Outbreak (Cholera)		343,000	386,000	729,000	
HLSP costs	39,000,000	13,000,000	16,000,000	29,000,000	10,000,000
Total	222,298,344	101,414,369	88,952,975	190,367,344	31,931,000

Source: DFID Health Resource Centre, MSP in South Africa Output 5: RRHF Draft Progress Report
Expenditure for May 09 – Oct 09 reflects only amounts that have been spent in the second half of the one-year programme.

5. Tender and Procurement Processes

5.1 The Managing Agent

HLSP manages DFID's Health Resource Centre (HRC) in London, under a framework contract which was won in a competitive tendering process in 2006. HLSP is consultancy firm specialising in the health sector. HLSP is based in the UK and has regional offices in Asia and Africa. The framework contract followed DFID's normal procurement procedures, with advertising of the framework contract placed in the Official Journal of the European Union (OJ.E.U.) and a copy placed on the DFID website. DFID's Procurement Group (PrG) was responsible for the competitive bidding process, which is untied.

The framework contract includes various call-off provisions which DFID is able to use to contract additional work to HLSP without requiring furthering tendering for these contracts. Under the existing framework contract DFID contracted HLSP during 2007 to complete the remainder of the MSP, citing unhappiness with the consultants who were managing the programme at the time. While the programme is slightly different in nature, the RRHF has procedurally been classified as an output of the MSP (output 5), thus falling under the existing contract between DFID and HLSP to manage the MSP.

At the initial stages there was a difference of view between DFID and the South African Government (through the IDC and National Department of Health) on the issue of contracting HLSP to manage the RRHF:

- The National Department of Health expressed the belief that the full amount of aid agreed to (GBP 15,000,000) should be made available to it. In addition the National Department of Health and the IDC considered the total "fee" awarded to HLSP for managing the fund excessive.
- The IDC viewed the contracting of HLSP to manage the RRHF, without any competitive tendering specifically for the RRHF, as possibly a way of implicitly tying aid by DFID.

It is understood that in response DFID explained that:

- The need for a fast and highly flexible fund (as requested by the Minister of Health) meant that the best way for DFID to expedite the setting up and implementation of the fund was to include the contract under the overall MSP, the management of which was contracted to HLSP.
- In addition to ensuring a quick response to the Minister of Health's request, having HLSP manage the contract (under the MSP) would allow the fund to be fully flexible to the health ministry's requirements, both in terms of output requirements and movement of funds between budget lines.
- The management fee awarded to HLSP included full access to HLSP's technical advisory team and was therefore inclusive of any technical assistance that would be provided by HLSP.

DFID has acknowledged that the "fast and flexible" aspect of this fund, which required a very quick and pro-active response to the Minister's needs meant that the easiest and fastest way to achieve this would be to look "within one's own network" where trusted and qualified expertise can be found.

Essentially, the major implication here is that on certain occasions, the considerations of time-effectiveness may take precedence over any notions of both overt and implicit tying of aid. While having initial reservations, the acceptance of using HLSP to manage the RRHF by both the Ministry of Health and the IDC, implies an acknowledgement of the trade-off between time-effectiveness and any *de facto* tying considerations, especially given the IDC's strong exertion of ownership of aid and commitment to the Paris Declaration.

5.2 Procurement for the RRHF

While HLSP has been directed by the Ministry of Health in terms of procurement for the RRHF, the procurement process followed can, in most cases, be considered ad hoc. Again, this seems to be a result of both the need for a fast-acting fund and the uncertainty surrounding exactly what the fund's objectives (as directed by the Minister of Health) would be.

The RRHF has provided funding support for Civil Society Organisations to monitor the NSP. Calls for proposals were made through SANAC with HLSP administering the selection process. The selection of the media organisation appointed to run the World AIDS Day campaign was based on an adjudication process handled by SANAC and assisted by the Chair of DBSA. Six media organisations were invited to express their interest by HLSP, all of which were based in South Africa. The media organisation selected to manage and implement the campaign was a South African majority owned company with extensive experience in media and communications. The PMTCT Acceleration Plan which has received funding support from the RRHF is largely managed by SANAC and the National Department of Health in terms of procurement, with this procurement largely of a local nature. Consultants procured for the Acceleration Plan were suggested by a combination of the National Department of Health, DFID and SANAC. Finally, the RRHF provided technical assistance to SANAC to assist in the drawing up of job descriptions and advertisements for vacant positions within SANAC. The actual selection and recruitment for these positions is overseen by the DBSA.

The biggest expenditure item in the RRHF has been focused on providing direct funding support to Government-related health organisations that have experienced significant levels of financial distress and would have potentially led to an inability to provide their mandated services in combating HIV/AIDS. The RRHF provided funding against outstanding bills for the NHLS and SANBS in order to ensure they were able to continue functioning through to the end of the financial year. The only element of procurement has seen the RRHF make payment on behalf of the Free State Department of Health for a "once-off" emergency supply of ARV drugs, at the Department's request and procured from the Department's preferred supplier. This procurement saw a turnaround time of two days. HLSP also sourced and contracted a specialist, at the request of the National Department of Health, to assist in co-ordinating efforts to respond to a Cholera outbreak.

The procurement of consultants for the MACHs, TTTs and ISTs has been largely at the Health Ministry's discretion. Senior members within the TTTs and ISTs were individually selected by high-level Health Ministry officials. In some cases the individuals selected have gone on to select their team members. As an example, the Minister of Health selected as the leader of the Finance IST a person who was previously employed in the Government's auditor-general's office and was currently employed for a major auditing and consulting firm. The Finance IST team was selected by this

individual, all of whom are from the same international auditing and consulting firm. These consultants were contracted at varying rates but all benchmarked against the Government's Public Service Administration (PSA) rates. The exception to this was the finance consultants who were contracted at official Auditor-General rates. HLSP also contracted several consultants to assist senior officials in the Health Ministry. These consultants were selected by the Health Ministry. In addition HLSP has provided two technical experts for the costing of ART. At the request of the Minister of Health the RRHF supported the Auditor General Audit with funding and technical assistance.

In total 2 out of the 17 members of the management team are non-South African while 68 of the 69 consultants contracted under the RRHF were South African.

6. Aid and Developmental effectiveness

Developmental effectiveness is measured both by the use of local over foreign goods or services to achieve the aid programme's objectives and also the extent to which the use of local goods or services builds capacity in the recipient country (i.e. by increasing employment, improving ability etc.). In the first instance, the RRHF has made overwhelming use of South African firms and consultants to achieve the objectives of the RRHF. As the table provided by HLSP shows (see Appendix A), almost all consultants contracted by the RRHF are South African, with the use of foreign consultants the exception rather than the rule. This is not surprising given that to a large extent the National Department of Health was responsible for the selection of these consultants and procurement rules would have required the selection of South African over foreign consultants where possible. For other aspects of the programme where there was procurement of services, South African firms have again been contracted.

For cost-effectiveness, the HLSP's contracting of consultants for the MACHs, TTTs and ISTs has been used. HLSP indicated that the 12 – 14 bands of the PSA rates were used (though few were either higher or lower) for the majority of contracts, with contracts varying between "all overheads" and "partial overheads", and between "mark-up" and no "mark-up rates".

Table 2 DPSA consultant rates, hourly in ZAR

South Africa, DPSA short-term rates				
	All overheads		Partial Overheads	
	Mark-up	No Mark-up	Mark-up	No Mark-up
15	1957	1507	1683	1291
14	1647	1268	1416	1087
13	1348	1038	1160	890
12	725	558	624	479
11	612	471	527	404

Source: DPSA Consultant Rates, 2009.

Information has been provided by DFID on the average rates generally used for experienced consultants. DANIDA's standard consulting rates in South Africa have been used for comparative purposes. For comparison purposes, Band 13 of the DPSA rates (with "all-overheads" and a mark-up included, since the donor rates already account for this) has been used. Though these rates are

based on varying assumptions, from the analysis it is clear that the use of South African Government consulting rates has not been cost-effective.

Table 3 Donor consultant rates, hourly in ZAR

DANIDA (includes overheads)				DFID (includes overheads)	
	Junior	Medium	Top-of-the-top	Type	Rate
Local	657	986	1,315	Local	684
Local expatriate	657	1,191	1,479	Regional	941
				International	1,027
				Highly specialised	1,198

Source: DANIDA and DFID
 Rates have been converted to ZAR using the average exchange rates for the period Jan – Jun 2009. For DFID rates were converted from daily to hourly (assuming an 8-hour day).

The rates, which HLSP were directed to use by the Health Ministry, are between 37% and 43% higher than the donor rates used as a comparison. This suggests that the aid may have been more cost-effective had donors' rates been used to contract the consultants.

While the management and technical skills of HLSP has come at a cost to the programme, this can be weighed against the aid effectiveness provided in terms of improving time efficiencies and reducing the reporting and procedures burden that otherwise may have been shouldered by the Government. HLSP has been able to produce quick turnaround times for the project, time efficiency that would not likely have been produced had either DFID or the Government acted as the managing agent for the project. Though the project is not necessarily aligned with the Government in terms of procedures and systems, in situations where there is an important time element and where an external agent is likely to produce much quicker results, there may be a need for flexibility in demands on alignment and harmonisation of aid.

Appendix A: Consultant nationalities in RRHF

Consultant nationalities for National Department of Health's Integrated Support Teams (ISTs), Ministerial Advisory Committee on Health (MACH) and Technical Task Teams (TTTs), funded by DFID's RRHF

Consultant category	Unit (Days)	Nationality
IST Management & Finance – IST		
Xxxxxx	Up to 20	South African
Xxxxx	Up to 10	South African
Xxxxx	Up to 2	South African
Health Systems Strengthening - IST		
HLSP/RRHF/PB/030912	Up to 85	South African
HLSP/RRHF/LR/030913	Up to 85	South African
HLSP/RRHF/AM/030915	Up to 40	South African
HLSP/RRHF/JVH/030937	Up to 30	South African
HLSP/RRHF/AF/030916	Up to 40	South African
:HLSP/RRHF/GN/030919	Up to 50	South African
HLSP/RRHF/JM/030920	Up to 43	South African
HLSP/RRHF/CW/030924	Up to 43	South African
HLSP/RRHF/HS/030925	Up to 35	South African
HLSP/RRHF/CG/030926	Up to 40	South African
Management and Organisational Development - IST		
HLSP/RRHF/CD/030914	Up to 43	South African
HLSP/RRHF/AM/030917	Up to 65	South African
HLSP/RRHF/AVE/030927	Up to 30	South African
HLSP/RRHF/AS/030928	Up to 85	South African
HLSP/RRHF/AM/030923	Up to 50	South African
HLSP/RRHF/MW/030934	Up to 43	South African
HSLP/RRHF/XXXXX/22	Up to 10	BRITISH
HSLP/RRHF/XXXXX/xx	Up to 30	South African
HLSP/RRHF/OSD/020909		South African
MACH		
HLSP/RRHF/ETCM/030931	Up to 101	South African
HSLP/RRHF/8/AT/050947	10	
Finance - TTT		
HLSP/RRHF/HM/030935	Up to 20	South African
HLSP/RRHF/KvH/030938	Up to 40	
HLSP/RRHF/SMb/030939	Up to 40	South African
HSLP/RRHF/JK/040961	Up to 20	
Health Workforce - TTT		
xxxxxxx	40	
Information TTT		

Consultant category	Unit (Days)	Nationality
HLSP/RRHF/HE/030910	Up to 70	South African
Workshop Facilitators	Up to 2	
Workshop Facilitators	Up to 2	
Workshop Facilitators	Up to 2	Nigeria & South African
Workshop Facilitators	Up to 2	
Workshop Facilitators	Up to 2	
Workshop Facilitators	Up to 2	
Workshop Facilitators	Up to 2	
Medical Products - TTT		
HLSP/RRHF/PM/020907	Up to 39	South African
HLSP/RRHF/MA/030918	Up to 35	South African
HLSP/RHHF/JB/030930	Up to 16	South African
HLSP/RRHF/AG/050950	Up to 10	South African
HLSP/RRHF/BP/050951	Up to 10	South African
HLSP/RRHF/PF/050952	Up to 10	South African
HLSP/RRHF/BP/050953	Up to 10	South African
HLSP/RRHF/RS/050946	Up to 10	South African
HLSP/RRHF/NG/050954	Up to 10	South African
HLSP/RRHF/QJ/050955	Up to 10	South African
HSLP/RRHF/SG/030929	Up to 24	South African
HLSP/RRHF/BO/050956	Up to 10	
HLSP/RRHF/UM/050957	Up to 10	
HLSP/RRHF/FS/050945	Up to 10	South African
xxxxxxx	Up to 120	South African
HLSP/RRHF/UM/050958	Up to 10	South African
Service Delivery, Leadership, Governance - TTT		
HLSP/RRHF/PL/040959	Up to 15	South African
HLSP/RRHF/VD/080948	Up to 10	South African
xxxxxxx	Up to 3	South African
xxxxxxx	Up to 3	South African
xxxxxxx	Up to 40	South African
xxxxxxx	Up to 40	South African
TA - ARV Costing		
HLSP/RRHF/SC/030940	Up to 6	British & South African
xxxxxxx	Up to 3	Zimbabwe & South Africa

Source: Information provided by HLSP

Annex 2: Extended Programme for Delivery of Primary Health Care case study

1. Background

The 2000-2002 European Commission's Country Strategy Paper (CSP) and Multi-Annual Indicative Programme (MIP) foresaw the need for the development of public-private partnerships in relation to health. This resulted, in 2001, in the introduction of the Partnerships for the Delivery of Primary Health Care including HIV and AIDS Programme (PDPHCP) where non-profit organisations (NPOs) partnered with the South African Government to provide primary health care to South Africans. The programme was introduced in five of South Africa's nine provinces as a six-year programme with funding instalments in 2001 and 2004 of 25,000,000 Euros each. As a result of implementation delays and following requests from the four remaining provinces to be included in the programme the second instalment was delayed to 2006 with the programme adapted as the Expanded Partnerships for the Delivery of Primary Health Care including HIV and AIDS Programme (EPDPHCP) to acknowledge the inclusion of the four additional provinces. The funding amount for this period was revised up from 25,000,000 Euros to 45,000,000 Euros. The programme is to be implemented through to 2011 and the closure phase of the programme will run from this date to 2013.

2. Objectives, Scope and Method of Investigation

As one of the biggest donors in South Africa, it was felt that selecting an E.U. project would be appropriate. In addition the use of a health programme would provide for a contrast with the DFID RRHF programme chosen for this study. This case study looks at how goods and services for the programme are procured and whether these guidelines have any *de facto* tying implications. A conclusion on the effectiveness of aid is drawn from the study of the procurement practices. Interviews with the programme managers at national and provincial (Gauteng) level have been relied upon for information provided in this case study along with operational plans, financing agreements, annual reports and other external sources.

3. Contracting, Funding and Administrative arrangements

The contracting agent for the project is the South African government (specifically the National and Provincial Departments of Health) with funds flowing from the E.U. through the National Treasury's RDP Fund account to the relevant health departments. The programme has evolved since initiation in 2001 and can be broken up into three distinct phases:

2001 – 2006. Under this phase, the programme (named the PDPHCP) was implemented as a sector programme using a programme-based approach (PBA) that followed E.U. guidelines under the terms of the financing agreement and the E.U.'s Practical Guide to Contract procedures for EC external actions¹ (commonly referred to as PRAG).

¹ The E.U. Practical Guide relates to procurement from both the E.U.'s budget and EDF and has undergone several revisions since 2001, with changes mainly relating to the thresholds identifying which procurement process to use.

2006 – 2007. This can be considered the transition phase. Though the second instalment of funding was expected to be transferred in 2004, implementation delays for the project resulted in this being pushed back to 2006. Under the new financing agreement in 2006, the remaining provinces were added to the programme (resulting in the Extended PDPHCP or EPDPHCP) and it was agreed that the project would be converted from a PBA to a sector policy support programme (SPSP) using a sector budget support (SBS) aid modality as soon as the eligibility criteria were met. In this interim phase, E.U. procedures and the PRAG were used for management and procurement of the programme.

2007 – 2011. In 2007 the programme was changed to an SPSP using the SBS modality after an independent review of the seven key assessment areas (Sector Policy; Sector budget and Medium-Term Expenditure Framework; Sector Coordination framework; Institutional Capacity; Performance Monitoring; Macro-economic policy and Legal and Institutional framework surrounding Public Finance Management) was done and the eligibility criteria for using an SBS modality were found to have been met. Using a SBS modality meant that the programme was free to use South Africa's financial management and procurement systems and procedures. Key changes included the move from the E.U.'s Logical Framework Approach to the South African "Objectives" approach (impacting the financial and management reporting) and the use of South African financial systems. In terms of procurement, the programme moved from the E.U.'s PRAG to South Africa's procurement guidelines. While an SBS modality is used, the financing method for the project has remained fairly unchanged and funds for this programme can still only be used to achieve the objectives of the programme. The total funds committed to this phase of the programme amounts to 45,000,000 Euros with variable disbursements over three years (from 2007 to 2010) and conditional upon the National Department of Health formally requesting disbursement each year and giving justification for the disbursement of funds.

4. Project structure

Since the move to an SBS modality the programme has been reported on using an "Objectives" approach. Table's 1 and 2 show the expenditure estimates for the 2008/2009 period at a national and provincial (Gauteng province as an example) level. Table 3 outlines the expenditure estimates for 2008/2009 for the programme as a whole.

Table 1 National Programme Management Unit's (NPMU) Expenditure Estimate 2008/09 (Amounts in ZAR)

Objective	Objective Description	Amount
1	To appoint and manage programme staff at National Management Unit	3,200,000
2	To Develop a community based health services framework	350,000
3	To develop a guideline for staff working with NPOs in the Health Sector	200,000
4	To facilitate NPO funding process in all nine Provinces	1,500,000
5	To implement NPO Monitoring and Evaluation system	1,000,000
6	To develop a Community health worker vocational qualification framework	100,000
7	To develop and implement Community health worker training programme according to EPWP	300,000
8	Refine and finalise Guidelines for coordination and management of NPOs	100,000
9	To implement Human Resource development plan and mentoring for all staff in the	1,500,000

	Programme	
10	To continue with collaboration and support to stakeholders outside the department	850,000
11	To finalise and implement an accredited NPO management training programme	1,500,000
12	To develop baseline data on all funded Provincial NPOs	300,000
13	To develop a research agenda and commission research on Community based health services	300,000
14	To finalise and implement an NPO supervision manual and Quality Assurance Tools	100,000
15	To develop financial management / accounting tools or systems for NPO's	2,500,000
16	To implement clinical associate programme for South Africa	10,000,000
17	To coordinate all relevant initiatives within the Department of Health and Health Programmes	1,500,000
	Total	25,300,000

Source: National Department of Health Operational Plans

As Tables 1 and 2 both show, the programme has focused on soft objectives (rather than “hard”, infrastructure objectives). This makes the programme much harder to evaluate in terms of cost-effectiveness, especially where these objectives are implemented through the procurement of services.

Table 2 Gauteng Province's Expenditure Estimate 2008/09 (Amounts in ZAR)

Objective	Description	Amount
1	Maintain Provincial and District programme management structures	4,000,000
2	To implement NPO partnership for health framework for DHS	100,000
3	To increase access to PHC services through partnerships with NPOs	18,700,000
4	To implement NPO monitoring and evaluation system	700,000
5	To support implementation of Community Health Workers training programme	1,500,000
6	To facilitate training of NPO management structures on Project Management and Financial Management	1,000,000
7	To implement NPO financial management systems framework	200,000
	Total	26,200,000

Source: National Department of Health Operational Plans

Table 3 shows that much of the funding has gone towards the procurement of consulting services, technical assistance and NPOs. Here “compensation of employees” largely reflects the technical assistance component provided by individuals and contracted as employees to the respective health departments in order to manage and administer the programme. The expenditure on NPOs is reflected under “Transfers” in accordance with South African reporting guidelines. The expenditure on goods and services was primarily for consulting and other technical services, including the provision of training courses and the development of systems and tools.

Table 3 Overall programme budget by province 2008/09 (Amounts in ZAR Millions)

	E. Cape	Gauteng	Kwazulu-Natal	Limpopo	W. Cape	Free State	Mpumalanga	North West	N. Cape	National Unit	Total
Compensation of employees	3.53	3.20	2.74	4.00	1.94	3.00	2.50	2.50	2.50	3.20	29.11
Goods and services	5.72	5.00	2.43	2.80	0.22	2.70	3.00	3.00	3.20	20.70	48.77
Capital	0.05	-	-	-	-	-	0.40	0.10	0.25	1.30	2.10
Transfers	10.00	18.00	14.82	18.00	14.00	9.00	9.00	9.00	9.00	-	110.82
Machinery and Equipment	-	-	0.17	0.84	0.05	0.50	0.30	0.60	0.25	0.10	2.80
Total	19.30	26.20	20.16	25.64	16.20	15.20	15.20	15.20	15.20	25.30	193.60

Source: National Department of Health Operational Plans

5. Tender and Procurement Processes

5.1 The E.U.'s PRAG

The E.U.'s PRAG has undergone several revisions since 2001, but the core elements remain the same. The guidelines represented here are those from the E.U.'s latest revision, the 2008 guidelines².

The oft-used management modes under PRAG are determined by whether the E.U. has remained the contracting agency (centralised) or whether the E.U. has secured an external entity as the contracting agent (decentralised).

Under the centralised management mode decision-making authority is with the E.U., which acts on behalf of the beneficiary country. Under a decentralised approach, the contracting agent has some decision-making and executing power, with either *ex-ante* or *ex-post* approval procedures enforced by the E.U. These *ex-ante* or *ex-post* procedures are determined either by the financing agreement or by the PRAG or by both.

Assistance from the E.U. is classified as being either from the EC's general budget or from the European Development Fund (EDF). The two different financing sources have different rules on eligibility and under these guidelines aid from the EDF is partially untied in that procurement is open to all African, Caribbean and Pacific Group of States (ACP) states, member states of the E.U. and the state that is being financed. In addition to partial untying of aid, there is a price preference for contracts financed by the EDF. This price preference is given to natural and legal persons from ACP countries: 10% preference for works contracts less than 5,000,000 Euros and 15% preference for supply contracts where at least 50% of supplies originate from ACP states. For service contracts preference is given to ACP experts and institutions that have the required competence; offers where consortiums with ACP firms have been formed; and offers where ACP firms have been sub-contracted. Aid from

² The two phases of the EPDPHCP would have followed different versions of the PRAG, given that the financing agreements would have been signed in different years. The overall limits (determining which procedure to use) would have therefore differed slightly for the two phases and from those outlined here.

the E.U. budget is partially untied to developing countries and the state that is being financed and there is no preference given to any country. Because South Africa only has qualified membership of the Cotonou Agreement and has a special framework for relations with the E.U. (through the Trade, Development and Cooperation Agreement) unlike other ACP states it does not have access to funding from the EDF and there is therefore no preferential treatment for procurement. Between 2000 and 2006 South Africa was financed through the European Programme for Reconstruction and Development in South Africa (EPRD). At the end of 2006 this was replaced with a general thematic and geographic financing instrument that aid provided to South Africa for the period 2007 – 2013.

The PRAG stipulates the preferred procurement procedures as outlined below:

Table 4 Procurement procedures under 2008 PRAG (Amounts in Euros)

Services	≥ 200,000	< 200,000 but > 10,000		≤ 10,000
	International restricted tender procedure	1. Framework contracts 2. Competitive negotiated procedure		Single tender
Supplies	≥ 150,000	< 150,000 but ≥ 60,000	< 60,000 but > 10,000	
	International open tender procedure	Local open tender procedure	Competitive negotiated procedure	
Works	≥ 5,000,000	< 5,000,000 but ≥ 300,000	< 300,000 but > 10,000	
	1. International open tender procedure 2. International restricted tender procedure	Local open tender procedure	Competitive negotiated procedure	

Source: 2008 Practical Guide to Contract procedures for EC external actions

For the first two phases of the EPDPHCP (2001 – 2004 and 2006 – 2007), programme estimates were kept below the threshold for international open tenders, ensuring that all procurement could occur at a local level through either an open tender or competitive negotiated procedure. *Ex-post* controls were placed on the award procedures and contracting of providers for contracts up to a certain limit (5,000 Euros for the first phase, 50,000 Euros for the second phase of the programme) while *ex-ante* controls were placed on contracts above these limits. In addition to the above procedures, the EPDPHCP made use of the “calls for proposals” procedure when procuring and contracting NPOs for the programme as required under the PRAG’s guidelines for grants.

Given that the procurement procedure was localised, advertising for all procedures was required in local media only (either official government media or other equivalent media). Under the competitive negotiated procedure, the contracting authority is not required to advertise but draws up a list of at least three firms which are invited to tender. Contracts below the appropriate threshold could be awarded even where there was only a single tender. However under PRAG guidelines the local tender procedure (whether the open, competitively negotiated or call for proposal procedure) must provide other eligible contractors with the same opportunities as local firms. Thus the use of South Africa’s preferential policy was not allowed, as this gave a price preference to certain South African firms with the over-riding criteria for selection of the provider being price.

For the procurement of services (including technical assistance) the preferred procedure is through framework contracts (when above the minimum threshold), with the competitive negotiated procedure

to be used only in exceptional cases. However, the majority of services at both the national and provincial level were not procured using framework contracts (with most using the competitively negotiated procedure). This is likely a result of the inclusion in the financing agreement of a number of stipulations relating to Technical Assistance. These required that the government (through the relevant departments of health) be involved in the design of the terms of reference for all technical assistance and that the selection and appointment of technical assistance had the approval of the appropriate levels of government (national, provincial, municipal). Almost all technical assistance is provided by South Africans, with many employees from within the respective health departments most often selected to provide the technical assistance to the programme.

5.2 South African procurement guidelines

For the third phase of the EPDPHCP, South Africa’s procurement policies and guidelines have been used. The three levels of government are allowed to follow independent procurement guidelines but all are required to follow South Africa’s preferential procurement policy. The preferential procurement policy was designed to allow state organs to give preference to South Africans who had “been historically disadvantaged by unfair discrimination on the basis of race, gender or disability” due to Apartheid and thus favours certain South African firms and individuals. Under the preferential policy for the historically disadvantaged, a price preference is given through a points system. Points are awarded based various criteria including: being a historically disadvantaged individual (HDI); subcontracting with an HDI; and HDI management and equity ownership in the company. The preference is set in two bands, the first band for tenders / procurement is between R30,000 and R500,000 (referred to as the 80/20 system) and the second is for tenders greater than R500,000 (the 90/10 system). The table below shows the premium tender applications can potentially receive, depending on the points awarded. Where price is the sole criteria (i.e. there is no technical element in the tender), the 80/20 system can result in a maximum price premium of 25% while the 90/10 system can result in a maximum price premium of 11%.

Table 5 Price premium under South Africa’s preferential system

Points	Price premium				
	0	5	10	15	20
80/20 System (R30,000 – R500,000)	0%	6%	13%	19%	25%
90/10 System (> R500,000)	0%	6%	11%		

At the national level there are three thresholds that determine the way in which a product is procured. If the product to be procured is valued at R5,000 or less, a minimum of three quotations is required. These quotations must be retrieved either through the local database established for this purpose or through telephonic requests. A local database is established by advertising in local media for businesses to register as potential suppliers for goods and services. For procurement between R5,000 and R100,000 at least three written quotations must be retrieved, preferably through the local database. Preferential policies apply for procurement greater than R30, 000. If procurement of products is greater than R100,000 a competitive bidding procedure is used. Where there are sufficient suppliers in the market, advertising in the local media (at a minimum the Government Tender Bulletin) is required. Advertising in international media is required only if there is a specific need for international

procurement (such as no suppliers available in South Africa). Where the number of local suppliers is low a limited bidding procedure can be used, limiting competition to a few prospective bidders. For NPOs a call-for-proposal procedure was also used, with the additional criteria of the preferential policy.

Different provinces follow different systems. Whereas in some cases individual provincial departments manage their own procurement, in others procurement is centralised. For example, in the Gauteng Province the procurement process is centralised through the Gauteng Shared Service Centre (GSSC). The GSSC is responsible for procurement of products once they have been notified of the need of a specific product by the provincial Department of Health. While the aim is to reduce corruption at a departmental level, this can have the effect of increasing the time taken to procure goods and services.

6. Aid and Developmental effectiveness

The programme has largely made use of local procurement in order to fulfil objectives, though different procedures have been used at varying phases of the project. The EPDPHCP has made predominant use of South African consultants, NPOs and academic institutions for implementation. Technical assistance for this project has been contracted locally, often from within the respective National and Provincial Health Departments. This is likely to have had a beneficial impact in terms of the availability of technical assistance within South Africa. There is some evidence of this within the national and provincial departments, where South African individuals are beginning to create and implement policies related to the programme. Rather than a transfer of skills and knowledge, there has been a developmental impact through increased experience and learning by doing.

Part of aid effectiveness is the level at which there is an alignment of systems and procedures to enhance time savings and reduce the overall burden of multiple reporting systems. Evidence of this is mixed for this project. Government officials managing the EPDPHCP have commented on severe delays experienced by implementing certain aspects relating to PRAG, particularly relating to ex-ante controls. For example, while still using a PBA, any procurement over 5,000 Euros for the EPDPHCP required approval from the E.U. office in South Africa before the good or service could actually be purchased. This resulted in delays of up to 3 months and hampered implementation. Contrasting this, the same officials greatly appreciated the single tender procurement procedure under PRAG, which dramatically simplified procurement for small tender amounts and provided significant reductions in time wasted on procurement. The use of E.U. procurement guidelines and reporting for the earlier phases of the programme added a level of complexity to the administration of the programme as this had to be done within existing government systems, often by staff familiar with government systems but unfamiliar with E.U. procedures.

Annex 3: Storm-water Management Project case study

1. Background

In August 2002 heavy rainfall resulted in severe flooding of streams running through Duncan Village (an informal settlement area within the Buffalo City (formally East London) Municipality). This resulted in the loss of both lives and property and displaced in excess of 4000 people. In 2005 Buffalo City Municipality, through the municipal twinning partnership established in 1996 with the City of Leiden (Netherlands), requested assistance in storm-water management especially relating to Duncan Village. VNG International, the International Co-operation Agency of the Association of Netherlands Municipalities, provides both funding and technical support to developing country municipalities, through the partner municipality in the Netherlands. Through this arrangement VNG has co-funded the storm-water management project in Duncan Village with the Buffalo City Municipality. The project is primarily a vehicle for the building of capacity through information and knowledge exchange between the two municipalities but also contains an element of investment or infrastructure funding. VNG International is funded by, among others, the Netherlands Ministries of Foreign Affairs and Home Affairs, the European Union, the World Bank and various United Nations agencies.

2. Objectives, Scope and Method of Investigation

The storm-water project co-funded by the VNG was one of the few projects in the water and sanitation sector identified by the project. Analysis of this project ensures that there is at least one project in South Africa in the water and sanitation sector that can be compared to the other country case studies. Similar to the other South African case studies, the project has a high degree of funding for technical assistance and the provision of services, though there is some procurement of goods relating to the objectives of the project itself. The investigation has relied primarily on information provided by the Buffalo City Municipality, including progress report documents, budgets and tender documents. In addition interviews of the Buffalo City Aid co-ordinator and project manager have provided valuable information. The analysis focuses on procurement within the project, looking specifically at how the municipal partnership differs from “normal” aid programmes. A “ground-truthing” visit to the project site was also made for first hand verification of work and to interview the project manager and some of the project consultants.

3. Funding and Administrative arrangements

The project is co-funded by VNG International with the Buffalo City municipality providing some counter-funding for the project. The funding provided by VNG International is largely for travel expenditure for officials from both municipalities and partial re-imburement of employee costs to the Dutch municipality. VNG International only provides limited funding for infrastructure and other non-travel related expenditure. Thus, while travel expenditure by Buffalo City employees (to the Netherlands, as part of the knowledge-exchange process) is covered by funding from VNG, Buffalo City can be required to provide substantial counter-funding for non-travel related expenditure. VNG disburses funding for all projects through the Dutch-based municipality, as such Buffalo City receives funding only indirectly from VNG International. A significant part of the project revolves around the “twinning” between the municipalities, with information exchange occurring through the bi-lateral travel of engineers and officials from both municipalities. Buffalo City is funded by the City of Leiden

municipality through VNG International for these travel-related costs. While involved in the twinning arrangement Leiden City does not provide any direct funding. However the time spent on the project by Dutch municipal officials (on the country visits, in the information exchange meetings, in organising the project) is considered in the budget as the municipal's "own financial contribution", though this amount is not fully reimbursed by VNG International. Buffalo City functions on both a spend-and-claim basis and on a funded-prior-to-spend basis. Buffalo City through Leiden City applies for funding every two years. VNG evaluates the project on a yearly basis, with bi-annual reporting on the project by Buffalo City Municipality for the benefit of Leiden Municipality.

For the period 2009-2010 application a total budget (excluding any counter-funding by Buffalo City Municipality) of 566,815 Euros was estimated, with 269,815 Euros requested from VNG International. The remainder of the budget can be effectively seen as the technical assistance contribution from Leiden City, though as mentioned earlier this amount is not fully reimbursed by VNG International. For the 2009-2010 application VNG International has provided less than requested and this has resulted in an adjustment of the budget, with the Dutch municipality making up some of the shortfall by sourcing funding from the Unie van Waterschappen. The budget has been revised down to 436,366 Euros with this budget incorporating funding from the Unie van Waterschappen, amounting to 60,569 Euros for 2009. The funding contribution from Leiden City (i.e. the technical assistance provided by Leiden City staff in monetary terms) was revised but the exact amount was not provided.

4. Project structure

The project was initially developed in 2005 to determine floodlines and establish the hydraulic capacity of major and minor drainage systems of Buffalo City Municipality in order to develop a Storm-water Management System. Relating especially to Duncan Village, the project aimed to prevent building below the floodlines, ensure that the drainage system remained cleared and improve sanitation in the area. At the initial stage the project comprised three sub-projects:

- i. Clean up of the main streams and the drainage system in Duncan Village
- ii. The Amalinda flood plane project, which comprises the redesign of the floodplain area to ensure that no permanent living facilities are constructed within the floodplain.
- iii. Establish a master plan at a municipal level concerning storm-water policy that can be implemented on all levels to prevent future storm-water problems and enable the local government to take action.

Further sub-projects have been initiated as the project has continued and evolved:

- iv. Establish storm-water by-laws and guidelines together with other authorities and stakeholders and train staff on by-laws enforcement;
- v. Define a plan to implement a storm-water management system, including a rainfall and stream flow monitoring system;
- vi. The expansion of sanitation facilities and
- vii. The counteraction to pollution in order to improve the water quality in the Amalinda stream.

The budget applications for the period 2007 – 2010 are shown in Table 1¹. VNG International provides guidelines on the budget applications, indicating the amounts that may be applied for under each section².

Table 1 Budget application proposals for project (Amounts in Euros)

	2007	2008	2009	2010
Return tickets	17,056	15,600	15,600	16,700
Other travel expenses	6,229	7,282	7,674	7,380
Accommodation	22,226	16,603	22,524	20,693
Input of local experts	13,440	9,400	14,300	4,500
Investment costs	45,000	45,000	45,000	45,000
Other expenses	9,000	17,500	12,000	22,000
Contingencies	6,428	6,369	6,425	6,424
Audit	2,000	3,000	-	-
VNG International funding	121,379	120,754	123,523	122,697
Partial reimbursement of salary costs	13,600	13,000	11,400	12,200
Dutch organisations' officials time	69,000	108,900	153,400	143,600
Technical Assistance by Dutch Officials	82,600	121,900	164,800	155,800
Total	203,978	242,654	288,323	278,497

Source: Project budget applications provided by Buffalo City Municipality

Other Travel expenses include travel costs, airport taxes, visa costs, insurance costs and vaccinations.

Travel and accommodation. A significant portion of the budget is for travel and accommodation of both Leiden and Buffalo City officials. VNG International provides funding for economy class tickets, airport taxes, travel expenses, visa costs, vaccinations, insurance costs, a daily subsistence allowance and accommodation. Each municipality is responsible for the procurement of their own flights and accommodation.

Contribution of Dutch organisations. VNG International does not reimburse the Dutch organisations during work visits of the partner (developing country) municipality to the Netherlands. However, these costs are included in the budget as the financial contribution by the implementing municipality in the Netherlands and can therefore be considered aid in the form of technical assistance. For the 2009 – 2010 application, this rate used was 700 Euros per person (from the Dutch organisations) for each day of the working visit (including weekends). The same rate applies for work visits to the developing country municipality (i.e. when Dutch officials travel to the partner country) with

¹ Buffalo City was not able to provide clear counter-funding amounts for this project. Total expenditure on the project is estimated to have amounted to ZAR 1,708,776 for the period 2006 – 2008, while Buffalo City Municipality has budgeted a counter-funding amount of ZAR 4,000,000 for the 2009/2010 financial year. The budget applications in Table 1 therefore only reflect the contribution (financial and technical assistance) from VNG International and the Dutch municipality.

² The guidelines on financial limits and requirements for the budget in the following section are taken from VNG International's LOGO South Application Manual for 2009-2010.

weekends excluded. However for work visits to the developing country municipality VNG provides partial reimbursement of salary costs to the Dutch organisations at a maximum rate of 200 Euros per person for each work day of the country visit (for the 2009 – 2010 application), with weekend days not reimbursed. Under the budget, the contribution by Dutch organisations during partner country visits is therefore reflected as a sum of the Dutch non-reimbursed amount (500 Euros per person per day) and the amount reimbursed by VNG International to the Dutch organisation (200 Euros per person per day).

Investment costs. VNG International also provides limited funding for investment costs and input of local experts. Investment costs are considered the “hardware” that is needed to implement the project and need to have a clear relationship with the capacity building activities of the project. VNG International funds 50% of these costs, up to 45,000 Euros, with counter-funding required either from the Dutch or local municipality. VNG International requires that these goods be purchased locally.

Local experts. Local experts can be contracted for assistance in activities such as training or research and funding for this by VNG International is limited to 20% of the total budget amount claimed from VNG International.

A large portion of the budget applications is in the form of technical assistance that is provided by Leiden City: technical assistance comprises over half the budget for 2009-2010 and because of the nature of partnership (or twinning) agreements this technical assistance is tied to Dutch organisations. Table 2 shows the breakdown of funding provided to each municipality for flights and accommodation, based on application budgets. Over the period 2007 to 2010, just over half the travel-related budget is for the travel of Dutch officials and experts from Leiden to South Africa. Again, the implication is that this portion of aid is effectively tied to the Dutch municipality since the funding (while notionally untied) is provided to cover the travel expenses of Dutch officials.

Table 2 VNG funding to municipalities for travel related expenditure

	2007		2008		2009		2010	
	Leiden	Buffalo City	Leiden	Buffalo City	Leiden	Buffalo City	Leiden	Buffalo City
Flights	14,000	6,444	13,950	6,200	12,400	7,700	12,400	8,850
Travel	1,082	1,759	1,617	1,114	1,420	1,754	1,449	1,367
Accommodation	13,294	8,932	10,244	6,359	8,896	13,628	10,504	10,203
Total	28,376	17,135	25,811	13,673	22,716	23,082	24,353	20,420

Source: Project budget applications provided by Buffalo City Municipality
Other Travel expenses include travel costs, visa costs, insurance costs and vaccinations.

Buffalo Municipality has been able to provide information on three non-travel related expenditure items between 2007 and 2009 for the storm-water project. These are:

- The construction of gabions in Amalinda stream. The work included the excavation of material for the stream platforms, construction of gabion mattresses along the banks of the stream and backfilling behind the gabions. The works made use of rudimentary materials (basic stone and wiring) to create the gabions. The total expenditure on this project was R161,207.40.

- The construction of a walkway over Amalinda stream. The work included the manufacture and installation of a recycled plastic walkway over the stream, constructed over an existing concrete sewer pipe. The total expenditure on this project was R49,189.50.
- The development and implementation of a storm-water management plan. This is a three-year project (2007 – 2009) that required extensive consulting services to develop a floodline guideline manual, compile a river referencing system, compile a regional hydrological model and integrate all the developed data with the Integrated Management Query System (IMQS). The original cost of this part of the project was R2,078,505 but has increased to R5,790,818 due to additional requests made by Buffalo City Municipality. The exact amount funded by VNG International is not clear but is believed to be in the region of R1,500,000, with Buffalo City therefore providing the bulk of the funding.

Buffalo City Municipality has been able to provide only limited information on non-travel related expenditure and the counter-funding required for these aspects of the project. As can be seen here however, the biggest non-travel expenditure item has been the procurement of consultants to develop a storm-water plan.

5. Tender and Procurement Processes

The storm-water project (and all VNG International funded projects under Buffalo City Municipality) uses the local municipality's procurement guidelines for all South African related expenditure. For the expenditure on flights and accommodation for the Dutch municipal employees, the local Dutch municipality's procurement guidelines are followed.

Under the Buffalo City Municipality procurement guidelines there are three procurement procedures that can be used:

- i. For purchases between R2,000 and R10,000 three written price quotations are required. Requests for quotations can be drawn either from a list of providers that is updated quarterly or from outside of this list, provided that the provider meets the listing criteria.
- ii. For procurement between R10,000 and R200,000 three formal price quotations can be drawn from a list of providers. Prospective providers can submit applications for listing at any time. Where the procurement is in excess of R30,000 the procurement notice must also be advertised on the municipality's website and the local notice board.
- iii. A competitive bidding process must be used for procurement of long term contracts and for contracts greater than R200,000. Public invitation of competitive bids must be through advertisement in local newspapers and the website of the municipality and any other appropriate media (which may include the Government Tender Bulletin).

Buffalo City procurement regulations follow South Africa's preferential procurement policy for Historically Disadvantaged Individuals (HDIs). This policy gives up to a 25% price preference for procurement lower than R500,000 and up to an 11% price preference for procurement greater than R500,000. The municipality also supports the Proudly SA Campaign, with preference given firstly to suppliers within the municipality, secondly suppliers within the relevant province and thirdly suppliers within South Africa.

For travel and accommodation, Buffalo City Municipality would follow the price quotation procedure, and given that travel and accommodation needs arise frequently, this would be sourced from a list of providers that has already been established. The procurement of the three non-travel related expenditure items is described below.

The construction of the gabions was performed by a company based within the Buffalo City Municipality, Mvezo Plant and Civils, The advertisement for the construction work was placed on the relevant notice board and only two tenders were received for the contract. Mvezo Plant and Civils submitted the lowest price and was awarded the contract.

The walkway over the Amalinda stream was constructed by Imvubu Construction, also based within the Buffalo City Municipality. Advertisement for the work was placed on the relevant notice board and two tenders were received. As the lowest-priced tender, Imvubu Construction was awarded the contract.

For both these contracts, basic materials was used in construction, with labour costs constituting the bulk of the expenditure.

For the storm-water management plan advertisements were placed for tenders. Though there were several requests for bid and tender documents from the tender office, only one tender was actually received for the contract. This tender was received from a joint venture, with companies in the joint venture based in South Africa, and with all companies having representative offices within Buffalo City Municipality. Though there were no other tenders, following a revision of terms the joint venture tender was accepted and contracted.

6. Aid and Developmental effectiveness

From a developmental perspective, for elements where there has been direct procurement of works, the project can be considered beneficial and effective. The project has made use of local works companies, through the local procurement system. Qualitative evidence suggests that these companies have provided some employment benefits to the region and have made use of local materials in construction. With the procurement of consultants this is less clear. While the consulting companies are all South African it is difficult to judge the developmental effectiveness of hiring local consultants, aside from the increased experience that this provides them.

The use of local systems may also have the unexpected implication of generating uncompetitive results. In the Storm-water project, for the three contracts above, response was very low, with the services contract receiving only one tender (which was accepted) and the works contracts receiving two tenders each. This is likely the combined result of low levels of capacity in the region and the fact that the tenders are advertised only at a local level. Nevertheless, the lack of competition can effectively lead to inefficiencies which are most often reflected in a higher cost for the good or service. Thus in circumstances where local procedures are used and where local capacity is limited there is potential for untied aid being less cost-effective. Again this implies a trade-off between accepting a higher cost in order to develop local capacity. The ground-truthing exercise was partially beneficial in confirming the local government officials' views on the use of South African versus donor procurement systems. However, as part of the wider objective of establishing whether the project had satisfied the

initial objectives, the ground-truthing exercise was less beneficial. This is partially a result of the fact that a large part of the storm-water project consisted of intangible activities: the exchange of information between donor and recipient municipalities and the procurement of consulting services to draw up a storm-water management plan. While it is clear that the consultants hired to develop the storm-water management plan are delivering on the agreement, the direct benefits to the local community will not be able to be assessed until the plan is actually implemented. For the two small infrastructure activities, the ground-truthing exercise proved helpful in confirming the completion of these activities and the associated benefit for local residents in the area.

It should also be noted that a large portion of the budget of this project is in the form of technical assistance, from a budget point of view. While VNG only reimburses a small amount of the total estimated technical assistance provided by Leiden City, within the budget technical assistance accounts for over 50% of aid. As a result of the twinning arrangement, and because VNG funds can only be accessed through partnering with a Dutch municipality, the technical assistance is *de facto* tied. Travel-related expenses for Dutch officials provided for by VNG International can also, in this sense, be considered effectively tied. Consultants and Buffalo City municipality officials have given conflicting views regarding the effectiveness of the twinning arrangement. One point is that it is an effective way of sharing information, as Leiden City officials and consultants provide information that is both beneficial and not found in South Africa. The second view is that the bi-lateral travel provides only a small benefit and that the travel itself is largely seen as a reward for specific officials and is a by-product of the partnership programme.

Annex 4: Econometric analysis of Aid and trade for South Africa¹

1. Introduction - objectives and scope of investigation

This section investigates econometrically whether there is any evidence that bilateral aid and associated tying practices are trade distorting. The aim is to understand whether Official Development Assistance, its tying status and the different forms in which aid is provided (different aid instruments: loans and grants) have any discernible impact on aggregate donor export flows at the country level, in this case to South Africa.

The econometric investigation is undertaken for each of the six case study countries and an overall analysis for the six countries will be provided in the Draft Synthesis Report (DSR) for the Thematic Study. The six countries are deliberately paired according to trading region: South Africa, here analysed, is one of six studies including Zambia, also in SADC region, Ghana and Burkina Faso in West Africa and Laos and Vietnam in South East Asia and ASEAN.

2. Theoretical framework

The basic idea is to consider whether there is any trade distorting effects of aid at an aggregated level by examining whether bilateral aid from a particular donor to a recipient country affects trade between that donor and recipient pair differently from aid from other donors. There could be several reasons why Official Development Assistance could lead to an increase in the donor's exports (positive impact).

The most obvious explanation is that aid is formally tied to exports from the donor country (direct effect); by definition tied aid results in trade dependency². However, there are several ways for a donor to effectively tie aid without a formal tying agreement. Therefore, also *de facto* tying by covert restrictions on sourcing can generate increased trade with the recipient.

There are however other indirect effects that might lead to a positive correlation between ODA and donor's exports. Aid might have a macroeconomic impact in the recipient countries; higher rates of economic growth and structural economic reforms such as trade liberalization might indirectly impact on donor's exports. Moreover, aid flows could result in an increase in trade with the donor, reflecting the goodwill of the recipient towards the donor. Finally, the aid relationship might facilitate trade between the donor and the recipient by increasing the recipient's proclivity to procure goods from the donor (reinforcing commercial ties).

In theory, bilateral aid could also decrease donor's exports to the recipient country (negative impact); if aid were tied there might be a straight forward substitution effect (Osei et al., 2004; Wagner, 2003;

¹ Authored by Luisa Natali, ODI, United Kingdom.

² Tied aid may simply finance donor exports that would have been procured from the donor country anyway, however, we would expect tied aid to usually increase donor's exports.

Martínez-Zarzoso et al., 2008; Zarin-Nejadan et al., 2008;). Also if there were a partial tying restriction, for example to local, regional or developing country sourcing, that could have a negative effect.

In general, earlier studies (Nilsson, 1997; Wagner, 2003; Martínez-Zarzoso et al., 2008; Zarin-Nejadan et al., 2008; Nowak-Lehmann et al., 2008; Petterson and Johansson, 2009) have found a positive correlation between donor aid and donor exports; these results have usually been seen to corroborate the hypothesis that aid is tied (formally or informally) to exports from the donor country (Petterson and Johansson, 2009).

3. Review of possible methodologies

The aim is to study the impact of ODA on bilateral exports; the initial and main hypothesis is however that tying practices are critically important in driving the trade distortion. Some of the methodologies used to study the relationship between bilateral exports and aid which could lend themselves to the possible inclusion of a tying status variable are therefore reviewed.

One option is the gravity approach. The original gravity model (Tinbergen, 1962; Bergstrand, 1985) has bilateral exports as a dependent variable and as explanatory variables: GDP and GDP per capita of trading partners; distance; dummies for a common language and colony. Additional to the typical gravity variables it is possible to add an aid variable. Nilsson (1997) is the only study, using a gravity model, which tried to control for the degree of tying by including a dummy for those donor countries which, on average, tied more than half of their bilateral aid (the variable, however, was not found to be significant).

However, in the literature there have been criticisms to empirical studies of trade that use aid flows as an explanatory variable (i.e. gravity models). Most of the studies use cross-section or pooled data; however, the nature of the aid-trade links might differ among donor-recipient pairs. Therefore results may be misleading if estimations are performed over the whole sample. For this reason, data should be pre-tested to determine the nature of the aid-trade links for donor-recipient pairs using Granger causality (Osei et al., 2004). Lloyd et al. (2000), Arvin et al. (2000) and Osei et al. (2004) have used this methodology. Arvin et al. (2000) is however the only study which distinguishes aid by its tying status. Arvin et al. (2000) investigates the relationship between untied assistance and donor country exports using German data over the period 1973-1995.

In general, there is a very limited number of studies which have tried to include explicitly/directly the tying status of aid. Tajoli (1999) estimates the impact of Italian tied aid on total imports of recipient countries and tries to examine whether the distortionary impact of tied aid overcomes the trade generating effect.

4. Methodology

4.1 Variable selection

The gravity approach has been often praised for its remarkable explanatory variable and it is solidly based in the empirical literature (as opposed to Tajoli methodology which is only a minor approach). Granger causality itself has several limitations and would be difficult to implement given the limited number of observations available. For this reason it was decided to use a gravity model and adapt it to

the country level. Under the gravity model several basic variables are included in the specification:

- GDP and GDP per capita of the exporting countries which proxy respectively for their economic size and level of development are potentially important determinants of bilateral exports, It could be expected that the larger the exporting country's GDP the higher the level of exports, with countries such as Japan or United States exporting more than Luxembourg or Switzerland.
- Empirical investigations have found that bilateral trade between two regions (countries) is inversely related to the distance between them; distance usually proxies for transport costs as well as time, unfamiliarity, market access barriers and so on. Common language, is often used to proxy the existence of common cultural factors, which can help to facilitate trade flows between countries.

There are other possible influences that should be taken into account: foreign direct investment is a potentially important influence on trade between countries. There might also be a number of unmeasured influences that affect both aid and exports in the model. The omission of variables representing such influences (either difficult to measure, such as political ties, or simply underlying relationships not identified as potential determinants) could lead to over-estimating the explanatory power of the variables included in the model. In order to overcome this problem the residuals from an import regression can be included in the original equations. This procedure is carried out on the assumption that underlying relationships between trading partners affect imports and exports in the same way (Wagner, 2003).

In order to analyse the effect of ODA on exports by the donor country (to the recipient country), several measures of aid can be included in the basic gravity model:

- Aid flows from donor countries to South Africa might be a possible influence on exports; but it is important to distinguish between a donor's ODA and ODA that South Africa receives from all other bilateral donors. The basic idea is to consider whether there is any trade distorting effects of aid at an aggregated level by examining whether bilateral aid from a particular donor to a recipient country affects trade between that donor and recipient pair differently from aid from other donors.
- It could also be that certain aid instruments impact differently on trade flows; it might therefore be important to disaggregate ODA into loans and grants and keep distinguishing aid instruments based on the origin of the flows.
- Moreover, when a donor provides tied aid, the recipient is constrained to the purchase of donor country exports; there is a direct link between formally tied aid and trade; the formal tying status of aid, computed as the percentage of donor ODA reported as tied, could therefore be a potentially important factor in determining bilateral exports. It has sometimes been suggested that the ACP-E.U. relationship might be an influence on exports from E.U. countries; including a variable for EC disbursements is a way to explore further this relationship.

4.2 Empirical specification

In this section, the empirical specification used to test empirically the hypotheses is set out. This follows closely the methodology adopted by Massa and Te Velde (2009).

First, the following regression is computed in order to understand whether aid flows have an impact on total donors' export flows to the recipient country at an aggregate level.

$$\ln(Exp_{it}) = \alpha + \beta_1 \ln(Y_{it}) + \beta_2 \ln(Ypc_{it}) + \beta_3 \ln(Dist_{it}) + \beta_4 \ln(ComL_{it}) + \beta_5 \ln(FDI_{it}) + \beta_6 \ln(Im pR_{it}) + \delta_1 \ln(ODA_{it}) + \delta_2 \ln(ODA_{All-it}) + \varepsilon_{it}$$

(ODA aggregated)

The dependent variable Exp_{it} represents the export flows³ from country i to the recipient country; Y_{it} and Ypc_{it} measure respectively the GDP and GDP per capita of donor country i ; ODA_{it} is the country i 's Official Development Assistance to the recipient country whereas ODA_{All-it} represents ODA the recipient country receives from all the bilateral donors other than country i .

FDI_{it} stands for foreign direct investments to the recipient country; $Dist_{it}$ stands for the distance between the exporting and the recipient country whereas $ComL_{it}$ is a dummy indicating whether the donor country and recipient share a common official language⁴. ε_{it} is the error term, normally distributed, with mean 0 and variance σ_{ε}^2 . $ImpR_{it}$ stands for import residuals and is included in order to assess the effect of implicit relationships. An OLS regression is run on imports from the recipient to the donor and the residuals from this regression are included in the original equations.

Second, the above regression is re-estimated including a potentially important extra variable TS (tying status). TS_{it} stands for the percentage of donor ODA reported as tied. There is a direct link between formally tied aid and trade. When a donor provides tied aid, the recipient is constrained to the purchase of donor country exports.

$$\ln(Exp_{it}) = \alpha + \beta_1 \ln(Y_{it}) + \beta_2 \ln(Ypc_{it}) + \beta_3 \ln(Dist_{it}) + \beta_4 \ln(ComL_{it}) + \beta_5 \ln(FDI_{it}) + \beta_6 \ln(Im pR_{it}) + \beta_7 \ln(TS_{it}) + \delta_1 \ln(ODA_{it}) + \delta_2 \ln(ODA_{All-it}) + \varepsilon_{it}$$

(Tying status)

³ Exports include all traded goods but not services. Ideally, we would have liked to use exports of goods and services as a dependent variable; this exercise would have proved particularly interesting considering aid is often tied to consultancy services. However, exports of services had to be excluded due to the unavailability of disaggregated data (see Annex – data issues for further details).

⁴ In order to adapt the original gravity model to the country level, we do not include in the regressions the recipient's GDP and GDP per capita (which only vary across years and not across donors). We also drop the dummy 'colony' indicating whether the donor and the recipient have been in a colonial relationship; at the country level this variable loses its interest and moreover it is likely to be highly correlated with the common language variable.

Third, the regression above is re-estimated disaggregating ODA into loans and grants⁵ to test whether certain aid instruments impact differently on trade flows.

$$\begin{aligned} \ln(Exp_{it}) = & \alpha + \beta_1 \ln(Y_{it}) + \beta_2 \ln(Ypc_{it}) + \beta_3 \ln(Dist_{it}) + \beta_4 \ln(ComL_{it}) + \beta_5 \ln(FDI_{it}) \\ & + \beta_6 \ln(Im pR_{it}) + \beta_7 \ln(TS_{it}) + \delta_1 \ln(Loans_{it}) + \delta_2 \ln(Loans_{All-it}) + \delta_3 \ln(Grants_{it}) + \delta_4 \ln(Grants_{All-it}) + \varepsilon_{it} \end{aligned}$$

(ODA disaggregated)

Aid instruments are distinguished based on the origin of the flows. Grants_i is the country *i*'s grants to the recipient country whereas Grants_{All-i} represents the grants the recipient country receives from all the bilateral donors other than country *i*. Similarly, Loans_i and Loans_{All-i} are respectively the loans the recipient country receives from exporting country *i*, and from all the countries other than country *i*⁶.

Finally, the above regression is re-estimated including an EC disbursement variable to identify the effect of the ACP-E.U. relationship on exports from E.U. countries.

5. Problems in estimation – the aid and trade relationship

5.1 Direction of causality

We believe aid could be endogenous to trade. Although aid flows determine exports, there are several arguments that support that trade impacts on aid and therefore the existence of reverse causation (donors might decide to give aid to countries they have a trading relationship with; both aid and trade are likely to be high to countries donor has had a colonial relationship with; and so on). However, we are not able to instrument for aid; it proves difficult to find any variable that could be used as a credible instrument (and therefore an instrument which is correlated with aid but which does not itself belong in the trade explanatory equation) (Pettersson and Johansson, 2009). Granger causality tests could be used to pre-test the nature of the aid-trade links for donor-recipient pairs. However, Granger causality itself has several limitations (for Granger causality drawbacks see Osei et al., 2004:112) and would be difficult to implement given the limited number of observations available.

We would like to try and control for potential endogeneity of ODA flows to exports by using lagged disbursements. However, the restrictive dataset we used did not allow us to carry out such analysis. There are a limited number of observations in the dataset and the inclusion of an extra variable (lagged disbursements) would have reduced the sample further. Moreover, it is difficult to identify the right lag structure - an assumption is needed to choose the lag lengths for the analysis and the results are crucially dependent upon the lag structure selected for the variable. Several lag lengths were tried with no clear advantage over the results without lags.

⁵ Aggregated ODA includes loans, grants, equity investment and grant-like (see Annex - definitions). However, once we disaggregate we lose information about equity investments and grant-like aid.

⁶ We cannot compute the log(loans) or log(grants) when the variable is equal to zero (the log is undefined). To handle this type of problem we add 1 to the data before logging it – log(0+1). We assume that such adjustment is immaterial in the dataset as all positive values in the data are large numbers.

5.2 Selection bias

When estimating the determinants of exports we only observe trade information on those donor countries that export. If only 50% of DAC donors export to the recipient country under analysis, we will only have export information on those donors that trade. The problem of this kind of model is that the sample actually observed may not be random. In order correct for selection bias the Heckman procedure should be followed.

6. Data

6.1 Data availability

The study can only make use of the data available. However, there are two key areas where it is immediately apparent that the wanted data is not readily available.

Firstly, the data on tying can only capture formal tying. Both the investigation and the literature suggest that there is a substantial amount of *de facto* tying which is therefore not captured in the tables or econometrics. The tying status of aid is determined not only from the formal restrictions on spending which require recipients to contractually procure only from the donor country, but also from actual and practical restrictions which render aid funds *de facto* tied. There are several ways for a donor to effectively tie aid without a formal tying agreement. Informal tying might be the result of donors' commercial interests and pressures (and as such intentionally practised). It can occur when powerful donor countries are able to steer procurement towards national firms; through an implicit contract donors are able to persuade recipients to give preference to their suppliers within competitive bidding procedures (Tajoli, 1999). Donors may direct aid towards projects, goods or countries in which its industries have a comparative advantage in an attempt to assure that the procurement will happen in the donor country (Bhagwati, 1985; Jepma, 1991). Donors may also indirectly support national firms through the advertisement of the tender in publications which are not read outside of the donor country, or by evaluating bids against standards only applicable in the donor country (ActionAid, 2000). Donors might also informally tie their aid by first inviting bids and then deciding to support only those projects for which its home suppliers won the contract (U.S. Congress, 1993). Furthermore, informal tying can manifest itself as a 'secondary consequence of an arrangement already in effect' (Jepma, 1991). Tying of a small amount of aid might indirectly lead to a much larger amount. For example, large projects are usually undertaken after some preliminary examinations; when donors tie their aid to this pre-project phase, they often acquire substantial advantages in bidding for the project (U.S. Congress, 1993). In the provision of equipment with technical specifications, recipient countries might prefer to continue procurement from the same donor so as to avoid incompatibility or extra spending in technical training. The definition of (formal) tied aid might therefore underestimate the actual impact of tying practices on export flows. However, it cannot be excluded that some of the exports procured through tied aid would have been procured from the donor country anyway.

Secondly, Technical Assistance/Cooperation, which accounts for a large slice of tied aid, does not usually enter the trade statistics. As highlighted in Stavlöta et al. (2006), if donor country representatives carry out consultancy services in a recipient country, the transaction will be registered as domestic (i.e. the consultants bill the donor directly which supplies them as services-in-kind) and will not enter the trade balance although these services could be regarded as export of services. This

is important, as TC is both a significant share of ODA and an even larger share of tied ODA. Globally, 27% of TC related aid was tied as compared with only 13% for bilateral ODA in 2006 (Clay et al., 2008, Table 3.5). Moreover, the definition of exports in the analysis is restricted to goods and does not include services. This is likely to lead to underestimating the impact of the tying status variable on donor export flows.

We were also unable to get satisfactory data on additional variables for the econometrics e.g. FDI (for all countries), bilateral trade agreements, etc. FDI were only available for South Africa at a satisfactory level, though this meant losing observations for 2007.

6.2 Data reliability

Data reliability is mainly an issue of reporting⁷ quality. As quality has improved over time, we have retained data for only the latest years (2002-2007) but this restricts the sample, leaving us with a limited number of observations and therefore limiting the robustness of results. In particular several issues have contributed to the unreliability of data:

- Non response (tying status)
 - Overall - Some donors e.g. the US, only started reporting the tying status of ODA to the CRS this year (2008).
 - Partial – e.g. reporting of TC components – a high percentage of projects by value do not report the TC status.
- Differential reporting. Different donors interpret the reporting directives differently. For example, whether aid channelled through NGOs is tied or untied or over the precise definition of budget support. This has also changed over time and is becoming more consistent.
- Coverage. For the most part the study uses the CRS dataset as it has the project level data required however, comparison with the DAC dataset reveals that especially for the earlier years a substantial amount of ODA is not included.
- Commitments vs. Disbursements. Where possible the study tries to use the most appropriate, commitments have traditionally had more complete coverage whereas disbursements are closer to reality in terms of trade effects.
- The exports data used in the study includes all traded goods. However, data represents only exports of goods and not services. Data is drawn from the IMF DOTS (Direction of Trade Statistics).

7. Results

Tables 7.1 and 7.2 present the empirical results for South Africa and Zambia respectively. Regressions have been estimated using simple OLS, fixed effects and random effects (RE) panel regressions; however, we report only results obtained using RE estimation. Empirical estimation

⁷ Reporting the tying status of aid is not mandatory; consequently this information is often not complete and missing especially in early years.

includes 21 DAC donor countries to South Africa with observations only covering the years 2002-2006 because of data quality issues and availability.

7.1 Results for South Africa

The results for South Africa are presented in Table 7.1. In line with expectations and previous published findings, the size of donor economy seems to be an important determinant of bilateral exports; the parameter estimate⁸ indicates that a 1% increase in GDP is associated with around a 0.9% rise in exports.

Table 7.1 Econometric results for South Africa

<i>Dependent variable: Exports</i>	ODA	Tying status	Loans and grants	EC variable
GDP _i	0.970***	0.940***	0.915***	0.897***
GDP per capita _i	0.699	0.546	0.167	-0.009
ODA _i	0.016	0.038		
ODA _{All-i}	0.209	0.17		
Distance _i	-1.585	-1.373	-1.186	-1.115
Common language _i	0.269	0.222	0.085	0.044
FDI _i	0.050***	0.056***	0.058***	0.065***
Import residual _i	0.259***	0.266***	0.238**	0.267***
Tying status % _i		0.272	0.449**	0.513**
Grants _i			0.110**	0.136***
Grants _{All-i}			0.131	0.335
Loans _i			-0.008	-0.01
Loans _{All-i}			0.014***	0.012**
EC disbursements				-0.005
Constant	-89.307**	-108.111**	-159.716***	-187.165***
<i>N</i>	76	75	75	75
<i>N_g</i>	21	21	21	21
<i>R²_w</i>	0.795	0.789	0.8	0.792
<i>R²_o</i>	0.823	0.83	0.84	0.851
<i>R²_b</i>	0.803	0.813	0.829	0.842

All variables are in natural logarithms (except Common language and Tying status).

All regressions include a time trend not reported.

Legend: * significance at 10 percent **significance at 5 percent *** significance at 1 percent.

Data covers the period 2002-2006.

Aggregated aid flows, from the donor or from other bilateral donors, do not have any statistically significant impact on donor exports. This result is not unexpected for a country such as South Africa

⁸ The parameter estimates commented in this section refer the last specification of table 7.1.

which receives low level of aid and has a limited number of active donors: ODA commitments as a percentage of GDP measured less than 0.4% in 2007⁹.

Other flows seem however to have a bear on bilateral export flows; FDI have a positive influence on bilateral exports toward the host country, South Africa; a 1% increase in FDI causes an 0.065% increase in exports. This could be explained by patterns of intra-firm trade within multi-national enterprises (MNE), that is exports between home country parents and their foreign affiliates (Hejazi and Safarian, 2001). For instance, new facilities set up by a MNE subsidiary could be equipped using imported capital goods from the home country.

The statistical relationships found highlight influences reflecting the available data; in reality there are other relationships that are often difficult either to identify or measure. The import residuals variable, which is used to control for such underlying relationships between the donor and the recipient countries, is highly significant and positive in all specifications, implying that special relationships between trading partners do exist and impact positively on the exports level. This result suggests the existence of a complex reciprocal relationship, one that runs both ways.

The direction of the relationship between formally tied aid and exports is as expected but not at all robust: the estimated tying status variable is positive but not always significant. However, when aid is disaggregated in terms loans and grants, grants from the donor country are found to be positively associated with donors' exports; a 1% increase in grants from the donor country causes a 0.136% increase in bilateral exports. When aid is disaggregated in terms loans and grants, grants from the donor country are found to be positively associated with donors' exports; a 1% increase in grants from the donor country causes a 0.136% increase in exports to South Africa. This suggests that grants may have a trade distorting effect and may reflect some combination of *de facto* tying or a more indirect effect where donor grants improve goodwill and therefore the recipient's proclivity to procure goods from the donor.

In contrast, loans from the donor country is not statistically significant whereas loans from all other bilateral donors is statistically significant. For the South Africa a disaggregation of ODA into loans and grants is perhaps not very meaningful since the loan component has been very small¹⁰.

Other potential influences are found to be wholly insignificant: disbursements from the EC, distance and common language, and the level of development of donor countries, measured by their income per capita level, has no impact on bilateral export flows.

⁹ Based on data from the IMF's World Economic Outlook, April 2009 and the OECD's CRS Aid Activity Database. The major trading partners for South Africa over the analyzed period (2002-2006) in our dataset are Germany (24%), Japan (14%), USA (14%), UK (12%).

¹⁰ Only around 10% of disbursements (grants and loans) in our dataset are represented by loans.

7.2 South Africa and Zambia: A comparison

It is interesting to compare results for South Africa, an upper middle income country, with those obtained for Zambia (Table 7.2), a least developed and relatively aid dependent country in the same trading area, SADC.

Table 7.2 Econometric results for Zambia

<i>Dependent variable:</i> <i>Exports</i>	ODA	Tying status	Loans and grants	EC variable
GDP _i	0.751***	0.855***	0.750***	0.771***
GDP per capita _i	0.873	0.709	0.458	0.731
ODA _i	0.091	0.03		
ODA _{All-i}	-0.055	-0.064		
Distance _i	-0.24	-0.238	-0.677	1.934
Common language _i	0.15	0.145	0.164	0.094
Import residual _i	-0.063	-0.027	0.019	0.028
Tying status % _i		0.408	0.714*	0.911**
Grants _i			0.165***	0.135**
Grants _{All-i}			0.192	0.164
Loans _i			0.009	0.005
Loans _{All-i}			0.006	0.005
Export credits _i				0.002
EC disbursements _i				0.089**
Constant	-299.202***	-315.955***	-64.238	-98.109
<i>N</i>	118	116	95	95
<i>Ng</i>	21	21	21	21
<i>R</i> ² _w	0.312	0.317	0.183	0.188
<i>R</i> ² _o	0.578	0.549	0.665	0.753
<i>R</i> ² _b	0.606	0.579	0.744	0.802

All variables are in natural logarithms (except Common language and Tying status).

All regressions include a time trend not reported.

Legend: * significance at 10 percent **significance at 5 percent *** significance at 1 percent.

Data covers the period 2002-2006.

The results are quite similar for the two countries notwithstanding some differences in the basis of the computations¹¹. GDP plays a significant role in explaining exports. It was expected that ODA levels might be more strongly associated with higher donor exports to Zambia given its aid dependency but this is not found to be the case neither at the aggregate level nor at the disaggregated level¹². Similar to the South African results, grants seem to have a trade distorting effect, with a 1% increase in grants

¹¹ South African specification includes FDI but does not include export credits.

¹² The major trading partners for Zambia over the analysed period (2002-2007) are: UK (16%), USA (15%), Sweden (10.3%), Japan (9.9%), Germany (9.1%) Canada (6.9%), Netherlands (6.2%), France (5.9%).

from donor *i* increasing exports from that country to Zambia by 0.165%. FDI has a positive influence on bilateral exports toward the host country for the South African results; such relationship could not be explored for Zambia due to data unavailability.

There are two striking differences between the South Africa and the Zambia results. In the case of Zambia, a full ACP member, EC disbursements are found to be positively associated with export flows from E.U. member states. Also in the Zambian case, import residuals are not significant. The comparison suggests that a different set of relationships are being captured: whereas there could be multiple (unspecified) relationships between South Africa and trading partners, while in Zambia the absence of any significant underlying relationship might indicate an more aid dependent relationship.

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Appendix A: Definitions

Official development assistance (ODA)¹³

Grants or Loans to countries and territories on Part I of the Development Assistance Committee (DAC) List of Aid Recipients (developing countries) which are:

- (a) undertaken by the official sector;
- (b) with promotion of economic development and welfare as the main objective;
- (c) at concessional financial terms [if a loan, having a Grant Element of at least 25 per cent].

Official Development Assistance is classified by type of flow in the OECD Creditor Reporting System as follows: ODA Loans, ODA Grants, ODA Grant-like, ODA Equity investments¹⁴.

Grants

Grants are transfers in cash or in kind for which no legal debt is incurred by the recipient. For DAC/CRS reporting purposes, it also includes debt forgiveness, which does not entail new transfers; support to non-governmental organisations; and certain costs incurred in the implementation of aid programmes.

Loans

Loans are transfers for which the recipient incurs a legal debt and repayment is required in convertible currencies or in kind. This includes any loans repayable in the borrower's currency where the lender intends to repatriate the repayments or to use them in the borrowing country for the lender's benefit.

Only loans with a grant element above 25 per cent are ODA eligible. In addition, an ODA loan has to be concessional in character. This means that its interest rate must be below the prevailing market rate.

Grant-like flows

Grant-like flows comprise a) loans for which the service payments are to be made into an account in the borrowing country and used in the borrowing country for its own benefit, and b) provision of commodities for sale in the recipient's currency the proceeds of which are used in the recipient country for its own benefit.

Equity investment

Equity investment comprises direct financing of enterprises in a developing country which does not (as opposed to direct investment) imply a lasting interest in the enterprise.

Exports¹⁵

¹³ As defined in the OECD Glossary.

¹⁴ The definitions for these flows have been extracted from: DCD/DAC(2007)39/FINAL, Reporting directives for the Creditor Reporting System, Available online: <http://www.oecd.org/dataoecd/16/53/1948102.pdf>. For further information on the creditor reporting system refer to this document.

The coverage of exports statistics should be sufficiently broad to encompass all merchandise leaving a country to another country, except goods being transported through a territory (i.e. transit trade).

*Export Credits*¹⁶

Official or private bilateral loans which are primarily export-facilitating in purpose. They are usually tied to a specific export from the extending country and not represented by a negotiable instrument. As they have a primarily commercial motive, official export credits are classified as OOF, not as ODA. Premia paid to insure export credits, and indemnities paid under such insurance, do not constitute flows and are not recorded in DAC statistics.

¹⁵ See IMF (1993).

¹⁶ As described in the DAC directives, Available online: <http://www.oecd.org/dac/stats/dac/directives>.

Annex 5: List of contacts

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Name	Department / Organisation	Position
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Storm-water management

Name	Department / Organisation	Position
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Other Contacts

Name	Department / Organisation	Position
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Cathy Moore	USAID / SA Bilateral Program	Deputy Director
Elaine Venter	National Treasury, International Development Co-operation (IDC) Division	Director
Erik Litver	Embassy of Netherlands	First Secretary Research and Education
Eudy Mabuza	Department of Science and Technology	Deputy Director: Development Partnerships
Helen Mealins	DFID Southern Africa	Head of Mission
Hilton Toolo	Department of Provincial and Local Government	Executive Manager: International and Donor Relations
Isabelle van Tol	Embassy of Netherlands	Senior Policy Officer
Lerumo Morule	Department of Provincial and Local Government	Senior Manager: Donor Relations
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