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RH

cc: P.C

10 DOWNING STREET

From the Private Secretary

24 July, 1984

MULTILATERAL VERSUS BILATERAL AID

The Prime Minister has noted the exchange of correspondence between the Chief Secretary, the Foreign Secretary and the Secretary of State for Trade and Industry on this subject. It is clear that decisions will be required in the context of the PES discussion in the autumn. The Prime Minister would wish to be consulted at that stage.

I am sending a copy of this letter to John Gieve (Chief Secretary's Office) and to Callum McCarthy (Department of Trade and Industry).

(C.D. Powell)

L. Appleyard, Esq.,
Foreign and Commonwealth Office.

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PRIME MINISTER

MULTILATERAL VERSUS BILATERAL AID

You should be aware of the attached exchange between the Chief Secretary, Mr Tebbit and Sir G Howe, even though no immediate decisions are called for.

In 1980 the Government wanted to give greater emphasis to bilateral aid and so undertook to look critically at expenditure on multilateral aid. But perversely, multilateral aid now consumes 50 per cent of the aid programme as against only 30 per cent in 1980.

The Chief Secretary (Flag A) argues that there are no significant political disadvantages for the UK from a further increase in multilateral aid; that the balance of commercial advantage is unclear (except in the case of ATP aid, we get a higher return on our contributions to the multilateral agencies than from bilateral aid); and that wider economic and developmental considerations favour multilateral aid. He concludes that the case for multilateral aid deserves greater weight now than was accorded it in 1980.

Mr Tebbit (Flag B) and Sir G Howe profoundly disagree. Mr Tebbit argues that the political and commercial arguments for more bilateral aid are if nothing stronger now than in 1980.

Sir G Howe (Flag C) argues that the business community are unhappy with the low share of bilateral aid; that we cannot afford to untie our aid as long as our competitors tie theirs; and that the upward pressure of multilateral aid at the expense of bilateral aid damages our relations with a lot of countries. He concludes that the present policy of priority for bilateral aid is right: but given the

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remorseless upward pressure of multilateral commitments, it is difficult to make it work unless the aid programme as a whole gets more resources.

The Chief Secretary's arguments smack of rationalisation for what is happening, and designed to head off pressure for a bigger aid programme by putting the best possible construction on ~~the~~ growth of multilateral aid. But nor are the Foreign Secretary's arguments entirely consistent: pressure to agree the additional multilateral commitments usually comes from the FCO. The choices need to be posed more starkly. Either take the hard political decisions to resist higher contributions to multilateral agencies, thus allowing bilateral aid a bigger share within a fixed aid programme. Or, increase the aid programme as a whole and give bilateral aid a priority claim on the new resources. This will need to be considered in the PESC context this Autumn though some decisions, eg on the size of EDF VI may be needed before then.

Agree not to intervene in the meantime?

*Y
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m*

C.D.P

23 July 1984

CC PC



FCS/84/217

CHIEF SECRETARY, HM TREASURY

Multilateral versus Bilateral Aid

1. You wrote to me on 25 May enclosing a note by Treasury officials which concluded that the case for multilateral aid deserves greater weight than was accorded to it at the time of the Aid Policy Review of 1979/80. This was copied to Norman Tebbit, who has already responded in his letter of 11 June.

2. Let me say right away I do not think that circumstances have changed in a manner which should cause us to reverse the policy on multilateral and bilateral aid set out in the then Minister for Overseas Development's statement of 20 February 1980.

3. One factor does, however, deserve emphasis because of the increasing pressure over time which it has brought to bear on aid policy. The aid ceiling has been suppressed in real terms to such a degree that bilateral aid is being dramatically reduced because of the increased share of the aid budget being pre-empted by the rising requirements of multilateral aid. I have not found the arguments in the Treasury minute convincing under any of the three main headings.



4. On the commercial arguments, Norman Tebbit's letter of 11 June makes the case very clear. Until such time as our competitors free their aid from bilateral ties it must be preferable from the United Kingdom point of view to keep our money in tied programmes if we are not to enhance the Opposition's chances of obtaining procurement on the basis of our aid programme at the expense of the chances of British firms. There is also no doubt that the business community regard what is happening to the bilateral programme as undesirable. This is brought home to me and Tim Raison whenever we meet them.

5. Secondly, the political costs and benefits of bilateral and multilateral aid are more difficult to assess than the Treasury minute would have us believe. We try very hard to follow a tough policy about finance for multilateral institutions despite the political costs of doing so with potential recipients and, because of disputes over burden sharing, with other donors. The problem is particularly acute in the context of the European Community. The additional multilateral burden we are being forced to bear cannot reasonably be offset by diversion of funds from recipients of our bilateral aid without incurring very considerable political costs. Aid remains a substantial element in many of our bilateral relationships, a point that is brought home to me and other Ministers whenever we have contact with other governments, especially in the Commonwealth.

6. Thirdly, the ODA has a number of operational advantages over many of its international counterparts, and generally is able to deliver aid cost-effectively. In contrast, the multilateral agencies vary widely in their performance and efficiency.



7. You refer in your letter to the need to do everything we can to improve the effectiveness of EC aid and the amount of procurement we get from it. We have worked hard on both counts over the last few years. But there are several limits on the extent of our influence on EC aid management and policies. Tim Raison has made a particular point in the Lome negotiations of seeking policy dialogue provisions to improve the quality of EDF aid. I believe there are two further important areas where we need to make progress. There must be an effective and independent ex-post evaluation of the Community aid effort. We must get rid of the quota on UK consultancy business under the EDF which is in clear contravention of the principles of free competition.

8. While I would not wish to suggest that this exchange should prejudice our forthcoming PES discussion in any way, I would like to make the point that the Treasury paper, in my view, serves to draw attention to the increasing problems for the aid programme of the policy of tight constraints, and the system of notional attribution of aid expenditure from the Community budget. In particular I am concerned about the distortion of our policy to the detriment of our bilateral aid. It is for this reason I have put in a PES bid for additional resources both for bilateral aid and to provide for those aspects of multilateral aid which we believe do merit support, such as the prospective General Capital Increase of the World Bank.

9. My conclusion is twofold: we should stick to our present policy: but it will be very difficult to make it work unless the aid programme gets additional resources.

10. I am copying this minute to the Prime Minister and the Secretary of State for Trade and Industry.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

23 July 1984

Overseas Aid: Policy Review Pt 4



JL 1984



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Secretary of State for Trade and Industry

11 June 1984

The Rt Hon Peter Rees QC MP
Chief Secretary
HM Treasury
Parliament Street
London SW1

To await FCS
comment
CDP 13/6

D Peter,

MULTILATERAL VERSUS BILATERAL AID

Thank you for sending me a copy of your letter of 25 May to Geoffrey Howe.

I have reservations about a number of points in your officials' note, which I think might have been improved by consultation between our officials. That we should seek to maximise UK procurements from multilateral agency projects is self-evident. My Department has a team devoted to stimulating interest in such opportunities.

The returns vary from one agency to another. Those from the EDF have in the past been disappointing. The latest figures from EDF V (UK share of contracts 16½% compared with UK financing of 17½%) suggest some upward trend.

It is by no means evident that we should reverse our carefully considered policy and now expand multilateral at the expense of bilateral aid.

Whether UK procurements result from multilateral agency projects depends on such factors as the position of UK companies in the recipient countries and UK capabilities in the particular sectors. It is quite possible, for example, that increased IBRD activities might lead to a return below the quoted 1:1 average for multilateral aid, particularly if projects in Latin America were dominant.

Bilateral aid, by contrast, can be and is used directly to support our commercial, and political, objectives. Not only is bilateral aid tied, with minor exceptions, to the purchase of British goods and services, but it can be used through the Aid and Trade Provision (ATP) and in other ways to secure orders for British companies over and above those paid for by our aid. Bilateral aid in the form of ATP provides a 1:3 return. The industrial arguments in favour of ATP are probably stronger now than at the time of the Aid

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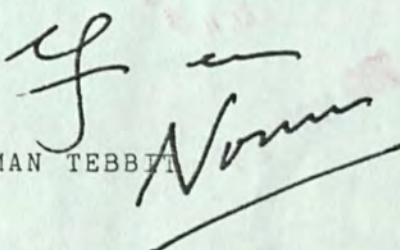
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Policy Review. With no immediate prospect of a shift by other countries away from mixed credit and other devices adopted in recent years, it is all the more important that we use ATP flexibly if UK companies are not to be denied opportunities for establishing themselves in prime developing markets. In the light of discussion between my Department and the Treasury and ODA I shall shortly be circulating to the EX Committee proposals for making the administration of ATP more efficient.

I must confess I am somewhat surprised at the suggestion that we benefit more from putting our aid resources into an international lottery over which we have little or no control, rather than to maintain control over the manner of their use. As the paper points out in para 13, it is cheaper in administrative terms to give away money in large lumps to be further distributed by international agencies than it is to make decisions on priorities ourselves. I wonder, however, what are the final costs of distributing that aid to the recipients.

I am copying this letter to the Prime Minister and Geoffrey Howe.


NORMAN TEBBIT

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Overseas and

Blue letter AT4



13 JUN 1964



CNG

- Mr Lister
- Mr Unwin
- Mr Ridley
- Sir Peter Middleton
- Mr Mansfield
- Mr Sedgwick
- Mr Schlar
- Mr Fitcher
- Mr Aaronson
- Miss Cund
- Mr Denison
- Mr Beattall

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State
Foreign & Commonwealth Office
Downing Street
London
SW1A 2AL

25 May 1984

Alan Geoffrey

MULTILATERAL VERSUS BILATERAL AID

In the light of the inevitable constraints on the size of the aid programme, we have been doing some thinking in the Treasury about the relative merits of multilateral and bilateral aid.

You will recall that we had some discussion of this during the last PESC round. This question of priorities is now becoming increasingly relevant in view of the discussions in international circles of a possible wider role for the World Bank as a contribution to dealing with the debt and development problems of the LDCs.

I therefore enclose a note by Treasury officials, which examines the arguments and concludes that the case for multilateral aid deserve somewhat greater weight than was accorded to it at the time of the Aid Policy Review in 1979-80. I believe these conclusions have a great deal of force.

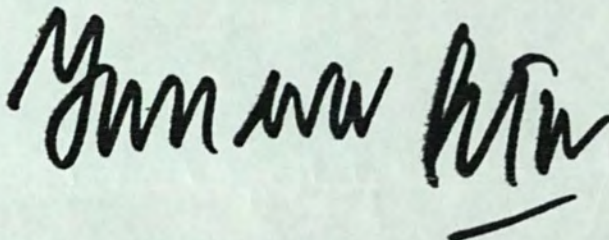
I do not think the note requires specific decisions from us; and in particular the assumption in it that the aid programme will remain at its currently planned level is not intended to prejudice our forthcoming PES discussion either way. Nevertheless I think it provides some useful background for future decisions on particular aid issues when they come up.

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should be interested in any comments you might have. On one specific point, I expect you will agree that we should do everything we can both to improve the effectiveness of EC aid and the amount of procurement the UK gets from it and I should be grateful to know if you think there is any further action we can take to this end.

I am copying this letter to the Prime Minister and to Norman Tebbit.

A handwritten signature in black ink, appearing to read "Peter Rees". The signature is written in a cursive, somewhat stylized hand. There is a horizontal line drawn under the final part of the signature.

PETER REES

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AID: MULTILATERAL OR BILATERAL?

In his statement on 20 February 1980, following the review of aid policy undertaken by the Government on coming into office, the then Minister for Overseas Development said, inter alia, that the Government believed it right to give greater weight in the allocation of aid to political, industrial and commercial considerations alongside basic developmental objectives; that the share of the bilateral aid programme taken by ATP would be increased, in order to maintain its value in real terms; that commitments to international agencies and bodies would absorb a larger proportion of the aid programme over the next few years; and that, as more room for manoeuvre was needed in bilateral aid, the Government would need to look critically at expenditure on multilateral aid programmes.

2. This note re-examines the arguments as between multilateral and bilateral aid in the light of recent experience. The actual and projected distribution of the aid programme from 1979-80 to 1986-87 shows an increase from around 30% to 50% in the proportion of the aid programme taken by multilateral aid. From 1983-84 onwards the increase in multilateral aid is entirely due to an increase in EC aid.

Commercial Arguments

(a) Balance of Payments

3. It is generally less costly to transfer aid funds to a recipient if this does not worsen the donor's overall balance of payments. This is the main reason why bilateral aid is tied as far as possible to procurement in the UK. Thus in 1982, the ratio between UK bilateral aid and direct procurement in the UK was 1:0.7. The ratio for ATP contracts is typically much higher than this - about 1:3 if the cost of ECGD support is also taken into account - because aid in the form of mixed credits under the ATP scheme is effectively on much harder terms. However, with the exception of EC aid, the ratio of procurement in the UK to our contribution to multilateral agencies is better than for tied bilateral aid other than ATP, the overall ratio for 1982 being 1:1.1. This reflects the fact that in the case of the IBRD and Regional Development Banks (as opposed to IDA and the other soft funds) our only contributions are occasional subscriptions of capital. (See Annex A).

(Aid-to-procurement ratios should however be treated with caution; they take no account of the import content of exports or indirect effects; it is also impossible to know to what extent aid-generated exports are genuinely additional).

4. Since the multilateral institutions award contracts by international competitive bidding, UK procurement is not directly affected by changes in UK contributions, provided we stay a member of the institutions. On the other hand, because of the tradition of burden-sharing, the total amount of resources available to the institutions is significantly influenced by the attitude taken to contributions by a major donor such as the UK.

5. The poor UK procurement record from EC aid contrasts starkly with our good record from other multilateral aid. This is partly because 40 per cent of EC aid is food aid and much of the rest goes to countries with which UK firms are not used to doing business. There is scope for UK firms to improve their procurement performance from multilateral aid, both from the World Bank group and, in particular, from EC aid. There is no such scope in relation to bilateral aid since it is already tied to procurement in the UK.

(b) Industrial Policy

6. Bilateral aid provides the government with more discretion than multilateral aid over which domestic export industries should be supported and on what scale. This may be useful in some instances, eg where a firm or industry is not internationally competitive now but might become so in future - the "infant industry" argument. However, it is very difficult for governments to "pick winners" by setting priorities between industries or firms. Such protective measures may therefore delay rather than induce increased efficiency and competitiveness in the economy. The discretion provided by tied bilateral aid is not necessarily an advantage.

7. Projects financed by multilateral aid, on the other hand, are in general open to international competitive bidding. Thus if UK firms make exports through the operation of multilateral aid, we can be fairly sure that they are efficient and competitive. The aid will not

be used to "featherbed" British industry and should also provide better value for money to the recipient. With mixed credits and ATP, the allocation of bilateral aid reflects international competition to some degree. However, in general only one or two rival bids are supported with mixed credits and the UK does not anyway always confine itself to "matching" the aid and credit terms of its competitors. Thus part of the subsidy is likely, in practice, to go to the exporting firm.

Political Arguments

8. In general the political benefits of bilateral aid are clearer because of the direct impact on relations with individual countries - at the cost, however, of the recipient obtaining some leverage over the donor. Indeed our political relationship with some smaller countries is perceived very largely in terms of our aid relationship - although we are never going to be able to offer more than small amounts of aid to many countries and the political benefits of this can be exaggerated. (The political argument applies much less to ATP which is seen by most recipients as being commercially orientated). However bilateral aid does not necessarily buy us the support of the recipient. Moreover, considerable importance is attached to the positions we take in multilateral institutions, notably IBRD/IDA, and this is impressed upon us in such fora as UNCTAD and meetings of Commonwealth Finance Ministers and Heads of Governments. There would undoubtedly be political costs in reducing our contributions to multilateral institutions and especially in withdrawing from them. For example, our relations with India are affected by our approach to IDA.

Developmental Arguments

9. Tied bilateral aid tends to give less value for money to the recipient because of the lack of international competition for the procurement contracts. Although the recipient country may prefer a bilateral deal in some cases in the interests of speed, multilateral aid should give the best value for money, both because of international tendering and because the projects selected are not affected by commercial motives. ATP, despite being subjected to tests of developmental soundness which are as strict as circumstances allow, will tend to give worst value to the recipient.

10. National aid agencies may be more effective in some areas of development, particularly perhaps on smaller projects, than the multilateral institutions because of a special expertise in some field or because of a long-standing relationship with a particular government. The competence of the multilateral institutions in assessment and monitoring also varies widely. The EC Commission, for example, is not highly regarded in this respect. On the other hand the staff resources available to the IBRD/IDA and their worldwide experience cannot be matched by any bilateral agency.

11. In the long run the rate of development of the LDCs depends much more on the economic policies pursued by their governments than on the limited amount of aid likely to be available, especially when, as in the case of UK bilateral aid, much of it is widely dispersed in penny packets among a large number of countries. In 1981 total aid from OECD countries represented only about 3% of LDCs' GNP (although within this total the significance of aid to the least developed is greater). Multilateral institutions are in a much stronger position to attach policy conditions to their assistance, notably the IBRD in its structural adjustment lending, than any national aid agency. We favour an expansion of the role of the IBRD in assisting with the problems of the LDCs. The EC is proposing a policy dialogue with recipients under Lome III.

Wider Economic Considerations

12. Although the commercial orientation of the aid programme and the use of ATP brings benefits to particular UK firms in the short run, the longer term effects are more difficult to evaluate. An increase in the use of ATP, especially if it goes beyond matching, is likely to provoke a further increase in the use of mixed credits by our competitors, with no net advantage to the UK. Moreover the continuing use of export subsidies is an expensive way of producing employment in the UK and in the long run the effect may be to help some sectors of the economy at the expense of others rather than to bring net benefits. The developed countries have a major interest in the rapid economic growth of the LDCs as markets for unsubsidised

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exports in the future. The forms of aid which are most developmentally effective are therefore arguably most in the UK's economic interests in the long term.

Administrative Costs

13. Multilateral aid imposes much lower administrative costs on the UK per £ of aid than bilateral aid. In 1982-83 ODA's multilateral aid departments dispensed £10 million of aid per staff member, the bilateral aid departments £2 million.

The Scope for Change

14. On the assumption that the size of the aid programme as a whole remains roughly as currently planned, there is very little scope for affecting the balance between multilateral and bilateral aid over the next three years, because the multilateral portion is largely determined already by existing commitments. Moreover even with a reasonably low UK contribution to EDF6 the multilateral share will stay at about 50% for the rest of the decade. The bilateral programme has been reduced by one third in cost terms since 1979 and is planned to decline by a further 20% over the next three years. Thereafter it might be expected to remain fairly constant.

Conclusions

15. There are no significant net political disadvantages to the UK in a further increase in multilateral aid at the expense of bilateral aid; the balance of commercial advantage is also unclear; and developmental and wider economic considerations tend to favour multilateral aid. At the very least therefore, the case for preferring bilateral aid is less clear cut than at the time of the Aid Policy Review in 1979-80. Within multilateral aid the World Bank group ranks high and EC aid relatively low in terms of advantages to the UK, while it is EC aid which is the main cause of the rise in multilateral aid as a whole.

16. There should therefore be some shift of emphasis in the policy

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established in 1980. In future discussions on the distribution of the aid programme and when major decisions on specific aid commitments are required it should be accepted that:-

- (a) In view of the constraints on the total size of the aid programme a further increase in the share taken by multilateral aid is inevitable, with a corresponding decline in bilateral aid;
- (b) Multilateral aid brings real political, commercial and developmental benefits, which we should seek to maximise;
- (c) While seeking to keep our EC aid commitments to the minimum which is politically acceptable, we should make strenuous efforts to improve both the effectiveness of EC aid and UK procurement from it.

UK AID/PROCUREMENT RATIOS 1982

	UK contribution	Procurement in the UK	Aid/procurement ratio
MULTILATERAL AID	£m	£m	
IBRD	-	122	na
IDA	137	97	0.7
Regional Development Banks and Funds	13	51	3.8
EC aid	162	48	0.3
Other multilateral (UN agencies, IFAD)	36	56	1.5
TOTAL	<u>349</u>	<u>374</u>	<u>1.1</u>
 BILATERAL AID (Excluding ATP)	 293	 207	 0.7

} 1.6