

STUDY ON THE EXCESS COST OF TIED ECONOMIC AID GIVEN TO IRĀN IN 1966/67

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The scope of work

The relative economic attractiveness, or the relative "worth", of the alternative lines of available foreign economic assistance, whether in the form of grants or loans, is determined ~~by~~ two sets of factors. The first set consists of the terms and conditions related to the repayment of the assistance received and the rate of interest charge on it.¹ For the sake of brevity, this set of factors is at times referred to as "credit terms" of loans. The second set of factors concerns the cost of goods and services procured under the aid programme.

The present study is concerned solely with the second set of factors mentioned; the first set of factors is taken as given. Moreover, it is confined to the "tied" bilateral public economic assistance; it excludes private investment, suppliers' credit and economic aid received from international agencies. The term "aid" is used loosely here to include gifts as well as long-term development loans.

The word "tied", appended to the words "loan" and "economic aid", signifies the presence of certain conditions in

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foreign aid agreements which limit either the choice of projects or the choice of suppliers of goods and services financed by the aid.² An "united" or "free" loan, on the other hand, would permit the recipient country to use the proceeds of the loan for any development project and for the purchase of goods and services from any country it chooses, through international tender invitations or otherwise.

The primary objective of the study is to examine the effect of "tying" of loans on their efficacy in providing economic assistance. More specifically, it aims at producing a rough estimate of the additional financial charge, if any, borne by Iran under "tied" economic assistance owing to price differentials. This additional financial charge is designated as "excess cost of tied aid". In other words, the "excess cost of tied aid" is the difference between the actual cost of goods and services imported under tied aid and the national cost that would have been incurred for the procurement of identical, or similar, goods and services had the recipient country been free in the choice of its projects and of its suppliers. For the sake of brevity, the term "excess cost" is, at times, used to convey the meaning of the "excess cost of tied aid".

The survey is also intended to throw some light on certain drawbacks of tying economic assistance which cannot easily be quantified, but which may, nevertheless, be of primary importance to the recipients of aid. These "unquantifiable" costs of tying aid could arise from the unsuitability to local conditions of certain goods and services imported under the aid programme. Such costs may also be incurred as a result of excessive delays in delivery due, for example, to long distances and language barriers between the suppliers of goods and services and the recipient countries.

It is to be hoped that there will be a gradual relaxation in the tying provisions of economic assistance *without a reduction in the volume of that assistance*. It is further to be hoped that any reduction in the cost of aid, through a relaxation of the tying provisions of loans, is not accompanied by a parallel tightening of their credit terms - the first set of factors mentioned in paragraph 8. These factors, which play a crucial role in determining the "worth" of economic assistance, are invariably taken into account by

developing countries in choosing between the alternative offers of assistance.³ At times, as in the case of recent tender invitations in Irān, this fact is expressly brought out in tender documents, which require the bidders to state the terms and conditions of credit offered (see Appendix I).

The data presented in this paper have been collected from the officials, in particular from the technical, financial and administrative personnel, of the government agencies and public corporations quoted as sources of information. The persons concerned have co-operated wholeheartedly and have rendered every possible assistance in furthering the purpose of the survey. But despite this fact, it has not been possible to examine the subject matter as thoroughly as one would have wished within the short period of about three weeks devoted to it.

Source, type and terms of aid

Table 1 of Appendix II presents a broad picture of the economic assistance received by Irān in recent years. The figures shown are confined to public development loans received from industrial countries and from international agencies; no account is taken of private inflow of capital and of military assistance. Similarly, a loan of \$17.5 million received from the International Monetary Fund (IMF) in October 1964 has been excluded from the table as it does not fall within the category of development loans.

An important fact which clearly emerges from Table 1, is the steep rise in the volume of economic assistance received in the year 1966/67; almost all of this increase is accounted for by the growth in bilateral tied aid. This is explained by an acceleration in the pace of execution of development projects under the Third Five-Year Plan due to end in March 1968. The fact that some of the bilateral credits were likely to expire before the end of the Third Five-Year Plan could have contributed to this process of acceleration of disbursements. The loss, if any, that can be attributed to the provisions limiting the period of utilization of loans in this case is a matter of conjecture.

A more significant fact from the point of view of this study indicated by the table is the steady increase in the number of the countries providing economic assistance to Iran in the course of the last two years. Although during this period the share of the United States in total economic assistance (about 50 per cent) has remained almost unchanged, the number of countries accounting for the remainder has increased considerably.⁴ Moreover, judging on the basis of the new loan agreements concluded in 1966 and 1967, it is quite probable that the share of non-United States sources in total inflow of development capital will grow substantially in the future. As explained below, this diversification in the source of foreign development loans has played an important part in enabling the Iranian authorities to reduce the cost of tied aid.

A brief description of the projects financed by tied economic aid in 1966/67 is given in Table 2 of Appendix II. It can be seen that over 85 per cent of disbursements were in respect of investment in infrastructure - sections A and B of the table. This percentage would be even higher in terms of the actual outlays on goods and services, since the disbursement of about \$8 million from the USSR loans, shown in Section C of the table, was almost exclusively a financial transaction. Strictly, this item is not relevant to the present study of the excess cost of tied aid in Iran during 1966/67. It is included in the table merely to indicate the future trend of disbursements - a shift from infrastructure to industry and the diversification of the source of economic assistance mentioned above.

Although all the loans mentioned in Table 2 can generally be considered as tied, there are significant differences between the tying requirements of the various donor countries. At one extreme, the loans granted by the United States and the USSR (lines (7) to (17)) are not only tied to specific projects, but are also tied to the financing of goods and services originating in the respective donor country. At the other extreme, the global credit of \$50 million granted to Iran by the Federal Republic of Germany, from which the projects specified in lines (1) and (2) of the table were financed, is made available for investment in any project deemed necessary for the general improvement of the Iranian economy. The only restrictive provision of the two

loan agreements A.L. 124 and A.L. 284, concluded under this credit, is that the proceeds of the loans should not be used for the purchase of goods and services from mainland China, from the socialist countries of Eastern Europe, and from Yugoslavia.

The global credits of \$60.8 million from France and \$11.2 million from the United Kingdom, through which the projects mentioned in lines (3) to (6) of the table were financed, are both tied to the import of goods and services from the respective donor country. But neither of the two credits is tied to specific projects. The United Kingdom credit is made available for financing development projects included in the Third Five-Year Plan of Iran,⁵ for the import of capital goods and for the employment of United Kingdom personnel. The French credit, which was initially made for a number of broadly defined projects and only for two years (1964 and 1965), was in practice made available for any development project chosen by a mixed Franco-Iranian Commission; its two-year validity period was also extended.

The availability of loans not tied to specific projects, from the three Western European countries has, as shown below, enabled the Iranian Government to reduce the cost of tied aid in many instances. It has extended the area within which tender invitations have been circulated beyond the individual donor country, thereby giving the authorities a larger freedom in the choice of the project contractors. This is particularly true of the credit granted by the Federal Republic of Germany with its limited tying requirements.

The main advantage of the project-tied loans granted by the United States and the USSR is their relatively easy credit terms shown in columns 3 to 5 of Table 2, in the case of the former country, this is true only of the Agency for International Development (AID) loans and not of the loans granted by the Export-Import Bank. The Iranian authorities have naturally taken these terms into account in estimating the "worth" of the loans in question. A further feature of the USSR loans which has added to their relative attractiveness is that they are generally repayable in kind. In particular, the loans specified in lines (16) and (17) of the table are expected to be settled by the export of gas from

the Iranian oil fields which has until now had little or no economic value.

Excess cost of tied aid

Except in a few cases, it has unfortunately not been possible to make an estimate for the excess cost of tied aid as defined in paragraph 11 above. This is partly because of the lack of the necessary data and partly on account of the limited time made available for this survey. Even in the cases where it was possible to examine this question in some detail, estimates of the excess cost are no more than rough approximations. The figures shown in columns (7) and (8) of Table 2 should, therefore, be treated as very rough, but rather cautious and conservative, estimates of the excess cost of tied aid in 1966/67. Where no figures are given, the sign (...) has been inserted to indicate "unknown", that is, no estimates were made in such cases.

A. Dams and electric power projects

Most of the projects listed under this heading in Table 2 were subject to some form of national or international tender invitations. The resort to international tender invitations was made possible by the availability of global credits, not tied to specific projects, from the three western European countries mentioned. This has enabled the Iranian authorities to reduce, if not wholly to eliminate, the burden of the excess cost of aid in many important instances.

Given the credit terms of aid, the wider the area over which tender invitations for a project are circulated, the lower is likely to be the excess cost borne on that project. Since, however, the credit terms of aid from various sources have not been identical, the choice of contractors has not always been confined to the lowest bidders (see page 4.). This being the case, it would have been necessary to compare the bids received under different credit terms in order to ascertain the amount, if any, of the excess cost involved. But, unfortunately it has not been possible to do so within the time available, and what is said on these projects does little more than give a broad hint of the order of magnitude

of the excess cost.

The contractors of the projects mentioned in lines (1) and (2) of the table were chosen through international tender invitations. Although disbursements on both these two projects were financed by loans received from the Federal Republic of Germany, the winner of the tender for project (1) was a non-Federal Republic Western European firm, this being allowed by the terms and conditions of the loans (see page 6). Since the credit terms of loans from the Federal Republic are only moderately easier than those available from the other major Western European countries, it can be assumed that the excess cost, if any, borne in these two cases would not be of a significant proportion.

Similar considerations apply to the disbursement of \$2.3 million in 1966/67 on various projects for electrical equipment and installations, (see line (6) of the table). These projects, amounting to \$9.5 million, were subject to an international tender invitation which was won by British suppliers offering the credit terms of the global credit of \$11.2 million granted to Iran by the United Kingdom Government.

The construction of projects (3), (4) and (5), financed from the global credit of \$60.8 million granted by the French Government, was entrusted to French contractors without a tender invitation. The reasons given for this was that project (3) consisted of an extension of the electric generating power of the Empress Farah Dam with generators similar to those supplied by the contractor in earlier years through an international tender invitation. Similar considerations have guided the choice of the contractor for the extension of the power network in Tehran (project (4)). The reason given for choosing the contractors of project (5) was that their earlier work in Iran was found very satisfactory; it is not possible to ascertain the effect of this decision on the cost of aid.

The AID loan H-016 for project (7) was for \$2.4 million of which only about \$800,000 was utilized for the first phase of the work and the balance was allowed to lapse. The reason given for this was a disagreement with the Aid authorities as to the disbursements on the second phase of the

project. The figure of 30 per cent is considered a conservative estimate of the excess cost of aid in this case. It is based on a comparison of the scale of salaries, fees and allowances paid to the United States technical and administrative staff with the scale of payments made to Western European personnel of similar qualifications and functions, (see pages. 12 and 20 below).

The choice of contractors for the Farah-Ābād power plant, constructed under a "turn-key" arrangement, was made through a tender invitation circulated among the United States suppliers. The tender had invited bids for smaller-size turbines (75 MW), but eventually an offer to supply larger-size turbines of 82.5 MW *ex-stock* was accepted. Some technical persons interviewed considered that, had the tender invitation been international, savings of 10 per cent or more could have been made in the construction of the plant. Others were of the opinion that as much as 20 per cent could have been saved, but there might have been a considerable delay in the delivery of the turbines and in the completion of the project. Owing to the complex nature of these problems and the absence of concrete data on the prices of the alternative offers of supply, no attempt has been made to estimate the excess cost of aid on this project. A further reason for this was the large weight of the disbursements on the project in the total economic assistance received during 1966/67; a relatively small error in the estimate of the rate of excess cost for the project would, by its disproportionately big effect on the total figure of excess cost, have seriously distorted the whole picture of the excess cost of foreign aid borne by the country.

The two dams mentioned in project (9) were constructed by the USSR on the frontier river of Aras; the cost of the project and the facilities provided by it are to be shared on an equal basis. The credit advanced to Iran by the USSR, to cover the former's share of the cost, is repayable in Rials which are to be used primarily for the purchase of goods and services in Iran, but which may, at the request of the USSR, be exchanged into a convertible currency. No attempt has been made to evaluate the amount of excess cost, if any, relevant to this project.

B. Transport and harbour projects⁷

It can be seen from Table 2 that economic assistance for this group of projects, unlike that for dams and electric plants, has come exclusively from the United States. As mentioned on page 6 above, these loans are not only tied to the financing of goods and services originating in America, but are also tied to the specific projects mentioned. As it was possible to study in some depth the disbursements made on most of these projects, this section provides a number of interesting illustrations of the excess cost involved in this type of tied economic assistance and of the techniques used by the Iranian authorities for avoiding such costs.

Project (10)- Road maintenance equipment. The bulk of the road maintenance and railway equipment purchased by the Iranian Ministry of Roads is imported from the United States. The primary reason for this is that the major components of this category of equipment, currently in use in Iran, are of United States designs and models. These items, which include diesel locomotives, bulldozers, tractors, trucks etc., have for a long period of over ten years been imported from the United States under its successive aid programmes. In the circumstances, it is almost imperative that most of the orders for replacements and spare parts should be placed with the United States manufacturers.

A further reason which goes some way to explain why the United States is the main source of supply of road maintenance equipment, is the important part played in the choice of orders for this equipment by the United States technical personnel - engineers, equipment specialists, etc. - employed by the Ministry of Roads. The goods are ordered for Iran by the United States Bureau of Public Roads in accordance with the instructions received from the Iranian Ministry of Roads. The Ministry is, in turn, advised on its purchases by procurement commissions on which sit United States personnel; their opinions are treated with some respect in such matters. These people, who are naturally more familiar with United States equipment, cannot but have a general preference for it even in those cases where the required goods can be procured from other countries.

Although the road maintenance equipment imported from the United States is generally of a very high quality, some of it is found to be unsuitable to the needs of the Iranian Department of Road Maintenance. An important example mentioned was a particular variety of larger size tractors ordered by one of the procurement commissions; these are found unnecessarily big for the normal requirements of the Department. Moreover, some of the equipment purchased is not wholly suited to local conditions. This is true, for example, of the "turbo-supercharger", an accessory attached to certain of the larger-size tractors; its purchase is obligatory. It is expensive and has a complex mechanism which cannot easily be handled and maintained by the Department's workers.

A further important factor which has raised the cost of economic assistance provided for this project is the relatively high rate of pay of the United States technical personnel employed by the Ministry of Roads. It was possible to examine in some detail the scale of salaries and allowances paid in dollars and in rials to the various grades of engineers and specialists now in the employment of the Ministry. It is clear that this scale is at least some 30 - 40 per cent higher than the scale of payments made to technicians of similar qualifications from other industrial countries working in Iran. The payments made to United States personnel in dollars alone have absorbed about 15 per cent of total dollar disbursements on the project up to date.⁸ Bearing in mind this fact and the points noted in the preceding paragraph, the estimate of the excess cost of aid (5 per cent) shown in Table 2 should be regarded as a rather conservative one.

Project (11)- Railroad equipment. The disbursement of about \$1.5 million on this project in 1966/67 consisted almost exclusively of payments for spare parts and replacements imported by the Iranian State Railways; the chief reason for buying the bulk of these goods from the United States was explained on page 11. Alternative price quotations were not available for the particular articles purchased in that year because most of them were not of specifications produced in other countries. But a comparison of price quotations by two United States suppliers and a supplier from another country for a sample of three standard-type spare parts disclosed that the United States prices were in one case

about 35 per cent and in the other two almost 80 per cent higher. It was the opinion of the officials interviewed that, on average, the United States prices for spare parts on a.c. i.f. basis are at least 30 per cent higher than those of the other sources of supply; this figure has been used as an estimate of the excess cost applicable to the disbursements made on the project in 1966/67.

Another cost mentioned in relation to the railroad spare parts financed by the United States aid is the relatively long delay in deliveries as compared with imports from most other industrial countries. This cost, which no doubt is also borne in the purchase of spare parts and replacements for road maintenance equipment (project 10), cannot easily be quantified and has not been taken into account. Theoretically, it would be equal to the cost incurred in carrying the extra volume of stocks of spare parts required for the purpose of avoiding prolonged interruptions in railway and road maintenance operations.

Project (12) - Construction of a section of the CENTO Railway. The AID loan K-001 of \$7.8 million was granted for the construction of an 80 km. section of the CENTO Railway, from Karah-Tapeh in Iran to the Iranian-Turkish frontier town of Kotour (Razi). Despite the relatively small amount of disbursement involved, the project provides some interesting examples of the excess costs of tied aid and of the techniques used by the Iranian authorities to avoid some of these costs.

In accordance with the general AID practice, purchases financed by this loan had to be made through tender invitations in the United States and were to be confined to the requirements of the project. The condition of tender invitations in this case could have resulted in the purchase of certain types of equipment of different models and specifications from the equipment currently in use on the rest of the railway. At the same time, the goods bought through the loan could not be used outside the 80 km. section of the railway mentioned.

The above conditions of the loans were likely to cause serious difficulties in terms of the operation and maintenance of the equipment bought. A number of workers, whose

skills would have been largely specialized to a small stretch of the railway, would have had to be trained to run the new equipment. It was only after strenuous and persistent efforts by the Iranian State Railways that AID was prepared to relax its requirement of tender invitations. The prolonged correspondence which ensued on this subject is one reason for a slow rate of utilization of the loan; total disbursements between the end of May 1964, when the loan agreement was concluded, and March 1967 consisted of the \$108,000 spent in 1966/67.

Another factor which partly accounts for a slow rate of utilization of this loan is the relatively high prices quoted in the United States for some of the materials required. Despite the very attractive credit terms of the loan, the Iranian authorities have, in some instances, preferred to resort to their own foreign exchange resources for the purchase of certain goods rather than to draw on the AID credit. The two clear examples of appreciable price differentials quoted by Source 7, relate to rails and to lubricators; in both cases the requirements of the project were financed by the country's own cash resources.

The following table compares the price quotations for rails of two United States manufacturers with those of two other countries received about mid-January 1967 in response to a tender invitation:

Cost and freight price quotations for rails^a
in mid-June 1967 (\$ per metric ton)

<u>United States</u>	
Firm I	167.19
Firm II	160.77
<u>Country A</u>	114.00
<u>Country B</u>	110.00

Source: Ministry of Roads, Iranian State Railways.

a. U.33 heavy type rails, weighing 46.303 kg.per linear metre.

It can be seen that even the lower bid from the United States was about 40 per cent higher than the bid from Country A and some 45 per cent higher than the bid from Country B. In the circumstances, the Iranian authorities used their own cash resources to buy 32,130 metric tons of rail from Country B; of this, about 8,000 metric tons were allocated to project (12). The switch from AID loan to the country's own cash resources thus resulted in a saving of over \$400,000 in the cost of this project - 8,000 tons at \$50.77 per ton.⁹

Moreover, the Iranian State Railways was able to induce some competitive bidding on the part of Country A in subsequent negotiations, by disclosing to it the bid received from Country B. In exchange for a purchase of 26,000 metric tons of rails at \$113.00 per ton, c. and f., from Country A, the latter agreed to reduce the price of "steel sleepers" by over \$10.00 per ton on a shipment of 10,000 tons.¹⁰ It can be seen that the extra cost of rail, as compared with the bid of Country B (26,000 tons at \$3 per ton) was more than offset by the reduction of the price of "steel sleepers".

The second example of shifting the source of supply from the United States to another country related to the procurement of "C-4, Lubricators" for Project (12). The terms of the two offers received for the supply of 200 lubricators were as follows:

- (a) From firm II in Country C on 24 November 1965
Price: \$162 per lubricator, c. and f.
Payment: Cash against irrevocable letter of credit
Shipment: 12 - 16 weeks after receipt of letter of credit.
- (b) From firm IV in the United States on 14 February 1966.
Price: \$499 per lubricator, c.i.f.
Payment: Cash against irrevocable letter of credit
Shipment: 26 months after receipt of letter of credit.

It can be seen that, even if it were assumed that the insurance charge from Country C were as much as 2 per cent of the c. and f. price, the price quotation received from that country would still be less than one-third of that

obtained from the United States,¹¹ moreover, the delivery period was much shorter in the case of Country C.

Having closely examined the two offers of supply, the Iranian authorities chose to use their own cash resources to order the 200 lubricators in Country C on 1 March 1966. In this way, a saving of over \$66,000 was made on a small transaction of about \$33,600 representing the final price at which 200 lubricators were invoiced.

The disbursement of \$108,000 made on project (12) in 1966/67 consists almost exclusively of the salaries, fees and allowances paid to the United States consultants and engineers engaged on the project. It is assumed that the excess cost involved in this case is of the same order of magnitude as that applicable to the pay of the United States technical personnel employed by the Ministry of Roads (see page 13). The figure of 30 per cent is, therefore, considered a conservative estimate of the excess cost borne on the project in 1966/67.

Project (13) - Bandar Abbās harbour. The tender invitation for this project, circulated among United States firms, was won by three contractors which had formed a joint venture for the purpose. The whole Bandar Abbās harbour project consists of four parts, or "lots" as they are called, made up as follows:

Lot 1 - Commercial section of the harbour;

Lot 2 - Floating equipment;

Lot 3 and 4 - Naval section of the harbour, and extension of harbour facilities.

It was initially intended to finance the construction of Lots 1 and 2 from the AID loan H-017 granted for the project. But price quotations from the United States contractors for the equipment included in Lot 2 were, as shown below, found to be considerably higher than certain quotations received from other countries. It was, therefore, decided to buy this equipment, with the country's own resources, from the latter countries, despite the very attractive credit terms of the AID loan. A similar decision was taken on the procurement of some of the equipment required for Lot 1. As a result, it is expected that only about \$12 million of the

total loan of \$15 million granted for the project will in the end be utilized.

Lot 2 (floating equipment) consisted of the provision of two tugboats and a pontoon barge for the harbour. The following table shows the price bids received from the United States and from other sources, through an international tender invitation, for the supply of these goods and for a major piece of equipment required for Lot 1.

Selected equipment for Bandar Abbas Harbour

(Price bids, in \$'000)

	<u>United States</u> <u>contractors</u>	<u>Other countries</u> <u>Bid^a</u>	<u>From</u>
<u>Lot 2</u>			
2,500 H.P. tugboats	543	382	Country D
1 pontoon barge	<u>907</u>	<u>496</u>	Country E
<u>Total, Lot 2</u>	1,450	878	
<u>Lot 1</u>			
1 overloading installation	<u>851</u>	<u>485</u>	Country E
<u>Total, Lots 2 and 1</u>	<u>2,301</u>	<u>1,363</u>	

Source: Ports and Shipping Administration.

a. Lowest bid received.

The wide disparity between the price bids from the United States and from the other countries mentioned explains the decision to place the orders in the latter. It can be seen that this decision, which involved the use of some \$1.4 million of the country's own cash resources on the project, resulted in a saving of almost \$1 million in its cost of construction.

Two estimates were received on the excess cost of goods and services imported from the United States for the project. The first, which was based more on a general impression rather than detailed calculations, considered a figure of 30 - 35 per cent a reasonable estimate of the excess cost. The second estimate was derived from a comparison of prices charged by the contractors for a sample of materials and of services with European prices for similar goods and services: the figure obtained was 15 - 20 per cent. In both estimates

a large weight was attached to the relatively high scale of salaries and allowances paid to the United States personnel working on the project. The figure of 15 per cent shown in Table 2 should be considered as a fairly conservative estimate of the excess cost of aid on this project.¹²

Projects (14) and (15) - Iranian National Airline Corporation. Project (14) consisted of the purchase of two jet aircraft for the Iranian National Airline Corporation. The decision to buy the particular type of aircraft involved was determined primarily by the transportation needs of the Corporation; it was not influenced by the credit terms of the Export-Import Bank loan which are, in any case, relatively hard. It has not been possible to compare the prices charged to Iran for these aircraft with those charged to other buyers at that time, but there is no ground to suspect that these prices are not similar.

The disbursement on project (15) represents payments to United States personnel for management, technical and training services rendered to the Iranian National Airline Corporation. It was possible to examine the scale of salaries and allowances paid to the United States personnel and to compare this, in some instances, with the pay of the European experts and specialists of similar qualifications working abroad. There is little doubt that the figure of 30 per cent is a very conservative estimate of the excess cost borne in this case.

Summary and conclusions

The excess cost of tied aid in 1966-67 on the six projects for which quantitative estimates were made, even according to the very conservative estimates made in this paper amounts to \$1.4 million; this is equivalent to about 15 per cent of the total disbursements in respect of these projects (see Appendix II, Table 2). But this figure no doubt exaggerates the average rate of excess cost incurred on total disbursements under tied economic assistance in 1966-67.¹³ The reason for this is that the sample projects for which estimates were attempted are confined almost exclusively to the

transport and harbour group of projects (Section B of Table 2) which according to all available indications involved a higher rate of excess cost. The rate of excess cost borne on dams and electric power projects (Section A of Table 2), which accounted for over 60 per cent of the total disbursements under tied aid, is likely to have been considerably smaller, (see pp. 7&9). It is, therefore, very probable that the average rate of excess cost on total tied economic aid received in 1966-67 was of the order of 10 per cent or less.

The figures of excess cost shown in Table 2 exclude certain costs, not easily quantifiable, which have been imposed on Iran by tying the assistance given to her. These consist of: (a) purchases of materials not wholly suitable to the requirements of the country; (b) relatively high prices paid for spare parts; (c) long delays in the delivery of some goods; and (d) administrative headaches in managing some projects (see pp. 12&13).

The burden of excess cost borne by Iran on tied aid, even if less than 10 per cent, can by no means be considered insignificant for a small developing country; attempts are therefore being made to have it reduced in the future. It is, nevertheless, probable that the amount of excess cost, measured as a percentage of the tied economic assistance received, is considerably lower for Iran than for most other developing countries. An examination of the factors which have enabled the Iranian authorities to reduce the ratio of excess cost should be of some value to both Iran and many other developing countries in formulating their policies on foreign economic assistance.

The major factors which have, according to this survey, contributed to a reduction of the cost of tied aid in Iran are:

- (a) Success in the diversification of the source of aid, indicated in Tables 1 and 2 (Appendix II);
- (b) Negotiation of global credit agreements, not tied to specific projects, with the Federal Republic of Germany, France and the United Kingdom (see pp.6&7)
- (c) Utilization of the country's own foreign exchange resources to finance parts of some projects.

The first two factors, taken together, have enabled the Iranian authorities to invite international tenders for many projects and to utilize the line of credit available to the most acceptable bidders. This has been true of the allocation of most of the contracts for dams and electric power projects (see page 9), and is no doubt largely responsible for the relatively low ratio of the excess cost borne on these projects mentioned. These two factors have also enabled the authorities to induce competitive bidding among potential suppliers thereby reducing the cost of imports (see page 15).

The third factor mentioned above has operated primarily in relation to the project tied assistance received from the United States. Despite the relatively easy credit terms of the AID loans available for some projects, the Iranian authorities have chosen to resort to the country's own cash resources in order to procure certain equipment required for these projects from outside the United States at appreciably lower prices than those quoted by American businessmen (see pages 15 and 16).

The extent to which a country is able to make use of some technique or other to offset the adverse effects of tied economic assistance on costs clearly depends on a number of political and economic factors which need not be discussed here. Generally, however, the less rigid a country's external relations, the more credit-worthy its economy and the more effective its planning machinery, the greater would be its freedom in the choice of suppliers and the lower its burden of excess costs. This means that some of the poorest developing countries, in greatest need of foreign economic assistance, are least able to avoid the excess costs of tied aid. But even countries which find themselves in a more favourable position in this respect enjoy only a limited freedom of manoeuvrability in such matters. In other words, any move to untie, or to tie less rigidly, foreign economic assistance will benefit all developing countries, but especially some of those who are in greatest need of that assistance.

Notes

1. In addition to the length of the periods of grace and amortization, these terms and conditions cover the form of repayment, i.e. whether in cash or in kind, and, if in cash, whether in internal or foreign currencies.
2. These are two important ways of "tying" aid considered here; other aid conditions, formal or informal, limiting the freedom of action of the recipient countries are not taken into account. For a full discussion of this and other subjects, see J. N. Bhagwati, *The tying of aid* (TD/7/Supp. 4) and a Secretariat progress report *The costs of aid tying to recipient countries* (TD/7/Supp. 8).
3. Developing countries have no special interest in the important fact that certain public loans with relatively easy credit terms do in effect play the role of an export subsidy; this is a matter for the consideration of the industrial member countries of GATT.
4. The share of the United States in total economic aid would have been substantially lower in 1966/67 than in the preceding two years but for the fortuitous fact that disbursements on two major projects (lines (8) and (14) of Table 2), accounting for over two-thirds of the total United States assistance, were made in that year.
5. The contracts under which payments are made have to be concluded before 19 September 1967; the period covered by the Plan ends on 20 March 1968.
6. The sources of information for this section of the paper are publications of the Plan Organization of Iran and the Ministry of Water and Electricity.
7. The sources of information for this section of the paper are publications of The Ports and Shipping Administration; Ministry of Roads, Department of Road Maintenance; Ministry of Roads, Iranian State Railways; and Iranian National Airline Corporation.
8. The number of the United States technical personnel has, however, declined in recent years - from over thirty-five, some time ago, to about twelve.
9. \$50.77 is the difference between the lower bid received

- from the United States (\$160.77) and the bid of Country B (\$110.00).
10. The "steel sleepers" were now bought at \$112 per ton; the price charged in the past had ranged from \$122 to \$126 per ton.
 11. In view of the wide disparity between the two sets of price quotations, these were verified by a close scrutiny of the correspondence exchanged between the suppliers and the Iranian State Railways. The railway personnel were firm in their opinion that the lubricators offered for sale by the two suppliers were of an identical model.
 12. It should be emphasized that "excess costs" on a project do not necessarily produce "excess profits" for the contractors. In this case, a senior employee of the contractors forecast a substantial loss for his firm on the project; this may well prove to be correct.
 13. The economic aid received for industrial projects (Section C of Table 2) is not included in the figure of "total disbursements", since it consisted almost exclusively of financial transactions - advance payments on account of future procurements. This also explains why these projects were excluded from the discussion of "Excess Cost of Tied Aid" in the section IV of the paper.

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APPENDIX I*

CREDIT PAYMENT CONDITIONS

The Ministry would prefer to have a loan, governmental or private, proposed by the bidder, so that it can be applied to the items contracted.

A bid incorporating terms for financing would therefore have priority over a cash bid.

The following table is provided for use by bidders offering terms for financing.

Credit payment conditions

No.	Description	This part to be filled out by the bidder
1.	Type of loan (government or supplier)	
2.	Duration of loan: (1) Due date of the first principal payment from the date of the contract (2) Due date of the first interest payment from the date of the contract (3) Date from which interest is charged (in relation to the exact date of the contract) (4) Number and duration of installments	
3.	Interest pertaining to the loan	
4.	Costs and expenditures: (1) Costs of transfer through the bank (2) Costs of services provided by the bank (3) Costs of insurance provided in the country submitting the bid to secure the amount financed (4) Other expenses connected with export promotion, costs of other additional insurance, and so forth (5) The effect of variation in the rate of cost of services when there is a lengthy period involved prior to the signing of the contract	
5.	Transfer conditions of the promissory notes (considered only when this type of payment applies): (1) Conditions the promissory notes covering the principal must comply with (2) Conditions the promissory notes covering the interest must comply with (3) Relative due dates of the promissory notes covering the principal and the interest respectively	

6.	<p>Miscellaneous conditions:</p> <p>(1) Whether the loan of the original country submitting the bid can be extended to cover products not manufactured by the original country, yet included in the proposal</p> <p>(2) Various charges arising from the fact that the amount of loan, tentatively approved and decided upon previously, is not put to use</p>	
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*Extracted from: *Supply of Underground Cables, Bare Conductors and Accessories, Project No. 050-15, Tender Documents, February 1957, Imperial Government of Iran, Ministry of Water and Power, Power Division.*

APPENDIX II

Table I

External public economic assistance
in the years 1964/65 to 1966/67
(Disbursements, in \$'000)

<u>Source</u>	<u>1964/65^a</u>	<u>1965/66^b</u>	<u>1966/67^c</u>
I. <u>Tied Loans</u>	15,256	22,653	56,709
Federal Republic of Germany ^d	5,996	4,199	8,533
France	-	-	3,413
United Kingdom	-	-	2,338
United States	9,260	17,579 ^e	32,739
USSR	-	875	9,686
II. <u>Free loans</u> (International Bank for Reconstruction and Development)	<u>5,330</u>	<u>7,009</u>	<u>7,671</u>
<u>Total (I + II)</u>	<u>20,586</u>	<u>29,662</u>	<u>64,380</u>

Source: Bank Markazi Irān (The Central Bank of Irān) and the Plan Organization of Iran

a. Calendar year ending 21 March 1965

b. " " " 20 March 1966

c. " " " 20 March 1967

d. "Tied" only to the extent that no purchases are permitted from mainland China, from the socialist countries of Eastern Europe and from Yugoslavia.

e. Includes \$10.3 million assistance under *Title IV of Public Law 480* for the purchase of wheat and maize.

Table 2: Iran: Tied economic assistance and its cost in 1966-67^a (in \$1,000)

Source of aid	Contract	Projects	Total loan (1)	Date of loan (2)	Rate of interest per annum (3)	Terms of loan			Disbursement (6)	Excess cost of aid	
						Grace period (4)	Amortization (5)	As per cost of disbursement (7)		(8) = (6) X (7)	
(1) F.R. of Germany	No.A.L.124	A. Jung and electric power Irrigation network for the Euphrates Farah (Safid-Rud) Dam and Ghan Electricity	18,230 ^b	18.12.63	3½	4½	9½	4,771	...	...
(2) " " "	No.A.L.284	Mangil - Tehran power line	5,875 ^b	21. 4.66	4	3½	11½	3,762	...	...
(3) France	No.1515	3 hydro-electric generators for the Euphrates Farah (Safid-Rud) Dam	2,415 ^c	1966	5	7	10	725	...	...
(4) " "	-	Sundry equipment for Tehran power network	1,169 ^c	"	"	"	"	1,169	...	...
(5) " "	-	Shah Abbasi Great Dam	14,584 ^c	"	"	"	"	1,519	...	...
(6) UK	-	Sundry projects for electrical equipment and installations in Tehran and provinces	9,498 ^d	"	6	5	15	2,338	...	...
(7) USA AID	No.H-016	Preparation of master electrification plans	799	26. 6.63	5	5	25	50	30	10	
(8) " Exim Bank	No.2238	Power plant (with two 82.5 MW turbines) for Farah-Mangil, Tehran	20,000	5.11.65	5½	-	15	13,768	...	...
(9) USSR	No.L-9342	2 jacks on Aras River and related installations	36,500	27. 7.63	3½	-	12	1,616	...	...
(10) USA Exim Bank	No.2131	Broad maintenance and technical services	4,500	25.11.64	5½	1½	6½	1,821	5	1,420	
(11) " "	No.2177	Railroad equipment	4,200	"	"	"	"	2,552	30	130	
(12) " AID	No.R-001	Construction of a section of CENTO Railway	7,840	31. 5.64	3½	5	30	198	30	30	
(13) " "	No.H-017	Bandar Abbas Harbour	15,000	26. 6.63	3	7	23	4,589	15	690	
(14) " Exim Bank	No.2246	2 jet aircraft	9,760	26. 2.66	5½	1	6½	9,760	...	...
(15) " AID	No.H-022	Management, technical and training services for Iranian National Airline Corporation	1,500	1.12.64	3½	3	17	433	30	130	
(16) USSR	No.8000	C. Industry	154,000 ^e	13. 1.66	2½	1	12	8,070	...	...
(17) " "	No.3675	Steel plant and related installations	38,500 ^e	"	2½	1	"	8,072	...	...
Total (A + B + C)								56,709	...	1,430	

Source: Bank World Bank (the Central Bank of Iran); the Plan Organization of Iran; The Statute of Loans and of External Credits of the Imperial Government of Iran, from September 1955 to 20 March 1967. Plan Organization (1) indicates "unknown".

a. Year ending 20.3.67
 b. Part of the global credit of 530 million (DM 20 million) granted on 15.8.61.
 c. " " " " " 860.8 million (Fr. fr. 300 million) granted on 13.12.63.
 d. " " " " " 511.2 million (£4 million) granted on 19.9.66.
 e. " " " " " 9288 million (roubles 260 million) granted on 13.1.66 for the construction of a steel plant, machine manufacturing factory and gas pipes. Conversion rate in column (1) is rounded to Noubles 1 = \$1.1.
 f. The sum of the six items stated only.