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# The U K Development Aid Programme and the British Domestic Economy

by R. S. May, N. C. Dobson, St. Andrews\*

**The effects of development aid programmes on the domestic economy of donors are relatively infrequently examined. This study<sup>1</sup> reviews the impact of the United Kingdom's Development Aid Programme on the British economy over the period 1975-79 with particular attention to employment creation and multiplier effects both in aggregate and by industrial sector. Some comparisons are made with German experience. Also examined are the types of companies which benefit from aid-financed orders, the implications for the donor's own assisted regions and potential benefit to normal commercial trade. It is argued that a greater awareness of these effects should create a more favourable climate for the increase in aid levels.**

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Although most attention has been paid, and rightly so, to the effects which development aid programmes have on the recipient country, there can also be important consequences for the donor's own economy. Particular industries will benefit from the receipt of aid-financed export orders and consequently domestic income and employment will be generated both directly and indirectly through the Keynesian multiplier effect. To the extent to which such industries are concentrated in particular geographical areas there may also be noticeable regional effects. Such orders may also have longer term commercial advantages such as the provision of spare parts and other inputs: exports may also be increased as a consequence of the advertising effect of aid-financed goods in use in overseas markets. There are also Balance of Payments considerations: to the extent that aid funds are spent in the donor's economy rather than elsewhere the foreign exchange cost of development assistance is reduced.

The British aid programme provides an interesting case study of these effects which complements reviews made of the aid impact on the German economy which were published in earlier issues of *INTERECONOMICS*.<sup>2</sup>

A reasonable length of time of five years was taken for the review since the type of goods supplied varied considerably from year to year as individual aid projects, often of a considerable magnitude, were undertaken. The industrial "mix" over these years was considered to

be more representative. The particular period chosen, 1975-79, had two particular advantages – first, sufficient time had elapsed to enable companies to ascertain the extent of "follow-up" orders while not being so distant in time that the immediate impact was forgotten. Secondly, the period was before the reorientation of British aid policy of February 1980, when the Minister of Overseas Development announced that "we believe it is right at the present time to give greater weight in the allocation of our aid to political, industrial and commercial considerations alongside our basic developmental objective."<sup>3</sup>

The study was conducted at both a micro and macro level. Detailed information on all individual aid orders worth over £ 20,000 was obtained from the Crown Agents, the institution in Britain responsible for the system of tendering for orders financed by bilateral capital assistance. From this source some 500 companies were identified. About half of these provided further information through questionnaires and interviews.

It is of course possible for a donor government, by means of the judicious use of tying and project selection,

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<sup>1</sup> The authors wish to acknowledge with thanks the financial assistance of the Carnegie Trust for the Universities of Scotland which supported this research.

<sup>2</sup> D. Schumacher: Development Aid and Employment in the Federal Republic of Germany, in: *INTERECONOMICS*, No. 3/1981; G. Ashoff: Effects of German Development Aid on the Internal Economy, in: *INTERECONOMICS*, No. 5/1979.

<sup>3</sup> Hansard, February 20, 1980, p. 464.

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to steer aid orders towards particular industries and domestic regions: they may do this to take advantage of undercapacity or to alleviate unemployment. Such considerations, however, seem to have been of relatively minor significance during the period under review. The United Kingdom's aid was primarily directed towards the interests of the recipients, particularly the poorest, least developed countries. It was a policy which was firmly supported by the influential all-party Select Committee on Overseas Development: "Aid must be given on the basis of *aid* criteria alone. Aid cannot legitimately be used as a covert means of subsidizing British exports or distorting the import demands of aid receiving countries."<sup>4</sup>

### The Aid Programme as a Whole

The most important factor in determining the overall impact of the aid programme on the British economy is, of course, its relative size and characteristics. Details are given in Table 1.

Aid is only a tiny proportion of GNP at 0.42 % over the period although this is a higher proportion than that for all DAC (Development Assistance Committee) countries which averaged 0.33 %. As a proportion of total public expenditure it is only slightly higher at about 1 %. The sums involved therefore will make only a modest impact on the economy as a whole. However, when one examines aid in a narrower context it becomes rather more significant. Thus gross expenditure on development assistance amounts to over 15 % of the UK's exports to non-oil producing developing countries and in the case of certain individual countries very much more, and this not merely so in the case of small countries with relatively substantial UK support: in the case of India, for example, the proportion is about one third. Thus, companies with strong trade links with these countries are likely to be affected both directly and indirectly by the aid programme.

Of course, not all of the aid funds will return directly to the United Kingdom through purchases of goods and services: some proportion will be spent on imports obtained from other industrialised or even developing countries. The main reason for this is that only a proportion of aid is tied to the purchase of British products and relates to the bilateral type. Multilateral aid, a substantial and increasing element in British aid, is virtually untied and open to world-wide tender. It has been estimated that the amount of actual orders placed

**Table 1**  
**Gross Disbursement of UK Official Aid Flow by Type of Assistance, 1975-79**

	£ mn	%
<b>Multilateral Aid</b>		
Financial Aid	669.3	21.2
Technical Co-operation	236.8	7.5
Total Multilateral Aid	906.1	28.7
<b>Bilateral Aid</b>		
Project Aid	826.4	26.2
Non-project Aid of which:		
Programme (Import) Financing	489.0	15.5
Debt Re-Financing	73.1	2.3
Budgetary Support	52.4	1.7
Food Aid	50.5	1.6
Fertilizer Programme	27.2	0.9
Disaster Relief etc.	42.6	1.3
Total Financial Aid	1,561.2	49.4
Technical Co-operation	689.0	21.8
Total Bilateral Aid	2,250.2	71.3
<b>Total Gross Expenditure</b>	<b>3,156.4</b>	<b>100.0</b>

Note: Totals may not add precisely because of rounding.

Sources: British Aid Statistics, 1975/79, Overseas Development Administration HMSO 1980.

directly with British industry in 1977 from the two types of aid taken together amounted to £ 415 mn out of a total £ 685 mn or a return of some 60 %.<sup>5</sup>

At first sight this would appear to reduce the impact of aid on the British economy still further as a proportion is "lost" to the benefit of other suppliers. However, there is another source of orders emanating from the DAC's aid programme as a whole which may partially, fully or more than compensate. These are the orders which are placed in the UK which are financed by the "captured" untied bilateral aid of other donors. As an approximation, the proportion of orders so gained may be taken as the same as Britain's share of trade with the non-oil exporting developing countries which was 8.3 % in 1978. Applying this to the fully untied aid of other industrialised countries in 1978 would give some £ 352 mn – in other words bringing the gross order benefit to some £ 767 mn, clearly above that of the UK aid contribution. In other words, some net benefits are indicated in the way of export orders emanating from the world development programme. And this is without

<sup>5</sup> Reply by the Minister for Overseas Development to Parliamentary Question, Hansard, March 1, 1980, p. 23.

<sup>6</sup> It should be noted, however, that the existence of net beneficial effects need not continue. As pointed out by A. Krassowski (Aid and the UK Balance of Payments, Overseas Development Institute, 1965), a good deal will depend on the relationship between the donor's share of world trade compared with world aid. In the UK's case the former has been greater than the latter, but as trade performance declined and the relative reduction of the US aid contribution placed greater responsibility on other donors, so the ratio in recent years has turned unfavourably against the UK and may be one reason for the current curtailment of the aid programme.

<sup>4</sup> First Report from the Select Committee on Overseas Development, Session 1977/78, HMSO.

including the so-called "reflection effects" – the commercial orders placed in the UK as the recipients' GNP and trade grow as a consequence of aid. Thus by taking the simple aid flow figures for the period 1975-79 in the present analysis of the impact on the UK economy, one is adopting a somewhat conservative view.<sup>6</sup>

### The Companies Securing Aid Orders

It was the participation in export trade, particularly with the developing countries, which most characterised those companies in receipt of aid orders, the propensity being about three times that of the national average. Yet even in this group, aid-financed orders constituted only a very small proportion – 1½ % on average – of total sales although rather larger, at over 5 %, of export sales. These averages concealed a wide variety of experience but almost invariably where these percentages were substantially exceeded small and medium/small firms were involved.

One rather unexpected feature which did emerge from this part of the survey was the large number of

small specialist companies which received orders. Almost a fifth employed less than 100 workers and over one half employed less than 1,000. A number of possible explanations for this phenomenon appear likely, of which the most important relate to the type of goods supplied. Where this was specialist scientific and medical equipment or a particular type of custom-built vehicle, the smaller companies were quite common. Also invariably of small size were the merchanting houses and those private companies with close family and ethnic ties with particular developing countries. It was certainly not the case that the aid programme brought orders only to the large international trading companies. Furthermore, there were the additional benefits to the smaller companies which acted as sub-contractors or suppliers to the major firms.

### Domestic Industries Affected

The particular UK industries which have supplied goods financed by bilateral financial/capital aid are indicated in Table 2 and it is interesting to compare them

**Table 2**  
**Direct and Indirect Effects of £ 100 mn Orders Emanating from Bilateral Financial Aid**  
(1979)

SIC		Production Effects			%
		Direct £ mn	Indirect £ mn	Total £ mn	
I	Agriculture, Forestry, Fishing	–	0.2	0.2	0.1
II	Mining and Quarrying	–	2.4	2.4	1.4
III	Food, Drink & Tobacco	0.2	0.4	0.6	0.4
IV	Coal & Petroleum Products	0.3	4.7	5.0	3.0
V	Chemicals including Fertilizers	7.5	3.6	11.1	6.6
VI	Metal Manufacturing	15.5	11.4	26.9	15.9
VII	Mechanical Engineering	22.5	4.0	26.5	15.7
VIII	Instrument Engineering	1.1	0.2	1.3	0.8
IX	Electrical Engineering	10.4	3.3	13.7	8.1
X	Shipbuilding & Marine Engineering	4.9	0.4	5.3	3.1
XI	Vehicles	15.3	1.7	17.0	10.1
XII	Other Metal Goods	–	5.7	5.7	3.4
XIII	Textiles	2.3	0.9	3.2	1.9
XIV	Leather & Leather Goods, Fur	–	–	–	–
XV	Clothing & Footwear	–	–	–	–
XVI	Bricks, Glass & Cement	1.7	0.8	2.5	1.5
XVII	Timber & Furniture	0.2	0.5	0.7	0.4
XVIII	Paper, Printing	1.4	2.7	4.1	2.4
XIX	Other Manufactured Goods	0.6	1.6	2.2	1.3
	Total Manufacturing III-XIX	83.9	41.9	125.8	74.6
XX	Construction	–	1.1	1.1	0.7
XXI	Gas, Electricity, Water	–	2.7	2.7	1.6
XXII	Transport & Communication	8.0	5.1	13.1	7.8
XXIII	Distributive Trades	–	5.5	5.5	3.3
XXIV-V	Professional Services, Banking etc.	8.1	9.5	17.6	10.5
		100.0	68.4	168.4	100.0

Sources: Derived from Crown Agent data: "Report on the Census of Production 1979 and Input/Output Tables for the United Kingdom 1974".

with those supplying West German capital aid goods.<sup>7</sup> In both cases mechanical engineering is the single largest supplier, but far less predominant than in the German case (22.5 % compared with 42.2 %). Metal manufacturing is the second most significant item and in contrast is relatively much larger (15.5 % as compared with 3.3 %), while the vehicle industry also receives a much higher proportion (UK – 15.3 % : Germany – 9.0 %) as do chemicals, including fertilisers (7.5 % compared with 3.3 %). The difference is less substantial as far as electrical engineering is concerned (10.4 % and 13.4 %). There is a wide gap with regard to “construction” (zero and 20.0 %) but this is probably due in large part to different methods of interpretation and definition, for example “erection services” in the UK case is included under “other services”.

In examining the internal effects we were anxious to discover to what degree in practice the aid programme had eased the adjustment problems of domestic industries – to what extent had aid orders gone to industries in decline which were suffering from above-average unemployment and to particular regions where these problems were concentrated? There are many facets to the argument here. Thus although in general the UK aid policy was officially “development orientated” as indicated earlier, internal conditions of overcapacity, for example in the shipbuilding industry, could in practice sometimes play a part in the decision as to which projects were to be financed. Given a choice between projects of fairly equal development status it would not be surprising if those with good domestic income and multiplier effects were chosen. There may also have been some cases where domestic circumstances were paramount. On a more general level of argument, too, one perhaps might expect those industries producing less sophisticated products, for example textile machinery, which were facing long-term decline both within the United Kingdom and in the world market as a whole, still to provide aid-financed goods which were appropriate to the conditions of abundant labour supply and industrialisation from a local resource base frequently met in developing countries.

As a test of the impact the weighted percentage change in the index of production for the categories of aid goods shipped overseas was compared with the overall change in the total manufacturing production index between 1970 and 1979. This showed that aid goods did come from industries which had experienced lower rates of expansion at rather less than one third of the average of manufacturing industry as a whole. The

**Table 3**  
**Estimated Direct Employment Effects of Bilateral Capital Aid by Domestic Development Area**  
(1975-79)

Area	(A) Breakdown (in %)	(B) Total Manufacturing Employment 1977 (in %)	(A)/(B) (in %)
Non-Development Area	42.3	53.1	80
Intermediate Areas	14.5	22.8	64
Development Areas	13.2	9.0	147
Special Areas <sup>1</sup>	30.0	15.1	199
	100.0	100.0	–

<sup>1</sup>Including Northern Ireland.

Sources: Derived from Crown Agent data, company information and the Report on the Census of Production 1977, HMSO.

same exercise undertaken in respect of employment also indicated that these were industries which had experienced rather greater than average contraction.

Also noted were the very substantial orders placed with the nationalised industries and those firms such as British Leyland which were in receipt of public financial support. British Steel was predominant within the major sector of metal manufacturing, supplying considerable quantities of steel rails and sleepers for railways as well as a variety of poles, plates and joists. Similarly British Shipbuilders supplied most of the ships and British Leyland secured almost two thirds of the substantial vehicle orders. Even British Rail, via its Engineering Division, received orders in excess of £ 30 mn in the last two years of the period under consideration. With few exceptions the very large individual orders went to such corporations. There is thus some evidence to show that the aid programme has been of some support to those industries in Britain which were in relative decline or facing particular difficulties.

Table 2 also specifies the “knock-on” production effects. Given the usual assumptions regarding unused capacity (and in this respect the vast majority of companies reported such a situation) total output would rise by £ 168.4 mn for every £ 100 mn of aid-financed orders. Among those industries benefitting from the secondary and subsequent orders, metal manufacturing and metal goods were prominent, while there was a substantial demand for coal and petroleum products and chemicals. The demand for services would also increase substantially.

### Regional Effects

From questionnaires and interviews with the companies, the locations of manufacturing plants which had received the orders were identified. Such

<sup>7</sup> Cf. D. Schumacher, *op. cit.*, Table 1.

information was received in respect of about half of the bilateral capital aid orders worth more than £ 20,000. By such means it was possible to determine to what extent those areas experiencing relative decline, and which had been categorised as internal "development areas" and as such entitled to various categories of regional assistance, e. g. investment grants, incentives etc., had benefitted from the external development aid programme. The results are given in Table 3 in respect of the direct employment creation effects.

This indicates that development areas have been in receipt of above-average aid-financed orders and that the greater the degree of internal support, shown by the graduation from "intermediate" to "special" area, the greater are the benefits. Some regions did particularly well – for example Scotland, with its heavy engineering and steel fabrication. It would thus appear that the UK's external development aid programme has had the effect of supporting internal regional development policies.

Companies were asked to what extent aid-financed orders had led on to additional commercial business. About a quarter of them indicated that they could identify follow-up orders, very often in the form of spare parts, a

type of business which frequently brought higher than average profits. In a small number of cases, also, aid-financed orders were seen as a most valuable means of penetrating a market which had hitherto been effectively closed: usually these were countries which were facing Balance of Payments difficulties and where host government purchasing played a key role: it was very much easier to make the initial critical entry into the market through the provision of goods for which there were no problems of finding scarce foreign exchange. The British companies concerned particularly welcomed these aid orders as a means by which their goods would be seen in use and thus, it was hoped, promote further sales. For the majority of companies, however, aid-financed business would appear to have had little significant impact on further exports.

### Employment Effects

Two different approaches were used to estimate these effects, first at the macro level using input/output methods, and sectoral output/employment indicators, and, secondly at the individual company level using replies to questionnaires/interviews together with an analysis of the firm's published accounts.

**Table 4**  
**Direct and Indirect Employment Effects of £ 100 mn Orders**  
**Emanating from Bilateral Capital Aid (1979 prices)**

(Numbers of Employed)

SIC	Industry	Direct	Indirect	Total	%
I II	Agriculture, Mining	–	175	175	2.0
III	Food, Drink and Tobacco	3	10	13	0.2
IV	Coal and Petroleum Products	2	16	18	0.2
V	Chemicals including Fertilizers	181	86	267	3.1
VI	Metal Manufacturing	590	434	1,024	11.9
VII	Mechanical Engineering	1,229	218	1,447	16.9
VIII	Instrument Engineering	74	14	88	1.0
IX	Electrical Engineering	586	185	771	9.0
X	Shipbuilding and Marine Engineering	387	32	419	4.9
XI	Vehicles	725	81	806	9.4
XII	Other Metal Goods	–	314	314	3.7
XIII	Textiles	140	55	195	2.3
XVI	Bricks, Pottery, Glass etc.	82	38	120	1.4
XVII	Timber, Furniture	10	26	36	0.4
XVIII	Paper, Printing etc.	68	133	201	2.3
XIX	Other Manufactured Goods	33	89	122	1.4
III-XIX	Total Manufacturing	4,110	1,731	5,841	68.1
XX-XXV	Construction and Other Services	965	1,602	2,567	29.9
		5,075	3,508	8,583	100.0

Sources: Derived from Crown Agent data: "Report on the Census of Production 1979" and Input/Output Tables for the UK 1974.

The results of the first are given in Table 4 which shows that there is an employment multiplier value of some 1.69 in respect of bilateral capital aid. For every £ 100 mn of such aid at 1979 prices, employment in the absence of any other governmental action would benefit by some 8,600 in total. It is not anticipated that there would be much variation in this value in respect of multilateral financial aid. On the basis of the 1979 capital aid expenditure, and assuming a return of direct and indirect orders for goods amounting to an equal amount for the reasons stated earlier, this part of Britain's development aid programme would result in an increase in employment of approximately 54,000 or, more probably, judging from the companies' response, in the avoidance of an increase in unemployment of a like number. The distribution of employment by sector is similar to the pattern already indicated but with the more capital intensive such as chemical manufacturing and refining industries not gaining so much and vice versa. There were quite substantial indirect gains to the service sector: consultancy, erection and supervisory services and others of a professional nature were particularly in evidence.

With regard to the companies themselves, each was asked in which ways if any, their employment situation would have differed if the aid-financed orders had not been received. They were requested to indicate the actual number of jobs created or saved as well as any effect on short-time working. The replies indicated a considerable diversity of experience. About two thirds indicated that the effects were either nil or negligible. Five per cent said that there had been a substantial positive effect on employment, with the rest (a quarter) indicating a distinct measurable effect. These results were not surprising in view of the fact that aid orders constituted such a tiny proportion of sales on average for the majority of companies. In only seven per cent of cases did the aid/sales ratio exceed 0.05 with only four per cent being above 0.1. Without exception all of these latter firms were of small size, with sales of less than £ 5 mn per annum. It was not the case, however, that only small companies reported positive effects: about a half of those so doing were of large size. The benefits were not in practice diffuse in nature since the aid orders tended to be concentrated in particular plants or divisions where their effects would be more noticeable. The survey also threw up a number of interesting cases where the aid orders had either been so substantial or had come at a time when particular commercial difficulties had been experienced that they had the effect of avoiding a company crisis. The very substantial orders obtained by the British nationalised industries

also came as a welcome boost to these corporations facing mounting deficits.

It was also possible to estimate the employment effects of aid for each company by multiplying existing employment by the proportion which aid orders bore to sales over the period. Assuming a constant labour to output ratio, this gave a figure very near to that obtained by the other method – 5,190 as compared with 5,075 per £ 100 mn of orders.

A few companies also reported that aid orders, by extending the viable life of certain sections and lines of production had enabled them to keep in employment some older personnel with special skills in the manufacture of particular products which were facing a market decline.

### Positive Benefits

Although the aid programme by itself cannot have a major impact on the British domestic economy, there are a number of not insubstantial effects which occur and benefits which accrue.

Firstly, the indications are that for every £ 1 of financial and capital aid allocated at least £ 1 of orders returns either directly or indirectly to the United Kingdom: in this respect the experience is similar to that of Germany's.<sup>8</sup> Secondly, the orders appear to have the effect of helping to support Britain's declining and more slowly growing industries. Then there are some spin-off trade effects, but these are not very great. It is with regard to employment creation, or, more likely, unemployment prevention, that the main effects are to be seen with an estimated 8,583 jobs per £ 100 mn of orders, with a marked favourable bias towards Britain's less prosperous regions.

As far as the participating companies are concerned a large number of small and medium-sized firms are involved in addition to the giants. Nationalised and state-supported corporations benefitted from orders of substantial size.

While drawing attention to these effects, however, it is not the intention to suggest that the United Kingdom's aid policy has been or should be formed with domestic considerations in mind. Between 1975 and 1979 the UK's development aid programme was implemented quite clearly with the needs of the recipients in prime place. However an appreciation of the positive benefits which may accrue to the donor's own economy should help to promote a more favourable climate towards the restoration of Britain's aid programme to former levels.

<sup>8</sup> D. Schumacher, *op. cit.*