Third International Conference on Financing for Development
Addis Ababa • July 2015

Why modernise official development assistance?

Official development assistance (ODA) reached an all-time high of USD 135.2 billion in 2014. While reliance on ODA varies across developing countries, and in some may seem "a drop in the bucket" compared to other international financial flows, for the least developed countries it represents over 70% of available external finance and more than one-third of their total public revenue and expenditure. This highlights the importance of the target set by the United Nations in 1970: for donors to allocate 0.7% of their GNI as ODA.

Most ODA continues to be provided in the form of grants. Nonetheless, concessional loans – in other words, loans provided on favourable terms to developing countries – are also important, and will continue to play a key role in mobilising resources to support the Sustainable Development Goals (SDGs). The concept of ODA was developed by the OECD Development Assistance Committee (DAC) in 1969, yet until recently the definition of what made a loan "concessional in character" – which in turn determines the extent to which a loan can be reported as ODA – was open to interpretation. Because this resulted in inconsistent reporting across DAC members, it was agreed that clarification was needed.

A fairer picture of provider effort

At their High Level Meeting in December 2014, DAC members agreed to make important improvements in the system. Whereas in the past the face value of both grants and loans was counted as ODA, they agreed that only grants and the "grant portion" of concessional loans would be considered. This provides a more realistic comparison of loans and grants, and encourages the use of grants and highly concessional loans. The discount rate used in the calculation is also differentiated by developing country groups. Therefore, a loan to a least developed country (LDC) or other low-income country (LIC) will score more ODA than a loan provided under the same conditions extended to a middle-income country (MIC). This incentivises lending to poorer countries based on the consideration that it involves greater effort by providers (in terms of both the funding cost of the loan and the risk associated with it).

THE REVISED SYSTEM

- has only a marginal effect on overall ODA volumes
- conveys a fairer picture of provider effort
- ensures comparability of resulting data across providers
- works well in today's complex development co-operation landscape
- helps to ensure that lending is aligned with developing country needs, capacities and constraints in terms of volumes, concessionality and debt sustainability
- strengthens the integrity of DAC statistics and the transparency of development co-operation
- includes private sector investment

More and better conditions for countries most in need

Futhermore, higher concessionality thresholds have been introduced to fix softer terms and conditions for lending to countries most in need. What does this mean? In the past, the threshold for ODA eligibility was set at a grant element of 25%. Under the new system, loans to LDCs and other LICs must reach a grant element of at least 45% to be reportable as ODA, while lower middle-income countries (LMICs) will require only a minimum 15% grant element and upper middle-income countries (UMICs) a minimum 10% grant element. Particular emphasis has also been placed on debt sustainability: to be reportable as ODA, loans must comply with the International Monetary Fund's (IMF) Debt Limits Policy and the World Bank's Non-Concessional Borrowing Policy. Finally, the maximum ODA interest rates permitted have been lowered for all country categories and nearly halved for LDCs and other LICs.

Why do these changes matter?

This new statistical framework measures ODA loans more accurately and credibly, ensuring comparability of data across providers. It incentivises more and better allocation of concessional resources to implement the SDGs. It also promotes greater transparency and heightened accountability, helping to ensure that ODA goes where it is most needed and has the greatest development impact.

	BEFORE: CASH FLOW	AFTER: GRANT EQUIVALENT
Grant element threshold	• 25%	• 45% for LDCs and other LICs • 15% for LMICs • 10% for UMICs
Discount rate	• 10% • used for assessing the concessionality of a loan	• 5% base (current IMF discount rate) + adjustment factors of: ⇨ 4% for LDCs and other LICs ⇨ 2% for LMICs ⇨ 1% for UMICs • used both for assessing the concessionality of a loan (threshold) and for calculating its ODA grant equivalent
Measurement of flows	• counted as ODA when disbursed • subtracted from ODA when repaid	• grant equivalent of loan disbursements (grant element multiplied by amount disbursed) counted • repayment of past loans not subtracted from ODA but data continues to be collected and published • more ODA credit for softer terms and conditions loan • grants score more ODA than loans
Debt sustainability safeguard	• no explicit measure	• linked to IMF Debt Limits Policy and Non-Concessional Borrowing Policy

Transparency on resource flows is essential to support developing countries in making best use of the diversity of funding sources available to them today. By strengthening dialogue with developing countries, the OECD DAC works to ensure that the DAC statistical system contributes to meeting their information and planning needs. This includes continuing work to develop DAC systems for measuring the actual resources that enter developing country budgets, building on longstanding work with country programmable aid.

When will these changes take effect?

For the time being, ODA will be reported using both the new grant equivalent and previous cash flow-based systems to allow for full data on actual disbursements and repayments of loans collected and published. This means that full transparency regarding the impact of changes on ODA volumes will be maintained. The new system will become the standard for reporting from 2018 on (for which ODA reporting will take place in early 2019).