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DEVELOPMENT FINANCE - MODERNISING OFFICIAL DEVELOPMENT ASSISTANCE (ODA)

Options for Modernising the ODA Measure

DAC Meeting, 27 January 2014

This document is submitted for DISCUSSION under Item 4 of the Draft Annotated DAC Agenda [DCD/DAC/A(2014)1].

The paper presents three options for modernised ODA measure drawn from discussions to date. Its main focus is on what forms and instruments of support should be included and how. Rough estimates (scenarios) of their impact on the volume of ODA using data for 2012 are also shown. Members' feedback is invited on the options/scenarios and the elements within each.

The eligibility of peace and security expenditures, climate finance and other global goods is not discussed, as a separate paper on these issues is being prepared for the DAC meeting scheduled on 10 February 2014.

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OPTIONS FOR MODERNISING THE ODA MEASURE

Introduction

1. This paper constitutes the basis for a second in-depth discussion on options for modernising the ODA measure, as per the working calendar being used to guide DAC deliberations on development finance. It draws on guidance and views received from the 21 October and 3 December 2013 DAC meetings, as well as papers provided by members and perspectives of the Expert Reference Group. Discussions at the WP-STAT Expert Workshop on Concessionality held on 19 November 2013 have also been taken into account.

2. The paper presents three options for a modernised ODA measure, using the current measure as a reference point, *i.e.* the inclusions and exclusions in comparison with the current ODA definition and coverage are explained. No commentary on items that would remain unchanged is provided. Also, the options are presented with the understanding that any items removed from ODA may be covered in the broader measure of total official support for development (or development finance resulting from official efforts), reflecting the HLM request to elaborate a proposal for such a measure. Thus, decisions on the ODA options may influence the composition of the broader measure.

3. The main focus of the paper is on what forms and instruments of support should be included in the modernised ODA measure and how. The eligibility of peace and security expenditures, climate finance, and other global goods is not discussed, as a separate paper on these issues is being prepared for the 10 February 2014 DAC meeting. The questions related to improving data on developing countries' resource receipts (finance actually transferred to developing countries) are also deferred to a later stage as noted in the calendar for development finance.

4. To help members consider the three options, the paper presents scenarios with rough estimates of the impact of each on the volume of ODA using data for 2012 as the baseline. The scenarios could be further elaborated, although additional ad-hoc data collection would be required. In commenting on the options, members may therefore wish to express their views on the usefulness of such scenarios for future discussions and their willingness to provide additional data that may be required. Finally, it is stressed that the options are not "cast in concrete". For simplicity three are laid out. Other scenarios could be developed where a consensus among members emerges.

Three Options

5. This section presents three base scenarios for a modernised ODA measure, hereafter referred to as i) focused ODA, ii) new ODA, and iii) updated ODA. Members are requested to provide feedback on these scenarios and the elements within each. The paper for the SLM will present a further elaborated set of options, in an integrated manner for both ODA and total support.

Option 1: focused ODA

6. One of the main critiques of the ODA measure over the years has been that it overestimates the governments' efforts in providing development assistance by including items that do not result in, or relate to, flows to developing countries, and by counting as aid the face value of loans and debt relief. One option to consider would thus be to modify ODA measurement so that it more accurately reflects the

budgetary expenditures incurred by the government in development co-operation. This would imply maintaining the "developmental test"[1] of ODA as at present, but:

a) **excluding from reporting in-donor expenditures** that do not result in, or relate to, flows to developing countries, *i.e.*

- removing from ODA the following types of aid: imputed student costs, in-donor refugee costs and development awareness.[2]

b) **measuring expenditures actually incurred by the government** in development co-operation, *i.e.*

- excluding the capital of loans and equities, but counting budgetary expenditures on capital subscriptions, grants or subsidies to national development finance institutions, development banks and other loan/equity/guarantee extending agencies;

- counting capital subscriptions to multilateral development banks (and agencies listed above) on an encashment basis[3]; and

- for debt relief operations, counting the actual expenditure by the government to purchase debt from the private sector or compensate loan extending agencies (but not the losses covered by these agencies through insurance or through revenue such as fees charged for guarantees).

7. The counting of other forms or instruments of aid would not change, *i.e.* grants whether extended for budget support, project-type interventions or technical assistance would be reportable at their face value (deducting however from net ODA any recoveries on grants).

8. The types of support removed from ODA could be included in the broader measure of total official support for development. Similarly, the face value of any non-grant instruments and more generally the outflows from the DFIs would be included in the broader measure of support. The entire cash flow would be captured in the data on developing countries' resource receipts.

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1 . Transactions administered with the economic development and welfare of developing countries as their main objective.

2 . Another category of in-donor costs is "administrative costs not included elsewhere". Their exclusion from the ODA measure would be less straightforward, given that some administrative costs are also embedded in project-level data (overhead costs). It would nevertheless be desirable to clarify the methodology for calculating administrative costs and consider whether costs of agencies or diplomatic staff performing aid duties part-time would better fit in the broader measure of total support. This question, and the possible broadening of the coverage of in-donor costs in the total measure, will be further elaborated in the paper for the 10 February 2014 DAC meeting.

3 . Capital subscriptions made in the form of notes and similar instruments unconditionally encashable at sight by the recipient institutions are currently reported in DAC statistics on a deposit basis, *i.e.* they are reported as disbursements as of their date of issue, whether or not they have actually been encashed. Reporting on an encashment basis records the amounts of capital subscriptions that have actually been encashed, i.e. the total drawn down by multilateral institutions during the year reported on from notes lodged by the reporting country, whatever their date of issue.

Option 2: new ODA

9. An alternative way for modernising the ODA measure would be to modify it to better reflect the **budgetary effort of development co-operation** and the way the costs are assessed in aid agencies', DFIs' and development banks' balance sheets. As in Option 1, no modification to the developmental test of ODA would be made, but **reporting would be on accruals basis and for non-grant financial instruments only include the grant equivalent (instead of the face value) of the flow** as follows:

a) for loans, counting as ODA the "grant equivalent", calculated taking into account both the cost of borrowing and risk of default (i.e. a "recipient benefit" approach);

b) consequently, removing from ODA all bilateral debt relief (given that the risk of having to provide relief will be valorised ex-ante[4]), except for relief of uninsured or unguaranteed export credits or other private debt;

c) for equity investment, including in ODA only the acquisition of all forms of equity bearing a comparatively higher risk than other equity classes in the same investee (e.g. first-loss shares, locked-up equity)[5]; and

d) for guarantees, counting the difference between the premia actually charged and those the market would charge[6].

10. The above would provide a basis for fair assessment of burden-sharing between all-grant and grant-and-loan providers. The implications of accruals-based reporting for grant financing will have to be studied in greater detail, but no major changes are to be expected.[7] Capital subscriptions to multilateral development banks would be reportable on a deposit basis (as at present).

11. The concept of budgetary effort could include certain in-donor costs, such as those for subsidised students and newly-arrived refugees, as well as for raising development awareness in the donor country. But reporting would be reformed and standardised – resulting in an estimated 20% cut to current figures.

12. As under Option 1, any amounts removed from ODA could be captured in the broader measure of total official support for development and the entire cash flow would be captured in the data on "receipts".

Option 3: updated ODA

13. A third option could be to **maintain ODA measurement on a cash basis, but modernise it on a number of items** to ensure uniform reporting and help direct ODA where it can catalyse other flows. In this case, non-grant instruments could only be valorised if ODA was measured on a gross disbursement basis as any return flows in a cash-based system count as negative flows. This would obviously raise the issue of a mismatch between the measure (gross) and the ODA/GNI target (net). A cash basis implies:

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4 . If concessionality is assessed applying a risk-free discount rate, debt relief could remain in ODA, but reporting should be limited to government compensation to loan-extending agencies.

5 . The estimation of a grant equivalent for equity investment is impossible because the future proceeds are unknown and the risk assessment is highly subjective.

6. If guarantee agencies charge fees based on assessed risks, no explicit provider effort is involved.

7 . In the case of grants, cash basis and accruals basis lead to the same results (cash payments are captured).

a) for loans, reporting the gross disbursements of those loans assessed as concessional when using a risk-adjusted discount rate.[8]

b) for debt, some adjustments would be needed in order not to valorise risk twice. However, it should be noted that since a) maintains the cash basis of reporting, it does not valorise risk for any loan that fails to meet the grant element threshold.

c) for equity, given that grant element cannot be estimated, counting the face value of acquisitions based on the reasoning that one core function of equity is crowding in private investment.

14. Guarantees would not fit in a cash-based reporting system, but the amounts mobilised could be captured in the broader measure if this was defined as "development finance resulting from official efforts".

15. As regards multilateral ODA, the cash basis would mean reporting capital subscriptions on an encashment basis. In addition, other financing to multilateral agencies leveraging private finance, such as reimbursable grants, could be included at face value (similarly to equity investment).[9]

Comparing the Options

16. Table 1 below presents the three options in a summary form and includes for ease of reference information on the current ODA measure. It further includes estimates on the amounts that would be recorded as "focused ODA", "new ODA" and "updated ODA". These estimates have been calculated using ODA data for 2012 and should be considered as rough proxies indicating orders of magnitude. If members consider such scenarios helpful, they can be further elaborated. The table includes notes where estimation would require additional data from members.

- The net projected impact of Option 1 on "ODA" is a decline of 10%. It is not surprising that this change is not larger because the large majority of ODA is grants and the possible modifications discussed are, in absolute terms, marginal.

- The net projected impact of Option 2 on "ODA" is a slight increase (2%) as the decline in the volume of in-donor costs is more than compensated by a large increase in the volume of ODA recorded for loans. The loan figure also does not include the grant equivalent of non-concessional developmental loans. It should be recalled that this option involves a major change in the basis of measurement of loans. (The current system accounts for the net cash flow of outstanding loans in 2012 whereas the grant equivalent accounts for the net present value of the entire future cash flow of loans committed in 2012.)

8 . This assessment would require more information from members, e.g. on the terms of OOF loans. The result could both bring into ODA some loans now reported as OOF, and exclude some loans now reported as ODA. As a first approximation, the current gross ODA loans figure is used in Table 1.

9 . In discussions on total official support for development, the possibility of attributing IFIs' non-concessional outflows to donors in proportion to their shareholding in these institutions has also been raised.

- The net projected impact of Option 3 on "ODA" is an increase of 9%. The difference is mainly explained by the fact that loans and equity are measured on a gross basis.

17. Further remarks on the scenarios are given in the notes to the table. The impact of each option on the volume of ODA could change over time if the composition of ODA, however finally defined, changes. If the use of non-grant instruments expands significantly over time, then the level of ODA also would increase but by a smaller percentage since the share of grants in any total measure of ODA is likely to remain dominant for the next number of years. A complete assessment of the impact of each option would require a simulation over a number of years and also additional data from members on a number of items.

18. **Members are invited to express their views on the three options/scenarios, addressing both the underlying rationale and how this would respond to the HLM mandate, and the treatment of specific items.** Based on members' feedback at earlier discussions on ODA and total official support for development, the Secretariat understands that there is wide interest in exploring how to incentivise the provision of development finance in the form of market-like financing as appropriate, so options to accommodate this interest are incorporated in the scenarios presented. There has been some interest in moving in-donor costs from a new measure of ODA to a new measure of total support. However, historically, these costs have been subject to a lot of criticism as they do not directly flow to or benefit developing countries, so it would seem necessary, as a minimum, to make some adjustments to this reporting to improve the transparency and comparability of data between donors.[10] Finally, none of the scenarios include estimates of tax concessions in favour of development, including the cost of tax deductions for contributions to developmental NGOs. This is because there has been a marked divergence in members' views and there are significant challenges in accurately measuring or collecting the needed information.

19. As noted in paragraph 3, the inclusion of peace and security expenditures, climate finance, and other global goods is not discussed in any detail, but will be covered at the 10 February DAC meeting. It can be noted however that there is strong interest in exploring an expanded treatment of security as an enabler of development and possible broader coverage of such activities in ODA. The measurement of climate finance will also be discussed, but here the issue is improved quantification of the flows through the Rio marker system, noting that most climate finance meets the developmental test of ODA and its inclusion or not depends on the decisions on the treatment of loans. The paper will also cover the issue of financing other global public goods and enablers of development and contributions to international organisations which currently qualify as ODA only partially because of their global programmes and standard-setting activities.

10 . For example, the coverage of in-donor refugee costs could be better defined by clarifying the categories of refugees included, types of expenditures covered, and methodology used to assess costs during the eligible period of stay.

Table 1. Summary table on options for a modernised ODA measure of provider effort, post-2015

2012 ODA data as reported by members and simulations using 2012 ODA data (USD million)

	Current ODA (net disbursements)	Options: #1. Focused ODA (budgetary expenditure)	Options: #2. New ODA (budgetary effort)	Options: #3. Updated ODA (gross disbursements)
A) Grants				
A1) in donor costs	*administrative costs, imputed student costs, development awareness, in-donor refugee costs*	only administrative costs	included but based on narrowed eligibility criteria ESTIMATE [(4)]	administrative costs, imputed student costs, development awareness, in-donor refugee costs
	13 549.1	**6 672.3**	**10 839.2**	**13 549.1**
A2) other grants	*face value (net)*	face value (net)	face value (net)	face value (gross)
	96 886.8	**96 886.8**	**96 886.8**	**97 358.8**
B) Debt/loans	*net value of eligible loans*	government interest subsidies injected in loans, other expenditures covered under F2) *ESTIMATE [(1)]*	grant equivalent of developmental loans calculated with risk-adjusted discount rate *ESTIMATE [(5)]*	face value (gross disbursements) of eligible loans, updated eligibility rules *ESTIMATE [(8)]*
	2 430.5	**311.0**	**10 564.0**	**13 797.2**
C) Debt Relief	*face value plus interest (offset for principal ODA claims)*	compensation by the government to loan extending agencies *ESTIMATE [(2)]*	private claims not insured or guaranteed *ESTIMATE [(6)]*	adjusted rules (gross less offsetting entries) *ESTIMATE [(9)]*
	3 007.3	**1 470.0**	**480.2**	**3 007.3**
D) Equity	*net*	covered under F2)	acquisition of higher risk equity e.g. first-loss shares or locked-up equity	face value (gross)
	596.3	**..**	***TBD***	**1 529.8**
E) Guarantees	*-- not measured --*	covered under F2)	difference between premia paid and market price *ESTIMATE [(7)]*	*-- not measured --*
	..	**..**	**185.5**	**..**
F) Capital contributions to				
F1) multilateral institutions	*capital subscriptions on deposit basis*	capital subscriptions on encashment basis	capital subscriptions on deposit basis	capital subscriptions on encashment basis
	10 469.0	**8 727.9**	**10 469.0**	**8 727.9**
F2) bilateral aid agencies and DFIs	*-- not measured --*	capital subscriptions *ESTIMATE [(3)]*	*-- not measured --*	-- not measured -- (as already captured as outflows in sum of A+B+C+D)
	..	**401.7**	**..**	**..**
TOTAL ODA	***126 938.9***	***114 469.6***	***129 424.7***	***137 970.0***

Notes to the table:

For several items and options proposed, there are no data readily available in DAC statistics and the Secretariat has produced estimates. It is important to note that a number of estimates are very rough and need to be considered with caution. The notes below provide details on the calculations and highlight the caveats. They also indicate what information would be needed from members if more refined estimates were to be produced.

Option 1:

(1) Loans, estimate for the government interest subsidies injected in loans: these amounts in principle appear in the budget of members providing such subsidies. The Secretariat has consulted the budget for France and Belgium and extracted numbers only from these, to be confirmed by the countries concerned. The resulting figure shown in the table is a **partial estimate**. It could be refined upon provision of the relevant budgetary information by members.

(2) Debt relief, compensation for debt relief by the government to loan extending agencies: as above, these figures in principle appear in the budget of members providing such compensation. The figures for Belgium and France (to be confirmed) were extrapolated to total DAC countries on the assumption that Belgium and France accounted for 7% of the total DAC GNI and took part in debt relief operations in proportion of their GNI. The resulting figure shown in the table is a **partial estimate**. It could be refined upon provision of the relevant budgetary information by members.

(3) Capital subscriptions to bilateral aid agencies and DFIs: data were found in DFIs' annual reports and confirmed in CRS reporting for a few members.

Option 2:

(4) In-donor costs, included but based on narrowed eligibility criteria: application of a 20% discount to current figures.

(5) Loans, grant equivalent of developmental loans calculated with risk-adjusted discount rate: the Secretariat calculated the grant element of all members' ODA loans committed in 2012 (except for Poland that did not report on loan conditions) using a variable discount rate (currency-specific and adjusted for beneficiary country risk). See the details of the methodology used at http://www.oecd-ilibrary.org/development/the-evolution-of-official-development-assistance_5k3v1dv3f024-en and the description of the discount rate in DCD/DAC/STAT(2012)22. The resulting figure has to be considered with caution as i) only loans qualifying as ODA under the current rules were included in the calculation, and not developmental OOF loans below the 25% threshold which could still include a concessional element (no information being available on terms for OOF loans), and ii) the exact composition of the discount rate to use for a grant equivalent calculation would necessitate an in-depth research and agreement among members.

(6) Debt relief, private claims not insured or guaranteed: as it is not possible to separately identify in the data uninsured or unguaranteed private claims, debt relating to all private claims was included under the estimate shown in the table. To refine this estimate, the Secretariat would need to request from members separate data on this.

(7) Guarantees, difference between premia paid and market price: guarantee fees are assumed to be charged as a lump sum at the beginning of the contract and the formula used to calculate the figure is as follows:

Concessionality of a guarantee = (market fee$_i$ *minus* premia charged by the public institution) *times gross exposure,* *where* i = country risk category.

The market fee for country i was approximated using the OECD Export Credit Group up-front Minimum Premium Rates (http://www.oecd.org/tad/xcred/crc.htm). The premia charged by the public institution was set at a fixed rate of 3% which is a rough estimation based on publically available data. The gross exposure is the full amount the guarantor will pay to the investor if the risk covered by the guarantee materialises, regardless of reinsurance. The source of this information is the survey on guarantees for development (http://www.oecd.org/dac/stats/guaranteesfordevelopment.htm) and data thus relate to year 2011.

The resulting figure shown in the table is an estimate that needs to be considered with caution as it makes several assumptions.

Option 3:

(8) Loans, face value (gross disbursements) of eligible loans, updated eligibility rules: obtaining a proper estimate would require conducting a significant amount of research/calculations to re-assess the grant element of ODA and OOF loans committed over the years and showing a disbursement in 2012. This would necessitate determining a risk-adjusted discount rate for many different years and would imply getting additional information from members on loan conditions (for OOF, there is no information on terms in the CRS; for ODA, information on terms is attached to commitments but it is not always possible to link current disbursements

to their original commitments in the CRS). The figure shown in the table is therefore not adjusted at this stage *i.e.* it relates to gross ODA disbursements as currently reported.

(9) Debt, adjusted rules: some adjustments would be needed to the current figure in order not to valorise risk twice. However, this option maintains the cash basis of reporting, and so does not valorise risk for any loan that fails to meet the grant element threshold. Thus, pending more details on the nature of adjustments needed, the current figure has been used as a proxy.