

Expert Reference Group Meeting – 3-4 October 2013

Session 3 – Revisiting the ODA Concept

Discussion Paper¹

Background

Official Development Assistance (ODA) is defined as those flows to countries and territories on the DAC List of ODA Recipients and to multilateral development institutions which are:

- i. provided by official agencies, including state and local governments, or by their executive agencies; and
- ii. each transaction of which:
 - a) is administered with the promotion of the economic development and welfare of developing countries as its main objective; and
 - b) is concessional in character and conveys a grant element of at least 25 per cent (calculated at a rate of discount of 10 per cent).

The [DAC Statistical Reporting Directives](#) give detailed guidance on coverage of ODA and other flows. The 2012 [DAC High Level Meeting](#) agreed to maintain the ODA definition but to elaborate a clear quantitative definition of concessionality and examine the implications of any new measures for ODA coverage.

- **Participants' views are invited on which of the following are most important in a renewed ODA concept:**
- **Allow fair comparison of donor/provider effort;**
 - **Provide information to recipients on aid inflows;**
 - **Encourage the most efficient use of aid and other resources and/or;**
 - **Provide precise and reliable delineation of what will be reportable as aid.**

Other suggestions are also welcome. Participants' priorities may help establish a framework for considering various proposals for changes to the ODA definition, some which are outlined below.

Current Issues with the ODA Definition

ODA and its associated UN targets (0.7% of GNI for total ODA; 0.15-0.2% of ODA for least developed countries) have been a vital benchmark for comparing efforts among donors and galvanising political support to allocate more resources for development. Whether or not the specific targets remains valid today, they have clearly helped maintain donors' commitment to development co-operation.

¹ The ideas expressed in this working paper do not necessarily represent views of the OECD, the OECD's Development Assistance Committee (DAC), or their member countries, or the endorsement of any approach described therein.

The ODA definition has, however, come under criticism over the past decades. Many argue that it is too broad because it includes expenditures not giving rise to cross-border flows to developing countries. Some would also exclude aid to middle-income countries that still feature on the “DAC list of ODA recipients”. But others argue that the definition is too narrow, as it omits some genuine official efforts in favour of development, or acts as a disincentive to develop new, innovative financial mechanisms (e.g. guarantees or rewards) that could mobilise significant amounts of private investment for development. Compounding these objections is the recent divergence among DAC members on how to interpret the ‘concessional in character’ criterion.

Is the Concept Too Broad?

a) *ODA-eligible Countries and Territories*

The “[DAC list of ODA recipients](#)” includes all low- and middle-income countries and territories, except G8 members, EU members and countries with a firm date for entry into the EU. The countries on the list are divided into three income groups – low, lower-middle, and upper-middle income – with a special group for the least developed countries. Even though the list has shrunk substantially over the years, with 55 having been removed from the list and only 17 added (11 of these being former Soviet Union republics), it has come under criticism for including as ODA-eligible some emerging economies that, themselves, are becoming increasingly important providers of development cooperation – e.g. Brazil, Chile, China and Turkey are still eligible for ODA. This raises questions, for instance, as to whether scarce ODA resources are being diverted away from the neediest countries, resulting in diminished development impact.

b) *Contested Areas of ODA Grant Reporting*

Refugees in Donor Countries – ActionAid’s “[Real Aid](#)” reports have repeatedly criticised the inclusion in ODA of the first 12 months’ sustenance costs of refugee claimants arriving in developed countries. The DAC has also considered proposals to drop this item, but has never arrived at agreement to do so. In recent years, Greece has argued that the item should rather be broadened. If the limitation to the first 12 months were lifted, this would greatly expand the amount reportable as ODA.

Imputed students’ costs – Since the late 1980s, members have been able to score as ODA the implicit subsidy of tuition of students from developing countries attending free or subsidised public universities in donor countries. NGOs have objected that these are domestic expenditures, and some have pointed out that where the students do not return home, the subsidy results in brain drain rather than capacity building. On the other hand, Greece has urged the DAC to consider widening this item, so as also to cover school children from countries on the DAC List of ODA Recipients.

Debt forgiveness – Current rules allow as an ODA grant, the cancellation by the official sector of claims on developing countries, even if the loans were not being repaid, regardless of the actual cost to the official sector of indemnifying the lenders (which is usually much less than the value of the debt cancelled). Again, NGOs have objected to this, and the Center for Global Development has proposed an alternative measure called “[Net Aid Transfers](#)” which deducts from ODA all debt relief on non-ODA loans.

- **Should refugee and student costs continue to be reportable as ODA?**
- **Should debt forgiveness be removed from ODA, or alternatively, valued only at the actual cost to the official sector of indemnifying borrowers, net of any payments received for insuring or guaranteeing the loans?**

Is the Concept Too Narrow?

c) How to Include Leveraging Instruments?

Despite the exceptions above, the DAC measurement system is based primarily on actual cross-border transfers of resources. This focus on actual outflows has been seen as a disincentive to many bilateral agencies to use instruments that could mobilise private investment for development. An increasing number of developing countries need private finance, guarantees or equity – rather than official grants – to boost infrastructure financing and economic growth, and to stimulate their private sector.

Some providers have been urging more generous interpretation of ODA, to allow coverage of programmes and activities extended by their development finance institutions – such as non-concessional lending, and loan and investment guarantees – that have minimal immediate cost to providers but offer large potential benefits to recipients. In fact, the current focus on net outflows tends to give more credit to investment projects that fail. This is because loss-making investments, like debt relief or forgiveness, score as positive net ODA whereas loans repaid on schedule and profit-making equity sales score as nil and negative ODA, respectively.

d) Global Public Goods: The Cases of Climate Change and Peace and Security

Global challenges have become an increasingly important part of the development agenda. Hence, more comprehensive monitoring of external development finance will prompt discussion on the need to finance global objectives or public goods (e.g. preventing contagious diseases, biodiversity protection, climate change mitigation and adaptation, peace and security). This will necessitate a review of statistical methods to track financing for global objectives or public goods. At present, the ODA rules only allow to the extent to which these activities have development as their main objective. Questions, however, are being raised as to whether maintaining this distinction is useful. For example, should donors' broad efforts to fight climate change, uphold universal rights, or promote global dialogues be counted as ODA, even when they do not focus specifically on developing countries?

By contrast, a very clear line has been drawn over the years by the DAC as to which [peace and security-related expenditures](#) can be counted as ODA. These include:

- Security system management and reform, more specifically management of security expenditure, enhancing civil society's role in the security system, security system reform to improved democratic governance and civilian control;
- Support to civilian activities related to peacebuilding, conflict prevention and resolution;
- Participation in UN peacekeeping operations for specific activities such as human rights and election monitoring, rehabilitation of national infrastructure, explosive mine removal (costs for military contingents participating in UNDPKO operations are not reportable as ODA) ;
- Reintegration of demobilised military personnel and small arm and light weapons control;
- Removal of land mines and explosive remnants of war, and;
- Technical co-operation to support the prevention of recruitment of child soldiers.

This narrow selection of activities excludes the vast majority of contributions to international peacekeeping efforts (only 6% of multilateral contributions to UN peacekeeping scores as ODA).

- **Should more peace and security expenditures be reported as ODA (in view of the ODA criterion of promoting the economic and social development of recipient countries), or be counted as part of a broader official measure of development effort?**

e) Tax Breaks for Contributions to NGOs

At present, “private charitable flows” include the full value of spending by developmental NGOs, without deducting the value of any tax concessions granted on the contributions that financed them. Over the years, several DAC members have urged that the value of tax breaks afforded to private charitable aid be counted as ODA, which means that it would need to be subtracted from the private flow to avoid double counting. The idea has also received some academic support, with one proponent arguing that “tax expenditures” on such concessions are a form of [“Hidden Foreign Aid”](#).

Other DAC members have objected, arguing that ODA should only count expenditure from revenue already raised, and that NGOs would resent the discounting of their efforts by subtracting imputed amounts of foregone tax revenue.

- **Participants’ views are invited on whether tax relief on contributions to NGOs might be shifted from private flows to ODA.**

Loan Concessionalality

f) Concessional in Character

The 2012 [DAC High Level Meeting](#) specifically agreed to:

“Establish, as soon as possible, and at the latest by 2015, a clear, quantitative definition of ‘concessional in character’, in line with prevailing financial market conditions.”

This refers to the part of the ODA definition that requires it to be “concessional in character”. There is already a quantitative test that the loan must bear a grant element of 25% calculated at a 10% discount rate, but with long-term interest rates now far below 10%, “profit-making” loans (where donors make net returns by lending at rates that exceed their fund-raising costs) may qualify under this test.

Opinions differ among DAC members as to whether concessionalality should be assessed from the donor’s or the recipient’s standpoint. From the donor’s standpoint, concessionalality may be seen as involving some implicit or explicit taxpayer subsidy of loan terms. From the recipient’s standpoint, concessionalality might be taken as implying terms more favourable than the country could obtain on its own faith and credit.

- **Participants are invited to read [the chronology of recent DAC discussions of this issue](#) and the [proposal by four DAC members](#) for a new way of measuring concessionalality from the borrower’s standpoint, and to give their initial views on the following questions:**
 - **Is the [grant element methodology](#) for combining consideration of interest rate, grace period and maturity a suitable basis for a quantitative definition of “concessional in character”? If not, what other basis would be preferable, e.g. consideration of interest rate alone?**

- Assuming a grant element calculation should be used, how should the discount rate be set? Is the method proposed in the members' paper suitable? What improvements could be suggested?
- What are participants' views of an alternative suggested by the United States, viz. to have only a single test of concessionality, using the [Differentiated Discount Rate](#) as the discount rate, and raising the required concessionality level to at least 35%?

g) *Splitting Loans into Concessional and Non-concessional Elements*

The cash basis of the data means that if a loan is classified as concessional, the whole amount disbursed is recorded as concessional, with repayments of principal later being deducted from concessional flows. However, users of the statistics often imagine that concessional official loans are divided into two portions, with the concessional elements recorded under ODA and the non-concessional under "other official flows".

In 1998, a World Bank research paper suggested that this second method was superior, and later that year the Bank's landmark report "[Assessing Aid](#)" showed figures for "Adjusted Official Aid" where only the concessional element of loans was included.

The continuing moves towards accruals accounting in budgeting and "mark to market" approaches to balance sheets would also seem to suggest that the case for recording concessionality as a separate quantity may have become stronger rather than weaker over the past 15 years.

On the other hand, splitting loans into "grant equivalent" and "market equivalent" portions would run counter to the cash basis of the data and involve the recording of transactions not visible to recipients.

- **Should ODA loan reporting shift to counting only the concessional element of the loan as ODA, as [recommended by the World Bank in 1998](#)?**