

# TREATMENT OF CONCESSIONALITY IN DAC STATISTICS

*G-NEXID*

*Workshop, Trade Regulations: Implications for the Financing of Trade  
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*Valérie Gaveau & Cécile Sangaré  
OECD Development Co-operation Directorate*

# Outline: TREATMENT OF CONCESSIONALITY IN DAC STATISTICS

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THE CONCEPT OF OFFICIAL DEVELOPMENT ASSISTANCE (ODA) AND MODERNISATION PROCESS

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LOANS TO OFFICIAL ENTITIES (SOVEREIGN AND SUB-SOVEREIGN) IN DEVELOPING COUNTRIES

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LOANS TO THE PRIVATE SECTOR IN DEVELOPING COUNTRIES

## Official Development Assistance (ODA):

- Concept of ODA, or aid, defined over 50 years ago.
- Refers to **public** financial **support** - either grants or "concessional" loans - from OECD-DAC member countries to developing countries in support of **development**.
- Tracking of ODA is crucial to inform decisions on aid targeting; UN target of 0.7% ODA/GNI.
- The Development Assistance Committee (DAC) sets the official definition of ODA and provides instructions through reporting directives.

## ODA modernisation process:

- DAC statistical system being modernised to better reflect the new global development landscape.
- **ODA modernisation** helps to ensure that the right incentive frameworks are in place to realise the ambitious and transformative post-2015 Sustainable Development Goals (SDGs)
- ODA modernisation comprises:
  - a revised method of recording **concessional loans**
  - an improved representation of the role of **private sector instruments** while offering the right incentives (and removing disincentives) for the use of these instruments

## 2014 High Level Meeting agreement:

- Differences in how loans were scored as ODA brought about a need to **clarify concessionality definition and measurement**.
- New measurement system where **only the grant equivalent of loans** is counted in ODA.
- **Quantitative definition of concessionality:** in DAC statistics, concessionality implies a **grant element** of at least
  - **45%** in the case of loans to LDCs and other LICs (calculated at a rate of discount of **9%**).
  - **15%** in the case of loans to LMICs (calculated at a rate of discount of **7%**).
  - **10%** in the case of loans to UMICs (calculated at a rate of discount of **6%**).

## Grant element:

- **Mathematical assessment of the financial terms** of a transaction or set of transactions.
- **Difference between the face value of a loan and the present value of the service payments** the borrower will make over the lifetime of the loan, expressed as a percentage of the face value.
- Four factors determine the grant element:
  - **interest rate**;
  - **grace period**;
  - **maturity**;
  - **discount rate** used to determine the present value of future payments.

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# LOANS TO OFFICIAL ENTITIES (SOVEREIGN AND SUB-SOVEREIGN) IN DEVELOPING COUNTRIES

	BEFORE: FULL FACE VALUE	AFTER: ONLY THE GRANT EQUIVALENT OF A LOAN
Grant Element Thresholds	<ul style="list-style-type: none"> <li>• 25%</li> </ul>	<ul style="list-style-type: none"> <li>• 45% for LDCs and other LICs</li> <li>• 15% for LMICs</li> <li>• 10% for UMICs</li> </ul>
Discount Rates	<ul style="list-style-type: none"> <li>• 10%</li> <li>• Used for assessing the concessionality of a loan</li> </ul>	<ul style="list-style-type: none"> <li>• 5% base (current IMF discount rate) + adjustment factors of               <ul style="list-style-type: none"> <li>○ 4% for LDCs and other LICs</li> <li>○ 2% for LMICs</li> <li>○ 1% for UMICs</li> </ul> </li> <li>• Used for both assessing the concessionality of a loan (does it meet the threshold?) and for calculating its ODA grant equivalent or the concessional portion of the loan.</li> </ul>
Measurement System	<ul style="list-style-type: none"> <li>• Positive ODA when disbursed, negative ODA when repaid</li> </ul>	<ul style="list-style-type: none"> <li>• Grant equivalent of loan disbursements (grant element multiplied by amount disbursed).</li> <li>• Repayment of past loans is not subtracted from ODA but will continue to be collected and published.</li> </ul>
Debt sustainability		<ul style="list-style-type: none"> <li>• Requirement to comply with IMF and WB policies.</li> </ul>

## LOANS TO OFFICIAL ENTITIES (SOVEREIGN AND SUB-SOVEREIGN) IN DEVELOPING COUNTRIES

### Parameters entering the assessment of concessionality in DAC statistics

	LDCs and other LICs	LMICs	UMICs
Base rate (IMF flat rate used in 2014)	5%	5%	5%
Risk adjustment factor	4%	2%	1%
Discount rate used in the calculation of the grant element	9%	7%	6%
Threshold (minimum grant element for qualifying as ODA)	45%	15%	10%

- ❖ The DAC will regularly **assess the need for adjusting discount rates**, in particular following any change to the IMF rate.
- ❖ **Tied aid** falls under the OECD Arrangement and must meet 35%/50% concessionality levels, calculated using DDRs.



- Measurement in ODA based on **grant equivalents**
- In DAC statistics, concessionality implies a **grant element of at least 10%**, calculated at a rate of discount of:
  - **5%** for global institutions and multilateral development banks
  - 5% plus an adjustment factor [1%], i.e. [**6%**] for other organisations, including sub-regional organisations

## Overview – High Level Meeting February 2016

- Agreement to reflect in ODA the **effort of the official sector in providing PSI** (15 principles).
- Objective: **set incentives (remove existing disincentives)** for the use of PSI in development co-operation and **strengthen the private sector** in developing countries.
- Measurement of donor effort based on **grant equivalents**.
- **PSI flows** are not recorded as ODA flows, but as OOF.
- **Two approaches** for reporting – institutional or instrument-specific.

## Key elements - Concessionality and grant element calculation

- **Criteria for ODA-eligibility and threshold**
  - **PSI are non-concessional in nature.** There should be either no threshold or purely technical thresholds. PSI should rather be **additionality**.
  - Thresholds agreed for sovereign loans could **incentivize unnecessary subsidisation of finance**, create market distortion & crowd out private sector.
- **Discount rate**
  - Financing the private sector is generally riskier than the official sector, in principle necessitating a **risk premium in the discount rate, additional to the agreed sovereign risk premia.**
- **Safeguards**
  - “At the same time, there is a need to avoid blurring the lines between developmental and commercially-motivated operations (trade and investment) with the private sector, hence a need for safeguards.”

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# LOANS TO THE PRIVATE SECTOR IN DEVELOPING COUNTRIES

**Concrete proposal for parameters of the ODA calculation, as discussed in October 2016**

	LDCs and other LICs	LMICs	UMICs
Base rate (IMF flat rate used in 2014)	5%	5%	5%
Risk adjustment factor	4%	2%	1%
<i>Discount rate for loans to official entities</i>	<b>9%</b>	<b>7%</b>	<b>6%</b>
Private sector surcharge	<b>1%</b>	<b>1%</b>	<b>1%</b>
Discount rate for loans to official entities	<b>10%</b>	<b>8%</b>	<b>7%</b>
Threshold (minimum grant element for qualifying as ODA)	<b>0%</b>	<b>0%</b>	<b>0%</b>

## Concerns raised by a number of members, and Export Credit Group (ECG) community

- The proposed discount rates and thresholds could **blur the line between developmental PSI and commercial operations.**
- A higher eligibility threshold allows an easy differentiation between “aid loans” & export credits.
- Allowing as ODA transactions with a low or even a zero concessionality level would alter the existing clear boundary.

**Concern relates to the possible unintended consequences of the ODA calculation in terms of:**

- **trade distortions:** tied aid may incorrectly be reported as untied aid to escape the Arrangement rules.
  - **conflicts with the rules of the World Trade Organisation (WTO):** possible legal challenges at the WTO if the application of DAC proposed discount rates result in positive grant elements that could be interpreted as subsidies.
- **On-going consultation between DAC and ECG: creation of a Task Force.**

## DAC-ECG Task Force

The task force should elaborate proposals on:

- **PSI grant element calculation and technical threshold:**
    - A discount rate that reflects the underlying instruments and their market-oriented character and that does not over-inflate ODA.
    - A technical threshold for PSI, compatible with the 2016 HLM agreement, considering the arguments put forward by members.
    - Possibly, alternative wording for describing the ODA calculation for PSI in DAC statistics.
  - **Qualitative safeguards**, reinforcing existing safeguards to avoid blurring the lines between export credits and ODA.
  - **Transparency provisions** to ensure that PSI do not infringe with the Arrangement and WTO rules
- **Invite expert on WTO rules to advise the Task Force.**

# Thank you!

HLM agreement in 2014:

<http://www.oecd.org/dac/OECD%20DAC%20HLM%20Communique.PDF>

HLM agreement in February 2016: <http://www.oecd.org/dac/DAC-HLM-Communique-2016.pdf>

Modernisation of the DAC statistical system:

<http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/modernisation-dac-statistical-system.htm>