Report

ODA loans: tracking a growing source of development financing

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Executive summary

Over recent years, an increasing proportion of official development assistance (ODA) has been given in the form of loans rather than grants. To improve the accounting methods used for deciding what should be counted as concessional loans, the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) has agreed to overhaul the method for calculating how much of donors' lending should be counted as ODA. The DAC adopted a new set of rules for counting ODA loans in December 2014, marking the biggest change in the way ODA is measured since the concept was introduced in the 1960s.

This report examines the increase in the amount of ODA provided in the form of loans between 2005 and 2013.[1] It highlights the main providers and recipients of loans and shows how the balance has changed between loans and grants for these countries. It looks at the most recent data on ODA loans alongside measures of debt sustainability to address whether ODA loans are being given to countries that can afford to repay them. It examines the new rules on accounting for ODA loans, explaining the changes and assessing what the impact on ODA levels might be. Finally, it sets out important implications and considerations for policy-makers and stakeholders.

Key findings

Trends in loan giving

- In aggregate, ODA loans have risen faster than grants and now account for over a quarter of total ODA disbursements to developing countries. Gross ODA lending from DAC donors increased by 73%, whereas ODA grants from DAC donors (excluding debt relief) grew at a much slower pace, rising by just 25%.
- Growth in ODA loans has been driven by a small group of donors. For some of these, the growth in ODA loan giving has far outstripped increases in ODA grant giving. For example, France more than trebled its lending, while French grants fell in real terms.
- The increase in ODA loans seems to be more pronounced in countries receiving higher overall levels of ODA. Some ODA recipients have seen loans increase at a much greater pace than grants, including a number of low-income countries. Four countries – Egypt, Kenya, Myanmar and Turkey – saw an increase in ODA loans of over 500%.
- The most recent data shows that donors typically give ODA in the form of loans to developing countries who are not overburdened with debt. However, overall levels of indebtedness and the cost of servicing that debt looks likely to increase for many developing countries over the next few years.

Impacts of the new DAC rules

- Under the new rules, only the grant element of a loan will be reported as ODA rather than the full face value. Also, loan repayments will no longer be subtracted from the headline ODA figure. These new rules certainly give a fairer measure of ODA in the sense that highly concessional loans will count for more ODA than loans at lower levels of concessionality. For loans disbursed under the new rules, it is sensible to discontinue the practice of subtracting loan repayments from the headline ODA figure as only the grant element of the original loan will have been reported in the first place.
- Loans disbursed under the old rules will also no longer have their repayments subtracted from the headline ODA figure. This has a distorting effect, meaning that, for some countries, the reported levels of ODA will appear significantly higher than under the old rules. For example, Japan's reported 2013 ODA appears over 50% higher when the new rules are applied.

[1] ODA loans have shown a marked increase since around the year 2005 so this report focuses on the period 2005-2013.As all references in this report to loan giving relate to the period 2005–2013; the period is not, therefore, repeated at every instance.

- Another effect of no longer subtracting loan repayments from headline ODA is that, in the long run, development assistance given in the form of loans will generate a higher level of reported ODA than was the case under the old rules. This may incentivise donors to give more aid in the form of loans to maximise their reported levels of ODA.
- The new rules allow donors to report a higher level of ODA for a loan to a low income country than for the same loan to a middle income country; this could create an incentive for donors to give more loans to the poorest countries.
- Some important elements of the new rules, especially in the area of debt relief, have yet to be agreed.

The state of play on ODA loans: trends and issues

Trends in lending by donors

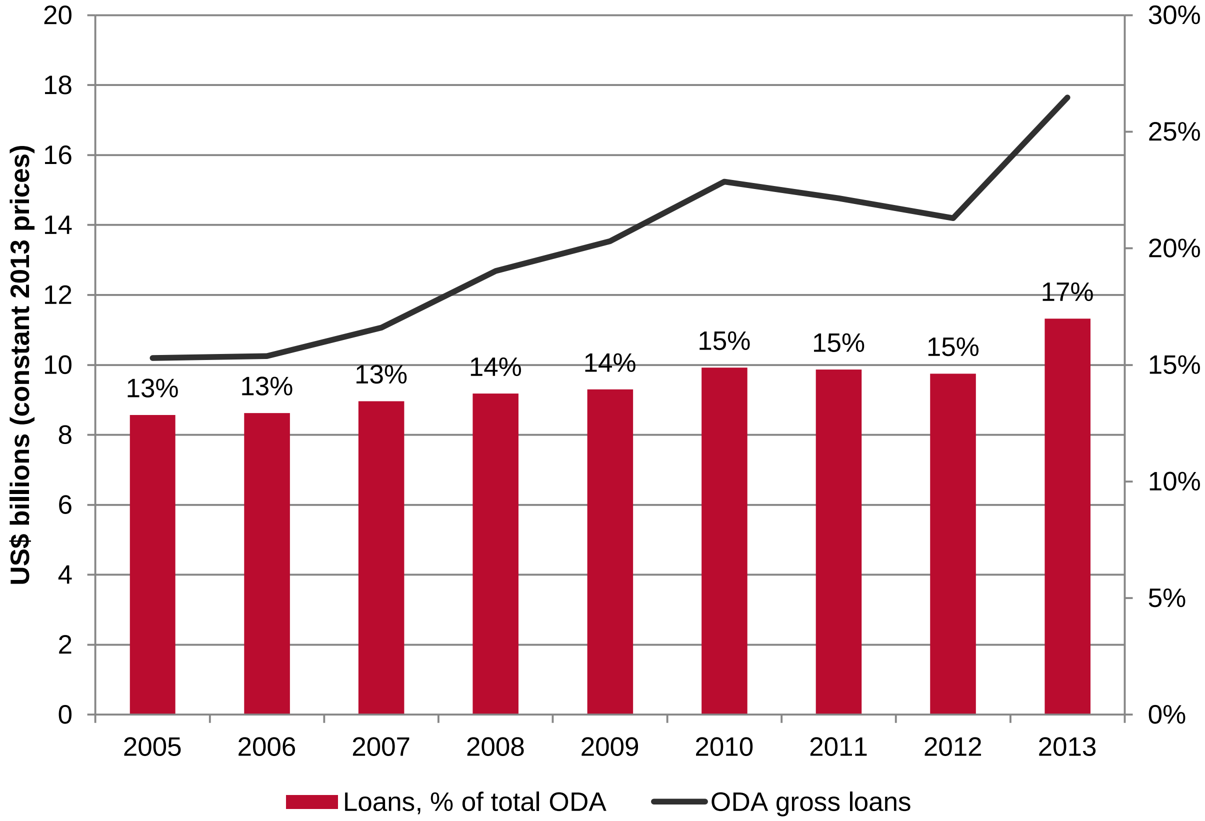
Official development assistance (ODA) can be provided by donors as either grants or concessional loans. In recent years, there has been a growing trend for more ODA to be disbursed in the form of loans. The Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) recently stated that

> … concessional loans provided to developing countries by bilateral and multilateral donors are an important and enduring feature of the development finance landscape.[2]

Between 2005 and 2013, gross ODA lending from DAC donors increased by 73%, whereas ODA grants from DAC donors (excluding debt relief) grew at a much slower pace, rising by just 25%.

The trend line in Figure 1 shows the dollar value of loans disbursed by DAC donors in each year since 2005 with the bars representing the share of total ODA given in the form of loans in each year. This shows that loans have not only increased in total value, but have also made up an increasing proportion of ODA over the period. By 2013, loans accounted for 17% of all gross bilateral ODA from DAC donors, with total new loan disbursements in that year standing at almost US$18 billion.

Figure 1: Bilateral ODA loans are rising, both in real terms and as a proportion of total ODA

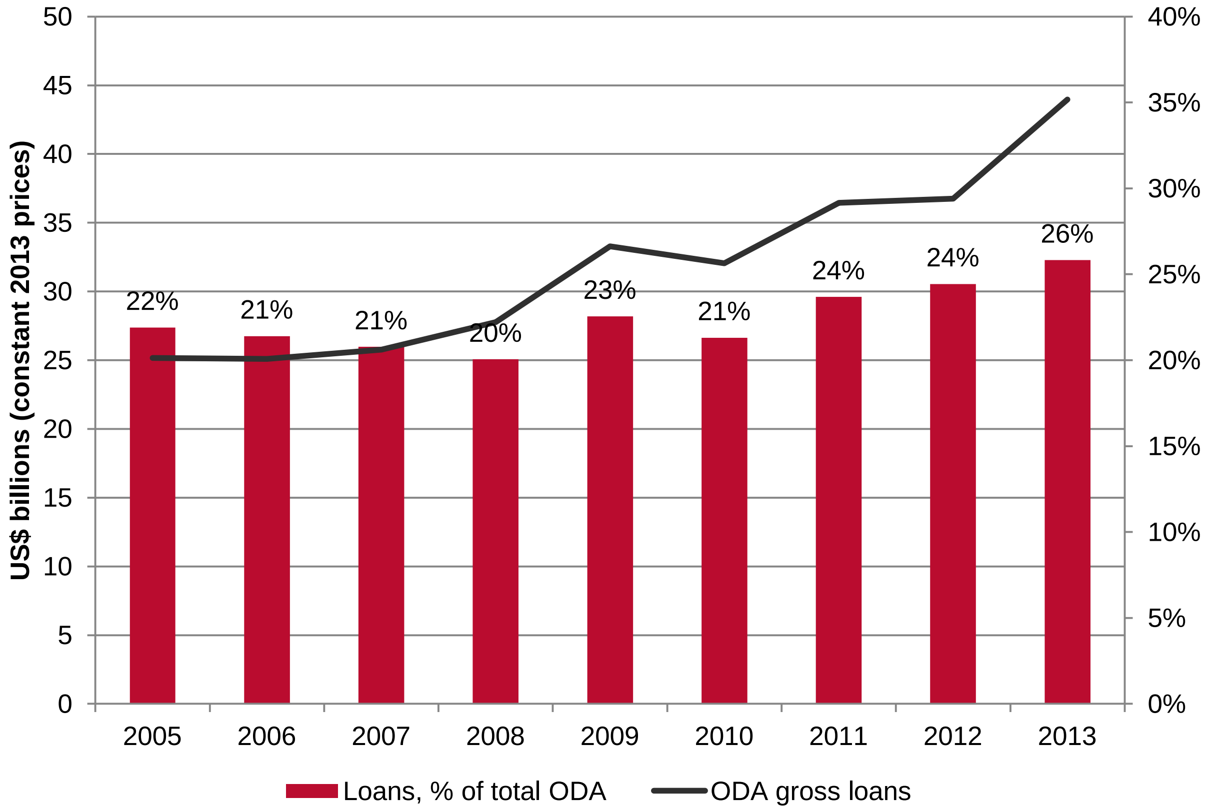


Source: OECD DAC

[2] OECD DAC, 2014: 'Modernising Official Development Assistance (ODA) Concessional loans before and after the HLM'. www.oecd.org/dac/stats/documentupload/ODA%20Before%20and%20After.pdf

The amount of ODA loans disbursed to developing countries increases significantly when multilateral and non-DAC donors are included. Many multilateral organisations (such as the International Development Association (IDA)[3] and the regional development banks) which receive ODA funding from donors pass these funds on to developing countries in the form of loans. In addition, there are donors that are not members of the DAC which give significant amounts of ODA in the form of loans. As Figure 2 shows, when lending from these sources is included, the total of ODA loans disbursed to developing countries in 2013 increases to US$44 billion, or 26% of total gross ODA (excluding debt relief).

Figure 2: The amount and proportion of ODA loans is higher when multilateral lending is included



Source: OECD DAC

Who provides ODA loans?

The great majority of ODA loans come from a small group of donors. Data for 2013 shows that:

- Japan, France and Germany accounted for almost 90% of ODA loans from bilateral DAC donors
- IDA and the European Union (EU) together accounted for 66% of ODA loans from multilateral donors
- The United Arab Emirates (UAE) alone accounted for 63% of ODA loans from non-DAC donors.

Among this group of donors, France, Germany, the EU and the UAE all recorded very large increases in the quantity and proportion of ODA disbursed in the form of loans, compared with the increase in the amount of ODA given in the form of grants by these donors.

[3] The IDA is a part of the World Bank Group established to provide concessional financing to the poorest developing countries.

Table 1: Growth in ODA loans, selected donors

	ODA loans in 2005	ODA loans in 2013	US$ increase in ODA loans	% change (loans)	*% change (grants)*
France	977	3,025	2,049	210%	-5%
Germany	841	2,961	2,120	252%	*55%*
Japan	6,884	9,721	2,837	41%	*64%*
European Union	579	5,182	4,603	795%	*18%*
IDA	8,570	9,913	1,343	16%	*64%*
United Arab Emirates	127	2,131	2,004	1,581%	*526%*

Source: OECD DAC. Monetary figures are in US$ million, constant 2013 prices.

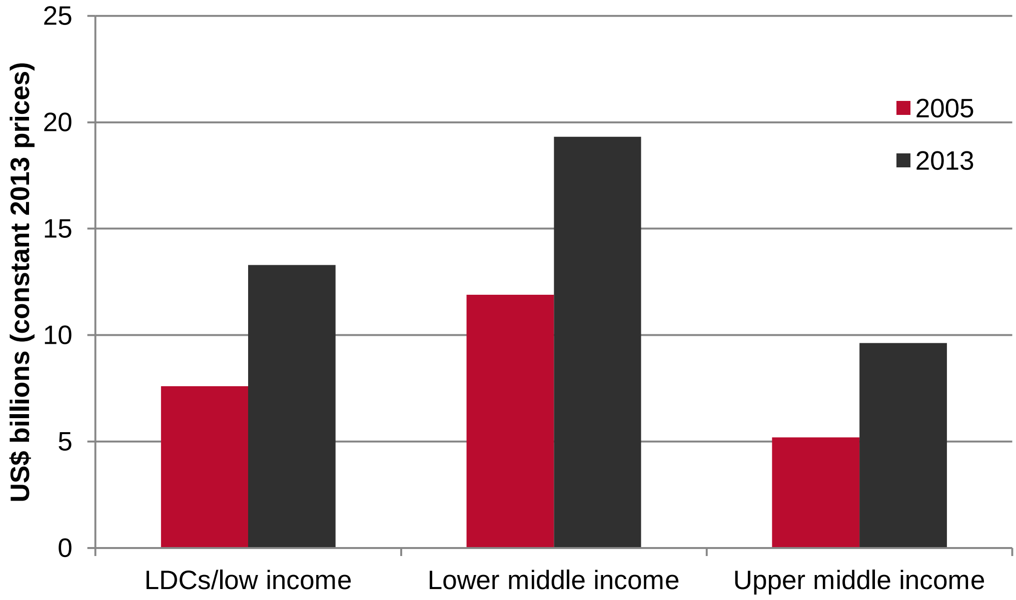
As Table 1 shows:

- The increase in ODA loans from France, Germany, the EU and the UAE considerably exceeded the increase in grants.
- ODA grants from France actually fell in real terms over a period when ODA loans given more than trebled.
- Lending from Japan grew substantially over the period, but grants increased at a faster pace.
- Grants from IDA grew at a faster rate than loans. This can largely be attributed to IDA only beginning to report substantial amounts of ODA grants relatively recently.

Which countries are receiving ODA loans?

ODA loans have increased across all developing country income groups, with gross lending to least developed and low income countries up by 75% over the period and increases of 62% and 85% for lower and upper middle income countries respectively.

Figure 3: Growth in ODA loans, by recipient 'group'



Source: OECD DAC

This aggregation of data does however mask the varying situations of individual countries. An investigation of individual country statistics reveals that half the countries that receive ODA saw loans grow faster than grants over the period. Furthermore, the data shows that the countries receiving the largest amounts of ODA were more likely to see a relatively rapid growth in ODA loans. To illustrate this point, eight of the 10 largest recipients of gross ODA (excluding debt relief) in 2013 saw ODA loans rise faster than grants between 2005 and 2013. Conversely, seven of the 10 countries that received the least ODA in 2013 saw grants rise faster than loans over the period.

The 10 largest recipients of ODA loans each received more than US$1 billion of gross loan disbursements in 2013. Five of these recipients were low income countries, four were lower middle income and one was upper middle income. All of these countries saw large increases in loan disbursements between 2005 and 2013 and saw ODA loans rising at a faster rate than grants, in most cases by a very wide margin.

Table 2: Growth in ODA loans (10 largest recipients in 2013)

Recipient	Income group	ODA loans in 2005	ODA loans in 2013	$ increase in ODA loans	% change (loans)	*% change (grants)*
Viet Nam	Lower middle	1,428	3,739	2,311	162%	*2%*
India	Lower middle	2,254	3,214	960	43%	***-17%***
Egypt	Lower middle	436	3,091	2,655	610%	*157%*
Myanmar	Low income	9	2,990	2,981	33,154%	*381%*
Turkey	Upper middle	303	2,846	2,543	838%	*19%*
Bangladesh	Low income	1,109	1,882	773	70%	*59%*
Morocco	Lower middle	412	1,656	1,245	302%	*0%*
Kenya	Low income	241	1,495	1,255	521%	*160%*
Ethiopia	Low income	474	1,255	781	165%	*47%*
Tanzania	Low income	512	1,204	691	135%	*63%*

Source: OECD DAC. Monetary figures are in US$ million, constant 2013 prices.

Most of the recipients in Table 2 receive ODA loans from a variety of lenders and the amounts involved have been on a broadly increasing trend over the period. However, four of these countries have seen an increase of more than 500% in ODA loans in this period:

- The very large increase in loans to Myanmar is mainly due to US$2 billion of loan disbursements from Japan as part of a wider debt relief and restructuring deal between the two countries in 2013. This was supplemented in that year by almost US$1 billion in loans from IDA and the Asian Development Bank.
- The increase in Turkey's ODA loans is due to lending from the European Investment Bank, which the EU has included in its ODA totals since 2011.
- Egypt received US$2 billion in loans from the UAE in 2013. In that year Turkey, itself an ODA recipient, reported disbursing US$500 million in ODA loans to Egypt.
- Kenya's rise in ODA loans was spread across a number of donors, with loan disbursements from Japan rising by US$208 million (a 13-fold increase). Loan disbursements from France rose by US$160 million (an 11-fold increase), while loans from IDA and the African Development Fund were up by US$450 million (a 12-fold increase) and US$226 million (a nine-fold increase) respectively. Most of this lending went to a variety of energy and transport infrastructure projects, with particularly large loans in 2013 being used to finance renewable energy projects and the improvement of port facilities at Mombasa.

Debt sustainability and the allocation of ODA loans

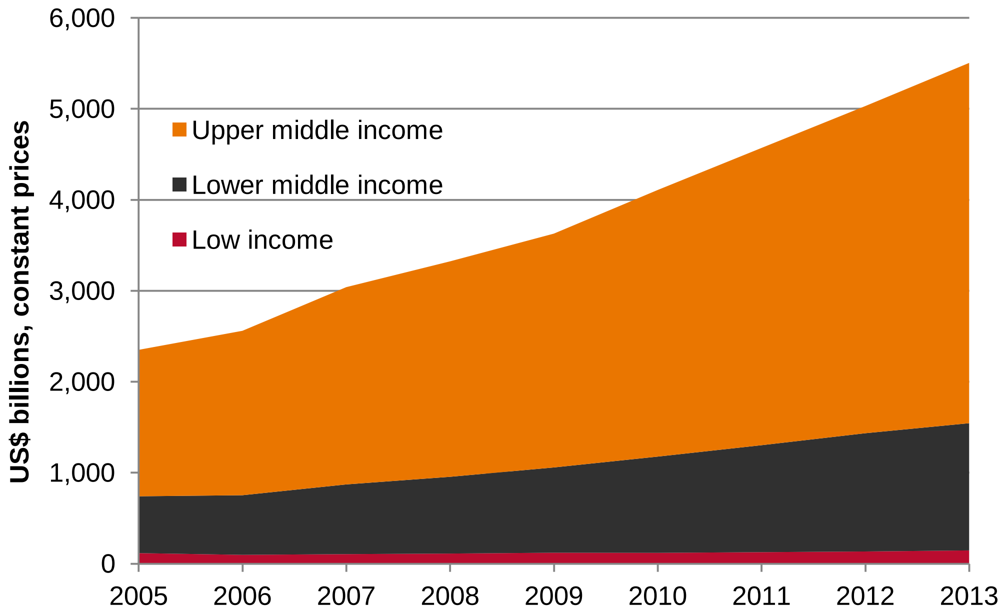
Levels of indebtedness in developing countries

A key concern surrounding any changes to the amount and the terms of loans to developing countries has to be the existing state of indebtedness in those countries and the sustainability of their debt obligations.

As can be seen from Figure 4, the total debt stock of developing countries has grown considerably since 2005. This rise has been concentrated in middle income countries, with aggregate debt stocks more than doubling in the period in both lower and upper middle income countries.

The debt stock of low income countries increased at a slower rate, reaching levels 25% higher in 2013 compared with 2005.

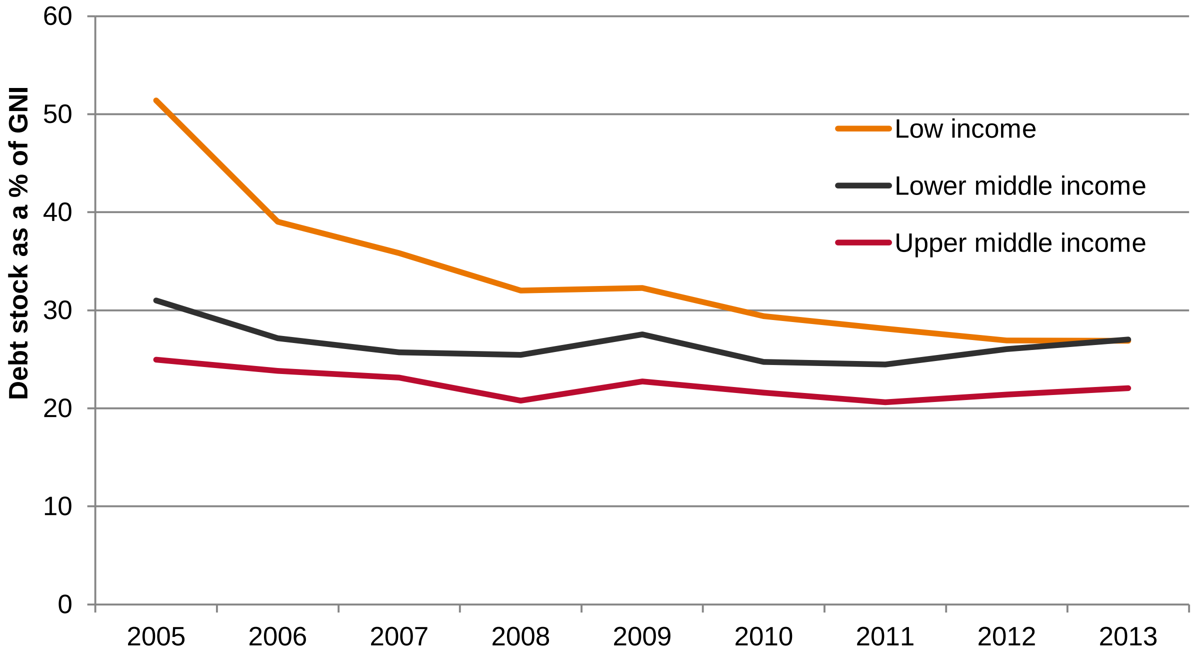
Figure 4: Aggregate debt stock of developing countries, by income group



Source: World Bank WDI

However, on average, economic growth in developing countries has outstripped the increase in debt. This means that total debt as a percentage of national income has fallen across all income groups.

Figure 5: Debt stock of developing countries as a percentage of GNI, by income group



Source: World Bank WDI

Therefore, although absolute levels of debt have grown, the economies of developing nations have grown even faster and the levels of indebtedness appear, on this measure at least, to have become more sustainable in recent years.

It would be wrong though to be complacent about this trend. Developing countries are increasingly obtaining credit from a wider range of sources and some have argued that a new lending boom to developing countries is imminent. For example, a recent report by the Jubilee Debt Campaign predicted an increase in the proportion of government revenue spent on debt payments in many low income countries over the coming years, if current trends in lending are continued.[4]

Specifically, the report predicted that spending on debt service would rise significantly as a proportion of government revenue

- in 11 low income countries, if IMF and World Bank predictions of continuous high economic growth over the next decade are met
- in 25 low income countries, if IMF and World Bank estimates of one economic shock over the next decade are met
- in 29 low income countries, if economic growth is lower than current IMF and World Bank estimates suggest.

This prediction was echoed in a briefing paper by Eurodad, which pointed out that, in addition to the concessional financing covered by the ODA statistics, developing countries have recently been borrowing from increasingly risky and more expensive sources.[5]

[4] 'Don't turn the clock back: Analysing the risks of the lending boom to impoverished countries': Jubilee Debt Campaign, October 2014.
[5] 'Why a United Nations sovereign debt restructuring framework is key to implementing the post-2015 sustainable development agenda': T. Stichelmans, Eurodad (European Network on Debt and Development), May 2015.

ODA loans, debt sustainability and responsible lending

When donors give ODA in the form of loans, it is important that these loans do not serve to burden the recipient with an unsustainable level of debt. Loans should, in light of this consideration, only be used as an instrument of aid in cases where the recipient's existing debts are manageable and where more lending will not put the country at risk.

The IMF conducts regular analysis of the debt sustainability in individual developing countries. It states that these analyses are designed to assess the existing debt situation, identify vulnerabilities and risks either in the debt structure or the country's policy framework, and ensure all policy options are explored to make certain that the country can repay its loans if it is at risk of defaulting.[6]

Based on the analysis, each country is then rated on its risk of debt distress – i.e. how high is the risk that it will be unable to pay back existing loans. There are four ratings: low risk of debt distress, moderate risk, high risk, and 'in debt distress'.

The International Monetary Fund (IMF) debt sustainability ratings are available for 70 countries. Table 3 shows the amount of ODA loans disbursed in 2013 to these countries, broken down by the four debt sustainability ratings.

Table 3: ODA loan disbursements in 2013, by IMF debt distress rating

Risk of debt distress	ODA loan disbursements (US$ million)	Number of countries	Average loans per country (US$ million)
Low	16,139	22	734
Moderate	4,114	32	129
High	283	13	22
In debt distress	178	3	59

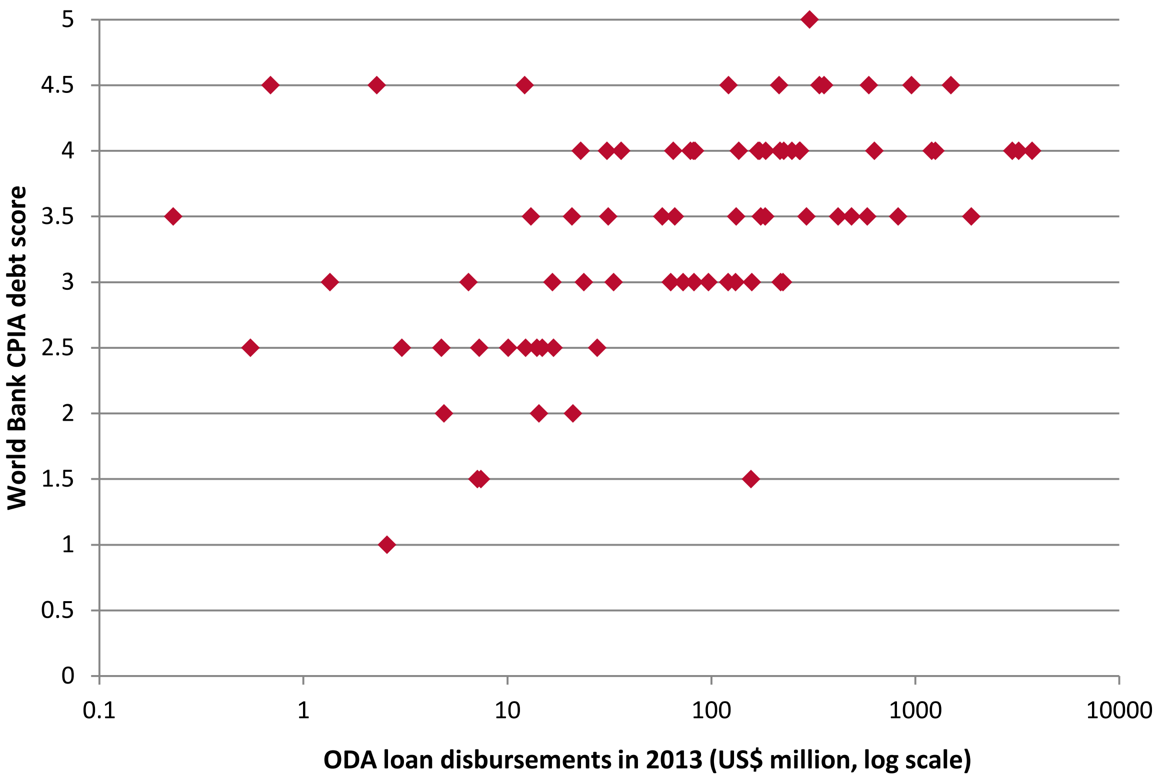
Source: IMF, OECD

It appears from the IMF's debt sustainability analysis that the great majority of ODA loans are disbursed to countries which are at low or moderate risk of debt distress. A total of US$461 million of ODA loans in 2013 went to countries at high risk of, or in, debt distress – approximately 1% of total ODA loans.

One key input to the IMF's debt sustainability analysis is the World Bank's Country Policy and Institutional Assessment (CPIA) debt score. This provides an assessment of whether a country's debt management strategy is helping it to predict, manage and avoid budgetary risks – and whether it assists the debt to be managed sustainably in the long term. This indicator scores each country on a scale of 1 to 5, with 5 representing countries with the 'strongest' debt policy framework. By plotting the amount of loans disbursed against the CPIA debt score for 80 developing countries, a correlation can be seen between the perceived strength of a country's debt policy framework and the amount of ODA loans that country receives.

[6] See IMF factsheet 'Debt Sustainability Analysis': www.imf.org/external/pubs/ft/dsa/

Figure 6: Correlation between CPIA debt score and amount of ODA loans in 2013



Source: World Bank, OECD

The better a country is perceived to manage its debt, the more ODA loans it receives (with some exceptions).

The overall impression from the data is that, with some exceptions, donors do appear to take issues of debt sustainability into account when determining which countries should receive ODA in the form of loans. Essentially, those countries with the smallest debt sustainability problems and the strongest debt policy framework currently get the largest amount of loans. It is therefore vitally important that donors pay close attention to debt sustainability when making lending decisions in future.

The new rules on ODA loans

How the rules on ODA loans are changing

On 16 December 2014, the OECD DAC published its proposals for changes to the measurement of ODA.[7] These rules have been mostly agreed, but not yet fully implemented. (Some areas awaiting agreement are considered later in this report).

Timeline: The OECD DAC's ODA loans rule changes

Proposal for new rules accepted by DAC High Level Meeting	December 2014
Changes to reporting directives finalised	December 2015
ODA data for 2015 reported using both existing and new method of valuing loans	April 2016
Data continues to be reported in parallel using both existing and new rules	2016–2018
ODA data for 2018 reported under new rules only, reporting under current rules discontinued	April 2019

The most significant change agreed by the DAC in December was in the way concessional loans are valued for ODA. The current method has been criticised as overstating the benefit of ODA loans to developing countries. Two of the main criticisms have been:

1. Under the existing system, any loans with a grant element[8] of more than 25% are included in the ODA figures in their entirety. This means that loans with low concessionality (just over 25%) are valued the same as highly concessional loans.

2. The reference rate used in the calculation of the grant element has, for years, been set at an artificially high 10%.[9] The effect of this has been to inflate the grant element of ODA loans to the extent that even loans at commercial interest rates could be counted as ODA.

The DAC has responded to each of these points by agreeing the following changes to the ways concessional loans are valued in ODA statistics.

- **In future, only the grant element percentage of the loan, and not the full face value, will be counted as ODA.** This means that, for the first time, loans with a very high grant element will count for more ODA than loans with a relatively low grant element, meaning that donors are effectively rewarded for being 'generous'.

- **The flat 10% reference rate (used to calculate how concessional a loan is) will be replaced with a range of rates, based on the IMF's reference rate plus a 'risk premium' that depends on the status of the borrower.** The 'risk premium' has been set at 1% for

[7] See OECD DAC (2014) 'High Level Meeting – Final Communiqué': www.oecd.org/dac/OECD%20DAC%20HLM%20Communique.pdf

[8] The grant element is the standard way of measuring how concessional a loan is. It can be viewed as the difference between the cost, in today's prices, of the future repayments a borrower will have to make on the loan in question and the repayments the borrower would have had to make on a non-concessional loan. This is therefore the amount of money that is considered to have been 'given away' by the donor, hence grant element. The grant element is normally shown as a percentage of the value of the loan.

[9] The reference rate is a benchmark interest rate used in the calculation of the grant element – the higher the reference, the higher the grant element. For an accurate measure of concessionality, the reference rate should have some relationship to the market rate faced by the lender. Former chair of the DAC Richard Manning provided a succinct critique of the 10% reference rate in a letter to the *Financial Times* in April 2013. The letter is behind a paywall but can be accessed via Owen Barder's blog of 11 April 2013 'Are OECD countries getting away with murder on aid figures?': www.cgdev.org/blog/are-oecd-countries-getting-away-murder-aid-figures

upper-middle income countries (UMICs), 2% for lower-middle income countries (LMICs) and 4% for least developed countries/low income countries (LDCs/LICs). Since the IMF reference rate is currently 5%, this gives an effective reference rate of 6% for loans to UMICs, 7% to LMICs and 9% to LDCs/LICs. The adoption of a higher reference rate for LDCs and LICs (compared with the reference rates used for MICs) means that the grant element of a loan advanced to an LDC/LIC will always be higher than the grant element of the same loan if it were advanced to an LMIC or UMIC recipient.

- **The current 25% grant element threshold will be replaced by a range of threshold values, also based on the income status of the borrower.** In the case of LDCs/LICs, only loans with a grant element of more than 45% should be counted as ODA. For LMICs and UMICs, the threshold levels will be 15% and 10% respectively.

These changes are designed to result in a more realistic comparison of grants and loans in ODA statistics and will incentivise donors to give loans at higher levels of concessionality to the poorest developing countries.

In addition to the above measures, which apply to donor practice, a critical change is also being made in the way that loan repayments are treated in the accounting stage. At present, the capital repayments made by recipients in respect of existing ODA loans are subtracted from the headline net ODA statistics.

Under the new rules, the headline ODA figures will not be adjusted for repayments. This means that, although the amount of each loan counted in the ODA figures will be lower under the new rules (as only the grant element percentage is counted as ODA), donors will no longer subtract loan repayments from their headline ODA figures. This is a sensible change for loans disbursed under the new rules, as only the grant element of these loans will have been reported as ODA, rather than their full face value. However the netting-off of repayments will also cease for loans disbursed under the old rules. These loans will have had their full face value reported in the ODA figures and recent loans will have had little or no repayments subtracted from them.

Following the 2014 High Level Meeting at which the rule changes were agreed, the DAC released a briefing stating that the 'revised system'

- has marginal impact on overall ODA volumes
- does not include private sector investment
- conveys a fairer picture of provider effort (ensur*ing* comparability of resulting statistics across providers)
- is adapted to today's complex development cooperation landscape (establishes a level playing field among the various instruments that make up the development finance toolbox)
- helps to ensure lending practices that are aligned with developing countries' needs, capacities and constraints in terms of volumes, concessionality levels and debt sustainability
- strengthens the credibility and integrity of DAC statistics and transparency of development cooperation.[10]

What will the new rules mean for ODA levels?

To examine the effect of the new rules and understand the likely implications, we applied them to 2013 ODA. We found that, if the new rules had been applied, the amount of ODA reported by DAC donors would have been 4–5% higher than under the old rules. In this respect, the DAC is correct to state that the new rules have a 'marginal effect' on overall ODA volumes.

[10] OECD DAC 2014, 'Modernising Official Development Assistance (ODA): Concessional loans before and after the HLM ', www.oecd.org/dac/stats/documentupload/ODA%20Before%20and%20After.pdf

However, as can be seen from Table 4, some donors do in fact see a significant change to their individual ODA volumes. In particular, Japan sees an increase of over 50% in its reported ODA. This is due to two main factors:

- Japanese ODA loans are, on average, among the most highly concessional of any DAC donor, with an average grant element of over 70%
- Because loans have formed a large part of Japan's ODA for many years, Japan receives more in repayments on past loans than any other DAC donor.

At present these repayments are subtracted from Japan's headline ODA figures, but this will not be the case under the new rules.

The US also sees a significant rise in its reported ODA levels because, although it does not currently give any of its ODA in the form of loans, it is still receiving repayments on loans advanced in previous years. These repayments are currently subtracted from the US's headline ODA figure, but this would not be the case under the new rules.

Conversely, France and Germany would have reported substantially less ODA in 2013 if the new rules had been in force. This is because these countries provide ODA loans that are, on average, some of the least concessional among DAC donors, with an average grant element of around 40–45%.

Donors who have never given significant amounts of ODA in the form of loans will see little or no change to their reported ODA levels under the new rules.

Table 4: Reported ODA in 2013 by donor: old rules vs new rules

	Net ODA (old rules)	ODA (new rules)	Change %	Change US$ million
DAC Countries, Total	**135,072**	**141,247**	**4.6%**	**6,175**
Australia	4,846	4,846	0.0%	0
Austria	1,171	1,174	0.2%	3
Belgium	2,300	2,347	2.1%	48
Canada	4,947	4,989	0.8%	42
Czech Republic	211	211	0.0%	0
Denmark	2,927	2,937	0.3%	10
Finland	1,435	1,435	0.0%	0
France	11,339	10,894	**-3.9%**	**-445**
Germany	14,228	13,459	**-5.4%**	**-770**
Greece	239	239	0.0%	0
Iceland	35	35	0.0%	0
Ireland	846	846	0.0%	0
Italy	3,430	3,481	1.5%	51
Japan	11,582	18,102	56.3%	6,520
Republic of Korea	1,755	1,726	**-1.7%**	**-30**
Luxembourg	429	429	0.0%	0
Netherlands	5,435	5,496	1.1%	61
New Zealand	457	457	0.0%	0
Norway	5,581	5,581	0.0%	0
Poland	472	458	**-3.0%**	**-14**
Portugal	488	417	**-14.7%**	**-72**
Slovak Republic	86	86	0.0%	0
Slovenia	62	62	0.0%	0
Spain	2,375	2,603	9.6%	228
Sweden	5,827	5,832	0.1%	4
Switzerland	3,200	3,203	0.1%	3
United Kingdom	17,871	17,871	0.0%	0
United States	31,496	32,032	1.7%	536
European Union	15,959	13,832	**-13.3%**	**-2,128**

Source: Development Initiatives, based on OECD data

Considerations and implications

Could the changes incentivise more loans to LDCs ...

As mentioned earlier, under the new rules for calculating the grant element of ODA loans, the reference rate used for LDCs/LICs will be 9%, for LMICs 7% and for UMICs 6%, and the adoption of a higher reference rate for LDCs and LICs (compared with the reference rates used for MICs) means that the grant element of a loan advanced to an LDC/LIC will always be higher than the grant element of the same loan if it were advanced to an LMIC or UMIC recipient.

Unpacking the impacts of this further allows us to see the possibility of perverse incentives for donors. For example, a 20-year loan with a five-year grace period and a 2% interest rate would have a 49% grant element if the recipient were an LDC or LIC, but only a 39% grant element if the recipient were a LMIC and 33% if the loan were advanced to a UMIC.

The practical result of this is that, for every US$100 lent on these terms, the donor could count US$49 in their ODA total when lending to a LDC or LIC but, if the recipient were an LMIC or UMIC, the donor would count only US$39 or US$33 respectively.

This potential perverse incentive for donors to give more loans to the poorest countries in order to maximise their reported levels of ODA could be a particular concern in the light of a possible increase in the existing targets for ODA to LDCs.[11]

... or will the new rules free up more grant financing for the poorest countries?

On the other hand, the lower thresholds that can now be applied to loans to MICs will allow loans to MICs with less concessional terms to count as ODA, meaning that donors will be able to count a proportion of their less concessional (and therefore more profitable) loans to MICs as ODA.[12] These amounts would be excluded altogether from ODA if the recipient was an LDC/LIC. In effect, this means that donors could also be incentivised to allocate more ODA as loans to MICs in order to reach overall ODA targets (such as 0.7% of GDP).

The fact that donors will be able to make a higher return on their lending to MICs could make more money available to fund highly concessional, including grant-based, ODA to low income countries.

There is currently a lack of evidence on the way reporting rules influence donors' ODA allocations. Monitoring donors' lending in the light of these new rules could therefore prove a valuable case study.

The changes may make trends in loan-giving over time difficult to analyse

The fact that capital repayments on outstanding loans (disbursed under the old rules) will no longer be subtracted from the donors' headline ODA figures is potentially problematic. It is reasonable for repayments not to be subtracted from the ODA figures for loans disbursed under the new rules, as these loans will only have had their grant element (not their full face value) included in the ODA figures. Subtracting the repayments in this case would only confuse the issue.

However, loans disbursed prior to the new rules coming into effect will have had their full face value counted in the headline ODA figure for the relevant year. Thus a 40-year US$10 million loan with a 30% grant element disbursed by Donor A to Partner Country B in 2014 would only count for US$3 million of ODA if it were accounted for under the new rules, but would count for

[11] Setting increased targets for ODA to LDCs, building on the established 0.15-0.20% of GNI targets coming from the Istanbul Agenda for Action, was on the agenda for donors at the OECD DAC High Level Meeting in March 2014. With the support of some donors, the group of LDCs are promoting a target of '50% of ODA to LDCs' in their official position in negotiations for the UN Third Conference on Financing for Development, to be held in Addis Ababa in July 2015: www.un.org/esa/ffd/wp-content/uploads/2015/01/ep-comments-LDCs-Feb2015.pdf

[12] Loans must have a grant element of at least 45% to count as ODA if the recipient is a LDC/LIC, but loans to LMICs and UMICs need only have a grant element of 15% or 10% respectively to qualify as ODA.

US$9 million of net ODA over the period 2014–18 because it was disbursed prior to the new rules coming into force.[13] Not subtracting repayments on old loans from the headline ODA figure will distort the value of these loans in ODA statistics.

This means that loans advanced under the old rules which as of 2018 have an outstanding balance greater than their grant element will have been overvalued in the ODA statistics in relation to the new assessments – so value judgements or comparisons of ODA become more difficult to make. It also means that, in future, anyone analysing trends in ODA over time and comparing donors must be careful in making allowances for this change in the rules in their calculations, making analysis more complex.

Interest repayments are still not included in any measure of ODA

The OECD has indicated that it will publish a 'cash flow' measure of ODA even when the new rules are in place (perhaps as a memo item in the statistics). However, this will still only take capital repayments into consideration and leave out interest repayments. The omission of interest repayments from the headline net ODA figure is a weakness in the current system of accounting for loans, as it ignores the fact that approximately US$5 billion in repayments flows from developing countries to donors every year. The new rules do not fully address this issue.

Debt relief has still not been dealt with, but it needs to be

In the existing rules, cancellation of debt qualifies as ODA and is therefore counted in a donor's total if such an action has a 'development motive'.[14] The counting of debt relief as aid has proved contentious in the past, with two key issues cited by critics. First, that cancellation of debt when partner countries cannot repay is effectively an 'accounting decision' rather than a disbursement of aid, and may be misleading if included in ODA totals. (The partner country will have no extra 'cash to spend' on poverty eradication as a result of debt cancellation, even though it may appear from the total as if money has been transferred.[15]) Second, critics claim that many older loans which are written off may not have been used for development purposes in the first place (a well-known example is money lent by the UK to Sudan in the 1970s).[16] Counting the cancellation of such debt in the total, the critics say, could risk legitimising spending that may not have been eligible as ODA, were the loan disbursed today.

No decision has yet been made on how debt relief will be handled in the new rules. One option is to apply the grant element of the original loan to the amount of loan balance forgiven in any debt relief deal. It is not clear, however, whether the data necessary to calculate the grant element is readily available on all old loans that may, at some point in the future, become the subject of debt relief. There is also an argument that, where loans have been advanced under the new rules, donors have already had the risks of lending priced into the amount of ODA credited to them when the loan was disbursed. This is because the higher reference rates applied to LDCs/LICs when calculating the grant element are explicitly designed to reward a donor (by allowing them to count a higher percentage of the loan as ODA) when lending to poorer and, so the reasoning goes, riskier recipient countries. In this case, there may be a case for discontinuing the practice of counting debt relief as ODA. In any case, the OECD should consider excluding accrued interest from the amount of debt relief counted as ODA, as this does not represent money that was ever transferred to the recipient.

[13] For a fuller discussion of this example, see the Methodological note at the end of this report.
[14] See OECD DAC, 'Converged Statistical Reporting Directives for the Creditor Reporting System (CRS) and the Annual DAC Questionnaire'. www.oecd.org/dac/stats/documentupload/DCD-DAC(2013)15-FINAL-ENG.pdf
[15] See, for example, Jonathan Glennie's coverage of Sudanese debt cancellation in his article 'Should we worry about redefining aid?' *The Guardian*, 6 January 2012. www.theguardian.com/global-development/poverty-matters/2012/jan/06/aid-definitions-public-money
[16] Tim Jones, 'The Staggers' blog: 'How cancelling made-up debt could help the UK meet aid targets', *New Statesman*, 30 December 2011. www.newstatesman.com/blogs/the-staggers/2011/12/aid-targets-debt-relief-sudan

Conclusions

Since the middle of the last decade, loans have become an increasingly important source of development finance and there are good reasons to believe that this trend will continue, with donors looking to leverage their ODA budgets further and also due to the fact that debt-to-GNI ratios among many developing countries are presently at relatively low levels compared with the beginning of the century.

As a consequence, half of all developing countries have seen loans grow faster than grants since 2005 and some – including Egypt, Kenya, Myanmar and Turkey – have seen an increase of over 500% in ODA loans over the period. Some donors – for example France – are rapidly scaling up their loan giving in relation to their grant giving. This is a trend that should be examined more closely in light of the high-level discussions on development finance and especially the continued financing needs of the LDCs and countries at risk of indebtedness. Grants are likely to be preferable to loans in the following cases:

- where the recipient is at risk of debt distress
- where the recipient is a low-income country
- where the aid is intended to fund social sectors.

These principles remain applicable in light of the DAC's rule changes.

There are also considerations for those interested in the measurement of ODA, both those involved in statistical accounting in donor or recipient countries, and those undertaking research or analysis. The new rules for calculating the ODA value of loans mean that donors who give softer loans will be credited with having given more ODA. This is certainly a fairer system than the existing situation, where loans at near-market rates count for the same amount of ODA as loans at very low, or even zero, rates of interest. For middle income countries at least, this calculation should give a more realistic assessment of the concessionality levels of ODA loans. However, the reference rate used for low income countries remains almost unchanged and could lead to criticism that the economic benefit of loans to these countries is being overstated in the ODA statistics. Furthermore, for some countries (especially Japan) the reported levels of ODA will be significantly higher than either under the old rules or if the new rules were applied consistently to pre-2015 loans. Close attention will need to be paid to the rule changes by anyone attempting to use DAC data to analyse ODA loans in future, especially when trying to assess trends over time.

Beyond these considerations, vigilance will be needed in two areas.

First, there are the potentially perverse incentives caused by the new rules, which may incentivise donors to give more aid in the form of loans in order to maximise their reported levels of ODA. In addition, the fact that the new rules allow donors to report a higher level of ODA for a loan to a low income country than if they gave the same loan to a middle income country could create an incentive for donors to give more loans to the poorest countries. For these reasons, it is more important than ever that donors pay close attention to levels of indebtedness, current and predicted debt service levels and other measures of debt sustainability when determining which countries should receive ODA in the form of loans rather than grants. It should be noted that there is limited documented evidence on the impact of reporting practices on donor behaviour more broadly, and this should be explored further.

Second, important elements of the new rules, especially in the area of debt relief, have yet to be agreed. In the past, the measurement of debt relief has significantly overstated the amount of ODA disbursed by donors (by including accrued interest in the amount of debt relief 'given'). We suggest that the reform of the measurement of ODA loans should be accompanied by similar reforms in the measurement of the value of debt relief in the ODA statistics.

Methodological note

For the purposes of estimating the effect of the new rules, we calculated the grant element of each new ODA loan commitment made by donors in 2013. The grant element was calculated first under the existing rules using a 10% reference rate, and then under the new rules using the appropriate reference rate and concessionality threshold depending on the income group of the recipient country.

The average grant element percentages for each donor calculated by this method were applied to gross loan amounts disbursed in 2013. As some of the loan disbursements made in 2013 relate to loans agreed in previous years, this assumes that the current concessionality level of ODA loans from each donor was broadly the same in 2013 as in previous years. Since there is insufficient data on old loans to calculate the concessionality level of every loan disbursed in 2013, this method gives us the best available estimate of the effect of the rule changes on loan disbursements.

Although repayments were not subtracted from the estimate of ODA under the new rules, offsetting entries for debt relief were subtracted. This is in order not to inflate the ODA figure by double-counting the principal value of forgiven debt included in previous years' ODA figures. This is in line with current OECD practice for the calculation of headline ODA figures, and it is assumed that this practice will continue however debt relief is accounted for in the ODA statistics in future.

The example on page 18 of an old outstanding loan distorting the ODA figures is calculated as follows:

> *Consider a 40-year US$10 million loan with a 30% grant element disbursed by Donor A to Partner Country B in 2014. This would have counted for US$10 million in the ODA total that Donor A gave to Country B in 2014, but would count for minus US$250,000 in each of the subsequent years (i.e. the net transfer of money in those years would be to Donor A, and this would be clear in the figures).*[17] *By 2018, when the final changes to the new rules take effect, only US$1 million of the loan would have been repaid and the net effect on the ODA level of the donor over the period 2014–18 would be a positive US$9 million. In other words, anyone wanting the total figure of ODA for Donor A to Country B over that four-year period would find that Donor A had given Country B US$9 million. The subtraction of loan repayments from Donor A's ODA total will then cease as the new rules come into full effect.*
>
> *However, if the same loan were counted under the new rules, disbursed from today onwards, its level of grant element would mean that Donor A would only be credited with giving US$3 million to Country B for the same loan.*

[17] This worked example assumes equal principal repayments, and no grace period.

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