Appendix

Commonwealth Perspectives on OECD-DAC Post-2015 Statistical Reform

Overview

1. The perspectives of the Commonwealth Secretariat on OECD plans for reform of the OECD-DAC statistical system are based on the conclusions drawn in the Secretariat’s background paper prepared for the 2014 Commonwealth Finance Ministers Meeting (CFMM) (FMM (14)1). This assessment was undertaken in order to investigate the potential implications of OECD-DAC statistical reform for the mobilisation of official resource globally, as well as for the financing of development in Commonwealth member countries.

2. The Commonwealth’s assessment was also geared towards preparing Commonwealth Finance Ministers and Commonwealth Senior Finance Officials for their upcoming Third UN Financing for Development Conference in Addis Ababa, Ethiopia, and towards stimulating discussions on the ongoing statistical reform at the 2014 CFMM, where the Secretariat collected various country perspectives.

3. In line with the proposals prevailing at the OECD-DAC as at end-October 2014, as garnered from technical documents prepared for OECD-DAC Senior Level Meetings (SLM) and Commonwealth Secretariat conversations with OECD-DAC officials, the Secretariat’s assessment focused on the implications of the following proposals:

   ▪ The introduction of a measure of Total Official Support Development (TOSD) as an additional means for capturing donor efforts towards development - particularly their support for development enablers and global public goods;
   ▪ Modernisation of ODA through a grant equivalent conceptualization, for the main purpose of better representing donor effort and recipient benefits;
   ▪ Harmonisation of OECD and IMF/WB discount rates for assessing loan concessionality; and
   ▪ The introduction of a new ODA target aimed at delivering at least 50 percent of total ODA to LDCs for the main purpose of ensuring that ODA is directed to where it is needed most.

I. Perspectives from the Commonwealth Secretariat

Commonwealth Secretariat Perspectives

4. The Secretariat’s review of the four main proposals above, reveal a number of potential opportunities and risks for developing countries, primarily with respect to issues of access to concessional finance by non-LDC countries, and the management of debt and debt sustainability in highly indebted small states. On the basis of these risks, the Secretariat’s main perspective on the reforms is that further consideration by the OECD-DAC should be given to the observed technical and political implications presented below, so as to ensure implementation of a fair, well-balanced and non-disruptive statistical reform.
- 2 -

The Opportunities

5. Regarding the opportunities, the Commonwealth’s assessment is that there are several to be gained from a reform of the OECD-DAC statistical system, as currently being discussed. The possible benefits for developing countries, include:

   a) An improved framework for monitoring financing for development;
   b) An ODA measure that overcomes some past criticisms by attempting to more accurately reflect donor effort vis-à-vis recipient benefit;
   c) A possible increase in the scale of development financing, albeit non-concessional; and
   d) Gains in international coordination - i.e. with respect to harmonisation of OECD and IMF/WB discount rates for valuing loan concessionality.

6. The Secretariat envisions that the revision of the OECD-DAC statistical system to include a measure of TOSD that captures donor support for development enablers, global public goods, as well as other non-ODA means of financing (market like instruments for example), should help to improve OECD statistical reporting and development finance reporting more generally. This would be especially true if TOSD also captures development financing from non-OECD providers, which by characterization would not otherwise be reported under ODA or Other Official Flows. TOSD could also help to incentivise the continued provision of donor resources for non-ODA priorities, and to assist with aligning the current OECD-DAC statistical framework with the more complex financing landscape and broader Post-2015 development agenda objectives.

7. Moreover, should the grant equivalent concept of ODA be implemented, it is expected that this may serve well for better capturing and aligning measures of donor contributions, with countries’ records of their receipts of official development aid. It would also help to more accurately reflect donor countries current political commitments, which is somewhat obscured in the current system because of the measure of ODA on a gross disbursement basis. In essence, the Secretariat believes that in the current framework, since loan contributions to ODA are only reduced through amortization, on loans that have at least a thirty-year maturity, it is often times the case that current measures of ODA are not truly reflective of government’s current political commitments to development financing. Over the maturity of one development loan, that loan could easily be attributing ODA to a country, which has seen at least three different government administrations in office that have very different views and policies on development financing.

8. In addition, it is the Secretariat’s view that aligning the OECD and IMF/WB discount rates for assessing loan concessionality could bring about desired international financial coordination, facilitate easier cross country comparison with respect to loan concessionality. It could also be a positive contribution to developing country debt management.

9. Specifically, more efficient debt management would be facilitated by the use of the common discount rate in the valuation of loans obtained from official sources.¹ By extension, it would also improve the simplicity and accuracy of low-income country debt

¹ Note, most Regional Development Banks (RDBs) also employ the Fund and Bank discount rate as well.
sustainability analysis. The current OECD discount rate, under current market conditions, is exaggerating the grant element in ODA loans because it is out of line with current and future market rates. Hence, given that the IMF/WB discount rate is closer to prevailing market conditions, harmonizing the OECD and IMF/WB discount rates would allow for a more accurate representation of countries’ concessionality gains - important for estimating the present value of debt, which is a key variable in the estimation of low income country debt sustainability. Another benefit of reducing the OECD discount rate in line with that of the Fund and Bank, is the limiting of perverse incentives. As it stands, the current OECD discount rate provides incentives for donor countries to increase ODA through loans rather than grants. This is because of the high discount rate relative to the market rate afforded to credit worthy donor countries, who can easily borrow at extremely low interest rates and on-lend to countries still well below the current OECD discount rate, thereby easily satisfying the 25 percent grant element requirement. It is the Secretariat’s view that development aid through these means does not constitute a true contribution by donors to development.

- The Risks

10. Should the OECD-DAC proposals be adopted as currently envisioned, the Secretariat sees several potential risks evolving. These risks include:

a) A possible increase in risks to developing countries’ debt sustainability due to a proliferation of private financing through increased use of market-like instruments;

b) A possible shift in incentives away from delivering the 0.7 percent ODA/GNI target, to one based on achieving a target on TOSD;

c) Further risks to debt sustainability in Commonwealth developing countries if the impact of introducing a lower discount rate in combination with a grant equivalent methodology of concessionality calculation, incentivises donors to increase non-concessional lending; and

d) A possible allocation imbalance with respect to grant funding, particularly between those classified as LDCs and non-LDCs, and negligence of other development priorities, such as the financing of global public goods.

11. Risks to debt sustainability in developing countries could arise from the introduction of TOSD, through a possible proliferation of private financing stemming from increased donor use of market-like resources. With a whole range of market instruments valorised under the TOSD measure, the Secretariat believes that it is quite likely that donors would be incentivised to increase the use of such instruments. At first glance, the potential benefit for developing countries is an increased access to a larger pool of aid resources. This would be welcomed of course, especially in the current financially constrained global environment. However, more frequent use of market-like instruments to finance development means that the composition of donor receipts by developing countries could very well be skewed towards less concessional rather than more concessional finance. The obvious implication for developing countries is the potential for an increased state of indebtedness, given the likelihood of a more costly financing environment. Low income countries - who are the main beneficiaries of ODA resources, despite receiving HIPC debt relief, have recently being showing heightened ratings of debt
distress. Therefore, these countries will continue to depend on more concessional rather than less concessional sources of finance.

12. Similarly, the proposals present risks to developing countries’ future debt sustainability when considering the impact of the combined effects of implementing a grant equivalent method of ODA calculation, and a lower IMF/WB discount rate. From the Secretariat’s assessment of these proposals, it is clear that the grant equivalent methodology will result in less ODA per loan attributed to donor countries. Further, harmonizing the OECD discount rate with the lower IMF-World Bank discount rate will require OECD-DAC donors to lend at traditionally lower interest rates in order for development loans to qualify as concessional and to be recorded in ODA.\textsuperscript{2} The only advantage for donors being that under the grant equivalent conceptualization, donor loans would no longer be required to carry a grant element of at least 25 percent in order to be recognised as ODA, thus removing any ceiling above which donors can lend relative to the new discount rate.\textsuperscript{3}

13. Taken together, the Secretariat believes that adopting the two proposals will result in a call for an increased effort on the part of donors.

14. The Secretariat sees donors reacting in either of two ways. At interest rates close to the discount rate, donors can expand the number, size and maturity of future ODA loans to increase the level of concessionality and contributions to ODA, or lend at interest rates well below the harmonized discount rate to increase the size of the loans’ grant element. Because the grant equivalent methodology removes the grant element requirement- which allows donors to lend at relatively higher interest rates, in the Secretariat’s view, the more likely outcome is the former. Hence again, although an increased quantum of finance would surely be welcomed by developing countries, it is clear that if not managed well, any reaction to these proposals that results in an increased on-lending of less concessional finance will present potential negative implications for developing countries’ debt sustainability.

15. With respect to allocation of ODA Post-2015, the Secretariat supports the view that ODA should be focused on reducing poverty and towards countries with less access to finance, i.e least developed countries (LDCs). However, on the issue of how to safeguard funds for these countries, and in particular, the proposal to ring-fence 50 percent of the total volume of ODA for LDCs, the Secretariat sees serious aid allocation implications.

16. The Secretariat assessment shows that the benefits of implementing a 50 percent LDC-ODA target are minimal. That is, the extra funds created by diverting grant funding away from non-LDCs will not result in a significant ramp-up of ODA for those countries most in need. In fact, the Secretariat’s assessment shows that without a substantial increase in the total volume of ODA, the introduction of an alternative target will not have substantial benefits. The current proposal for better targeting ODA will put at risks development in other countries and could lead to an imbalance in the financing of the new

\textsuperscript{2} Since the OECD discount rate will be lowered from 10 percent to 5 percent if harmonized, for loans to be concessional, donors will have to lend at interest rates below 5 percent in the future. Whereas a loan at 6 percent interest may have been concessional under the current system, it would not be under a new system with the new lower discount rate.

\textsuperscript{3} With a grant element requirement of at least 25 percent under a harmonized discount rate of 5 percent, assuming fixed face values and maturities, donors would have to lend at rates well below 5 percent in order to achieve the grant element requirement. However, without the grant element requirement, any rate below 5 percent under the grant equivalent method will be deemed as concessional.
global development agenda. What will be crucial therefore is for the international community to meet international ODA commitments.

II. Perspectives from Commonwealth Senior Finance Officials

17. The Commonwealth Secretariat tabled the topic of OECD-DAC statistical reform for discussion at the Commonwealth Finance Ministers Meeting to stimulate debate among Commonwealth Senior Finance Officials and to collect their perspectives. The potential opportunities and risks posed by the emerging proposals, as interpreted by the Secretariat, were presented to Officials to facilitate the discussion.

Donors Should Commit To Achieving ODA Targets

18. Senior Officials emphasised the crucial role played by ODA in Commonwealth developing countries, recognised the changing global economic dynamics and the fact that a more costly development agenda could be emerging. In light of the above, Senior Officials called for donors to maintain the focus on poverty, and to achieve and recommit to their ODA targets - precisely, the targets of 0.1 percent to 0.2 percent of ODA/GNI to LDCs and 0.7 percent of ODA/GNI for all developing countries. Moreover, officials also called for climate finance to be provided through concessional resources, primarily grants.

Commonwealth Senior Officials Recognise OECD-DAC Contributions

19. Senior Officials also recognised the important work being conducted by the OECD-DAC and welcomed efforts to improve the measurement and monitoring of development finance. In tandem, Senior Officials, recognising the potential significance of the OECD DAC reforms, called for further and wider discussion by the Commonwealth and encouraged the Secretariat to continue its work on assessing the implications of the planned changes.

A Larger Quantum of Finance, Improved Transparency, Accountability and Co-ordination is Welcomed

20. Specific perspectives among Senior Officials on the OECD-DAC proposals were wide ranging. Senior Officials welcomed the potential for an increase in the quantum of development financing Post-2015, noting that this could be mostly non-concessional. They in parallel called for a greater mobilisation of concessional resources, in light of the risks posed to debt sustainability - particularly with respect to highly indebted Commonwealth countries. Additionally, Senior Officials welcomed the move to improve donor incentives, transparency, accountability and co-ordination, while emphasizing that any such changes should not dilute ODA targets or the issue of the need for a greater quantum of financing.

ODA Should Remain the Cornerstone for Assessing Donor’s Contribution to Development

21. Senior Officials broadly welcomed the OECD-DAC’s proposal to introduce a measure of Total Official Support for Development. However, they expressed the view that TOSD should be additional to ODA and that ODA should remain the cornerstone for assessing donor’s contribution to development. Officials at the same time welcomed TOSD’s
potential value for crowding-in financing from the private sector, and incentivising continued and increased support for global public goods (for example, peace and security and climate change). With respect to non-DAC collaboration, the importance of South-South cooperation in sharing country experiences was highlighted.

A Grant Equivalent Approach and Harmonization of IMF-World Bank Discount Rates Welcomed

22. Senior Officials were informed about the OECD-DAC work on reconceptualising the ODA measure, particularly the measurement of loan contributions to ODA and their concessionality. In this regard, Senior Officials noted the current preference for ODA loans to be valued on a grant equivalent rather than on a cash basis. Further, Senior Officials held the view that the application of risk adjusted discount rates in determining concessionality appeared a complex approach, and a preference emerged for harmonisation with the IMF-World Bank discount rate, on account of the potential increase in IFI coordination and because of members’ concerns surrounding future debt sustainability, of which the IMF-World Bank discount rate takes account.

There is a Preference for an Increased Concessionality Requirement

23. Additionally, similar to that applied in the IMF’s debt sustainability framework, officials showed preference for a higher concessionality requirement of 35 percent in ODA loans.

This call for a higher concessionality requirement highlights the need for the OECD-DAC to think carefully about further reducing the inconsistency between the OECD and IMF-World Bank lending arrangements. At present, it is quite possible that low income countries - which are increasingly becoming highly indebted - to be restricted from accessing OECD-DAC concessional loans because the loan does not carry the IMF-World Bank required grant element of at least 35 percent. Under a grant equivalent methodology, this inconsistency will be further exaggerated since loans will only be required to carry some subsidy and not a specific grant element

No Consensus on how to better Target ODA

24. Senior Officials showed support for the OECD-DAC drive to safeguard concessional funding for LDCs, given the importance of maintaining a focus on poverty in a new development agenda. Nonetheless, with respect to how to achieve this, whether by maintaining the current LDC target or through the introduction of a new target based on volume of ODA to LDCs, Officials did not show strong preferences.