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Background paper: Including the cost of using private-sector instruments in ODA

Private-sector instruments are an important means of implementation of the post-2015 development agenda, both as a direct source of finance and as a catalyst mobilising additional resources from the private sector. However, current ODA reporting does not facilitate recognition of the official costs involved in using such instruments in a consistent manner. This has resulted in disincentives in the use of such instruments and incomplete reporting.

The 2012 High Level Meeting (HLM) mandated the DAC to "investigate whether any resulting new measure of external development finance (including any new approaches to measurement of donor effort) suggest the need to modernise the ODA concept". The HLM furthermore explicitly welcomed work by the DAC "to develop the statistical categories and methods to capture all relevant official finance and facilitate reporting by all providers of development co-operation [...]"

Since the 2012 HLM, the DAC has looked into ways of improving the reporting on all financial instruments in an impartial way. A new measure of Total Official support for Sustainable Development (TOSD) will capture the totality of official development finance on offer regardless of the types of instruments and terms provided. As part of the work on ODA modernisation and related to efforts to establish the TOSD measure, approaches have been developed to measure donor effort involved in using private-sector instruments.

Private-sector instruments in development co-operation

The term **"private-sector instruments"** refers to loans, guarantees, mezzanine finance and equity provided to enterprises in developing countries. They are deployed by development finance institutions (DFIs) and other financial intermediaries such as export-import banks or investment funds, but also by development banks, aid agencies or directly by Treasury Departments of donor governments. They are usually extended at non-concessional terms for investments for which economic returns are possible, but not yet sufficient, to attract private investment. The term **"market-like instruments"** is broader in scope, also covering cases where such instruments are extended to official (public) sector recipients (see Figure) and which may involve some element of concessionality. The two terms are often used interchangeably; this note uses the first (more common), but is relevant to both.[1]

Treatment of private-sector instruments in DAC statistics

To better reflect and facilitate the reporting on private-sector instruments in DAC statistics, the Working Party on Development Finance Statistics (WP-STAT) has developed – in consultation with DFIs – a **revised taxonomy of financial instruments**. The taxonomy was approved by the WP-STAT in September 2014, and the revised Reporting Directives will be presented for approval and endorsement by the DAC in the first half of 2015. This change will facilitate standardised reporting by all providers and allow for instrument-specific analysis in line with terminologies and categories generally used in finance.

[1] Another term found in literature is "non-grant instruments". It is not used here in the context of DAC statistics, as the term also covers ODA loans which are subject to a separate discussion. (See HLM Background paper on concessionality.)

As regards the inclusion in ODA of the costs incurred by the official sector in using private-sector instruments, two approaches have emerged: an institutional and an instrument-specific approach (see Figure).

The institutional approach looks at DFIs only. DFIs are mandated to provide support to the private-sector, *i.e.* finance and invest in private sector enterprises. They are expected to operate profitably, extending finance at market or near-market terms. In measuring ODA, the institutional approach **would include support that a donor government may extend to its DFI**, *i.e*. capital injections in – and divestments from – the DFI by the donor would be used as a proxy for the donor effort involved in using private-sector instruments.[2] However, complementary methods would be required for reporting on private-sector instruments provided by institutions other than DFIs.

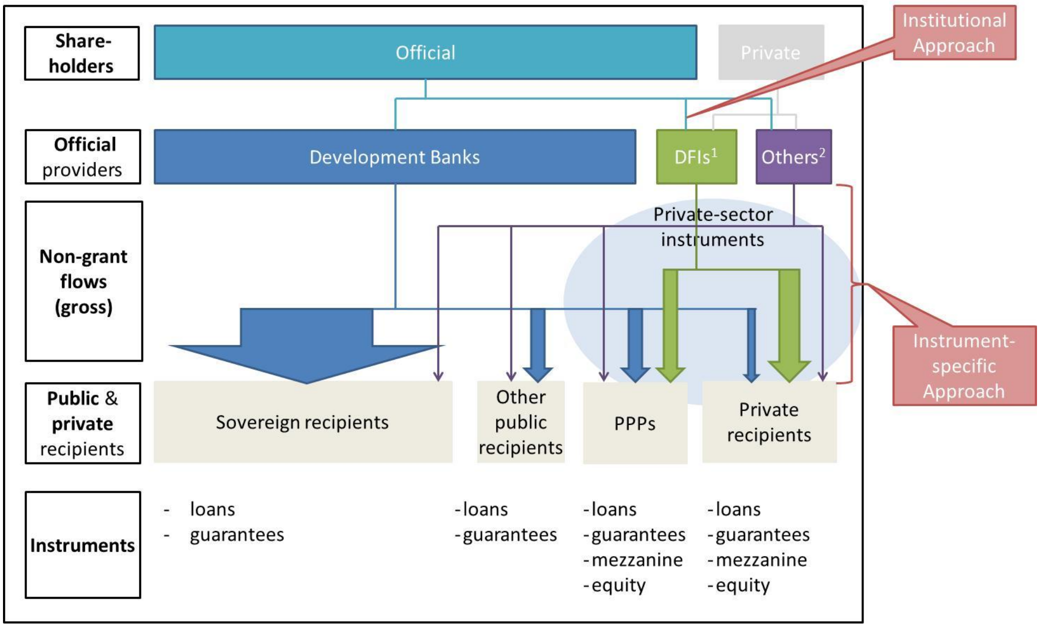
Under the instrument-specific approach, private-sector instruments would be counted in ODA in the same manner as grants and loans, *i.e*. by **reporting ODA-eligible flows in a flow-based system or estimated ODA grant equivalents in a grant equivalent system.** The approach could be applied to all providers. It rests on the assumption that only instruments that are concessional – instruments provided below market terms and possibly meeting concessionality thresholds – are ODA-eligible.

The two approaches were discussed in the October 2014 DAC Senior Level Meeting. Participants agreed that recognition of the cost of using private-sector instruments in ODA could create powerful incentives to provide more finance through these instruments in the future. More technical work was requested to further explore both approaches, including possible complementarities and possible risk of overlap.[3]

Work in progress, but what can be expected and when?

Building on the work carried out so far, the DAC will continue developing methodologies to quantify and report in ODA the costs incurred by the official sector in using private-sector instruments. The WP-STAT will examine the technical questions arising from the two approaches in the course of 2015, with a view to presenting proposals for approval and endorsement by the end of the year.

Private-sector instruments in development co-operation



1) Not all DFIs are wholly public. Several are established as PPPs. Austria's OeEB is privately-owned.
2) Aid agencies, Treasury Departments of the donor government or other financial intermediaries such as Export-Import Banks or Investment Funds.

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2 The instruments themselves would be captured under TOSD.

3 This conclusion also built on the recommendation by the DAC Expert Reference Group, of which "*most experts found it particular important to include [private sector] non-grant instruments in ODA while others conditioned their inclusion to the requirement that it can be done in a simple and easily justifiable manner*." Cf. http://www.oecd.org/dac/stats/ERG%20Recommendations%202014%2008%2007%20Final.pdf, Recommendation 14.