This addendum to document DCD/DAC/STAT(2012)17 presents three further responses to the survey questionnaire on approaches to determining concessionality of loans, received since 29 August 2012. It is for INFORMATION and DISCUSSION at the meeting of the Task Team.

For the responses of the UK and the USA, the answers to each question on the questionnaire have been copied bodily from survey returns. The general response by the Czech Republic is presented in the Annex, which also contains a general covering statement by the United States.

Contact: Ms. Julia BENN (julia.benn@oecd.org)
FURTHER RESULTS OF THE SURVEY OF APPROACHES TO DETERMINING CONCESSIONALITY OF LOANS

This addendum to document DCD/DAC/STAT(2012)17 presents three further responses to the survey questionnaire on approaches to determining concessionality of loans, received since 29 August 2012. It is for INFORMATION and DISCUSSION at the meeting of the Task Team.

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A. Does your country/organisation have an operational definition of “concessional in character”? If so, please write it out here:

UK

The UK reports a small proportion of its total ODA as loans, applying the definition of concessional in character as defined within the Directives (i.e. if the loan is extended ‘below the prevailing market rate’). The prevailing market rate can be referenced from a number of sources.

USA

While the United States has not issued an ODA loan since 2007, U.S. statutes and related policy guidance do provide operational definitions of “concessional in character” which remain in force. Specifically, two statutes define concessional loans for development:

1. **Sec. 122(b) of the Foreign Assistance Act of 1961, as amended**
   
   http://transition.usaid.gov/policy/ads/faa.pdf. The President shall determine the interest payable on any loan. In making loans under this chapter, the President shall consider the economic circumstances of the borrower and other relevant factors, including the capacity of the recipient country to repay the loan at a reasonable rate of interest, except that loans may not be made at a rate of interest of less than 3 per centum per annum commencing not later than ten years following the date on which the funds are initially made available under the loan, during which ten-year period the rate of interest shall not be lower than 2 per centum per annum, nor higher than the applicable legal rate of interest of the country in which the loan is made. USAID Policy Directive 66 http://transition.usaid.gov/policy/ads/200/pd66.pdf provide guidance. USAID has not issued a new concessional loan (five types: Dollar Country Loans, Currency Loans to Foreign Governments, Section 108 Currency Loans to Intermediate Financial Institutions, Currency Loans to Private Enterprises, and loans under the Enterprise for the Americas Initiative) since 1993.

2. **Title I Concessional Sales** under the Agricultural Trade Development and Assistance Act of 1954, as amended, (Public Law 480, 83rd Congress, a.k.a. Food for Peace)
   
Title I authorizes the sale of U.S. agricultural commodities to developing countries using concessional credit provided by the U.S. government. The terms are concessional because they include a maximum 30-year period for repayment, with a maximum 7-year grace period and interest “…at a concessional rate as determined appropriate by the Secretary” (Sec. 103(b)). Before the 1990s, the maximum allowable repayment period was 40 years and the maximum grace period was 10 years. Minimum rates of interest are 1% per annum during grace period and 2 1/2% thereafter. The last Title I Concessional Sales loan was to the Philippines in 2007.

The terms of all concessional loans under the above statutes satisfy the ODA requirements in the DAC reporting directives which are incorporated in Vol 1 Treasury Financial Manual Part 2—Chapter 4500, GRANTS, LOANS, CREDITS, AND CONTINGENT LIABILITIES INVOLVING FOREIGNERS http://fms.treas.gov/tfm/vol1/v1p2c450.html.

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B. Loans made from market-raised funds: How do you determine whether loans made from funds borrowed on the capital market are concessional? Please explain here:

UK

The UK assesses the ‘concessional in character’ element of loans as per the description in part A. The UK’s DFI is a self-financing entity i.e. raises funds from equities and can use these to generate lending finances. There are no market-raised borrowings used for financing loans given to other counterparties.

USA

See discussions under Section F.

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C. Loans made from government revenue: How do you determine the concessionality in character of loans made from general revenue rather than from borrowing? Please explain here:

UK

Please refer to section B above, as the UK applies the Directives as currently set. DFID would only use government revenues to finance borrowing facilities to others.

USA

See discussions under Section F.

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D. Possible qualitative test for concessionality of loans involving market-raised funds: Please indicate whether either or both options below would be acceptable to you. If both are acceptable, mark them 1 and 2 according to your preference. Leave boxes blank if options are unacceptable or you have no opinion. Loans made from funds borrowed on the capital market should only be reported as concessional if:

a. the loan terms are more favourable than the terms on which the funds were borrowed.

b. a subsidy has been added which results in terms softer than those on which the funds were borrowed.

USA

Comment: The so-called “qualitative tests” are essentially quantitative since “quantifiable” interest rates come into play – one at which the donor acquires funds on the capital market and the other at which the donor charges the developing country, and because other terms (grace period, maturity, structure) are also largely quantitative in nature. The qualitative nature of a loan is captured in the intent/nature/purpose of the lending which is already part of the existing ODA definition.

Option a. Comment: This goes to the heart of the US perspective of “concessional in character”: it is from the donor’s/lender’s perspective and the donor is giving something of value away. If a donor secures funds at market rates and then extends loans to developing countries at a slightly higher rate, the loans are not concessional and not ODA since the donor has not given anything related to the funds away but has charged a premium to the developing country above the rate at which the donor has acquired the funds in capital markets.

Option b. Comment: Is this not already addressed in treatments of “associated financing” within the DAC Directives and the OECD Arrangement? See the paragraph in Section F on the US position if the “loan package” includes guarantees as “indirect subsidies.”

No answer: UK

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E. Possible quantitative tests of concessionality of all loans: Previous DAC discussions have proposed numerical tests of “concessionality in character”. Please indicate whether one or more of the three options below would be acceptable to you by marking them 1, 2, 3, according to your preference. Leave boxes blank if options are unacceptable or you have no opinion.

E.1 Tests based on interest rate:

a. Interest rate lower than the DDR [cf. DCD/DAC(2003)25].

b. Interest rate at least 25% below the DDR [cf. DCD/DAC/RD(2004)17/RD3].

c. Further option: Interest rate at least 25% below the CIRR (see last column here: http://www.oecd.org/dataoecd/44/36/49361333.pdf).

Only a. marked: UK
a., b. and c. all not acceptable: USA

USA

There is a clear disconnect here. The question’s proposal to determine concessionality based on whether it is below the DDR or not (or at least 25% below the DDR or the CIRR) is misusing the DDR and the CIRR. The DDR should only be relevant if it is used as the discount rate in “grant element” calculations. It cannot be used to qualify a loan as "concessional in character" when the 10% is used as the universal discount rate. In today's interest rate climate, Governments can lend above their costs of funds, but below the DDR, and probably meet the 25% grant element threshold when using the 10% discount rate. Many ECA supported transactions (whether through a loan at CIRR or guarantee of a market rate) could qualify as ODA under this approach.

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E.2 Tests based on a minimum concessionality benchmark: Other tests of concessionality are also in use. Please indicate whether one or several options below would be acceptable to you. If all three are acceptable, mark them 1, 2 and 3 according to your preference. Leave boxes blank if options are unacceptable or you have no opinion.


b. IMF benchmark: minimum 35% “grant element” [concessionality level], measured against CIRRs differentiated according to loan length (http://www.imf.org/external/np/pdr/conc/index.htm).

c. Further option: Possible simplified IMF approach: minimum 35% grant element, measured against average of the CIRRs (i.e. the rates shown each year in the last column here: http://www.oecd.org/dataoecd/44/36/49361333.pdf).

No answer: UK, USA

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F. If you have any other suggestion(s) on how to determine “concessionality in character”, please write it/them here:

UK

Any changes to the fundamental ODA definition are not part of this mandate, and should therefore not be considered. In accordance with the overarching ODA definition, in our view ‘concessional in character’ should be defined in terms of benefit to the borrower. We therefore welcome a discussion on the practicalities of this at the forthcoming meeting later in September.

USA

The US basic perspective is that “concessional in character” for a loan means simply that the loan’s interest rate is below the lender’s risk-free market rate of interest. Accordingly, the US does not support:
- the borrower-based concepts;

- general concepts of terms being “softer,” which may not meet the above standard; and

- the additional “quantitative” standards comparing loans interest rate to the DDR or the CIRR.

Some donors state that if the borrower is getting a lower rate that it would normally pay on capital markets, it is getting a concessional loan regardless of whether it is getting a direct or indirect subsidy. The US disagrees with this perspective: concessionality is from the donor’s point of view, not the borrower’s, and whole concept of concessionality is that the donor is giving something of value away.

Loans made from market raised funds should only be concessional if the donor lends at a rate below the risk-free rate for the currency involved so that they are economically giving something away. The same applies for loans from general revenue. That is why the DDR is the best quantitative benchmark for determining concessionality when used as the discounting factor in lieu of the standard 10 percent factor for “grant element” calculation in the current ODA definition. DDR discounts the risk-free government cost of funds in the currency involved and includes an add-on to the margin for the tenor. It is the only coherent approach to determining true concessionality of a soft loan. The US knows that the substitution of the DDR for the 10 percent discounting factor in the “grant element” changes the definition of ODA, which lies outside of the current mandate from the DAC Chair in addressing “concessional in character,” but every other approach is totally unfounded. The US will raise this issue once again in 2015.

Further, if a loan package includes guarantees as an indirect subsidy, the US cannot see how a guarantee alone would work in the determination of “concessional in character.” If the donor makes a grant for 25% of the financing package and guarantees a loan for the other 75% of the financing package, then the financing package is clearly concessional because of the grant. But the US does not see how one can get concessionality out of a guaranteed loan by a commercial party, as the guaranteed party will have its own market-rate cost of funds to cover, regardless of the guarantee.
ANNEXES

ANNEX 1. Response by the Czech Republic

The following lines are an unofficial translation of an explanation by the Ministry of Finance (consulted also with the Ministry of Trade and Industry and Czech Export Bank):

The Czech Export Bank

1. does not provide any "concessional loans", the Czech Export Bank only and exclusively provides export credits in accordance with the OECD Arrangement on Officially Supported Export Credit, i.e. for rates at or above the CIRR rate (Commercial Interest Reference Rates), or at market rates.

2. does not receive state budget means for providing tied aid in order to reach the required 35 per cent of the concessionality level or 35 per cent of the amount of the subsidy.

3. does not operate in accordance with ODA rules and regulations.

ANNEX 2. Cover note of the response by the USA

The main US position on concessionality is that it is from the donor's perspective AND the donor must be giving something of value away. Consistent with this position, the US supports the DAC Secretariat interpretation that if a donor obtains funds from credit markets at a given rate and then uses these funds to provide loans to developing countries at a higher rate, then loans are not concessional and not ODA – something of value is not being given away but a premium is added to the donor’s costs.

While outside the scope of this survey since it would change the definition of ODA, the US repeats its position that the DDR should be the discount rate in lieu of the 10 percent rate for “grant element” computations, as is done by the World Bank and IMF in their treatment of concessionality. The DDR should not be used as the “prevailing market rate” against which the interest rate of a loan is simply judged as “concessional in character.”