THE MODERNISATION OF OFFICIAL DEVELOPMENT ASSISTANCE (ODA): FREQUENTLY ASKED QUESTIONS

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In 2012, the Development Assistance Committee (DAC) launched the modernisation of its statistical system to improve its accuracy, while reflecting major changes in development co-operation.

In the process, the DAC took a series of decisions at its High-Level Meetings (HLM) in 2014, 2016 and 2017 on the measurement of concessional loans to the public sector, private sector instruments (PSI), peace and security expenditures, and in-donor refugee costs.

This process has sparked a debate among policymakers, statisticians, civil society organisations and other observers who value official development assistance (ODA) as the "gold standard" of foreign aid. Have DAC decisions strengthened, or weakened, the integrity of ODA? Do these changes affect commitments by DAC members, and how? Are there any financial or symbolic benefits for donor governments in the process?

This FAQ, a companion to our online compendium on the Modernisation of the DAC statistical system, addresses the technical aspects underpinning this debate, with a view to promoting a transparent, informed and constructive dialogue.

Is your question unanswered? Write to us: dac.contact@oecd.org.

ODA modernisation

FAQ 1. Why change the way of counting ODA?

As their understanding of the challenges associated with poverty improves, countries develop new tools to support one another. Today, donors have a wide range of such tools to choose from, such as grants, loans, debt relief, and guarantees. To take account of this diversification and continue to measure donor 'effort' accurately over time, the aid accounting rules had to evolve.

In 2012, the Development Assistance Committee (DAC) launched the modernisation of its statistical system in order to improve the accuracy and comparability of the data, while reflecting major changes in development co-operation, such as the diversification of financial instruments, but also the increasing overlap of its policy objectives with those of other sectors, such as migration and security.

The ODA modernisation process effectively started in 2013-14 in the context of an "Expert Reference Group" bringing together practitioners and thinkers from OECD countries, multilateral institutions, think tanks, and CSOs. The group held three meetings, discussing a comprehensive set of issues related to ODA measurement: you can find more information here. The list of experts is in Annex 1 of this note.

Central to this reform, the modernisation of *ODA accounting for loans* aimed to correct flaws in the *cash-flow* method by measuring ODA loans on a *grant equivalent* basis. The rationale was the following:

- ODA statistics have traditionally valued grants and loans in the same way: by recording the flows of cash that were granted, or the face value of loans that were lent to developing countries, deducting any repayments on the loans. This "cash basis" or "flow basis" method has been used to compile ODA headline figures until 2018 (reporting on 2017 ODA spending).

- That method was simple, but it did not reflect accurately the efforts of donor countries: a grant represents a bigger donor effort than a loan; a loan with a very low interest rate and a long repayment period represents a bigger donor effort than a loan with a high interest rate and a short repayment period. The net ODA measure on a flow basis did also not reflect a government's aid efforts in a given year as repayments on old loans were deducted. That is why DAC members decided, at their 2014 High-Level Meeting, to introduce a new and fairer way of measuring aid loans, whereby only the "grant equivalent" of loans is recorded as ODA. The 2014 decision also differentiates between low and middle income countries, promoting greater concessionality for low-income countries.
- Instead of recording the actual flows of cash between lender and borrower, the headline measure of ODA is now based on the loans' "grant equivalents": the more generous the loan, the higher the ODA credit.

Today, even though the *grant equivalent* system has become the standard and is what the OECD publishes as its headline ODA figures each year, ODA is still collected and published in parallel on a *flow* basis for the sake of transparency and comparability.

FAQ 2. Was the ODA modernisation process transparent? Who was involved?

The revision of the aid statistics rules is a process of research, analysis, dialogue, debate and, ultimately, negotiation. DAC members have differing views, and technical solutions, while based on evidence, require consensus – this is the very nature of the work in a multilateral organisation. The 2014 DAC decisions on the "grant equivalent" system and ODA loans were the result of such a process. It was fully transparent – all papers were circulated as "unclassified" documents – and inclusive, involving many technical experts, policy makers, and other key stakeholders from DAC member countries, civil society organisations (CSOs), and beyond.

In particular, decisions relied on the conclusions from an "Expert Reference Group" bringing together practitioners and thinkers from OECD countries, multilateral institutions, think tanks, and CSOs.

FAQ 3. Has the measurement of ODA deteriorated? Has the quality of aid declined?

Testing for a potential deterioration of the ODA measure necessitates to have a point of comparison. During the first decades of measuring ODA, only aggregate data were collected and published and could hardly be challenged. With all countries now reporting full details of their ODA at activity level, transparency has improved, and all this information is available for public scrutiny here.

The DAC decisions have improved the measurement of ODA, correcting earlier flaws from the cash-flow system, and making it a more objective and transparent measure. The introduction of the grant equivalent system and of a quantitative definition of concessionality aimed at correcting major inconsistencies in DAC members' interpretation of the term "concessional in character" within the ODA rules. The clarifications of rules for reporting peace and security expenditures as well as refugee costs inside donor countries lifted existing ambiguities to ensure uniform, consistent and comparable statistical reporting.

Like any other global statistical system built by consensus, the ODA measure is not perfect and may not align perfectly with national specificities. There is always room for improvement. Still, overall, we believe it gives a fair representation of the collective donor effort and that the transparency built into it enables donors to be held accountable.

On the quality of aid, although the DAC's basic mandate – to help poorer countries create better lives for their people – has not changed since its creation in the 1960s, the Committee has been increasing its focus on the quality, effectiveness, and impact of development co-operation. A champion of development effectiveness, and an active member of the Global Partnership for Effective Development Co-operation (GPEDC), the DAC encourages all donors and partners to adhere to the principles of country-led development, mutual accountability, inclusive partnerships, transparency, and a focus on results. DAC accountability mechanisms support the integrity, quality, and transparency of aid. They include regular peer reviews of individual DAC members – who on average go on to implement 80% of the recommendations made --, as well as rigorous, independent evaluations.

FAQ 4. Is official support for the private sector unduly recorded as ODA?

At their February 2016 High-Level Meeting, DAC members agreed on the principles to better reflect, in ODA, the donor effort involved in the use of private-sector instruments (PSI), i.e. loans to private sector companies, equity investments, mezzanine finance and guarantees.

However, despite best efforts, all parties could not agree on all implementation rules to report PSI in ODA according to the agreed principles. The main disagreement was over the discount rates to be used for calculating the grant equivalent of PSI. Provisional reporting arrangements have thus been put in place, based on prior years' decisions and procedures: total ODA and the ODA/GNI ratio are calculated by adding net disbursements for PSI (including both instrumental and institutional approaches) to the grant equivalents for loans -- sovereign and multilateral -- and debt relief. As PSI only represent 2-3% of total ODA, this was deemed an acceptable solution while members continue to work towards a more permanent solution.

The DAC is conducting a review of these provisional arrangements.

Note that any private finance mobilised using private sector instruments is not included in ODA but captured as "amounts mobilised" in DAC statistics.

Grant equivalent system and discount rates

FAQ 5. Does the grant equivalent system over count loans in ODA? What is the impact of ODA modernisation on ODA figures overall?

By construction, the introduction of the grant equivalent system will increase ODA figures in the long term in comparison with a cash-flow system where the net ODA effect of a loan is zero. In the short term, however, for specific years and countries, the ODA figure based on the grant equivalent system can be lower than the figure based on net flows. You can find examples in our reports monitoring the grant equivalent system: see the 2020 edition and 2021 edition.

As foreseen when the new methodology was agreed upon in 2014, data show that introducing the grant equivalent methodology has had little impact on overall annual ODA volumes. For all DAC countries combined, and compared to figures calculated with the cash-flow method, ODA levels were higher in 2018 (+2.3%) and 2019 (+3.6%), and lower in 2020 (-0.2%). Preliminary data for 2021 indicate that the ODA grant equivalent methodology added 0.7% to total DAC ODA that year. The new methodology has therefore not led to a substantial inflation of calculated ODA volumes, although the impact can be significant for a number of individual members (+12% for Japan in 2021, +9% for Spain and -7% for France).

FAQ 6. Do the discount rates agreed by the DAC unduly inflate ODA? Would differentiated discount rates (DDRs) be a better option?

The discount rates agreed by the DAC in 2014 (9%/7%/6%) are sometimes criticised for being unrealistically high and for inflating ODA. Critics suggest using the DDRs instead.

In fact, the measure and quantification of concessionality are neither straightforward nor universal. There are multiple aspects to consider when opting for a method. The Differentiated Discount Rates (DDRs) used by participants in the *Arrangement on Officially Supported Export Credits* are one such method – different from, say, that of the International Monetary Fund (IMF) – and are not recognised as a universal benchmark. It is therefore a matter of interpretation whether ODA figures are inflated against them.

The 2014 agreement on concessionality was the result of transparent, in-depth discussions among technical experts, policy makers, CSOs and more stakeholders, who carefully examined all options. Those discussions are documented in a number of publicly available documents, including:

1. Proposal for clarification of concessional in character [DCD/DAC/STAT(2012)22]
2. Modernising the DAC's development finance statistics [DCD/DAC(2014)9]
3. Options on concessionality [DCD/DAC(2014)29]
4. Possible use of risk premiums for assessing the concessionality of loans in DAC statistics [DCD/DAC/STAT/RD(2014)2/RD1]

For more information, see our online compendium on the Modernisation of the DAC statistical system.

The 2014 reform of discount rates improved the quantification of concessionality and introduced in particular much stricter concessionality rules for LDCs and other low income countries (9% discount rate and 45% threshold, compared with 10% discount rate and 25% threshold previously). After reviewing the implications of various options (cost to donor vs. benefit to the recipient, budgetary effort vs. donor effort), the DAC decided to use the IMF's uniform rate of 5% as the basis for the ODA discount rates, then differentiate between income groups of recipient countries. The new discount rates (between 6 and 9%) are lower than the discount rate applied before the reform (10%) which should be acknowledged as progress.

When deciding on discount rates differentiated by income groups, the trade-off between precision and stability of ODA statistics was considered. Using *uniform rates* for ODA calculation allows to keep a certain stability while using a volatile base rate and risk premia would have introduced instability: a loan counted in ODA one year would no longer count the next year and could again count the year after. The ensuing lack of predictability in ODA budgets would create a major problem for both donor governments and beneficiary countries. The DAC therefore took a conscious decision to prioritise stability over precision and to apply uniform discount rates, differentiated by income groups, for the purpose of calculating the donor effort in DAC statistics.

The impact of the choice of discount rates on the valuation of loans is relatively low. Grants have always made up the bulk of ODA, with loans representing around 20% of total commitments. When measured on a grant equivalent basis, the share of loans in ODA is even smaller: loans represent less than 10% of ODA (8.5% in 2020). A few countries have traditionally had the largest shares of their portfolio in the form of loans (e.g. 21% for France and 48% for Japan, measured on a grant equivalent basis). Importantly, there are no significant changes in members' lending practices since the introduction of the grant equivalent system.

Finally, the DAC decisions provide for close **monitoring and review**. The DAC will regularly assess the need for adjusting the discount rates, in particular in the event of any change in the base factor (IMF rate). The next review is planned in 2023.

FAQ 7. Is risk double-counted in the reporting on ODA loans and ODA debt relief?

The agreed treatment of debt relief follows calls by developing countries and civil society for expanded international debt relief efforts. Creditors within the Paris Club, a forum of official creditors for negotiating debt restructuring, had asked as well for the system to encourage the forgiveness and rescheduling of debt. The new agreement paves the way for more resolute action to relieve developing countries of the burden of debt as they struggle with the economic and social consequences of the COVID-19 pandemic.

There is no double-counting: only *additional* concessionality involved in debt restructuring is counted as ODA. Besides, strong safeguards have been introduced in the grant-equivalent system against ODA inflation, in the form of a powerful ceiling for debt relief of ODA claims, including on late interest and penalties / nominal terms.

In parallel, the continued reporting of debt relief on a cash-flow basis allows for transparency on operations taking place and the amounts involved. The OECD keeps monitoring the impact of the debt relief methodology, including trends in ODA loans vs. grants.

FAQ 8. Does the new methodology encourage donors to provide loans rather than grants, potentially worsening the debt crisis?

Since the rules agreed in 2014, and implemented since 2018, introduced a generally more restrictive measure of concessionality, lenders have to extend more concessional loans for them to be recorded, partially, as ODA. The effects of these decisions are closely monitored and subject to reviews. At present, analysis reveals no sign of major changes in donor behaviour: grants continue to represent around 80% of total ODA.

The reform also introduced a new safeguard regarding debt sustainability: loans whose terms are not consistent with the IMF Debt Limits Policy and/or the World Bank's Non-Concessional Borrowing Policy/Sustainable Development Finance Policy may not be reported as ODA. See the Reporting Directives, paragraph 60.

FAQ 9. Does the reform affect the composition of climate finance negatively? Are OECD figures inflated?

Climate finance figures are largely unrelated to the grant equivalent system adopted by the DAC:

The large share of loans in total public climate finance reflects the large volume of loans from Multilateral Development Banks (MDBs), not from DAC members, whose ODA loans represent less than 20% of climate finance. The grant equivalent system does not apply to MDBs and has no bearing on their financing decisions.

The bulk of ODA (85%) and the majority of bilateral concessional climate finance (64%) is still provided in the form of grants. The introduction of the grant equivalent system in DAC statistics has not induced an increase in the share of loans in ODA. This aspect is kept under scrutiny by the DAC and the OECD. In any case, the DAC Recommendation on Terms and Conditions still requires members to maintain a high level of concessionality in their ODA overall (minimum average grant element of 86%) and for poorest countries in particular (90% for least developed countries).

Finally, the measurement of climate finance is outside the remit of the DAC. The United Nations Framework Convention on Climate Change (UNFCCC) has full latitude to choose to measure climate finance based on flows or grant equivalents, and to determine the parameters to be used in this context. At COP26, the UNFCCC adopted a new common tabular format for data reporting from 2024 onwards: the measure is still based on flows but allows parties to also report the grant equivalent on a voluntary basis (with no specification of the discount rates to use for that purpose).

Debt relief

FAQ 10. Does the methodology over-score ODA on relief for non-ODA debt?

The accounting of debt relief operations on non-ODA flows was not introduced by the ODA modernisation reform. The DAC rules have always allowed the entire face value of the cancelled commercial credit to be counted as ODA, plus accumulated interest and penalty charges.

The main rationale is that the debt relief operations are considered developmental, and therefore ODA-eligible, as they relieve the overall burden of debt for the beneficiary country by altering the amount or repayment terms of outstanding debt.

Debt relief is an intrinsic dimension of the SDG framework, in particular through SDG target 17.4, which calls for more assistance to "*developing countries in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate, and address the external debt of highly indebted poor countries to reduce debt distress*". It is commonly recognised that rising public debt may reduce the capacities of developing countries to mobilise resources for the implementation of the SDGs.

Private sector instruments

FAQ 11. Buying shares in financial structures counts as aid but selling them is not deducted. Does the treatment of private sector instruments unduly increase aid figures?

In the context of provisional reporting arrangements for PSI, equity investment qualifies as ODA only if it has a clear development intention, as per the ODA eligibility criterion. The DAC's 2016 decision removed the disincentives for using equity in development co-operation by introducing a cap on reflows. The profits made are not hidden, however: under the provisional reporting arrangement, members shall provide the OECD with detailed information on the sales and dividends to allow the necessary oversight to ensure the data report is sound.

Donations of COVID-19 vaccines

FAQ 12. Are rich countries sending doses of vaccines purchased for their own populations – in some cases outdated – to poor countries, and counting them as ODA?

The donations of vaccine doses represented only 1% of total ODA in 2021. The OECD's guidance for reporting these donations in 2021 helped protect development budgets, as all DAC members bar one followed this guidance. The guidance was drafted following a number of consultations and input from international experts from leading health organisations.

The longstanding DAC Reporting Directives allow donations in kind to be reported as ODA in addition to direct contributions of finance. Donors' donations of excess vaccine doses are a form of aid in kind. While the vaccines were not bought originally for developmental purposes, the donations themselves are for the benefit of developing countries. To respond to global vaccination inequities and the very low rate of vaccination in low-income countries, there were calls for high-income countries to share COVID-19 vaccine doses quickly, in particular through the COVAX Facility. Many donors have committed to share and donate doses, for example, in the 2021 G7 and G20 communiqués, and in the latest status report on dose donations to COVAX.

Given the Reporting Directives already allow for the reporting of vaccine donations, discussions have focused on the need for guidance on pricing and additional safeguards. The OECD's recommended price of USD 6.72 per dose aims to protect the integrity and credibility of ODA and DAC statistics, providing a simple and robust method, aligned with COVAX, while ensuring transparency and comparability in members' reporting.

In many cases, the USD 6.72 average price is an under-estimate of real costs incurred by DAC countries who donated a mix of vaccines, including higher-priced ones. It is therefore an effective safeguard against ODA inflation. When donor countries donated mostly lower-price vaccines, they adjusted their 2021 figures not to overstate their ODA, as per the guidance enforced by the OECD during the data processing.

In addition, the price of USD 6.72 per dose provides consistency in ODA reporting of cash contributions and donations: it is the price at which Gavi/COVAX will purchase doses using donors' ODA cash contributions. Opting for a higher price could be a disincentive for cash contributions, which is the preferred option of COVAX in the longer term.

Expired doses are not eligible as ODA. By default, donated doses are required to have a shelf life of minimum 10 weeks upon arrival in country, as recommended by relevant international health organisations.

The 2021 ODA data published by the OECD clearly distinguish ODA levels including, and excluding, donated vaccines.

See also our blog on COVID 19 vaccines and ODA.