MONITORING THE IMPLEMENTATION OF THE GRANT EQUIVALENT SYSTEM

Report by the Secretariat of the Development Assistance Committee

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BETTER POLICIES FOR BETTER LIVES

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Background

1. At its High Level Meeting in December 2014, the DAC agreed to modernise the reporting on loans in DAC statistics by introducing i) a quantitative definition of concessionality, based on discount rates and thresholds differentiated by income group (thresholds of 45%/15%/10% calculated using discount rates of 9%/7%/6%)[1], and ii) the measurement of donor effort in ODA on a grant equivalent basis. This grant equivalent system became the standard for measuring ODA starting with 2019 reporting on 2018 ODA.[2] Data on the grant equivalent measure were also collected and published during a transition period from 2015 to 2017.

2. This report looks into DAC members' reporting on ODA loans since 2015. It analyses the impact of introducing the grant equivalent accounting methodology.

3. This report was discussed at the WP-STAT meeting in February 2020 and subsequently revised based on members' comments. The data have also been revised to reflect the latest updates.

1. Analysis of the impact of the new accounting methodology on the composition and allocation of ODA loans

4. In the course of discussions on the ODA grant equivalent measure, members raised the importance of closely monitoring the impact of introducing the new accounting methodology. The Secretariat committed to monitor members' lending practices in this regard and draw members' attention to cases where the new concessionality rules could have unexpected implications on lending. This section presents the Secretariat's analysis of ODA loans over 2015-18. It presents a comparison of cash-flow and grant equivalent ODA figures, looks at trends in ODA volumes as well as shares, terms and conditions of loans, and their allocation by income group.

5. **Overall, the analysis shows that the new accounting methodology has had little impact on ODA figures, and there are no signs of significant changes in members' lending practices.**

[1] For loans to multilateral organisations, the discount rate is 5% (6% for sub-regional organisations), and the threshold is 10%.

[2] In April 2019, ODA headline figures for 2018 applying this new standard were published for the first time. See https://www.oecd.org/development/development-aid-drops-in-2018-especially-to-neediest-countries.htm.

1.1. 2018 ODA figures: grant equivalent and cash-flow bases

6. Although grant equivalent data were collected and published during a 3-year transition period (2015-17 ODA data), the grant equivalent system became the standard for measuring ODA only in 2019 on 2018 ODA data. ODA headline figures applying this new standard were published for the first time in April 2019.[3]

7. As foreseen when the methodology was agreed at the 2014 HLM, the implementation of the grant equivalent methodology has had little impact on ODA volumes overall: **it increased ODA levels by 2.3% in 2018 for all DAC members combined**.

8. However, it does have significant impacts on a number of individual countries: Japan + 40.7%, Portugal + 6.1%, France - 5.5%, and Spain + 11.8%.

1.2. Trends in volume and share of ODA loans

9. **From a long-term perspective, since 2009 and with the exception of Japan, loan-providing DAC members have not significantly increased their ODA loan portfolios in volume terms. The share of loans in total ODA has also remained quite stable for these members. The introduction of the grant equivalent system in 2015 does not seem to have changed these trends.**

10. Members that regularly reported ODA loans from 2009 to 2018 are EU Institutions, France, Germany, Italy, Japan, Korea, Poland, Portugal and Spain. Members with significant shares of loans in total ODA in 2018 include the EU Institutions (20%), France (36%), Germany (20%), Japan (68%) and Korea (57%). Figure 1 illustrates the trend of ODA loans in volume terms for individual members. Figure 2 focuses on the four DAC members that provided the largest volumes of ODA loans over the period.

11. In real terms, using 2017 as the base year, the overall ODA loan volume has more than doubled over the period 2009-18, increasing from USD 14.85 billion to USD 35 billion. The share of ODA loans in total ODA has also increased although at a slower pace from 14% in 2009 to 19% in 2018. However, these overall increases are largely due to Japan which accounts for almost half (USD 17 billion) of the total ODA loans in 2018.

12. Since the introduction of the grant equivalent system in 2015, an increasing trend of ODA loans in volume and relative terms was observed only for Japan, for which the share increased from 64% in 2015 to 68% in 2018. For all DAC members combined, however, the share of loans in total ODA remained stable around 19%. ODA still mainly consisted of grants in 2018.

[3] Data on actual flows (i.e. disbursements and loan repayments) continue to be collected and published to ensure transparency.

Figure 1. Volume of ODA loan commitments for major loan-providing members, USD billion (constant 2017 prices)

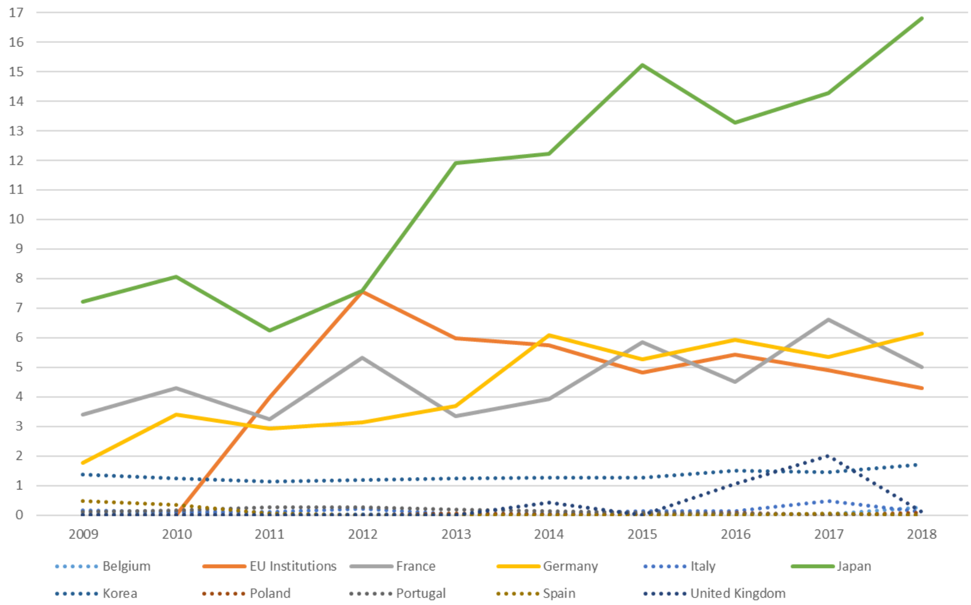
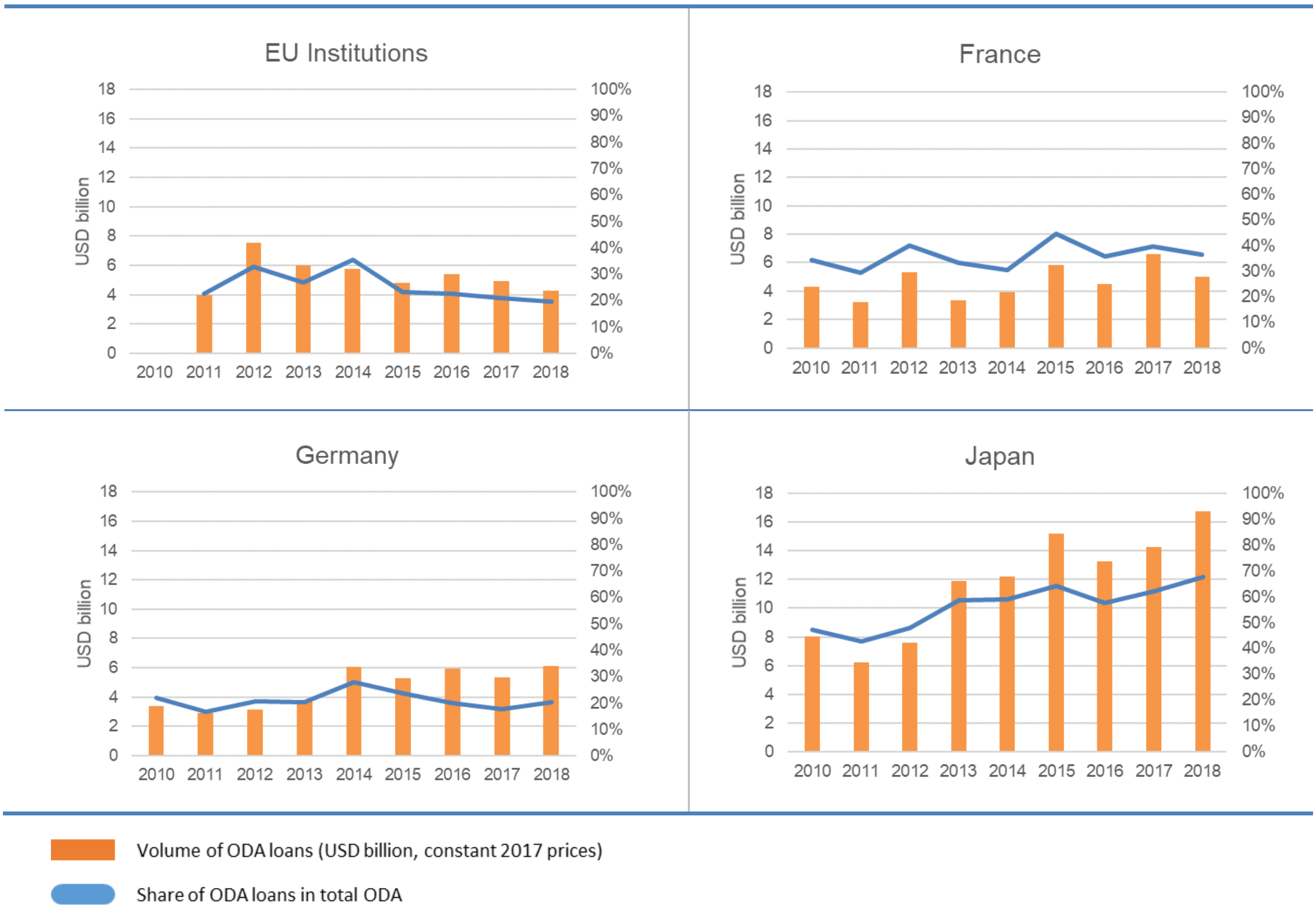


Figure 2. Trends in ODA loan commitments: volume and share in total ODA, 2010–18



1.3. Evolution of terms and conditions of ODA loans

13. **DAC members have overall not changed the concessionality levels of their ODA loans during the 2015-18 period. However, although the grant equivalent system was expected to incentivise lending on highly concessional terms to least developed countries (LDCs) and other low-income countries (LICs)[4], on average the terms of loans to LDCs hardened over the same period.**

Table 1. Average grant element of ODA loans over 2015-18

Calculated using 10% discount rate ("old" method) and discount rates differentiated by income group i.e. 9%/7%/6% ("new" method)

	2015		2016		2017		2018
	old	**new**	**old**	**new**	**old**	**new**	**New**
Australia	74%	64%	-	-	-	-	-
Belgium	87%	85%	88%	84%	93%	90%	67%
Canada	26%	17%	-	-	-	-	-
EU Institutions	49%	33%	49%	40%	49%	35%	38%
Finland	-	-	-	-	-	-	79%
France	54%	40%	54%	40%	53%	40%	44%
Germany	46%	31%	47%	32%	46%	31%	35%
Italy	93%	88%	95%	89%	85%	77%	81%
Japan	81%	71%	77%	67%	77%	67%	68%
Korea	88%	82%	87%	81%	88%	81%	80%
Poland	79%	77%	76%	73%	77%	73%	79%
Portugal	67%	56%	59%	46%	58%	47%	47%
Spain	-	-	-	-	51%	35%	41%
United Kingdom	-	-	61%	40%	72%	52%	31%
Average	**65%**	**53%**	**64%**	**52%**	**64%**	**51%**	**55%**

14. The average grant element[5] of loans to all developing countries combined slightly declined throughout the transition period (from 53% in 2015 to 51% in 2017), but the declining trend was reversed in 2018 (55%), see Table 1. Although this results in an increase over the entire period under review (2015-18), a number of members applied significantly harder lending terms: Belgium (grant element decreased from 85% to 67%), Italy (from 88% to 81%), Japan (from 71% to 68%), Korea (from 82% to 80%) and Portugal (from 56% to 47%).

15. Looking at the interest rate and maturity periods (see Table 2) allows deciphering the evolution of the grant element:

- Interest rate: the DAC average increased throughout the transition period (from 1.0% in 2015 to 1.2% in 2017) but then decreased in 2018 (1.1%). In fact, with the exception of Germany, all members that regularly reported ODA loans applied higher interest rates in 2018 than in 2015.

[4] See 2014 HLM Communiqué.

[5] As calculated based on the new accounting methodology.

- Maturity period: the DAC average slightly decreased during the transition period from 26 years in 2015 to 25 years in 2017, however, the declining trend was reversed in 2018 and the average reached 28 years in 2018. Members show different patterns.[6]

Table 2. Characteristics of 2018 ODA loans by loan provider[7]

	Belgium	EU Institutions	Finland	France	Germany	Italy	Japan	Korea	Poland	Portugal	Spain	United Kingdom	DAC Average
Average grant element	67%	38%	79%	44%	35%	81%	68%	80%	79%	47%	41%	31%	**55%**
Average interest rate	0.0%	2.0%	0.5%	1.7%	1.4%	0.1%	0.6%	0.2%	0.2%	2.0%	0.5%	0.0%	**1.1%**
Average maturity (years)	39	20	17	21	15	29	36	39	49	23	7	10	**28**

16. The average grant element of ODA loans to LDCs steadily decreased from 78% in 2015 to 73% in 2018. This is explained by higher interest rates (from 0.76% in 2015 to 0.84% in 2018) and shorter maturity periods (from 36 years in 2015 to 32 years in 2018). See Table 3. The decreasing trend in the grant element is mainly due to Japan (the average grant element to LDCs decreased from 84% in 2015 to 77% in 2018). Italy and Portugal also provided less generous loans to LDCs in 2018 than in 2015. All other members either maintained or increased the grant element of loans to LDCs. The increase for Germany is particularly prominent (34% in 2015 and 60% in 2018).

Table 3. Characteristics of ODA loans to LDCs

	2015	2016	2017	2018
Average grant element (new)	78%	75%	75%	73%
Maturity period (years)	35.8	33.5	32.6	32.0
Interest rate	0.76%	0.80%	0.94%	0.84%

[6] For instance, the average maturities increased for EU Institutions (from 15 years in 2015 to 18 years in 2017) and France (from 19 to 20) and continued to do so in 2018 (20 for EU and 21 for France). Data for Germany and Japan show more or less the same averages in 2015 and in 2018 (15 for Germany and 36 for Japan).

[7] Including bilateral ODA loans and ODA loans to multilateral institutions.

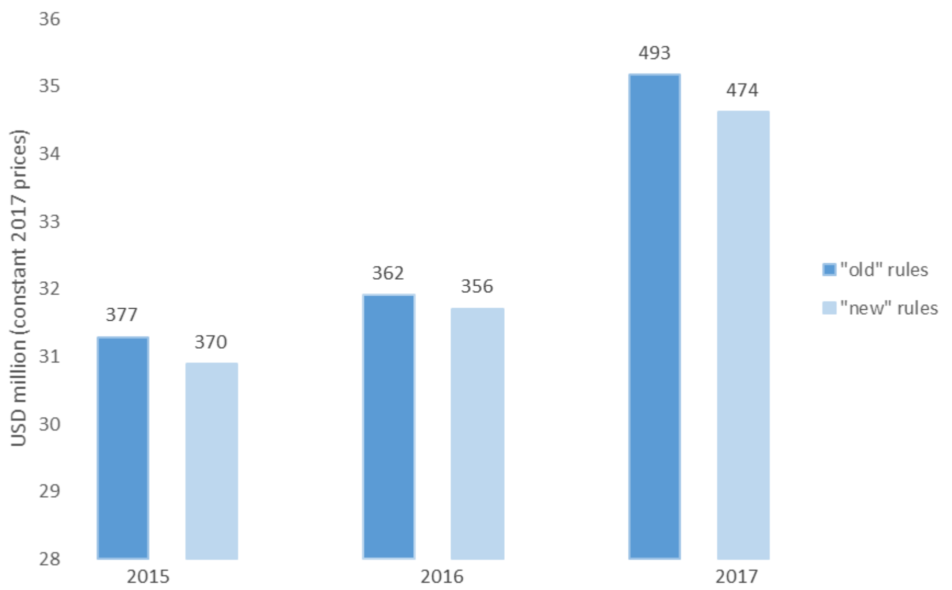
Eligibility of loans as ODA under the "old" and "new" concessionality rules

17. **The vast majority of ODA loans committed during the transition period would have qualified as ODA under the new concessionality rules as well. DAC members have used the transition phase to adjust to the stricter concessionality rules, without taking advantage of the theoretical possibility of making loans at terms not qualifying under the new concessionality rules**.

18. The new concessionality rules agreed in 2014 are stricter than the previous ones, due to the use of lower discount rates, and in the case of LDCs of a much higher grant element threshold. A three-year transition period was put in place during which loans qualifying under the "old" rules but not qualifying under the new rules were still reportable as ODA[8]. These loans were not encouraged but tolerated during the phase to adjust to the new rules. Members in the past pointed to the risk of a strategic behaviour from donors to commit this type of loans during the transition period while others felt that the time required for loan negotiations would in any case prevent such behaviour. [9]

19. The data show that, out of the 1232 ODA loans committed in 2015-17, the vast majority (1200) would still have qualified as ODA under the new rules (see Figure 3 below). Only 11 loans made by the EU, 14 by France, 2 by Germany, 3 by Japan, 1 by Portugal and 1 by Spain had terms that would not be eligible under the new rules. All but seven were for LDCs. Figure 4 illustrates, by income group and provider, the distribution of these commitments, which would not have been reportable as ODA after the transition period.

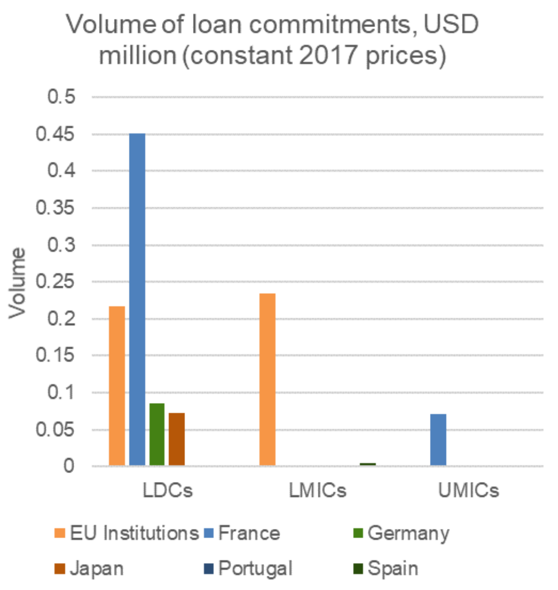
Figure 3. Volume and number of loans qualifying as ODA during the transition period ("old" rules) and that would have qualified under the new concessionality rules ("new" rules)

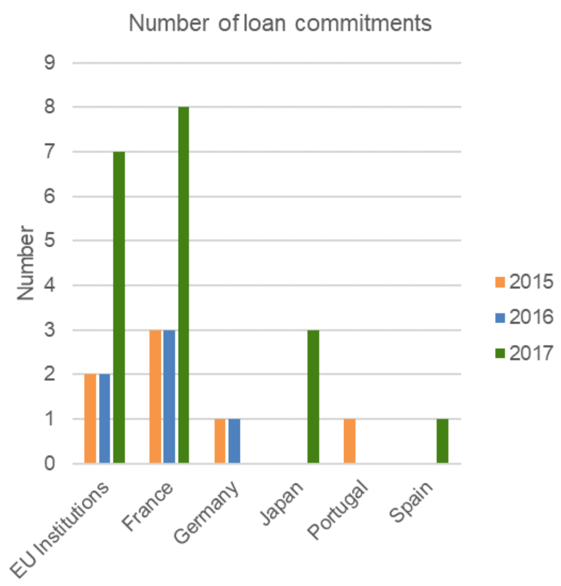


[8] The treatment of loans during the transition period is explained in Box 4 of the Reporting Directives. It was decided to apply a clear and unique rule, for the sake of consistency, whereby the time of commitment determined the treatment of loans: a loan qualifying as ODA and recorded as such at the time of commitment remains ODA throughout its life time and a loan not qualifying as ODA and hence recorded as OOF at the time of commitment remains OOF throughout its life.

[9] See DCD/DAC/STAT/RD(2015)5/RD3.

Figure 4. Details on loans that would not have qualified as ODA during the transition period





20. As noted above, conditions for qualifying loans as ODA under the new rules are generally stricter, but there may be a few specific cases[10] where loans could qualify as ODA whereas their grant element, calculated using a 10% discount rate, would not have passed the previous 25% threshold. The Secretariat has verified that there is no such loan in 2018: all ODA loans would have been reportable as ODA under the "old" rules as well.

[10] Loans to UMICs with short-term maturity.

1.4. Allocation by income group

21. **There is no significant change in the allocation patterns by income group following the introduction of the grant equivalent system.** Table 4 below shows the breakdown by income group for the four largest loan providers.

Table 4. Characteristics of 2018 ODA loans by income group for largest loan-providing members

EU Institutions	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	5%	33%	61%
Average maturity (years)	22.3	19.3	20.0
Number of loans with maturity < 15 years	1	12	25
Average interest rate	1.7%	1.8%	1.9%
Average grant element (new)	53%	40%	35%

France	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	20%	33%	23%
Average maturity (years)	20.8	16.7	17.9
Number of loans with maturity < 15 years	1	14	10
Average interest rate	1.2%	2.4%	2.8%
Average grant element (new)	56%	37%	30%

Germany	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	3%	63%	30%
Average maturity (years)	27.9	15.2	13.2
Number of loans with maturity < 15 years	1	11	25
Average interest rate	1.4%	1.4%	1.1%
Average grant element (new)	60%	37%	29%

Japan	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	19%	54%	2%
Average maturity (years)	34.2	37.3	20.2
Number of loans with maturity < 15 years	0	2	1
Average interest rate	0.2%	0.6%	0.9%
Average grant element (new)	77%	69%	44%

22. In 2018, the share of loans to LDCs, lower middle-income countries (LMICs) and upper middle-income countries (UMICs) combined accounted for 99% and 96% of the total ODA loans provided by EU institutions and Germany, respectively. This means that nearly all ODA loans provided by EU institutions and Germany went directly to developing countries. The figures for France and Japan add up to 76% and 75%, respectively. In fact, 18% of the total ODA loans provided by France and 19% of those by Japan in 2018 were allocated to multilateral institutions. In addition, loans unallocated by income group accounted for 6% for France and 5% for Japan.

23. Low-income countries benefit from more favourable terms than middle-income countries. Table 4 confirms that for loans made by largest loan providers in 2018, average grant elements are the highest for LDCs due to:

- lower interest rates, except in the case of the EU, that sets the interest rates almost equally for all income groups.
- longer maturities: although the difference between LDCs and the other income groups is not significantly large for the EU and France, LDCs still obtain loans with longer maturities from Germany and Japan.

24. LMICs had been the largest beneficiaries of ODA loans for long, followed by UMICs. In 2018, members continued providing ODA loans primarily to middle-income countries (see Figures 5 and 6), i.e., LMICs (51%) and UMICs (22%). The share of loans allocated to LDCs accounted for 16% of all ODA loans committed in 2018. Main recipients of ODA loans that year were India, Indonesia, Turkey, Bangladesh, Myanmar and Iraq.

25. Members have only recently started providing loans to multilateral institutions (e.g. International Development Agency 18 replenishment). The grant equivalent of such loans is calculated using a 5% discount rate (6% for sub-regional organisations) and the eligibility threshold is set at 10%. In 2018, loans to multilateral organisations represented 13% of total loan commitments. They originated from Belgium, France, Japan and the United Kingdom.

26. Loans to the private sector (PSI) are not the focus of this report, which monitors the implementation of the grant equivalent system, not applicable to PSI for now. In 2018, PSI loans reported according to the instrument approach amounted to USD 1.8 billion, representing 5% of all ODA loans. They were entirely allocated to middle-income countries.

Figure 5. Breakdown of ODA loans in 2018

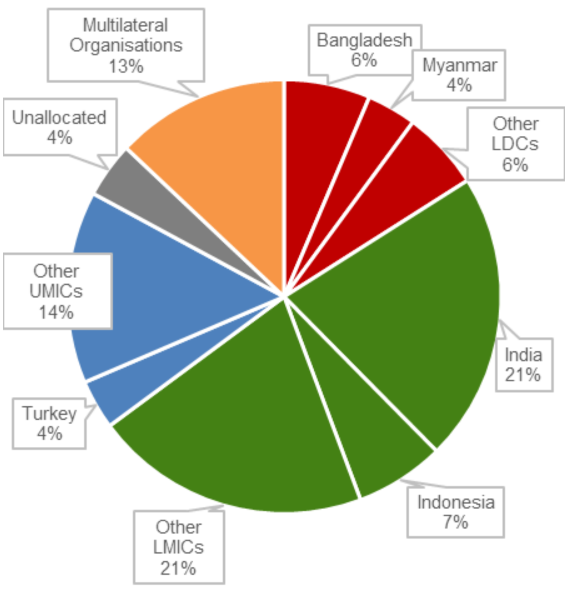
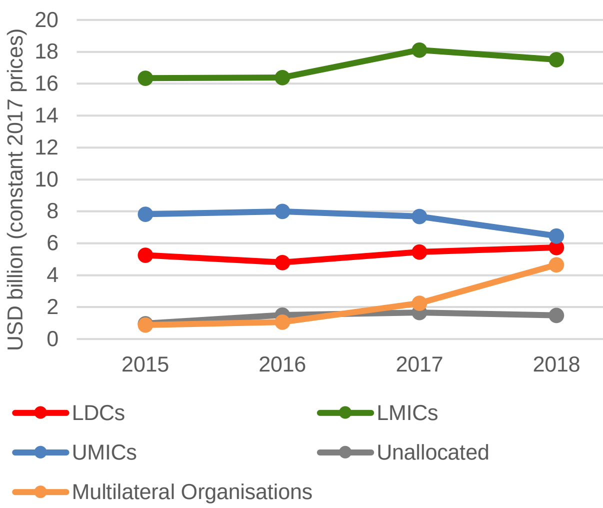


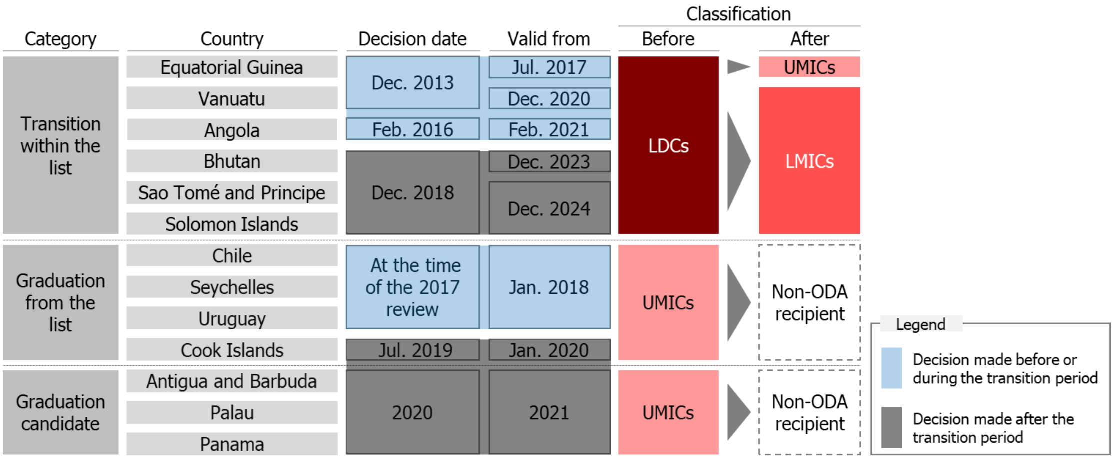
Figure 6. Distribution of ODA loans by income group 2015-2018



Loans to countries expected to graduate from ODA or LDC status

27. In past discussions, some members expressed the fear that the new rules could incentivise lending to countries expected to graduate from LDC status as lenders could apply higher discount rates in the grant equivalent calculation and would hence record higher ODA credits.[11] Others indicated that this would be a marginal issue in practice as loans were disbursed over 2-3 years, which was also the frequency for amending the DAC List of ODA Recipients. **The data show that this issue was indeed marginal so far, with very few new loans committed to countries foreseen to graduate from the LDC status.**

Figure 7. Recent decisions on the List of ODA Recipients and countries in course of graduation



28. Figure 7 illustrates recent decisions and potential changes to the DAC List of ODA Recipients. Countries in the category of “Transition within the list” have either transitioned from the LDC status or will transition from LDCs to LMICs in the coming years and the recording of the ODA grant equivalent for ODA loans to these countries will from that time be based on a 7% discount rate (instead of 9% currently). **The data show no particular upward trend of lending to these countries that would signal a potential change in members’ behaviour.** Since the decision on transition:

- Vanuatu has received one loan by Japan.
- Angola has received five new loans (three by France, one by Korea and one by Poland)
- The other countries received no loan. However, for Bhutan, Sao Tomé and Principe and Solomon Islands, the decision was taken end-2018 and it is too early to study the impact (reporting on 2019 loans will take place later this year).

29. As regards countries categorised under “Graduation from the list”, members have not reported any loans to these countries after the decision on their graduation.

30. Concerning the “graduation candidate” countries, Antigua and Barbuda, Palau and Panama were classified by the World Bank as high income countries in 2017, 18 and 19 and will be proposed for graduation from the List in the 2020 review. As mentioned above, reporting on 2019 loans will take place later this year, and thus it is too early to study the after-effect of graduation of these countries. While exceeding the high-income threshold, Panama received three loans (two from Japan in 2016 and one from EU institutions in 2018).

[11] The grant element as originally assessed at the time of commitment (and thus using the discount rate relevant to the income group of the recipient at that time) is used to calculate grant equivalents over the whole disbursement period of the loan, even if the recipient changes income group during the disbursement period.