

February 2018

accounting for ODA loans

the effect of the new rules

briefing

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Summary

The rules on how loans are accounted for in official development assistance (ODA) are changing. Currently the full value of concessional loans from donors is counted as ODA and capital repayments on old ODA loans are then subtracted from the net ODA measure. It is this net ODA figure that is commonly used to assess donors' performance against ODA targets, such as the commitment to give 0.7% of GNI as ODA.

After 2018 only a proportion of concessional loans will be counted as ODA. This reduction in the amount that donors report as ODA will be offset by the fact that repayments will no longer be deducted from the 'headline' measure of ODA.

The proportion of each loan that will be counted as ODA will depend on how concessional the terms of that loan are – the more concessional a loan is, the higher the proportion of the loan that will be counted as ODA.

The vast majority of ODA loans from Development Assistance Committee (DAC) donors in 2016 came from five countries – Japan, Germany, France, the UK and the Republic of Korea. The EU also disbursed large volumes of loans in that year through the European Investment Bank (EIB). Loans from the Republic of Korea and Japan are typically on more concessional terms than the other main loan-giving donors – Germany's loans are the least concessional among this group of donors.

Japan receives very large repayments on its old ODA loans – as much as all the other DAC members put together, although France the EU and Germany also receive significant repayments. In addition, the US receives over US\$500 million per year in capital repayments on old ODA loans despite having not given any new loans since 2007.

If the new rules had been in force in 2016, Japan's ODA would have been US\$3.4 billion higher than under the old rules. The US would have reported US\$510 million more ODA and Spain's ODA would have been US\$234 million higher. Germany's ODA would have been US\$1.7 billion lower and the UK's ODA would have reduced by US\$658 million – meaning that neither Germany nor the UK would have reached the target of 0.7% of GNI.

In aggregate, ODA from DAC donors would have been US\$1.8 billion, or 1.2%, higher in 2016 if the new loan rules had applied in that year. It is important to note that this increase is entirely due to changes in the measurement of ODA and does not reflect any increase in donor effort.

Background

Loans have always been a part of ODA. However, for a loan to be counted as ODA it must conform to certain criteria. Like all other forms of ODA the loan must be for developmental purposes and go to a country on the OECD list of ODA-eligible nations¹. In addition to this, ODA loans must be concessional. Specifically, a loan can only be counted as ODA if it has a 'grant element'² of at least 25%. Any capital repayments (but not interest repayments) made on existing ODA loans are subtracted from the headline net ODA figure.

Currently, loans which meet the 25% grant element threshold have their full face value counted as ODA. This means that a slightly concessional loan (with just a 25% grant element) counts for the same amount of ODA as a highly concessional loan (with perhaps a grant element of 90%+) despite the higher economic cost associated with the less concessional loan.

However, these rules are changing. After 2018 only the grant element % of the loan will count as ODA. This differs from the old method since in future a US\$10 million loan with 25% grant element will count for US\$2.5 million of ODA, whilst a loan of the same size at 95% grant element will count for US\$9.5 million of ODA. Furthermore, repayments of capital on existing loans will no longer be subtracted from the headline ODA figures.

There will also be a change to the calculation of the grant element. The discount rates (sometimes known as 'reference' rates) used to calculate concessionality are to be adjusted. Currently the discount rate is set at 10% for all loans. In future the discount rate will be differentiated depending on the income grouping of the recipient country. For Least Developed Countries (LDCs) and Low Income Countries (LICs), the discount rate will be 9%, for Lower Middle Income Countries (LMICs) 7% and for Upper Middle Income Countries (UMICs) 6%. This matters, as the higher the discount rate, the greater the calculated grant element of any given loan. Thus donors will be 'rewarded' for taking higher risk in lending to the poorest countries by having a higher proportion of loans to LICs and LDCs counted as ODA.

However, in order to incentivise more concessional lending to the poorest countries, the grant element required in order for a loan to LDCs and other LICs to be reported as ODA has been raised to at least 45%. Loans to LMICs and UMICs will be required to have a minimum 15% or 10% grant element respectively.

The current state of ODA loans

Any donor that either gives loans to developing countries, **or** has given loans in the past and is still receiving repayments on those loans, will see their levels of reported ODA affected by the new rules. The change in each donor's ODA will depend on three factors:

- The scale of lending to developing countries
- The level of concessionality of their loans (the grant element)
- The scale of repayments on old loans (as these will no longer be deducted from the headline ODA measure)

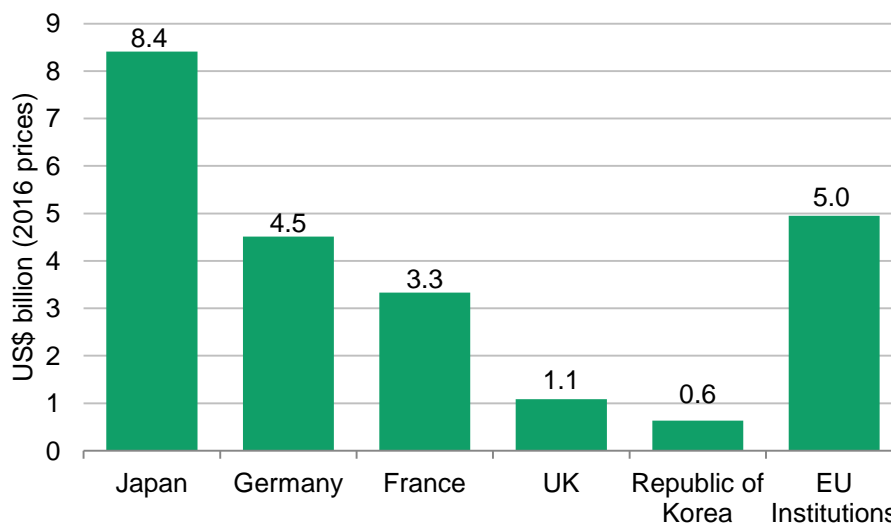
In short, donors who give the most concessional loans will see the smallest reduction in reported ODA as a result of only counting the grant element and donors receiving the largest loan repayments will see the largest rise in reported ODA due to these repayments no longer being deducted.

Which donors give the most ODA loans?

In 2016, bilateral DAC donors disbursed US\$16.6 billion in gross ODA loans. The EU, the only multilateral body that is a DAC member, disbursed US\$5 billion in ODA loans. Other multilateral bodies gave an additional US\$17.9 billion in ODA-eligible loans, while bilateral donors which are not members of the DAC disbursed US\$2.6 billion of gross loans. DAC members publish information on the terms of their ODA loans, making it possible to assess the likely effect of the new rules on the ODA levels of these donors.

Virtually all of the ODA loans given by DAC donors come from five member states – Japan, Germany, France, the UK and the Republic of Korea. These countries accounted for over 98% of new ODA loan disbursements from DAC country donors in 2016.

Figure 1: Most ODA loans from DAC donors come from five member states plus the EU (gross ODA loans in 2016)



Source: OECD DAC

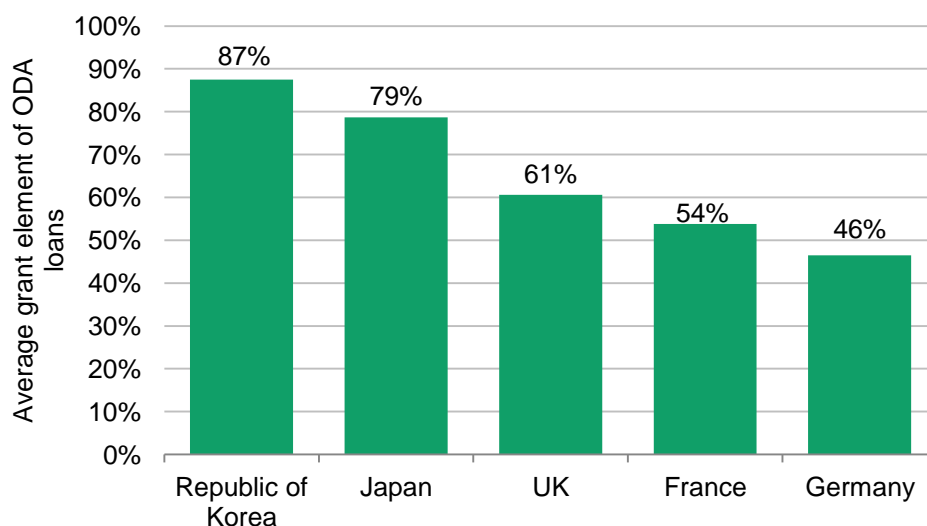
The UK is unique in that none of its loans went to developing countries in 2016 – all of the UK’s loans were classed as core support for multilateral bodies. This use of ODA loans to fund multilateral ODA is a recent change of policy for the UK – prior to 2014, the UK gave no ODA loans to either bilateral or multilateral recipients. Japan and France have also used loans for some of their multilateral ODA, but most Japanese and French loans are given as bilateral aid to developing nations. No other donor uses loans to fund multilateral ODA.

Aside from the main loan-giving donors shown in Figure 1, five other DAC donors gave smaller amounts of ODA loans in 2016: Poland (US\$77 million of gross lending), Italy (US\$72 million), Spain (US\$64 million), Portugal (US\$47 million) and Belgium (US\$16 million).

Which donors give loans on the most concessional terms?

As measured by the average grant element of ODA loan commitments in 2015 and 2016, the Republic of Korea gives the most concessional loans among the major loan-giving donors. ODA loans from the Republic of Korea are typified by very low interest rates – the majority of its ODA loans reported in 2016 had interest rates of between 0%–0.5%.

Figure 2: ODA loans from the Republic of Korea are almost twice as soft as loans from Germany (as measured by average grant element of loan commitments in 2015–16)



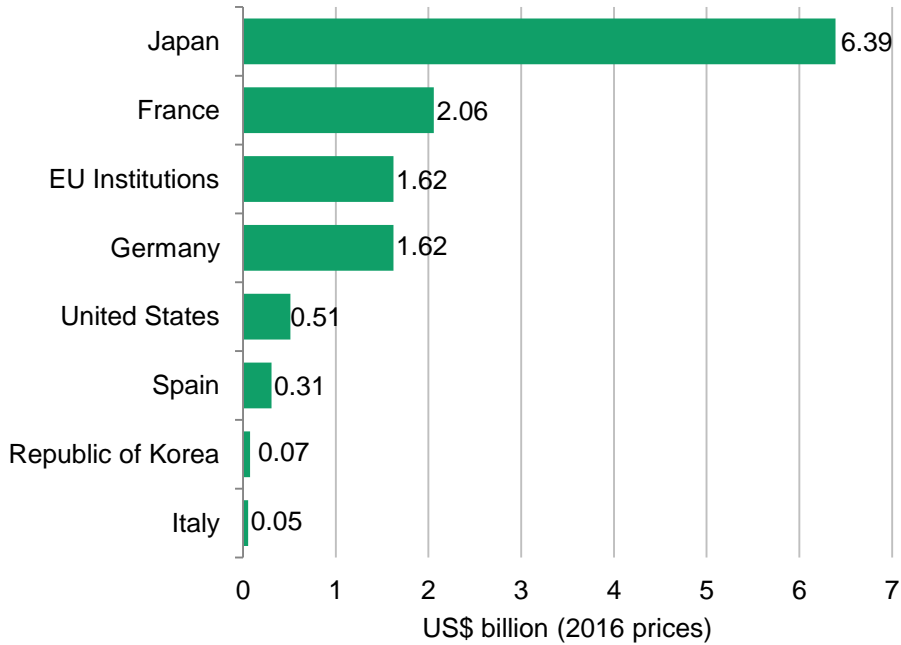
Source: OECD DAC

Some donors who only give small amounts of ODA loans also have comparatively high average grant elements. Italy's ODA loans in 2015–16 had an average grant element of 94%, while Belgium and Poland averaged 88% and 80% respectively.

Which donors receive the highest level of loan repayments?

Japan receives by far the largest amount of loan repayments of any donor. This is due to Japan's history of funding the majority of its bilateral ODA through loans. Japan is the only DAC donor to have disbursed more bilateral ODA in the form of loans than in the form of grants.

Figure 3: In 2016 Japan received roughly as much in loan repayments from developing countries as the rest of the DAC members combined



Source: OECD DAC

The United States, despite not giving any new ODA loans since 2007, still receives over US\$500 million per year in capital repayments on old loans. Similarly Spain, which is no longer a major supplier of ODA loans but, prior to 2012, gave a significant proportion of its ODA in the form of loans, received over US\$300 million in capital repayments in 2016.

In addition to the donors shown in Figure 3, a further 10 donors received smaller amounts of ODA loan repayments Austria, Belgium, Canada, Denmark, Finland, the Netherlands, Poland, Portugal, Sweden and Switzerland.

Notably the UK, despite being one of the largest donors of ODA loans in 2016, received no loan repayments in that year. This is due to the fact that the UK only started giving ODA loans in 2014 and repayments of these loans had not yet commenced by 2016.

The effect of the new rules

Table 1: Overall ODA would increase by US\$1.8 billion (just over 1%) if the new loan rules are applied to 2016 data, with very significant changes for some donors

	Net ODA (old rules)	Grants plus loan grant element (new rules)	Change (US \$million)	Change (%)
Australia	3,278	3,278	0	0%
Austria	1,635	1,635	-1	0%
Belgium	2,300	2,323	23	1%
Canada	3,930	3,971	40	1%
Czech Republic	260	260	0	0%
Denmark	2,369	2,382	13	1%
Finland	1,060	1,038	-22	-2%
France	9,622	9,586	-36	0%
Germany	24,736	23,031	-1,705	-7%
Greece	369	369	0	0%
Hungary	199	199	0	0%
Iceland	59	59	0	0%
Ireland	803	803	0	0%
Italy	5,087	5,132	44	1%
Japan	10,417	13,823	3,406	33%
Korea	2,246	2,191	-56	-2%
Luxembourg	391	391	0	0%
Netherlands	4,966	5,007	40	1%

New Zealand	438	438	0	0%
Norway	4,380	4,380	0	0%
Poland	663	670	7	1%
Portugal	343	350	7	2%
Slovak Republic	106	106	0	0%
Slovenia	81	81	0	0%
Spain	4,278	4,511	234	5%
Sweden	4,894	4,848	-46	-1%
Switzerland	3,582	3,555	-27	-1%
United Kingdom	18,053	17,395	-658	-4%
United States	34,412	34,922	510	1%
Total DAC	144,956	146,731	1,775	1%
EU Institutions	17,106	14,897	-2,210	-13%

Source: OECD DAC

The above table shows the amount of net ODA reported by DAC members in 2016 compared to how much ODA would have been counted for each member under the new rules. Whilst the change to total DAC ODA is relatively small, some individual donors show significant differences.

Japan would benefit both from the relatively high grant element of its loans and the fact that repayments on old loans are no longer deducted from ODA. The net effect would be that Japan's reported ODA would be US\$3.4 billion, or 33%, higher under the new rules.

Conversely Germany, whose loans are the least concessional of the major loan-giving donors, would see its ODA reduced by US\$1.7 billion or 7%. The US and Spain would see their levels of ODA apparently rise due to the fact that repayments on old loans will no longer be deducted from their headline ODA figure.

French ODA would be almost unchanged as the effect of only counting the grant element of loans would be almost exactly counterbalanced by ending the deduction of loan repayments from ODA.

ODA from the UK would be US\$658 million, or 4%, lower under the new rules as the UK receives no repayments to offset the fact that only the grant element of its loans to multilateral bodies would be counted as ODA.

Germany and the UK, two donors who gave 0.7% of GNI as ODA in 2016, would not have achieved this target if the new loan rules were in effect in that year. Germany's ODA would have fallen to 0.65% of GNI and the UK would have disbursed 0.67% of GNI as ODA. Japan's ODA in 2016 would have been 0.27% of GNI under the new rules, compared with 0.20% under the old rules. Spain's ODA would also see a small rise on this measure, from 0.35% to 0.37%.

Notes

¹ The current OECD DAC list of ODA recipient is available at: <http://www.oecd.org/dac/stats/daclist.htm>

² Grant element is the standard way of measuring how concessional a loan is. It can be viewed as the difference between the cost, in today's prices, of the future repayments a borrower will have to make on the loan in question and the repayments the borrower would have had to make on a non-concessional loan. This is therefore the amount of money that is considered to have been 'given away' by the donor, hence 'grant element'. The grant element is normally shown as a percentage of the value of the loan. Low interest rates and longer maturity periods will result in higher grant element percentages. Any loan with a 'grace period' – that is a period of time before any repayments have to be made – will also have an increased grant element.

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