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**INCLUSION OF THE EFFORT IN USING PRIVATE-SECTOR INSTRUMENTS IN ODA:
INCENTIVES EMBEDDED IN THE INSTITUTIONAL AND INSTRUMENT-SPECIFIC
APPROACHES**

DAC Meeting, 18 June 2015

This document is submitted for DISCUSSION under Item 4 of the Draft Annotated DAC Agenda [DCD/DAC/A(2015)7].

The document presents an analysis of how the institutional and instrument-specific approaches perform against the objective of incentivising more and better finance for development purposes. The questions for discussion are given in paragraphs 29-30. Members are also invited to send their written comments to the Secretariat by 30 June 2015 at the latest.

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INCLUSION OF THE EFFORT IN USING PRIVATE-SECTOR INSTRUMENTS IN ODA: INCENTIVES EMBEDDED IN THE INSTITUTIONAL AND INSTRUMENT-SPECIFIC APPROACHES

I. Introduction

1. The 2014 DAC High Level Meeting (HLM) recognised that “*the present statistical reporting system does not fully reflect the changing way in which members are engaging with the private sector, nor does it incentivise innovation*”. The participants of the HLM therefore decided to “*urgently undertake further work to reflect in ODA the effort of the official sector in catalysing private sector investment in effective development*”, and to “*explore further the institutional and instrument-specific approaches that have been developed by members, and potentially other approaches, with the aim of concluding at our next [HLM] meeting*”.¹

2. To take forward the exploratory work mandated by the HLM the Secretariat prepared a paper [cf. DCD/DAC/STAT(2015)3] examining the technical issues related to the operationalisation of the institutional and instrument-specific approaches, so as to achieve a better understanding of their implications, both qualitatively and quantitatively. The paper was presented for discussion at the Informal meeting of the Working Party on Development Finance Statistics (WP-STAT) on 2-3 March 2015. This confirmed that both approaches are technically feasible but would need to be further refined.²

3. Before carrying out further work on operational issues, there is a need to consider the incentives embedded in the two approaches and discuss their policy implications. This paper examines the incentives, in particular, **how the two approaches perform against the key objective of ODA modernisation i.e. incentivising more and better finance for development purposes**.³ The extent to which they can be expected to strengthen the credibility and integrity of the ODA measure – another key objective of ODA modernisation – will be addressed in a subsequent paper examining the consistency of the approaches and their possible co-existence within the general statistical framework.⁴

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1. Cf. <http://www.oecd.org/dac/OECD%20DAC%20HLM%20Communique.pdf>, paragraph 13.
 2. For a summary of the WP-STAT discussion see DCD/DAC/STAT(2015)10/FINAL, paragraphs 13-16. A compendium of members’ subsequent written comments has been issued in document DCD/DAC/STAT/RD(2015)3/RD3.
 3. The objectives of ODA modernisation were set at the DAC HLM in 2012. Cf. <http://www.oecd.org/dac/HLM%20Communique%202012%20final%20ENGLISH.pdf>, paragraphs 15-19.
 4. Based on members’ comments on DCD/DAC/STAT(2015)3, various options of institutional and instrument-specific approaches could be developed; alternative approaches have already been suggested. In order to focus the discussion on the incentives, this paper to a large extent overlooks the operational questions. The **institutional approach** is understood as applicable to bilateral development finance institutions (DFIs) and possibly other institutions extending finance to private sector entities in developing countries, with eligibility criteria and a system of ODA coefficients to be defined. The **instrument-specific approach** is understood as defining a methodology to calculate the amount of ODA in loans, equity, mezzanine finance and guarantees provided to private sector entities in developing countries. [Any financing to official non-sovereign entities (e.g. municipalities, public utilities) would be reportable as sovereign operations, given that they are categorised in DAC statistics as official entities.]

4. The paper is presented **for discussion** at the DAC meeting on 18 June 2015. Members are invited to express their views in particular on questions in paragraphs 29-30. Members are also welcome to send their **written comments** to the Secretariat **by 30 June 2015 at the latest**.

5. It is recalled that the treatment of private-sector instruments in ODA, i.e. the measurement of provider effort, is only a part of the broader work to better valorise these instruments in DAC statistics. The measurement of the volume of finance provided by the official sector and the amounts mobilised from the private sector is subject to discussion in the context of modernising the broader statistical framework, e.g. through measuring Total Official Support for Sustainable Development (TOSSD).

II. Incentivising more and better development finance

6. Members have extended private-sector instruments for a long time, despite the fact that the ODA reporting rules generally discourage their use (e.g. possibly negative net ODA in the case of equity, no ODA credit for guarantees and other contingent liabilities). There are many reasons for this, including the obvious fact that ODA is one but by far not the only framework condition or incentive for the allocation of official funding. Allocations may also be linked to altruistic motives and domestic interests. Indeed, it is a different policy decision to extend funds without financial returns ('giving') and funds for which there is a financial compensation or otherwise valued domestic benefit such as the opening of markets for national (domestic) stakeholders.

7. At the 2014 HLM, members agreed to change the ODA measurement of loans from net flows to grant equivalents. This new system allows for a better differentiation between the (higher) effort associated with the provision of grants as compared to loans and, by acknowledging the differentiated effort associated with different levels of risk-taking, incentivises highly concessional financing to the poorest countries. By providing for a more realistic comparison of grants and loans, the system establishes a level playing field between grants and loans. This level playing field should now be expanded by including in ODA the provider effort involved in the use of private-sector instruments. The note DCD/DAC/STAT(2015)3 illustrated that within the instrument-specific approach this objective could be pursued building on the grant equivalent system, but other options could also be considered for equity and guarantees for which the HLM agreement gives no directions. As regards the institutional approach, members have commented that the question of level playing field – between institutions in this case – should be further explored. (See paragraph 12.)

8. Recognising that ODA incentivises certain provider behaviour and can stimulate or prevent innovation, members have agreed that a key objective of ODA modernisation is to set the incentives (and remove any existing disincentives) to provide more and better development finance. *More and better* development finance has different aspects; this paper only looks at a few. More finance can be achieved both by *incentivising more official funding* and *using this funding more catalytically*, i.e. by deploying official funds in ways that mobilise additional private funds for development. Better development finance is a broad aspiration and also relates to development effectiveness. The two aspects looked at in this paper are *better targeting of finance where it is most needed* and *increased transparency of development finance*. Other quality aspects may be covered in future work. Box 1 – a synthesis by the Secretariat of members' feedback on the incentives embedded in the institutional and instrument-specific approaches – contains a number of suggestions that would enrich the discussion in this regard.

Box 1. Members' written feedback on DCD/DAC/STAT(2015)3 – Synthesis by the Secretariat of key points relating to the question of incentives

Capturing all financial instruments and encouraging innovation

- The statistical system should set incentives that encourage members **to use their aid budgets in innovative ways that maximise development impact, particularly for LDCs**. It should be **future proof and simple**, to fully reflect the changing ways donors work with the private sector now and in the future.
- **Continuous innovation in instruments applied by DFIs is desirable**, so it is not advisable to foresee a conclusive list of private-sector instruments and determine their ODA measurement at the instrument level. The aim of the work should continue to be promoting, not hindering, new types of development finance.
- The institutional approach provides incentives for using innovative financial instruments as it will result in **less volatile ODA levels**. (It makes budgeting easier and more exact – outflows from DFIs can vary considerably.)
- The key challenge is to widen the scope of the reporting to **appropriately reflect all instruments** (guarantees, equities, combinations of instruments and financing structures) in development finance statistics. Specific parameters and calculation methods will have to be defined, depending of the type of recipients (public or private), and the nature of the instruments (funded or unfunded, seniority status, and so on).

Avoiding market distortions

- The statistical system should encourage bilateral DFIs to **support the emergence of efficient and deep financial and risk capital markets in partner countries**. Behaviours that undermine existing commercial finance should not be encouraged; incentivising the use of subsidies must be avoided. **Sustainability of development impact in private sector development** is best achieved by operating at market terms. Moreover, non-concessional financing fosters **leveraging of private resources**, and profits allow for reinvestments and cost-efficient growth in private sector development operations. Developmental value-add of DFI activities is driven by other factors than concessionality.
- The subsidy logic behind working with the private sector should be different from that guiding assistance to the public sector. The **risk of over-subsidising the private sector** within the instrument-specific approach can be addressed through dedicated safeguard, including policy safeguards.
- The institutional approach provides no guarantees against over-subsidisation, and does not adequately address members' **concerns over crowding out private sector investment and involvement**. The concessionality limits in an instrument-specific approach *de facto* cap the grant element.

Targeting of resources to countries most in need

- Any approach to estimating risk which involves fixed assumptions on the investment terms does not incentivise donors to **make higher-risk investments** (which would be likely to lead to **high development impact**).
- An instrument-specific approach based on grant equivalent accounting and risk-adjusted discount rates enables **differentiation by country group**, in line with the 2014 HLM decisions.
- As the DFIs are mainly investing in richer developing countries, the institutional approach strengthens the incentives and the trend to **increasingly invest ODA resources to richer countries at the cost of the LDCs**.

Ensuring fair and neutral treatment of different vehicles of private sector development

- The institutional approach acknowledges the **complementarity and plurality** of different bilateral approaches and ensures a **fair and neutral treatment of the different vehicles of private sector development**, allowing donors to leverage their respective national strengths.
- The institutional approach may incentivise the **establishment of new, dedicated DFIs**.
- Statistical reporting should **neither incentivise nor penalise one institutional structure over another**; that is why it is both appropriate and required to have both institutional and instrument-specific approaches.
- Over the long-term, the institutional approach would incentivise **failure**, much in the same way as the current treatment of equity does.

II.1 Incentivising more official funding

9. **The institutional approach incentivises contributions to ODA-eligible institutions as long as these are not offset by returns.** This is generally the case for new and young institutions that are at an early stage of their development and thus need to be externally capitalised. The approach could therefore incentivise the **creation and (early) growth of new institutions that focus on private-sector instruments.**⁵ There are also occasions in which **mature institutions may require additional capital,** either because they do not generate enough earnings to grow organically or because they are making losses and need to be recapitalised. The reasons for the latter could be both external and internal, including inefficient management of official funds. In this context members have pointed to the **possible risk embedded in the institutional approach of discouraging efficient management practices,** including proper risk assessment. Mature institutions may also be recapitalised to **substantially increase their operating capital** – the institutional approach would also incentivise such expansion of private-sector operations.

10. While both new and recapitalised institutions can be expected to extend more finance to developing countries as compared to today, it should be noted however that the additional official contributions (in-donor expenditures) do not automatically translate into additional (cross-border) flows to developing countries.

11. To illustrate the above points, Tables 1 and 2 below look at the possible incentives provided by the institutional approach under the current institutional landscape across members. Table 1 presents a snapshot of data on the capital contributions, reinvested earnings and dividends in 2013 for bilateral institutions possibly to be considered under the institutional approach.⁶ Based on data in column B, members with “*institutions experiencing losses*” and members with “*financially self-sustaining institutions*” are identified and grouped in Table 2, together with the remaining members “*without private sector focussed institutions*”. This presentation shows that positive incentives would be given to 14 members to start new institutions or strengthen those experiencing financial difficulties, while 13 members that operate financially sustainable institutions may be incentivised to reinvest their earnings rather than to receive dividends. The positive incentive to expand operations would apply to all members with private-sector focussed institutions. Overall, the approach could thus increase the overall financing to private-sector entities in developing countries, provided this funding is not simply diverted from investments into ODA-eligible multilateral institutions or PPPs.⁷

12. At the global level, the institutional approach raises the policy question of the whether creation of institutions solely focused on private sector is desirable, considering the changing institutional landscape and the need to better interlink sovereign and non-sovereign operations. On the other hand, members have stressed the need to ensure a fair and neutral treatment of the different vehicles of private sector

5. There is also the theoretical possibility of gaming the system by successively starting and reporting on new institutions, once the predecessor institution has become financially sustainable and additional capital contributions would be offset by reflows.

6. In their feedback on DCD/DAC/STAT(2013)3 members were requested to validate the tentative list of institutions and the estimated capital contributions, reinvested earnings and dividends. Table 1 is based on Table 3 in DCD/DAC/STAT(2015)3. Figures for Belgium, Korea and the United States have been updated.

7. Tables 1 and 2 – based on data for only one year – are shown for illustrative purposes. An analysis of the incentives and ODA effects would require data on the institutions’ past performance for several years as well as indications on their forward programming.

development⁸, acknowledging their plurality and complementarity and members' respective national strengths. Over time, the creation of successive institutions – be it DFIs, PPPs or IFIs – would lead to a (further) fragmentation of the development finance architecture. This suggests there may be also a need to explore whether and how to incentivise private sector finance through existing institutions across members (i.e. members without a DFI providing capital to other members' existing DFIs) under the institutional approach.

Table 1. Estimated capital contributions, reinvested earnings and dividends of bilateral institutions potentially to be considered under the institutional approach
- 2013 data, thousands of euros -

Country	Institution	Estimated bilateral capital contribution since inception (1)	Estimated capital contributions 2013, bilateral share	Estimated reinvested earnings 2013, bilateral share (2)	Estimated dividends 2013, bilateral share
Austria	OeEB	0	-	0	-
Belgium	BIO	600,000	20,000	tbd	7,024
Denmark	IFU	154,468	-	9,676	-
Finland	Finnfund	127,986	-	2,489	-
France	Proparco	239,400	-	19,665	yes
Germany	DEG	627,852	-	78,265	-
Italy	SIMEST	84,855	-	3,564	3,230
Japan	JBIC	9,387,270	476,266	437,447	1,443
Korea	KEXIM	3,385,134	68,811	84,040	31,360
Netherlands	FMO	19,557	-	65,280	3,021
Norway	NORFUND	1,009,140	142,113	38,947	-
Portugal	SOFID	7,499	-	(595)	-
Spain	Cofides	21,148	-	5,557	2,587
Sweden	Swedfund	5,600	45	(10,416)	-
Switzerland	SIFEM	877,085	-	(24,374)	-
UK	CDC	916,190	-	156,531	-
USA	OPIC	36,316	-	117,924	309,417
TOTAL (3)		17,499,500	707,235	1,019,384	358,081
in % ODA			0.72%	1.04%	0.37%

Note: Based on table 3 in DCD/DAC/STAT(2015)3.

(1) Estimations based on share capital and share premia, no consideration of other reserves. (Exception FMO: Addition of special purpose reserve containing the allocations of risk capital provided by the State to finance FMO portfolio of loans and equity investments.) Attribution to donor country based on per cent of ownership. In the absence of detailed information, equal attribution of share premia over all shares.

(2) Net income minus dividends times bilateral shareholding (%). If no information on dividend pay outs was available, assumed full reinvestment of net income. Assumed equal attribution of earnings over all shares.

(3) Total calculated without consideration of losses incurred by SOFID, Swedfund and SIFEM.

Source: DFI Annual Reports 2013.

8. It has been suggested that same eligibility rules should apply to DFIs and PPPs, and that a level playing field between DFIs and IFIs would only be achieved if the same rules were also applied to private sector focused IFIs.

Table 2 – Illustration of incentives for more official funding under the institutional approach (2013)

Point of origin	Possible incentive	ODA effect	Countries*
Countries without private-sector focussed institutions	Set up and fund a new institution	Positive	Australia Canada Czech Republic Greece Iceland Ireland Luxembourg New Zealand Poland Slovak Republic Slovenia
Countries with institutions experiencing losses	Provide additional funding to strengthen institution	Positive	Portugal Sweden Switzerland
Countries with financially self-sustaining institutions	Reinvest earnings to avoid negative ODA. Potentially start successive institutions. Expand existing institutions.	Zero Positive Positive	Belgium Denmark Finland France Germany Italy Japan Korea Netherlands Norway Spain UK US

* Austria is not mentioned in this table as OeEB is fully privately-owned. Its classification as an “official agency” remains to be clarified. [OeEB administers fiduciary ODA funds on behalf of the Finance Ministry and benefits from official guarantees in parts of its portfolio. For more explanation see DCD/DAC/STAT(2015)3, paragraph 32.]

13. **The instrument-specific approach incentivises concessional development finance.** If built on the grant equivalent system agreed at the 2014 HLM, the approach would encourage high concessionality (the higher the grant equivalent, the higher the ODA credit) and allocating finance to higher-risk projects (higher discount rates for poorer countries).⁹ Given that the approach is independent of the type of provider (aid agency, development bank, DFI or other institution), **it could incentivise all providers to use private-sector instruments.**

9. The assessment of concessionality based on risk-adjusted discount rates recognises that lending to poorer (riskier) countries involves greater provider effort than lending to better-off (less risky) countries. In order to score as ODA, the provider effort has to be significant. No provider effort is recognised in ODA for loans that are not, or not enough, concessional (positive grant element but below the minimum concessionality thresholds).

14. On the flipside, the approach **may set an incentive to over-subsidise private-sector operations and lead to market distortions**. This issue has been subject to broad discussions among the multilateral development banks (MDBs), resulting in an agreement in 2012 on five “*core principles to guide MDBs’ engagement with and support of the private sector*” and adoption in a roundtable of several DFIs and IFIs in 2013 of *DFI Guidance for Using Investment Concessional Finance in Private Sector Operations*¹⁰ (see extract in Box 2). At the WP-STAT members have suggested that this guidance could serve as a basis for developing safeguards against over-subsidisation under the instrument-specific approach.

15. A policy question that needs to be discussed in this context is indeed concessionality. In their comments on DCD/DAC/STAT(2015)3, some members expressed the view that the concept of concessionality should not be mixed up with over-subsidisation – an action can be concessional just because it is enabling private sector development and because it would not have materialised in a pure market-based system (i.e. without the official sector taking on the risks and/or providing longer tenors). Other members see a fundamental contradiction between the intended avoidance of subsidies in private-sector instruments and simultaneous attempts to identify their concessional elements reflecting “assistance”. The different views also come across in members’ responses to the question about the applicability of minimum concessionality thresholds – some consider these as a must, while others would eliminate them or argue that maximum thresholds are required to avoid market distortions.

16. One member has suggested a broader discussion on the question of “what makes an investment ODA-eligible” and exploring in this context the aspects raised in the above-mentioned *DFI Guidance*. Indeed, this could help to **de-link the concepts of concessionality and additionality**. The principle that finance to the private sector should generally be provided on market-based, non-concessional and sustainable terms suggests that private-sector instruments should generally not count as ODA. If there is agreement on this principle, the question of how to encourage more development finance using these instruments can be focused on removing the disincentives from the current reporting system (see paragraph 20). If members consider that a positive ODA effect is required to incentivise the use of private-sector instruments, criteria other than concessionality (e.g. additionality) may need to be explored.

17. The **coexistence of the two approaches** would arguably incentivise most additional official funding, both towards the set-up of new and expansion of existing institutions, and towards the provisioning of private-sector instruments more generally. However, under any scenario going forward, in order to fully valorise the private-sector instruments ODA reporting will have to be complemented by an additional measure that captures the investments (including amounts mobilised from the private sector) at their face value.

10. See <http://www.ebrd.com/downloads/news/roundtable.pdf>, especially chapter 3.

Box 2. Extract from DFI Guidance for using investment concessional finance in private-sector operations

The starting point for the use of concessional finance by DFIs is the existence of a gap between private and social returns, reflecting the presence of a market failure resulting from such phenomena as (un-priced) externalities. Relevant externalities are usually “public goods”, such as emissions reductions, enhancing biological diversity, providing open access to recreational areas, research and development and deployment of innovative technologies, or affordable provision of basic infrastructure services. The fact that these benefits cannot immediately be fully monetised by investors makes the private financial internal rate of return lower than the true economic rate of return for society. An element of concessionality (explicit or implicit in the financial terms) can then bridge the gap between private and social returns and make the project happen.

With a robust rationale, concessional finance has the potential to catalyse private investments that deliver social benefits and that would otherwise not have happened with commercial financing or standard DFI financial products alone. Careful structuring of individual concessional finance products enhances the catalytic effect while helping to mitigate risks that accompany the use of concessionality (distorting the market, delaying the introduction of a necessary policy reform, undermining the development of sustainable markets).

Principles for designing of concessional finance products for the private sector:

Five core principles that guide MDBs’ engagement with and support of the private sector

Application to concessional finance

- | | |
|--|---|
| <ul style="list-style-type: none"> • Additionality: making a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector. • Crowding in: to the extent possible, catalysing market development and the mobilisation of private resources. • Commercial sustainability: expected to contribute to the commercial viability of the clients. • Reinforcing markets: structured to effectively and efficiently address market failures, and minimise the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants. • Promoting high standards of conduct in their clients, including in the areas of corporate governance, environmental, social inclusion, transparency and integrity. | <ul style="list-style-type: none"> • Concessional finance products should only be used in cases where the private sector is not able to provide adequate finance for a project to be viable. (Concessionality can undermine additionality if a DFI offers the same financial services on concessional terms as commercial financial institutions can provide on market terms.) • Concessional finance crowds in sustainable private investments if it is structured to provide the missing element in the overall financing that makes private projects commercially financeable and if it successfully creates a demonstration effect of commercial replicability. • Operations supported with concessional funds should be designed to contribute to the commercial sustainability of the relevant activity or sector, avoid creating permanent dependency on long-term subsidies and prevent rent-seeking behaviour among private beneficiaries. Concessional programmes should be time-bound, with credible expectations that they will be phased out over time. • Concessional finance would ideally supplement, and be consistent with, measures addressing the root causes of market failures and barriers. It should not substitute for, nor delay, more sustainable commercial or policy interventions. It should, to the extent possible, help develop a market that responds to appropriate incentive structures to provide the desired goods or services. Concessional finance should aim to align incentives of the project participants with market-compatible behaviour. It should encourage maximum delivery of social/economic outcomes or compensate for the incremental cost of going beyond standard practice in the sector. • Projects benefiting from concessional funds must adhere to particularly high corporate governance, environmental and social standards. When confidentiality permits, DFIs should aim to report on their concessional programmes, including quantification of subsidy levels and the results of these programmes, including, if possible, on the incremental impact of concessional finance. |
|--|---|

II.2 Using official funds more catalytically

18. Another avenue for attaining more development finance is to crowd in additional private finance alongside official finance. However, **neither the institutional nor the instrument-specific approach has a direct link to the mobilisation of additional private funds**, i.e. ODA eligibility is not conditioned to whether or not official funds mobilise private funds under either approach. Official providers extend private-sector instruments both on a stand-alone basis and alongside private investors. Consequently, private-sector instruments have the potential but do not automatically mobilise additional private resources.

19. The **institutional approach** measures official inflows in eligible official institutions. No immanent link exists to the catalytic or non-catalytic utilisation of these funds. There is no additional incentive (or disincentive) to use this funding in ways that maximise private participation, neither at the level of the institution itself (e.g. when DFIs are set up as PPPs) or at the level of the investments of the institution. Whether or not official inflows in ODA-eligible institutions result in additional funding from the private sector could rather be assessed (and potentially incentivised) through TOSSD and the measurement of amounts mobilised.

20. Similarly, there is no direct incentive under the **instruments-specific approach** for using ODA more catalytically – no immanent link exists to whether or not these instruments have mobilised additional private resources. However, under current reporting practices, the approach disincentivises the use by the official sector of certain private-sector instruments – equity, guarantees, sub-ordinated debt – which *could* mobilise additional private resources. Existing disincentives¹¹ should therefore be removed.

- In *flow-based reporting* these disincentives could be eliminated by capping reflows at the level of initial investment costs. However, guarantees would still be excluded and even very concessional instruments would result in zero net ODA.
- Applying the *grant equivalent system* to private-sector instruments would allow for capturing guarantees in ODA reporting. Non-concessional instruments would continue to result in zero net ODA while concessional instruments would contribute positive net ODA. Since the extension of private-sector instruments on concessional terms would have to be justified at activity level in order to safeguard against market distortions, providers would be explicitly requested to think through and reason for their ODA. This may indirectly stimulate more thinking about when and how to use concessional finance to crowd in commercial finance.

21. The **co-existence of the two approaches** would not lead to any additional incentives to use official funds more catalytically as neither of the approaches directly links ODA with the mobilisation of more private investment into development. In order to further enhance the catalytic role of official finance, removing existing disincentives to the use of private-sector instruments is necessary but not sufficient. It would have to be complemented by the new measurement of TOSSD and amounts mobilised to properly valorise (and thus incentivise) additional resource mobilisation. The instrument-specific approach could indirectly help to broaden the understanding and dissemination of information on private sector finance and leveraging, which is necessary given the importance of the private sector in the post-2015 financing for development framework.

11 . Negative equity flows, undervaluation of effort in subordinated debt, disregard of guarantees.

II.3 Incentivising better development finance

22. As noted in paragraph 8, better development finance has many aspects; this section examines only two – better targeting and greater transparency. At a later stage other questions related to the quality and effectiveness of private sector finance could be explored, such as those agreed upon by the MDBs (additionality, crowding in, commercial sustainability, reinforcing markets, promoting high standards) or those suggested by the UK and Sweden under the institutional approach (e.g. cost effectiveness).

Incentivising better targeting

23. In the context of private-sector instruments, targeting finance to where it is most needed means directing financing to areas where a financial or otherwise tangible returns are not sufficiently big for the private sector to invest. Better targeting means allocating more finance to where it is most needed.

24. The **institutional approach** would not incentivise better targeting i.e. it provides no incentives to finance higher-risk projects in higher-risk countries or sectors. (The discussion on possible coefficients under this approach has so far been limited to the eligibility of countries and has not considered different weighting of country groups.) The approach could thus result in less financing for least developed countries and other low-income countries (considered too risky), although one can also argue that these countries are most in need of concessional finance and that private-sector instruments, in general non-concessional, should rather be targeted to better-off countries.

25. The **instrument-specific approach**, if based on risk-adjusted discount rates, would incentivise higher risk-taking, since higher risk-projects generate larger grant equivalents (provided such risk is not financially compensated in which case the instrument is not concessional). The approach could therefore open possible avenues to direct more private-sector instruments to countries most in need of external finance (e.g. LDCs) which do not attract private investors, thus leading to greater additionality.

Incentivising greater transparency

26. In their feedback on DCD/DAC/STAT(2015)3 several members commented on the need for transparency and systematic reporting on DFIs' outflows in the CRS. Some explicitly requested the Secretariat to conduct a review of current reporting practices highlighting any lessons to be learnt from them. The Table in the Annex responds to this request, including however all main institutions extending private-sector instruments. It presents an overview of the coverage and quality of reporting in this area and provides information on specific issues such as the point of measurement (capital contribution vs. outflows), the possibility of separately identifying the institutions' operations in the database and the level of detail provided on various reporting items.

27. The Table shows that most members currently report on the institutions' outflows and generally provide activity-level data. There are exceptions, however. In some cases the institutions' outflows cannot be separately identified in the database (FMO, JBIC). In some other cases, the data are provided at a semi-aggregate level with limited information on the projects supported, the financial instruments used and the conditions applied (DEG, CDC). The Table also demonstrates that the level of transparency is not driven by the type of institution (DFI or other); it is rather dependent on the disclosure policy of each institution and, in some cases, the broader government transparency policy.

28. Both institutional and instrument-specific approaches provide incentives to increase transparency. The **instrument-specific approach** necessitates a high level of transparency due to the data requirements related to the grant equivalent calculation (e.g. financial terms). To achieve the same level of transparency, the **institutional approach** would need to be designed with a requirement to report on the institutions' outflows at the activity level. Based on the Annex, this would seem feasible. The two members that have implemented the institutional approach in their reporting (Belgium and Sweden) do also provide activity-level data for their respective DFIs. Finally, the valorisation of these operations in the possible broader measure of TOSSD should provide additional incentives to report and thereby increase transparency.

III. Questions for discussion and way forward

29. **Members are invited to:**

- **Express their views and observations on the above analysis on the incentives embedded in the institutional and instrument-specific approaches, state whether they generally agree with it, and if not, clarify which elements of the analysis raise concerns.**
- **Comment on whether they share the Secretariat's view that strongest incentives for "more development finance" would be created through coexistence of the two approaches and that this option should therefore be further explored, bearing in mind the need to ensure the consistency and integrity of the statistical system.**
- **Comment on whether they support a deeper analysis of the DFI Guidance and exploring the inclusion of some elements thereof in the ODA eligibility criteria for private-sector instruments or in the work on safeguards.**

30. **Members' comments are also invited on what would be the most appropriate process to take this work forward.** Some members have expressed their concerns over the timeline, signalling the need to ensure that all technical work be completed well before the end of the year to leave time for possible political negotiations ahead of the HLM where decisions on ODA modernisation with regard to private-sector instruments are due. Some members have suggested also seeking the views of the DFIs on the various questions – the Secretariat supports this idea but is of the view that both bilateral and multilateral DFIs as well as PPPs should be represented.

ANNEX. OVERVIEW OF MEMBERS' CURRENT REPORTING ON PRIVATE-SECTOR OPERATIONS

Country	Agency	Point of measurement	Reporting and coverage of flows	Level of aggregation	Category	DFI outflows are separately identifiable	Reporting by type of finance
		What is the point of measurement?	Do the reported outflows cover the whole portfolio of the institution?	Is the information reported at activity level?	Under what flow category are the agency's outflows reported?	Is it possible to identify the institution's operations separately in the CRS?	Does the reporting by type of finance comply with the Reporting Directives?
Austria	OeEB	Outflows of government programmes through OeEB	✓	✓	ODA	✓	✓
		Outflows	✓	Aggregates (by region)	Private flows at market terms	✓	✓
Belgium	BIO	ODA: Contribution to DFI (offset under OOF); OOF: outflows	✓	✓	OOF	✓	✓
Denmark	IFU	Outflows	✓	✓	Equities under ODA and loans under OOF	✓	✓
European Union	EIB	Outflows	✓	✓	ODA and OOF	✓	✓
Finland	FinnFund	Outflows	✓	✓	Grants and equities under ODA and loans under OOF	✓	✓
France	AFD	Outflows	✓	✓	ODA and OOF	☒	✓
	Proparco	Outflows	Equities are missing	✓	OOF	(Proparco operations reported under AFD's agency code)	✓
Germany	KfW	Outflows	✓	✓	ODA and OOF	✓	✓
	DEG	Outflows	✓	Semi-aggregates (by recipient and purpose)	Equities under ODA and loans under OOF	✓	✓
Italy	SIMEST	Outflows	Only support to national investors is reported	Aggregates	OOF	☒ (No CRS++ reporting)	☒ (No CRS++ reporting)
Japan	JBIC	Outflows	Cannot be assessed	Aggregates (by recipient)	OOF	☒ (No CRS++ reporting)	☒ (No CRS++ reporting)
Korea	KEXIM	Outflows	✓	✓	ODA and OOF	✓	✓
Netherlands	FMO	Government contributions to funds channeled through DFI (managed by FMO)	Cannot be assessed	Aggregates	Government funds managed by FMO under ODA	✓	✓
		Outflows*	Cannot be assessed	Outflows from FMO not separately identifiable	Private flows at market terms	☒	☒
Norway	Norfund	Outflows	✓	✓	ODA	✓	Loans reported as equity operations
Portugal	SOFID	Outflows	✓	✓	OOF	✓	✓
Spain	COFIDES	☒ No reporting					
Sweden	SwedFund	Swedpartnership operations reported together with Swedfund's ODA: Contribution to DFI (offset under OOF); OOF: outflows	✓	✓	ODA	✓	☒
					OOF		✓
Switzerland	SIFEM	Outflows	✓	✓	ODA	✓	✓
United Kingdom	CDC	Outflows	✓	Aggregated by recipient and purpose	Mostly ODA	✓	✓
United States	OPIC	Outflows	✓	✓	OOF	✓	✓

*: According to MFA, FMO's outflows might be included in aggregate data on private flows at market terms.

Reporting on commitments/disbursements	Reporting on reflows	Reporting on project titles/descriptions	Reporting on purpose codes	Rio markers	Loan repayment terms	Agency	Country
Is the institution reporting on both commitments and disbursements?	Is the institution reporting on repayments of loans (principal and interest) and sales of equity (including profits)?	Is the institution providing project-specific titles and/or descriptions?	Is the institution reporting on purpose codes?	Is the institution reporting on Rio markers?	Is the institution reporting on loan repayment terms (e.g. interest rate, repayment dates) also for non-ODA loans?		
✓	☒	✓	✓	✓	n.a.	OeEB	Austria
✓ (disbursements only for private flows)	✓	✓ for ODA activities only	✓ for ODA activities only	Only for grants	☒		
Commitments=disbursements	✓	✓	Pending for 2013	Pending for 2013	☒	BIO	Belgium
✓	✓	☒	Not for loans	☒	☒	IFU	Denmark
✓	✓	✓	✓	☒	✓	EIB	European Union
✓	✓	✓	✓	✓	✓	FinnFund	Finland
✓	✓	✓	✓	✓	✓	AFD	France
✓	✓	☒	✓	☒	✓	Proparco	
✓	✓	✓	✓	✓	✓	KfW	Germany
✓	✓	☒	✓	☒	☒	DEG	
Commitments=disbursements	☒	☒	☒	☒	☒	SIMEST	Italy
☒	✓	✓	☒	☒	☒	JBIC	Japan
✓	✓	✓ (Generic titles for OOF)	✓	✓ (No reporting for OOF)	☒	KEXIM	Korea
✓	Cannot be assessed	✓	✓	✓	Cannot be assessed	FMO	Netherlands
Disbursements only	✓	☒	☒	☒	☒		
✓	✓	✓	✓	✓	☒ Loans reported as equity operations	Norfund	Norway
✓	✓	✓	✓	All reported as 0	☒	SOFID	Portugal
☒ No reporting						COFIDES	Spain
✓	☒	☒	✓	✓	☒	SwedFund	Sweden
	✓	✓					
✓	✓	✓	✓	✓	n.a.	SIFEM	Switzerland
✓	No reporting on interest payments	☒	✓	☒	☒	CDC	United Kingdom
✓	✓	✓	✓	☒	☒	OPIC	United States