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DAC Working Party on Development Finance Statistics

Monitoring the Implementation of the Grant Equivalent system

WP-STAT Informal meeting, 16-18 June 2021, Virtual meeting.

This document presents an analysis of the impact of the grant equivalent accounting methodology on the composition and allocation of ODA.

The note is presented for DISCUSSION under item 8 of the draft annotated agenda [DCD/DAC/STAT/A(2021)2]. Members are invited to comment on the analysis and to check and signal any factual errors by 1 July 2021.

This version cancels and replaces the previous one to reflect the following changes:
- the reference to para 20 in para 29 has been changed to the reference to para 19.
- the reference to para 31 in footnote 9 has been changed to the reference to para 29.

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Monitoring the Implementation of the Grant Equivalent system

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. Data on the grant equivalent measure were also collected and published during a transition period from 2015 to 2017.

2. 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 measure of concessionality could have unexpected implications on lending. In this context, the first monitoring exercise covering the transition period (2015-17) and 2018 was carried out, and the result was shared with the WP-STAT in February 2020.[2] The analysis showed that the new accounting methodology had little impact on ODA figures, and there were no signs of significant changes in members' lending practices. The present report contains an updated analysis, which takes into account the latest figures available (2019 detailed ODA figures and 2020 preliminary aggregate ODA figures).

3. **Members are invited to comment on the analysis and to check and signal any factual errors by 1 July 2021.**

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

4. The report presents the Secretariat's analysis of ODA loans since the introduction of the grant equivalent system in 2018. 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. The data used for the analysis include multilateral loans and loans to the private sector (PSI). As explained below, however, these loans are quite small in volume terms, and their impact on overall ODA figures is quite limited.

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

[2] DCD/DAC/STAT(2020)11/REV1

5. 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 2019, only two loans to multilateral organisations were reported, by Finland and France, representing 0.4% of total loan commitments for all DAC members combined.

6. PSI loans are not the focus of this report, which monitors the implementation of the grant equivalent system.[3] In 2019, PSI loans reported according to the instrument approach amounted to USD 1.16 billion, representing 4.1% of all ODA loans.[4] Most of the recipients were middle-income countries.

7. Overall, the analysis confirmed that the conclusion drawn from the first monitoring exercise remained valid in 2019. **The grant equivalent measure had little impact on ODA figures, and there were no significant changes in members' lending practices.**

2019 ODA figures: grant equivalent and cash flow bases

8. Although grant equivalent data were collected and published during the three-year transition period (2015-17 ODA data), the grant equivalent system became the standard for measuring ODA from 2019 on 2018 ODA data. ODA headline figures applying this new standard were published for the first time in April 2019.[5] The latest data relate to 2020 ODA preliminary figures that were published in April 2021.[6]

9. 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 and by 3.6% in 2019 for all DAC members combined compared to the figures calculated by using the cash-flow system**. Although 2020 ODA data are preliminary and thus not the scope of this study, according to the preliminary figures, it increased the ODA level by 0.09% in 2020 for all DAC members combined.

10. However, in 2019, the introduction of the grant equivalent had a significant impact on a number of individual countries: Japan (+33%), Portugal (+8%) and Spain (+9%), and according to the preliminary figures, in 2020: Japan (+19%), Spain (+9%) and France (-11%).

Trends in volume and share of ODA loans

11. This report studies the potential impact of introducing the grant equivalent methodology on members' ODA. It primarily looks at flows (commitments) in order to monitor the trends in members' ODA portfolio in terms of volumes, terms and conditions as well as their allocation by income group.

12. From a long-term perspective, from 2009 until 2019 and with the exception of Japan, which shows major increases until 2018 but presents a sharp decrease in 2019, loan-providing DAC members overall have slightly 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 2018 does not seem to have changed these trends.

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[3] Based on a provisional agreement by the DAC, PSI loans are reported on a cash-flow basis. A review of this system is ongoing, see DCD/DAC/STAT(2021)17.

[4] Additionally, USD 0.32 billion of PSI loans were reported under the institutional approach, under OOF.

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

[6] https://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2020-detailed-summary.pdf

13. Members that regularly reported ODA loans from 2009 to 2019 are EU Institutions, France, Germany, Italy, Japan, Korea, Poland, Portugal and Spain. Members with significant shares of loans in total ODA in 2019 include the EU Institutions (16%), France (43%), Germany (16%), Japan (52%) and Korea (59%). 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.

14. In real terms, using 2019 as the base year, the overall ODA loan commitment volume has more than doubled over the period 2009-18, increasing from USD 15.15 billion to USD 35.44 billion. The rise can be largely attributed to the members that increased their loan volume in particular Japan. In 2019, loans fell to USD 28.06 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. This trend was also reversed in 2019, bringing the figure down to 15%. These overall increases in the volume and share during the 2009-18 period and the fall in 2019 are largely due to Japan, which accounted for almost half (USD 17.36 billion) of the total ODA loans in 2018 (USD 35.44 billion). In 2019 however, its share dropped to a third (USD 9.29 billion) of total ODA loans (USD 28.06 billion). Looking into each income group of recipients, from 2018 to 2019, Japan decreased its loan volume by 18% for least developed countries (LDCs) (from USD 3.31 billion to USD 2.70 billion) and by 42% for lower middle-income countries (LMICs) (USD 9.35 billion to USD 5.46 billion). Loans to upper middle-income countries (UMICs) increased from USD 0.40 billion to USD 1.04 billion. Thus, Japan’s overall decrease in 2019 can be largely attributed to its decrease of loans for LMICs.

15. Since the introduction of the grant equivalent system, from 2015 until 2019, increases in ODA loan volume were observed, in addition to Japan, for Italy and Korea. Italy increased its share of loans from 2.9% in 2015 to 7.6% in 2018 and then decreased to 4.8% in 2019, while Korea constantly increased the share from 41.7% in 2015 to 58.9% in 2019. All other members decreased the share of loans in their ODA, with the most prominent decrease observed for Portugal (from 19.0% to 1.0%). For all DAC members combined, during the 2015-18 period, the share of loan commitments in total ODA remained stable around 19%, but it decreased to 15% in 2019. The bulk of ODA is still provided in the form of grants.

16. According to the preliminary figures in 2020, some loan-giving members continued to increase their loans, in support of an inclusive global recovery in light of the pandemic.

Figure 1. Volume of ODA loan commitments for all loan providing members, USD billion (constant 2019 prices)

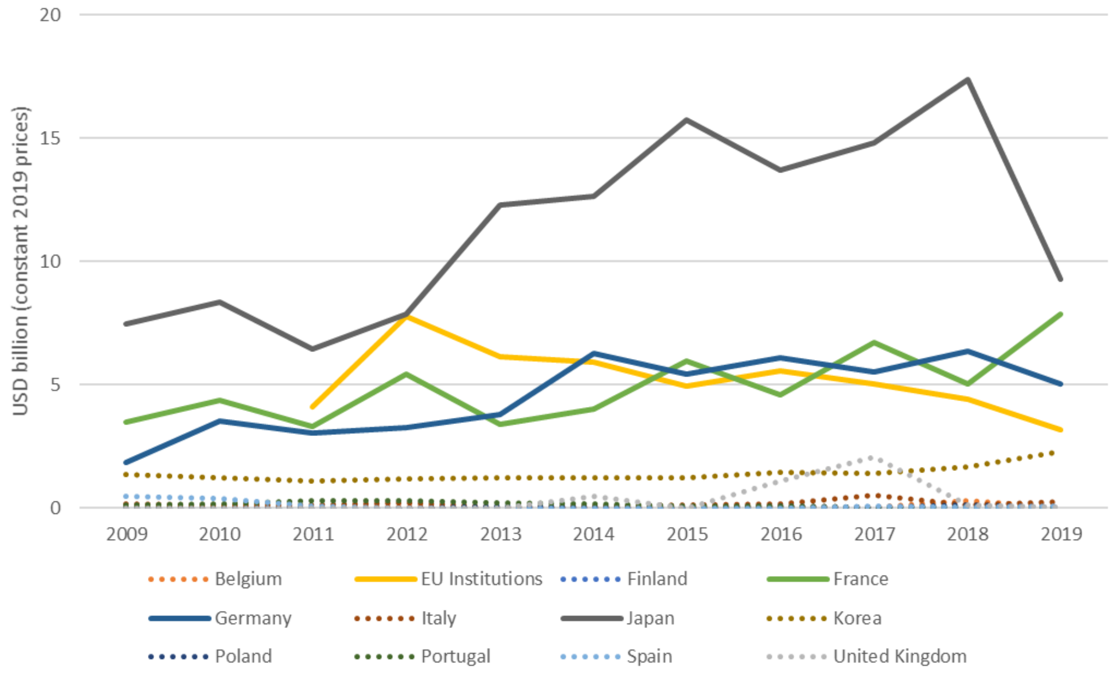
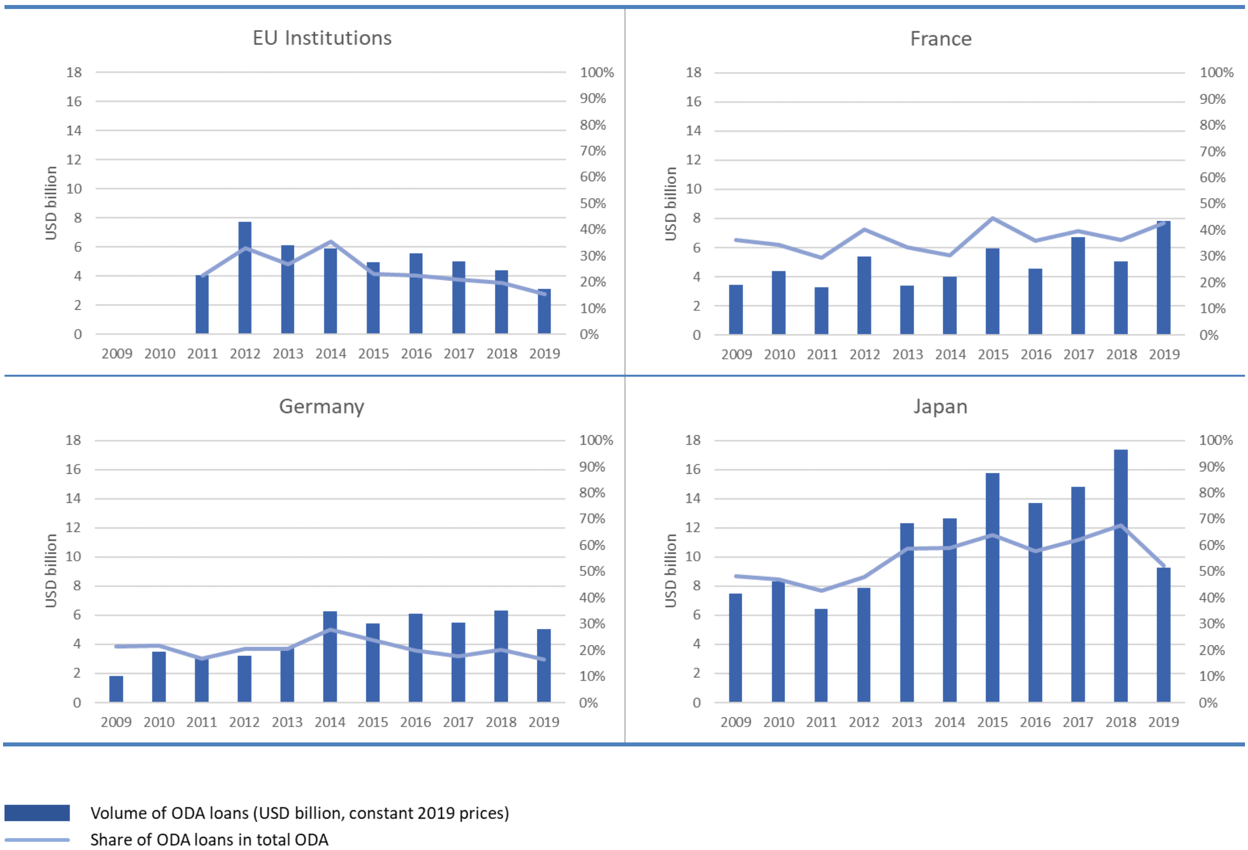


Figure 2. Trends in ODA loan commitments: volume and share in total ODA, 2009 – 2019



Evolution of terms and conditions of ODA loans

17. DAC members have overall not changed the concessionality levels of their ODA loans during the 2015-19 period. However, although the grant equivalent system was expected to incentivise lending on highly concessional terms to LDCs and other low-income countries (LICs)[7], on average the terms of loans to LDCs hardened over the same period.

Table 1. Average grant element of ODA loans over 2015-2019

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	2019
	old	new	old	new	old	new	new	new
Australia	74%	64%	-	-	-	-	-	-
Belgium	87%	85%	88%	84%	93%	90%	67%	83%
Canada	26%	17%	-	-	-	-	-	-
EU Institutions	49%	33%	49%	40%	49%	35%	38%	39%
Finland	-	-	-	-	-	-	79%[8]	67%
France	54%	40%	54%	40%	53%	40%	44%	45%
Germany	46%	31%	47%	32%	46%	31%	35%	36%
Italy	93%	88%	95%	89%	85%	77%	81%	68%
Japan	81%	71%	77%	67%	76%	67%	68%	70%
Korea	88%	82%	87%	81%	88%	81%	80%	77%
Poland	79%	77%	76%	73%	77%	73%	79%	68%
Portugal	67%	56%	59%	46%	58%	47%	47%	49%
Spain	-	-	-	-	51%	35%	41%	34%
United Kingdom	-	-	61%	40%	72%	52%	31%	40%
Average	**65%**	**53%**	**64%**	**52%**	**64%**	**52%**	**55%**	**54%**

18. The average grant element of ODA loans (loans to all developing countries and to multilateral institutions) slightly declined throughout the transition period (from 53% in 2015 to 52% in 2017). However, in 2018 it rose (55%) and fell slightly in 2019 (54%), see Table 1. Although this results in an overall increase from 2015, a number of members presented smaller average grant elements in 2019 than in 2015: Belgium (grant element decreased from 85% to 83%), Italy (from 88% to 68%), Japan (from 71% to 70%), Korea (from 82% to 77%) Poland (from 77% to 68%) and Portugal (from 56% to 49%).

19. The average grant element for Belgium decreased in 2018 to 67% from the previous years (2015: 85%, 2016: 84% and 2017: 90%), but increased again in 2019 (83%). This is due to a loan it provided to a multilateral institution and the low discount rate, which applies in this case (5%). In 2018, Belgium provided a multilateral loan to the World Bank with highly concessional terms (maturity period: 39 years and interest rate: 0%), representing USD 284.5 million and accounting for 97% of the ODA loans provided by Belgium that year. That loan, despite its highly concessional terms, conveyed a grant element of only 67%. The other loan was to Burkina Faso and presented a grant element of 79%. Therefore, although the average grant element for Belgium in 2018 decreased, it should not be interpreted as a sign of hardened lending terms overall. In addition to Belgium, during the 2015-19 period, Canada, France, Finland, Japan and the United Kingdom also provided multilateral loans.

[7] See 2014 HLM Communiqué.

[8] In 2019, Finland provided one loan to multilateral institutions, but there was no financial flow between Finland and developing countries.

20. The grant equivalent was introduced as a fairer measure of donor effort: a loan to a riskier beneficiary conveys a higher grant element and records a higher ODA amount than a loan with the same terms and conditions to a less risky beneficiary such as a multilateral institution as in the case of Belgium above. This case however illustrates that the introduction of differentiated discount rates by income groups has an impact on the calculation and meaning of members' average grant element for all loans combined.[9] The trends are less straightforward to interpret and looking at the interest rate and maturity periods (see Table 2) allows deciphering the evolution of the grant element:

a. 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%). The overall declining trend continued in 2019 (1.0%). In fact, with the exception of Germany, all members that regularly reported ODA loans applied higher interest rates in 2018 than in 2015. These members, however, applied lower interest rates in 2019 than in 2018, except for Italy (from 0.1% to 0.5%), Korea (from 0.2% to 0.3%), Poland (from 0.2% to 0.3%) and Spain (from 0.5% to 2.9%). Still, in 2019, all members except France and Germany applied higher interest rate than in 2015.

b. Maturity period: the DAC average slightly decreased during the transition period from 26 years in 2015 to 25 years in 2017. The declining trend was reversed in 2018, and the average reached 28 years. However, the average went down again to 25 years in 2019. From 2015 until 2018, members showed different patterns, however, all members, with the exception of Germany and Spain, applied shorter maturity period in 2019 than in 2018.

Table 2. Characteristics of 2019 ODA loans by loan provider

	Belgium	EU Institutions	Finland	France	Germany	Italy	Japan	Korea	Poland	Portugal	Spain	United Kingdom	DAC Average
Average grant element	83%	39%	67%	45%	36%	68%	70%	77%	68%	49%	34%	40%	**54%**
Average interest rate	0.0%	1.4%	0.1%	1.2%	1.4%	0.5%	0.6%	0.3%	0.3%	1.9%	2.9%	0.0%	**1.0%**
Average maturity (years)	34	18	40	18	16	26	34	38	33	22	20	8	**25**

[9] This impact has prompted discussions in the WP-STAT and in the DAC on the possible need to revise the 1978 DAC Recommendation on Terms and Conditions of Aid. See paragraph 29.

21. **The average grant element of ODA loans to LDCs steadily decreased from 78% in 2015 to 70% in 2019.** This is explained by higher interest rates (from 0.34% in 2015 to 0.80% in 2019) and shorter maturity periods (from 35.7 years in 2015 to 28.3 years in 2019). See Table 3. The declining trend in the grant element is mainly due to Japan (the average grant element to LDCs decreased from 84% in 2015 to 72% in 2019).[10] The following donors also provided less concessional loans in 2019 than in 2015: Korea (from 88% to 86%), Poland (from 77% to 74%) and Portugal (from 72% to 49%). Increase in concessionality was observed for Germany (from 34% to 53%).

Table 3. Characteristics of ODA loans to LDCs

	2015	2016	2017	2018	2019
Average grant element (new)	78%	75%	75%	73%	70%
Average grant element (old)	81%	78%	78%	77%	73%
Maturity period (years)	35.7	33.4	32.6	32.0	28.3
Interest rate	0.34%	0.49%	0.59%	0.67%	0.80%

[10] The fall in the grant element of Japanese loans is not observed for all recipient groups but only for LDCs. During the 2015-19 period, for LMICs, the grant element of loans is stable, and for UMICs, it increased significantly in 2019 compared to previous years. For LDCs, however, the average grant element of Japanese loans has been steadily decreasing. In fact, interest rates have been increasing and average maturity periods (years) have been decreasing. The fall however relates mainly to Bangladesh. Between 2015-19, with the exception of Bangladesh and Mozambique, grant element of Japanese loans to LDCs remained quite stable. The volume of loans to Mozambique is quite small and thus negligible. Japan increased its loan volume to Bangladesh from 2015 to 2019 significantly but also decreased the grant element of such loans during the same time period.

Allocation by income group

22. **There is no significant change in the allocation patterns by income group following the introduction of the grant equivalent system in 2018.** Table 4 below shows the breakdown by income group for the four largest loan providers.

Table 4. Characteristics of 2019 ODA loans by income group for largest loan-providing members

EU Institutions	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	13.7%	49.8%	36.5%
Average maturity (years)	24.1	16.0	17.7
Number of loans with maturity < 15 years	0	5	5
Average interest rate	1.58%	1.25%	1.62%
Average grant element (new)	57%	38%	35%

France	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	16.0%	53.1%	27.3%
Average maturity (years)	19.9	18.4	16.7
Number of loans with maturity < 15 years	1	23	14
Average interest rate	0.89%	1.03%	1.89%
Average grant element (new)	59%	46%	33%

Germany	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	1.6%	63.1%	25.8%
Average maturity (years)	17.1	16.2	15.5
Number of loans with maturity < 15 years	1	11	15
Average interest rate	0.86%	1.19%	1.57%
Average grant element (new)	53%	40%	31%

Japan	**LDCs**	**LMICs**	**UMICs**
Share of income group in total loans	29.1%	58.8%	11.2%
Average maturity (years)	30.5	34.4	39.4
Number of loans with maturity < 15 years	0	0	0
Average interest rate	0.82%	0.56%	0.32%
Average grant element (new)	72%	69%	70%

23. In 2019, the share of loans to LDCs, LMICs and UMICs combined accounted for 96.4% and 90.5% of the total ODA loans provided by France and Germany, respectively, due to their loans unallocated by income (3.0% for France and 9.5% for Germany) and loans to multilateral institutions (0.7% for France). The totality of loans provided by EU Institutions and 99.1% of that by Japan went directly to developing countries.

24. Table 4 confirms that for loans made by the largest loan providers in 2019, average grant elements are highest for LDCs. This, however, does not necessarily mean that lower-income countries benefit from more favourable terms than higher-income countries (due to the application of discount rates differentiated by income group and the fact that the grant element is by construction lower when applying a lower discount rate). In case of EU Institutions, although the average maturity is longer for LDCs (24.1 years) than LMICs (16.0 years) or UMICs (17.7 years), the average interest rate is higher for LDCs (1.58%) than LMICs (1.25%) (the average interest rate for UMICs (1.62%) is higher than both). In case of Japan, the lower the income level, the shorter the average maturity period (30.5 years for LDCs, 34.4 years for LMICs

and 39.4 years for UMICs) and the higher the interest rate (0.82% for LDCs, 0.56% for LMICs and 0.32% for UMICs). In case of France and Germany, in terms of both the maturity period and interest rate, LDCs received more favourable terms than LMICs, and so did LMICs than UMICs.

25. LMICs have been the largest beneficiaries of ODA loans for long, followed by UMICs. In 2019, members continued providing ODA loans primarily to middle-income countries (see Figures 5 and 6), i.e., LMICs (58%) and UMICs (21%). However, the gap between low-income countries and middle-income countries has been narrowed. While UMICs received ODA loans amounting to USD 5.71 million (21% of the total ODA loans), LDCs received USD 5.23 million (18%). Main recipients of ODA loans that year were Bangladesh, India, the Philippines, Uzbekistan, Morocco, Egypt and Iraq.

26. Preliminary data for 2020 also indicate that part of the increase in ODA in 2020 is due to loans to middle-income countries.

Figure 3. Breakdown of ODA loans in 2019

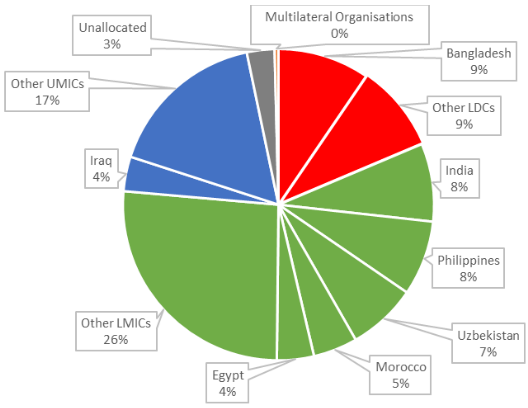
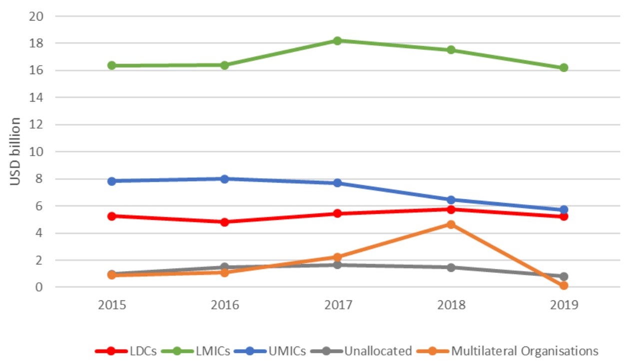


Figure 4. Distribution of ODA loans by income group 2015-2019



Implementation of the 1978 DAC Recommendation on Terms and Conditions of Aid

27. **Most but not all Adherents (DAC members) meet the minimum grant element of ODA commitments of 86%, as provided for by the 1978 DAC Recommendation on Terms and Conditions of Aid (hereafter referred to as the DAC Recommendation).** In 2019, France and Japan did not meet the 86% target (see Figure 5). **Moreover, all members except France, Japan and Poland met the specific norms for LDCs (90% annually for all LDCs combined or 86% over a 3-year average for each LDC) in 2019.** (See Figure 6 and Table 5.)

28. All other things being equal, the application of the new discount rates systematically lowers the grant element of loans. This is illustrated in Figures 5 and 6.

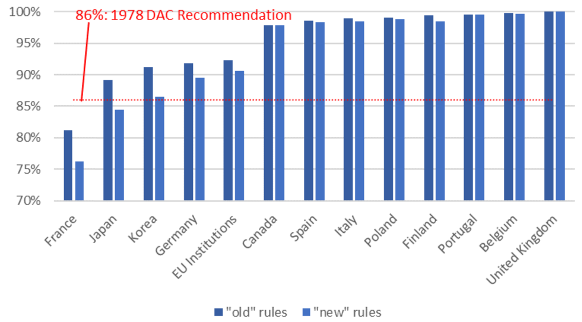
a. Applying a 10% discount rate, France has never implemented the DAC Recommendation during the 2009-19 period. Other members that did not implement the DAC recommendation during that period were EU Institutions (2012-14), Germany (2014), Japan (2017) and Portugal (2012).

b. Applying 9%/7%/6%, in addition to France, Japan would also fall below the threshold: the two members would never have implemented the DAC Recommendation during the 2009-19 period. Other members that did not implement the DAC Recommendation during that period were EU Institutions (2011-15), Germany (2009-10 and 2012-15), Italy (2009) and Portugal (2011-14).

29. The Recommendation is unchanged since 1978 and still refers to the definition of ODA as it stood before 2014, including to a discount rate of 10% for calculating the grant element. The Secretariat has shared with the WP-STAT and the DAC its assessment of the need to update the Recommendation, at least for such technical aspects. [See DCD/DAC/STAT(2020)11/REV1, DCD/DAC/STAT(2020)30 and DCD/DAC(2020)7]. It has also pointed out the difficulty in reconciling the current target for an overall minimum grant element of 86% with the introduction of discount rates differentiated by income groups. Indeed, as described in paragraph 19 above, the introduction of differentiated discount rates by income groups has an impact on the calculation and meaning of members' average grant elements: a decrease in the average grant element no longer necessarily reflects hardened lending terms, but possibly only a change in the allocation of loans by income groups and/or to the multilateral system (as the application of a lower discount rate in the calculation of the grant element systematically decreases the grant element). The DAC will discuss this topic again in the coming months.

Box 1. Implementation of the DAC Recommendation by Adherents

Figure 5. Grant element of ODA commitments in 2019, norm: 86%



Grant element of bilateral ODA commitments to LDCs in 2019, two alternatives

Figure 6. Annually for all LDCs, norm: 90%

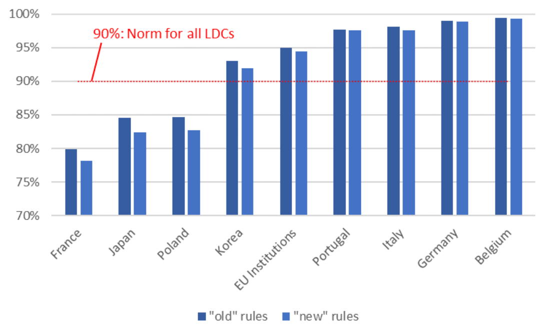


Table 5. Three-year average for each LDC, norm: 86%

Belgium		EU Instituions		France		Germany		Japan		Korea		Poland	
Sudan	84.3	Senegal	84.6	Niger	85.0	Uganda	85.8	Bangladesh	76.4	Nepal	70.5	Ethiopia	80.3
		Cabo Verde	81.3	Burkina Faso	81.6							Tanzania	79.0
				Mali	80.8								
				Benin	75.1								
				Senegal	74.3								
				Myanmar	71.0								
				Mozambique	70.1								
				Cambodia	68.1								
				Ethiopia	63.3								
				Uganda	63.2								
				Bangladesh	60.7								
				Angola	48.4								
				Nepal	38.8								

a) Excluding debt reorganisation. Equities are treated as having 100% grant element.
b) Only DAC members and LDCs where the 86% norm is not met are listed in the table.