ODI in conversation with DAC Chair Susanna Moorehead. The OECD's Development Assistance Committee (DAC) recently released a new set of rules for how it will record debt relief as official development assistance (ODA). That document is intended to resolve how DAC members deal with debt write-offs following the " modernisation of ODA."

SOURCE: ODI

DEBT RELIEF AND ODA

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INTRODUCTION

The world is in an unprecedented, multi-faceted crisis with the COVID-19 pandemic hitting developing countries particularly hard. In January 2021, the World Bank (WB) estimated that the number of people who would be pushed into COVID-19-induced poverty could increase to between 143 and 163 million. While these estimates are still preliminary, they suggest that the only certainty is that this crisis is truly unparalleled in modern history.[2]

Oxfam has estimated that half a billion people could be pushed into poverty, leading to increased social, economic and gender inequalities.[3] The spread of the pandemic is likely to erase the limited gains made in the past few decades to advance the Beijing Platform for Action,[4] across every sphere – from health to the economy, security to social protection. The impacts of COVID-19 are exacerbated for women and girls simply by virtue of their gender,[5] with strong evidence of a rise in gender-based violence.[6]

Economically speaking, developing countries have taken an enormous hit with record capital outflows, tightened financial conditions, currency depreciations and drops in export earnings, tourism and remittances. This is occurring in a context where debt obligations were already at high levels, a situation which has a significant negative effect on public service expenditures.[7]

The United Nations Development Programme (UNDP) expects that these factors will result in developing countries losing more than US$220 billion of their expected income.[8] Against this is the predication of the UN Conference on Trade and Development (UNCTAD) that the 'financing gap' for developing countries to stay at least somewhat on track to reach the Sustainable Development Goals (SDGs) is a staggering US$2 to $3 trillion over 2021 and 2022.[9] As the poorest and most vulnerable countries lack the monetary, fiscal and administrative capacity to respond adequately, the consequences of a combined health emergency and global recession are likely to be catastrophic.

Since the start of the coronavirus pandemic, the G20 has settled for repurposing established Paris Club debt treatment mechanisms to tackle developing countries' unsustainable debts. In April 2020, the G20 adopted the Debt Service Suspension Initiative (DSSI) whereby bilateral official creditors will, for a limited period, suspend debt service payments from the poorest countries that request this suspension. In total 73 countries are eligible for this program; but only 46 countries have applied. Parallel to this announcement, the International Monetary Fund (IMF) has offered a token amount of debt relief.

However welcome, these are limited and short-term solutions. On the one hand, these initiatives do not cover multilateral and external private creditors. On the other hand, for countries to be able to benefit from these initiatives, they must request support from the IMF and are expected to pay back the missed payments to their creditors over a six-year window. Essentially, they are only buying time.

But most importantly, it is unlikely that DSSI-eligible countries will be able to redeploy the temporarily saved resources to tackle COVID-19.[10] There are two main reasons: 1) These countries still have to meet their public external debt service obligations to private and multilateral creditors; and 2) The lack of commitment by the international community to provide long-term financing reduces the likelihood that countries will be able to redeploy all available resources towards emergency response efforts.

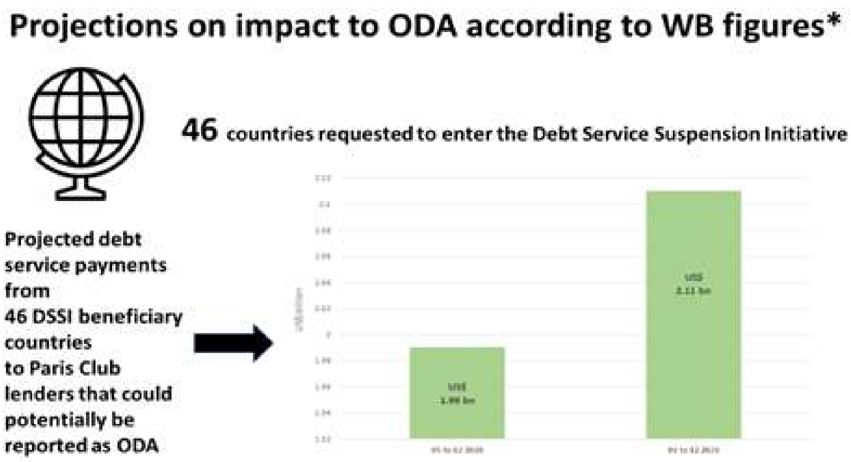
What about aid?

Official Development Assistance (ODA) has the potential to play a crucial role in tackling the immediate impacts of the coronavirus crisis and in supporting a recovery, one centred on human rights, gender equality and a just transition. However, the April 2020 joint statement from the Organization for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) – a forum of the main providers of aid – made just a modest call to "strive to protect aid budgets."[11] It seems certain that aid spending will remain at current levels, if not less, in the years to come.[12] Recent trends show that donors prefer loans over grants,[13] while the level of concessionality (the degree of 'softness' of a credit reflecting the benefit to the borrower compared to a loan at the market rate) has decreased. In this context, debt relief is expected to return as an aid modality.

Effective aid, in the form of unconditional grants, matters today more than ever. Equally important is the realization of donors' longstanding commitment to the 0.7 per cent target for ODA. With the exception of a few countries this commitment has not been fulfilled.

This chapter examines the recent agreement taken by the OECD DAC on the reporting of debt relief as ODA. It highlights a number of problematic effects that follow from this methodology as well as several concerns about the process.

FIGURE 1: PROJECTIONS ON IMPACT TO ODA FROM DEBT SERVICE PAYMENTS BY DSSI BENEFICIARIES (46)* **



* These figures are total debt payments, but we can expect that any debt rescheduling or cancellation for these 46 countries will impact ODA figures in the coming years.
** Fresnillo, I. (2020). Briefing paper: *The G20 Debt Service Suspension Initiative. Draining out the Titanic with a bucket?* Eurodad: Belgium.
Source: Source: Eurodad from International Debt Statistics, World Bank, October 2020

THE OECD DAC AGREEMENT ON THE REPORTING OF DEBT RELIEF AS ODA

In July 2020, the OECD DAC confirmed new rules for reporting debt relief as ODA.[14] This agreement was reached in the midst of an escalating debt crisis, compounded by the pandemic, and is likely to only exacerbate this crisis. More directly, it is likely to have an immediate impact on the future amounts of reported ODA (see Figure 1).

Not a new issue

At the 2014 High Level DAC Meeting, members agreed to change the way loans would be reported as ODA in the future, from a system based on cash flows to a grant equivalent system.[15] This change in reporting was implemented for 2018 ODA data.

With the earlier cash flow approach, donors counted the full face-value of the loan and deducted repayments further down the road. Under the new methodology donors will would no longer count the full amount of a loan but only its 'grant equivalent'[16] will be recorded as ODA (i.e. based on the extent to which a loan is concessional). The more generous the loan and related conditions are, the higher the ODA value that can be reported. The grant-equivalent system is also sensitive to the risk profile of the loan so the higher the risk donors take with their loan programming, the more ODA value they can report. With this methodology repayments are not deducted.

Originally, with this new approach, it was not anticipated that the 'grant equivalent system' would be combined with additional recording of ODA for debt cancellation or rescheduling. At the time members of the DAC acknowledged that:

> *"the ODA measurement from net flows to risk-adjusted grant equivalents will also change the basis for reporting on debt relief of official loans. Given that the new system would value upfront the risk of default on ODA loans, the eventual forgiveness of these loans would no longer be reportable as a new aid effort."*[17]

However, some DAC members were dissatisfied with the system in place and pushed for more generous rules for the reporting of debt relief. They argued that the new rules after 2018 did not fully capture the financial effort related to ODA loans and, thus, would 'disincentivise' debt relief from happening in the first place.

In 2020 further changes to the reporting rules allow DAC members to report any debt rescheduling or cancellation as ODA, even though these loans had already been reported as ODA when they were issued. In practice this means that they can report increases in their ODA figures without actually raising their ODA budgets in real terms.

WHAT ARE THE PROBLEMATIC EFFECTS OF THE NEW RULES FOR DEBT RELIEF?

The 2020 announcement of further changes to the rules for reporting debt relief as ODA was welcomed by many members of the DAC community. This was less the case for civil society organizations (CSOs) including Eurodad.[18] Some of the issues and effects that follow from these changes relating to debt relief include:

1. The new method generates inflated ODA figures and allows double counting.

There are political reasons for pursuing the reporting of debt relief as ODA. The more transactions a donor can include as ODA, the better their statistics would look relative to the United Nation's 0.7 per cent of Gross National Income target. And the better the statistics look, the less pressure the donor faces to scale up their ODA budgets in real terms and their contribution to eradicate poverty and inequalities. With the new rules, DAC members will be able to claim ODA for debt relief without any actual transfer of resources.

The new rules allow donors to double count their aid contributions. Under the grant equivalent system, ODA loans are recorded using 'risk-adjusted discount rates' that factor in the possibility of a loan not being paid back. The higher the risk, the higher the risk-adjusted discount rate.[19] In practice this means that donors receive a special benefit – they can designate a greater percentage of a high-risk loan as ODA when the loan is granted to compensate for the fact that some of these loans may not be fully paid back. But to record debt relief for the same loan as additional ODA is clearly double counting.[20]

2. Delaying debt relief increases the amount of ODA that can be reported.

The methodology to calculate how much ODA can be recorded for debt relief uses the grant equivalent risk-adjusted discount rates. These rates are used to calculate the 'present value' (at the time of debt treatment) of the original loan and to measure the value of the amounts due, including interests and arrears.

The use of a discount rate allows donors to take account of the fact that the original value of a loan, in monetary terms, has likely decreased over time (due to inflation). Thus, a loan of US$1 million in a given year will not be worth US$1 million anymore in future USD, but less. For example, US$100 in 2021 will be equivalent to US$75 in ten years at a 2.93 per cent annual rate of inflation.[21]

As mentioned above, the DAC agreement on debt relief uses the grant equivalent risk adjusted discount rates (see footnote 18 for details) to calculate the 'present value' of a loan at the time of debt treatment. These discount rates are significantly above the average inflation rate (close to 3 per cent)[22] and, consequently, so the loan's value is decreased accordingly.[23] The lower the value of the money that is still due, the more ODA the creditor country can record at the end of that year.

Furthermore, the later debt relief is granted in the loan maturity timetable, the lower the value of the amounts due and, thus, the more ODA the creditor country can record at the end of that year. For example, if a credit has a maturity of 20 years, from an ODA recording point of view, it would be much more advantageous for the creditor country to grant debt relief at year 15 rather than at year five (considering how much loss of value the amounts due, interest and arrears would have accumulated). Thus, the later debt relief is granted, the higher amounts of ODA that can be recorded.

3. An equal amount of ODA can be recorded for rescheduling a loan as for forgiving this loan.

The new methodology allows the recording of ODA for both the cancellation of loans and the rescheduling of loans. Thus, creditor countries have all the incentives to reschedule debt payments rather than cancelling them. According to these rules they can record ODA in the year when a debt has been rescheduled but then continue to receive repayments. As well, guidelines have not been established for how long a loan can be rescheduled or how long the creditor country can report ODA for it.

4. The methodology encourages the provision of loans to lower-income countries.

In theory the new rules aim to encourage debt relief (rescheduling or forgiveness) to lower-income countries. As noted above, the methodology uses the grant equivalent risk-adjusted discount rates to calculate the amount of ODA to be reported when debt relief is granted, and these are higher for lower-income countries (9 per cent). Thus, creditor countries are able to record higher volumes of ODA when debt relief is granted to lower-income countries. However, there are potential incentives to provide loans to lower-income countries in the very first place for the very same reasons. The amount of ODA the creditor country can record if debt rescheduling or cancellation is granted will be higher for lower-income countries. Yet, what countries with the most fragile economies most need is ODA in the form of grants.

5. An agreement taken with little transparency or inclusivity.

In July 2018, the DAC took an historic step forward by agreeing the framework for dialogue with civil society organisations, which includes a commitment that the DAC will "provide space for consultation with CSOs before key decisions are made."[24] Despite this commitment, negotiations on the reporting rules for debt relief were taken with high levels of secrecy and little timely inclusion of CSO views. Official documents relating to these discussions and negotiations were not made available, including previous ones, dating to 2017. According to the OECD DAC rules these 2017 documents should have been made public.[25]

This lack of transparency is concerning. CSOs had repeatedly requested access to relevant analysis and options on the negotiation table but were denied this information. Furthermore, while CSOs and other independent experts have been largely shut out of the process, the Paris Club – an informal group of creditor country treasury departments with very different objectives to ensuring ODA is a credible reflection of donors' efforts – has been invited to be involved in the decision-making process. Legitimacy, transparency and accountability are three fundamental principles for ODA and relevant to the DAC to ensure that stakeholders are able to assess the impacts of its deliberations.

THE WAY FORWARD

The new debt relief rules have the potential to create a situation where loans, rather than grants, are favoured by ODA donors. The benefits for a donor, particularly in terms of ODA reporting, are very attractive. But the decision to provide debt relief should be informed by the economic necessity of a recipient country rather than ODA accounting considerations.

The agreement reached in July 2020 includes a commitment "for close monitoring of the implementation of the new method."[26] It also pushes for a close monitoring by the Secretariat of the grant equivalent system and an assessment of "the impact of the debt relief methodology including trends in ODA loans versus grants," which is to be completed in 2023.[27]

CSOs expect clear commitments from the OECD DAC to monitor and review this agreement going forward. The review should also include the re-evaluation of the 'risk-adjusted discount rates' agreed to in 2014, particularly their relevance in a context where debt relief is now being recorded. In keeping with the spirit of the 2018 DAC-CSO framework for dialogue, CSOs should be invited to contribute to all aspects of the review.

The top priority for DAC members should be to ensure that the systems put in place promote responsible and sustainable financing. In this sense and following the whole ODA modernisation process and related reporting,[28] members of the DAC should seriously consider an external review of the changes made over the last few years to continue ensuring the quality of ODA statistics.

ENDNOTES

1. The author thanks Daniel Munevar (Eurodad), María José Romero (Eurodad) and Jean Saldanha (Eurodad), for their advice, corrections and comments. And Vicky Anning, who assisted with copyediting.

2. World Bank (2020). *Updated estimates of the impact of COVID-19 on global poverty: Looking back at 2020 and the outlook for 2021*: https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty-looking-back-2020-and-outlook-2021#:~:text=As%20reported%20above%2C%20the%20pandemic,between%20143%20and%20163%20million

3. Oxfam (2020). *Dignity not destitution: An 'Economic Rescue Plan for All' to tackle the Coronavirus crisis and rebuild a more equal world*: https://www.oxfam.org/en/research/dignity-not-destitution

4. Agreed in 1995, the Beijing Platform for Action flagged 12 key areas where urgent action was needed to ensure greater equality and opportunities for women and men, girls and boys. It also laid out concrete ways for countries to bring about change. This platform is still relevant today and a pillar of the Sustainable Development Goal 5 on achieving gender equality and empowering all women and girls.

5. UN Women (2020). *Policy Brief: The Impact of COVID-19 on Women*.

6. See UN Women. The Shadow Pandemic: Violence against women during COVID-19: https://www.unwomen.org/en/news/in-focus/in-focus-gender-equality-in-covid-19-response/violence-against-women-during-covid-19

7. For further information, please check: Fresnillo, I. (2020). *Out of service: How public services and human rights are being threatened by the growing debt crisis*. Eurodad: Belgium: https://www.eurodad.org/outofservice.

8. UNDP (2020). *Statement by UNDP Administrator Achim Steiner on UN COVID-19 Global Humanitarian Response Plan*: https://www.undp.org/content/undp/en/home/news-centre/news/2020/Statement_by_UNDP_Administrator_Achim_Steiner_on_UN_COVID-19_Global_Humanitarian_Response_Plan.html

9. UNCTAD (2020). *The Covid-19 Shock to Developing Countries: Towards a "whatever it takes" programme for the two-thirds of the world's population being left behind*: https://unctad.org/system/files/official-document/gds_tdr2019_covid2_en.pdf

10. Munevar, D. (2020). *G20 debt service suspension: A response not fit for purpose (I) at Eurodad*: https://www.eurodad.org/g20_debt1

11. OECD (2020). *Covid-19 Global Pandemic: Joint Statement by the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD)*.

12. Dodd, A. et al. (2021). *Aid data 2019–2020: Analysis of trends before and during Covid*. Development Initiatives: UK: https://devinit.org/resources/aid-data-2019-2020-analysis-trends-before-during-covid/#downloads

13. OECD (2019). *Development Co-operation Profiles. Trends and insights on development finance*: http://www.oecd.org/dac/development-cooperation-report/Trends-and-insights-on-development-finance-2019.pdf

14. Available here: https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/Reporting-Debt-Relief-In-Grant-Equivalent-System.pdf.

15. These figures are total debt payments, but we can expect that any debt rescheduling or cancellation for these 46 countries will impact ODA figures in the coming years.

16. Fresnillo, I. (2020). Briefing paper: *The G20 Debt Service Suspension Initiative. Draining out the Titanic with a bucket?* Eurodad: Belgium.

17. See https://www.youtube.com/watch?v=-O4oFS7O-jg&t=40s.

18. This is equal to the difference between the total value of the loan at day one and the present value of future repayments (from the understanding that money loses value throughout the years). To calculate the future value of the repayments throughout the life of the given loan discount rates are being applied. These discount rates are supposed to reflect the risk of lending to different country income levels. The discount rates for lending to least developed countries or low-income countries is 9 percent, and the discount rates for lending to lower and upper middle-income countries are 7 percent and 6 percent, respectively.

19. DAC (2014: 3) *Background paper: The treatment of loan concessionality in DAC statistics*: http://www.oecd.org/dac/financing-sustainable-development/DAC%20HLM2014%20Background%20paper%20The%20treatment%20of%20loan%20concessionality%20in%20DAC%20statistics.pdf

20. Van de Poel, J. (2020). *Eurodad response to the DAC's agreement on reporting debt relief as ODA*: https://www.eurodad.org/eurodad_response_oecd_dac_oda_debt_relief.

21. On top of the IMF/World Bank 5 per cent discount rate, the grant equivalent method includes an ex ante adjustment anticipating the default risk of 1 per cent for upper middle-income countries, 2 per cent lower middle-income countries and 4 per cent for low-income countries. Thus, the discount rate for upper middle-income countries is 6 per cent, that of lower middle-income countries is 7 per cent and that for low-income countries is 9 per cent.

22. For other authors arriving at the same conclusion, please look at Ritchie, E (2020). *New DAC Rules on Debt Relief – A Poor Measure of Donor Effort*. CGD: UK: https://www.cgdev.org/sites/default/files/WP553-Ritchie-DAC-Debt.pdf or Rivera, J. (2020). *Why the DAC's latest move is bad for global development*. ONE: France: https://www.one.org/international/blog/dac-latest-rules-bad-for-aid/

23. Average inflation between 2009 to 2019 according to World Bank data.

24. bid. 23.

25. See, for example, the examples in section two (p. 10) of Euan Ritchie's paper *New DAC Rules on Debt Relief – A Poor Measure of Donor Effort:* https://www.cgdev.org/sites/default/files/WP553-Ritchie-DAC-Debt.pdf

26. OECD-DAC (2018). Framework for Dialogue between the DAC and Civil Society Organisations available here: http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DCD/DAC(2018)28/FINAL&docLanguage=En.

27. Classified documents should be declassified after three years.

28. OECD-DAC (2020 : 3). *Reporting on debt relief in the grant equivalent system*. OECD-DAC: France.

29. Ibid. 25.

30. For further information, please check here: https://www.oecd.org/development/financing-sustainable-development/modernisation-dac-statistical-system.htm.