

**LETTER TO THE CHAIR OF THE OECD DEVELOPMENT ASSISTANCE COMMITTEE,
MS SUSANNA MOOREHEAD**

Giving Credit Where Credit's Due - Addressing Flaws in the Calculation of ODA in Loans

Developing countries are being made to pay for a climate change they did not cause, while OECD countries are claiming credit for aid that they have not given.

Dear Ms. Moorehead,

I am writing to you to highlight major flaws in the "Grant Equivalent" system that the Development Assistance Committee (DAC) uses to calculate the Official Development Assistance (ODA) in concessional loans, and in its treatment of debt relief.

The ramifications of these flaws are serious. Firstly, the ODA figures lack credibility and OECD taxpayers are being misled about the costs they are bearing in supporting the development of poorer countries. Secondly, the DAC's methodology is encouraging OECD donors to feed an impending debt crisis through incentivising ODA loans instead of grants at a time of high levels of debt stress in already over-extended countries.

The most urgent problem is the impact on climate financing. An equitable settlement for meeting the costs of climate change is essential if we are to forge an effective international consensus to tackle this urgent and existential threat. Climate finance is already highly contentious in the context of UNFCCC negotiations, and there are accusations from many quarters that the figures produced by the OECD are inflated.

As donors take advantage of the incentives inherent in the DAC methodology, ODA for climate finance is being extended overwhelmingly in the form of loans rather than grants, even to the poorest countries. This is saddling the developing world with debts to meet the costs of adapting to the climate crisis and for cleaning up the damage it brings. This is completely at odds with the "polluter pays principle". The DAC is allowing OECD countries to claim credit for aid that they have not given while developing countries are being made to pay the costs of a climate change they have not caused. This is grossly inequitable and the antithesis of climate justice.

A briefing note¹ that the UK Parliament circulated on the eve COP26 last year lamented the fact that most climate finance from public funds is provided through loans rather than grants. Instead of "wishing" that donors would do more giving and less lending, we need to remove the incentives that encourage them to do the opposite.

¹ <https://commonslibrary.parliament.uk/cop26-delivering-on-100-billion-climate-finance/>

There is a need for urgent change to the system for counting ODA in loans. My paper raises the following major drawbacks of the current methodology:

- The massive exaggeration of ODA caused by using a base element in the discount rate of 5 per cent, instead of currency-differentiated discount rates that reflect the true (and much lower) costs of funding for donors.
- The flawed assumption that countries in a similar World Bank-defined income grouping carry similar credit risks. The OECD's published analysis on country credit risk shows this to be untrue.
- The unjustifiable inclusion of an adjustment in the discount rates for credit risk, given the DAC's decision to count the costs of debt relief as additional ODA. (This "double-counting" issue has been raised by others, but I hope to bring some new perspectives.)
- The indefensible counting of debt relief for non-development loans as ODA. Others have queried why loans that provide no development benefits and do not qualify as ODA when they are extended should count as aid when they are forgiven. To that I would add that the costs of debt relief will, in many cases, have been funded by the developing countries themselves through their payment of risk-based premiums, either as fees or risk spreads. If the debt relief entails no donor effort and no cost to the donor countries' taxpayers, it should not count as ODA.
- The fact that these flaws in the Grant Equivalent methodology are mutually reinforcing in their effects and ALL serve to exaggerate the ODA in loans suggests that the methodology has been politically influenced. Indeed, it could be construed that, unrestrained by the presence of aid recipients and unheeding of financial expertise, the "donors club" has reached a self-serving consensus to exaggerate to their taxpayers their largesse and generosity to developing countries.

To address these flaws and to eliminate the huge incentives for donors to provide ODA in the form of loans rather than grants, the attached paper makes a series of recommendations:

1. Use discount rates, differentiated by currency, that more accurately reflect the true funding costs of donor governments
2. Stop the "double-counting" for credit risk by both adjusting the discount rate and allowing additional ODA for debt relief when it occurs
3. Ensure that any adjustments for credit risk in the discount rate reflect more accurately the different risk levels of borrowing countries
4. Re-examine the minimum grant element for loans to qualify as ODA as part of the broader reform
5. Stop allowing the costs of debt relief for non-ODA loans, where risk premiums/spreads have already been collected, to count as additional ODA

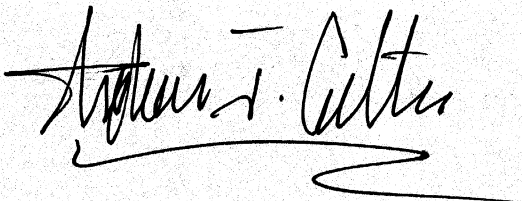
6. Reassign the task of defining and calculating ODA to an independent organisation that is not under the political control of a group of like-minded countries. Perhaps, in the first instance, a small experts' group with the requisite knowledge and experience could analyse the relevant issues and develop a sound methodology, drawing on international best practice – commercial and public.

My assumption is that this last recommendation, in particular, will not be well received. However, given the DAC has failed, for a second time, to put in place a robust methodology for defining and counting ODA in which the public can have confidence, it is difficult to envisage that a consensus can be built within the "donor club" to make the necessary changes within a short timeframe.

Some of the issues raised in these papers are technically complex and require further expert analysis. In other areas, there are decisions that need to be made among different trade-offs. This paper does not pretend to have all the answers, but it is intended to highlight the serious flaws and offer some concrete suggestions on possible ways to proceed. In this regard, I hope that it is considered a constructive contribution to an important and urgent issue.

I would of course be available to discuss these issues further with you or any interested stakeholders and can be contacted at ODAreform@icloud.com.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Stephen J. Cutts". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Stephen J. Cutts

18 February 2022