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Official Development Assistance (ODA) - is the concept still in step with the times?

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The introduction of the concept of "Official Development Assistance (ODA)" in the late 1960s made government development aid quantifiable and comparable for the first time. ODA as a share of a country's GNI continues to be the main parameter for comparing the efforts made by the donor countries.

However, the world has changed considerably since the 1960s. Former developing countries have become influential protagonists in politics and business, global challenges are defining political agendas, and private financial flows are expanding the scope of development policy intervention. As a result, the question arises whether the ODA concept is still relevant or whether the system needs to be fundamentally overhauled.

The ODA concept was originally developed by the OECD's Development Assistance Committee (DAC) in 1969 with the aim of identifying the activities of the members performing development cooperation (DC) and making them comparable. Initially, ODA mainly comprised compensation payments by former colonial powers to their former overseas territories.

Over the years there have been repeated initiatives to enhance the ODA system. Changes require a consensus of the DAC members, so that the expansion or change of the concept tended to advance in rather small steps (e.g. updates to the list of recipient countries[1], additions to the measures falling within its scope).

Definition: What is ODA?

In sum, ODA comprises official payments by the DAC donor countries to developing countries with the primary objective of promoting economic and social development and satisfying particular criteria regarding their financing structure. ODA payments comprise the transfer of funds in the form of grants, loans, equity or direct contributions (for instance, in the context of German technical cooperation).

Today the concept is defined by five criteria:

1. Origin: The funds must be provided by official agencies (ministries or state development agencies) or by the government's executing agencies.

2. Recipients: Developing countries that are on the so-called DAC list of recipient countries or international institutions[2] supporting these developing countries.

3. Purpose: The payments must be administered with the promotion of the economic development and welfare of developing countries as the main objective. The DAC issues a detailed list of areas of cooperation (Creditor Reporting System).

4. Concessionality: Loans must be "concessional in character", that is, these funds must generally be granted on concessional terms, which means the interest rate must be below the interest rate in the free credit market.

5. Grant element: Every loan must also convey a grant element of at least 25 %[3]. All ODA payments of a donor combined must have an average grant element of at least 86 %.

The origin of the 0.7 % ODA/ GNI target

The ODA target expresses the amount of ODA provided by country as a percentage of its gross national income (GNI).

As early as in the 1950s and 1960s, it was calculated how much additional capital developing countries needed in order for their gross domestic product to grow at an annual rate of 5 %. The Pearson Commission for International Development appointed by the World Bank in 1969 came to the conclusion that the developing countries could not achieve this unless official development assistance was raised to 0.7 % of the donor countries' GNI. At the same time, the United Nations Conference on Trade and Development (UNCTAD) required the industrialised countries to provide one per cent of their gross domestic product for ODA. The OECD then began to publish annual statistics showing the ODA financing volume provided by a country as a percentage of its gross national income (ODA/GNI ratio).

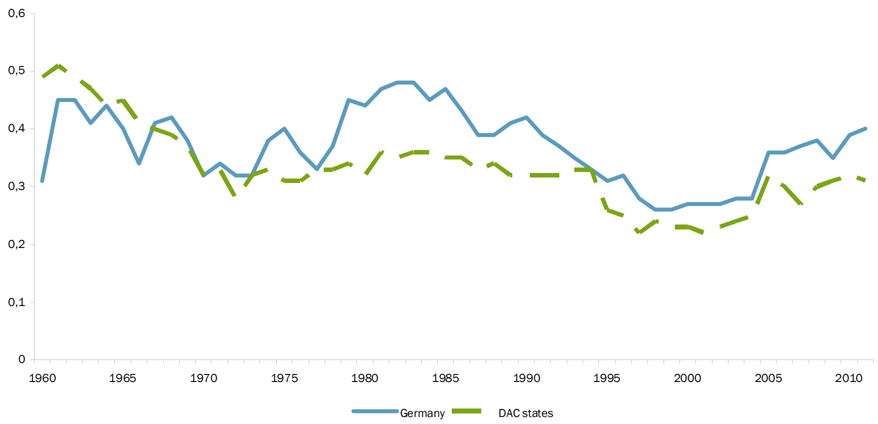
When the parties to the 2002 UN Summit in Monterrey, Mexico, convened to discuss the financing of the Millennium Development Goals, the 0.7 % target was again used as a benchmark. After that, in 2005, the EU member states in Brussels adopted a binding step-by-step plan to scale up ODA funds. From 2010, the ODA target for states that had acceded to the EU before 2002 was to be scaled up to 0.51 % of GNI; for states that had joined after 2002 that target was to be increased to 0.17 %. Up to 2015, inclusively, older member states are to provide ODA of 0.7 % of GNI for official development assistance for developing countries and newer member states 0.33 %. Incidentally, not all DAC donors have committed to achieving the

[1] A list of all countries can be downloaded from http://www.oecd.org/dac/aidstatistics/48858205.pdf.

[2] The list of international organisations is available at http://www.oecd.org/document/9/0,3343,en_2649_34447_43748297_1_1_1_1,00.html (Annex II).

[3] The terms of the loan such as the interest rate, maturity, grace years etc are relevant for achieving the 25 %. In the DAC calculation method, the grant element is the difference between the face value of a loan and the present value of all service payments to be made in future, calculated at a discount rate of 10 %.

Figure 1: ODA / GNI over time



Data source: OECD

0.7 % target; the USA, for example, orientates their targets only on absolute figures, usually with a focus on a particular sector or region.

The ODA target of 0.7 % does not necessarily provide an accurate reflection of the financing requirements in developing countries. Other studies have also arrived at different target figures: for example, the ODI in its current study notes that an ODA ratio of 0.3 % may be sufficient to reduce global poverty sustainably (MDG 1).

Bases of calculation

As a general feature, ODA does not count payment promises ("commitments") but actual flows of funds. Because of this principle, the statistics cannot capture financing instruments such as guarantees, which are not based on payment flows. However, this fundamental principle is breached on several occasions as well; for example, when debts on commercial loans are cancelled, the cancelled amount is counted as ODA in the year of the cancellation. As well, costs of foreign students can be imputed as calculatory costs.

Gross versus net principle

The data presented in the ODA statistics distinguishes between gross and net ODA.

Gross ODA contains all disbursements of the relevant OECD country to the recipient states within one year. However, the development policy debate usually contemplates only net ODA (the 0.7 % target also refers to the net payments). Net ODA deducts the repayments from the developing countries to the donors. Such repayments also comprise repayments on loans, for example. Because of this principle it is even possible, in theory, for states to have a negative ODA balance as soon as the return flows from developing countries are higher than the gross payments made by the donors.

What counts as ODA?

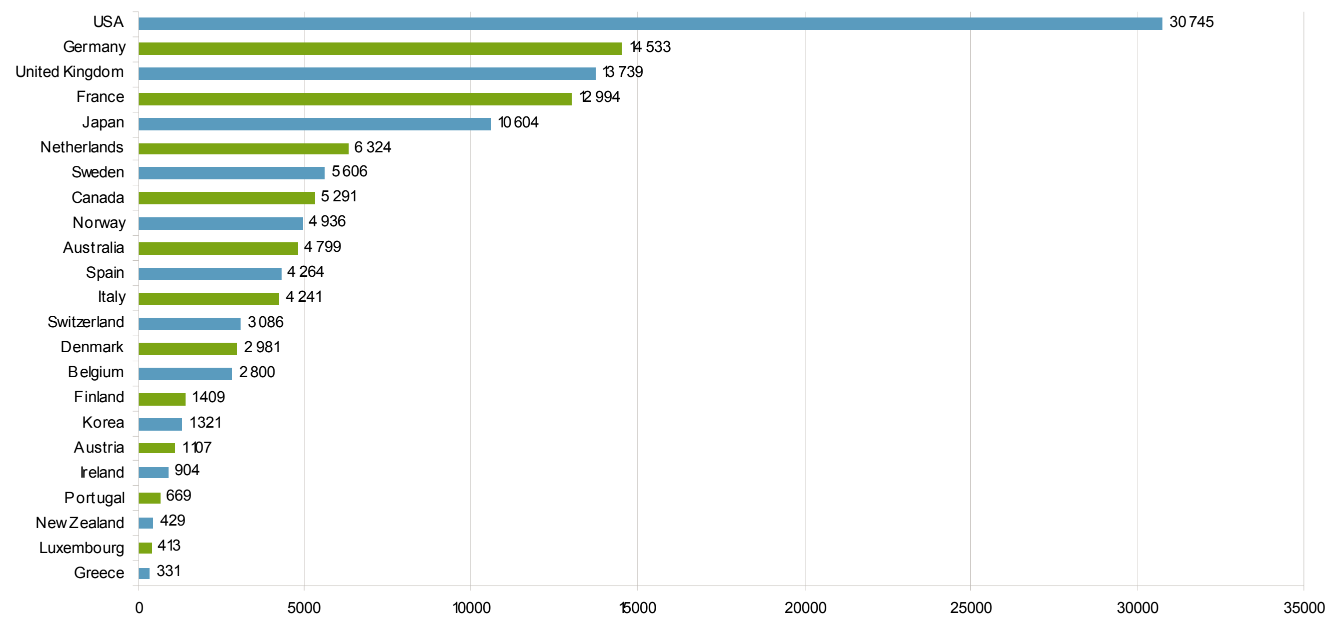
For the list of ODA payments, the DAC sums up expenditures in the following areas, among others (provided they meet the above criteria):

- Technical and financial cooperation
- Contributions to multilateral development organisations
- Debt payment relief / debt relief
- Public expenditure in the donor country for citizens of partner countries: study costs for students from developing countries, costs of refugees in the first year of their stay, expenditure on raising development awareness
- Developing country-specific direct research (for example on tropical diseases or the development of more resistant seeds)
- General administration expenses incurred by the donors
- Support of non-governmental organisations / private foundations / research institutes

ODA in figures

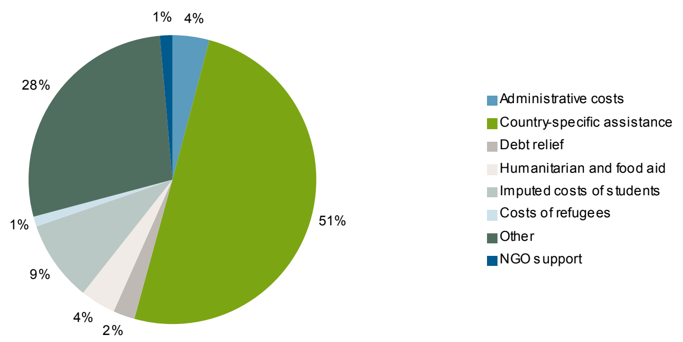
In 1960, the ODA of all DAC member states was only USD 4.3 billion. Since then it has grown almost continuously to USD 133.5 billion in 2011 (nominal price). If we look at the ODA / GNI ratio, a slightly different

Figure 2: Net ODA by comparison in 2011 (in USD millions, preliminary figures)



Data source: OECD

Figure 3: Bilateral ODA composition (gross) Germany 2010



Data source: OECD

picture emerges (Figure 1). The ODA ratio (on average for all DAC donors) remained around approximately 0.35 % over the whole period, fell to a low of 0.22 % around the turn of the millennium and has been rising again since then.

With USD 14.53 billion in net ODA in 2011, Germany is the second largest bilateral donor (see Figure 2). In multilateral ODA, Germany is even the biggest donor worldwide today (USD 5.6 billion) (although a large portion of the funds are disbursed as a compulsory amount through the EU). For bilateral ODA Germany spent USD 8.9 billion. Normally, between 30 % and 50 % of this flows directly into the developing countries as so-called "Country Programmable Aid (CPA)" (in 2010 this was 51 %, see Figure 3). With respect to the ODA ratio, Germany only ranks mid-range among the DAC donors (Figure 4) and is still far from achieving the 0.7 % target, as are many other donors.

In the wake of the economic crisis, some countries have put the committed ODA increase on hold, so that the interim target of 0.51 % of GNI for 2010 on average could not be achieved. The Nordic states lead the field by much as more than 1 %.

Criticism of the ODA concept

In recent years, criticism of the ODA concept has become increasingly louder. Many critics question what kind of transfer should be eligible and to what extent.

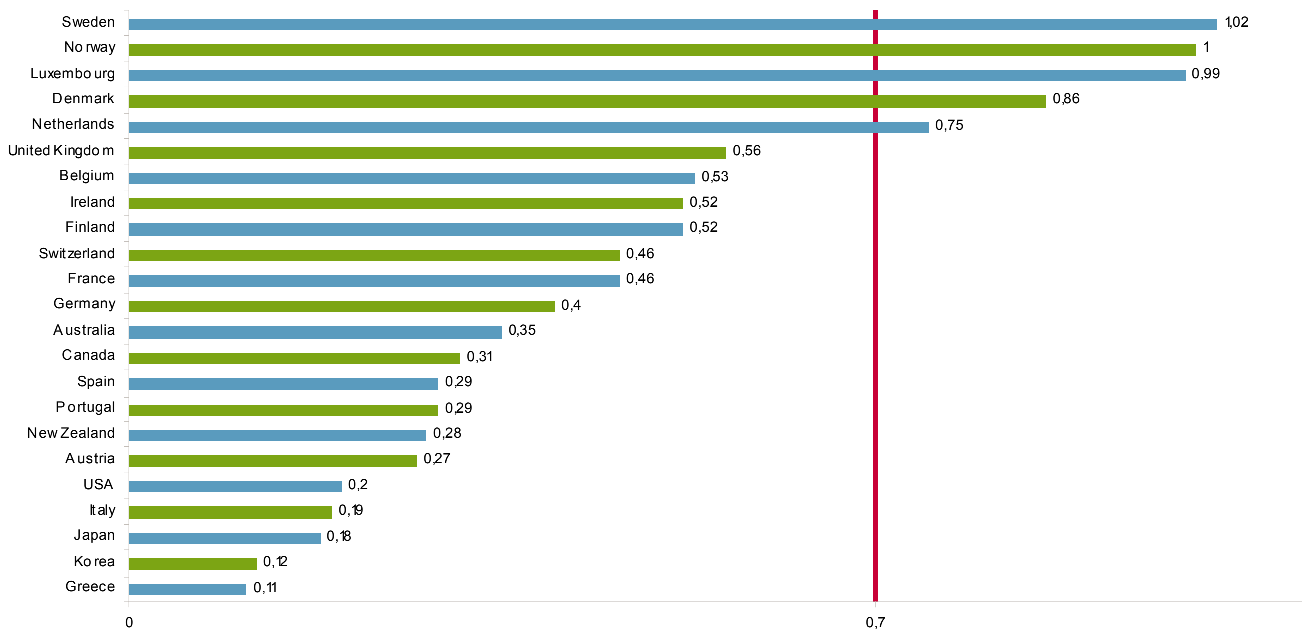
Conceptual weaknesses

Some critics object that many of the above ODA eligible activities actually do not benefit the partner countries directly. Among others, the general administrative costs of the donor countries, debt relief, scholarship costs for students from developing countries studying in the donor states (who often do not return to their home countries) and the money spent on refugees are funds that are not available to the partner country itself.

The modes of calculating the ODA payments are also being questioned, such as the 25 % limit for the grant element. Critics claim that this limit could just as well be 20 %, or any other random figure. This illustrates the arbitrariness of this regulation that determines whether a loan is eligible or not. It may also lead to false incentives or misallocations, for example, when a loan with a grant element of 15 % would be sufficient for a specific project, but this project receives either no loan at all or one with a higher subsidy than necessary because of its eligibility as ODA. The additional budget funds that are necessary for a higher subsidy will then not be available for further poverty reduction measures.

Critics also question the calculation of the grant element. In the 1970s (a time of higher interest rates), a discount factor of 10 % was set for the calculation of the grant element that has since then never been adjusted. However, the paramount criterion for eligibility as ODA is, in addition, that the loan terms must be "concessional in character", that is, below the market interest rate. How exactly "concessional in character" should be construed in practice is currently being debated

Figure 4: Net ODA/GNI by country in 2011 (preliminary figures)



Data source: OECD

intensively within the DAC.

Once a loan meets the criteria for concessionality and the grant element, the entire loan amount is counted fully as ODA when it is disbursed. However, when it is repaid the repayments are counted negatively (see gross-net principle). For this reason a loan has a net ODA impact of zero across the entire life of the loan, although in economic terms a loan with, for example, a maturity of 40 years, 10 grace years and an interest rate of 0.75 % is almost equivalent to a grant.

Changing environment for development cooperation

In addition to the ODA calculation bases, there is more profound criticism based on the fact that the world and the development cooperation environment have changed very much since the 1960s, particularly in the last 15 years. Severino and Ray [4] for example have described this development very accurately as a "*Triple Revolution"*. Today, "more actors" are pursuing "more objectives" with "more instruments". Many of these activities, however, are not incorporated in the ODA calculation or, at best, are mentioned for information only.

Alongside the traditional DAC donors, many other countries are also active in development cooperation. These states, often summed up under the keyword of "new donors", form quite a heterogeneous group. They include Arab donors, mainly Saudi Arabia, which have been conducting development aid / cooperation with substantial amounts for decades and can therefore hardly be referred to as "new". Then there is the group of industrialising countries such as China, India, Brazil or South Africa, but also countries such as Colombia, Egypt and Thailand, which are already active in development cooperation although the DAC definition considers them developing countries themselves. They transfer expertise and financial support under so-called South-South cooperation. Commercial transactions and aid payments often cannot be separated in this context. And, not least, there is the group of "new donors in the stricter sense", such as the new EU member states, which are aspiring for closer coordination with or for membership in the DAC. The assistance provided by these diverse donors has for some years sometimes been mentioned by the DAC for information as "Other providers of Development Co-operation" (2009: USD 11.8 billion gross). The figures are based on official notifications from these countries, but mostly on DAC estimates and therefore present only a vague idea of what the new donors are delivering.

Unlike in the 1960s when official payments were by far the most important external source of funding for many developing countries, today the bulk of international payments takes place outside the ODA framework. Private capital flows today are many times higher than official payments. Private remittances by migrant workers alone were USD 351 billion in the year 2011, more than twice the ODA in the same period.

Some private development institutions make higher disbursements to developing countries than most bilateral donors. For example, the volume of disbursements by the Bill and Melinda Gates Foundation was USD 3.4 billion in 2011 alone, placing it in the medium range of DAC donors (compare Figure 2). Further, many new financing instruments (guarantees, structured funds etc) are not counted either or are counted only partly as ODA, irrespective of the fact that they represent clear commitments and partly mobilise enormous sums of additional private funds.

Today more than ever before, global challenges such as climate change, demographic change, peacekeeping or the control of pandemics define political agendas. Many developing countries are particularly affected by these challenges and are dependent on the provision of global public goods. This raises the question of which development objectives will be at the centre of attention in future and how a possibly expanded set of objectives will be depicted in a statistical data entry system.

If one’s intention is to sum up global efforts on development, it becomes clear, that the ODA system cannot keep up with these profound changes.

This issue is compounded by the overarching question of what significance a purely input-related parameter such as ODA should have at a time in which the overall development policy debate revolves around the issue of greater impact orientation.

Conclusion

The concept of Official Development Assistance is a system that has grown over the years and is based on consensus between the donors, and whose original purpose was only to measure the efforts undertaken by the OECD donors. It was (and continues to be) of crucial importance for mobilising official funds for development cooperation in the DAC donor countries.

Nevertheless, the concept no longer appears to be in step with the times. Some of the points of criticism would be solvable within the existing ODA logic while others demand a more radical reorientation.

2015 is the target year for 0.7 % ODA / GNI and for achieving the Millennium Development Goals. Now is therefore the time to debate which concept will be required after 2015. The paramount objective of a revision should be a statistical reporting system that firstly captures all relevant activities and secondly does not create false incentives. It should ensure that the best possible support and financing structure be provided for any development project or objective. ■

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