Proposal for the 'Modernisation of Private Sector Instruments': CSO background paper

1. This paper has been coordinated by the European Network on Debt and Development (Eurodad), with the input of various Civil Society Organisations (CSOs). It provides an analysis, with key recommendations in bold, of the proposals made by the Development Assistance Committee (DAC) secretariat in the paper DCD/DAC/STAT(2016)14: "Implementation of the Principles of ODA Modernization on Private Sector Instruments," which unfortunately has not been made publicly available. The DAC's proposals would allow a wide variety of 'private sector instruments' (PSI) to be used as vehicles for aid. This means an increase in the possible use of aid to invest in or give loans to private companies, or to underwrite their activities, through guarantees. We believe that these proposals are arguably the biggest change to Official Development Assistance (ODA or 'aid') rules for several decades.

2. **The timeline for PSI reform should be extended after consultation with stakeholders, and after the potential impacts of all reforms have been carefully estimated.** We are very concerned that major changes are taking place to the ODA definition extremely rapidly and without sufficient time for affected countries and civil society organisations to input. The rapid timeframe and lack of public or partner scrutiny means the potential for mistakes and unintended consequences is significant: this is why careful estimates of the potential impacts of reforms should be produced to aid discussions, and the timeframe significantly extended to allow all stakeholders to input.

3. **It is centrally important that a process to end tied aid– both in policy and in practice – should be conducted in parallel to the PSI reforms to prevent any weakening of the development focus of ODA.** Tied aid inflates costs, reduces impact, and dilutes ODA's focus on development. In addition, the 2016 monitoring report of the GPEDC states that "… the reasons for not untying aid seem to be driven by other considerations, such as the increasing role of donor-country private sector firms in the delivery of development co-operation." The proposed changes to 'modernise' private sector instruments (PSI) create significant opportunities for donors to increase tied aid, undermining the credibility of ODA.

Extending the DAC's agreement on untying to all countries and all categories of aid would help restore credibility and end tied aid in policy, but to end it in practise a process will be needed to assess and remove the barriers that result in almost half of aid contracts going to firms based in donor countries. As the DAC proposal suggests, other safeguards are also needed, particularly much stronger requirements for transparency.

4. We are concerned about the potential for dilution of the development focus of aid and the creation of a 'blurred line' between commercial and development motivations on the part of the donor. We also believe there is a significant risk that PSI become incentivised over other legitimate uses of aid, when decisions about the best modalities for aid should be made at the country level. The following amendments to the proposal would help reduce these risks:
    a. **Concessionality should remain a feature of ODA: PSI loans should adopt a similar approach to that used for concessional public loans.** Dropping concessionality as a feature of ODA would set a worrying precedent, undermining a key distinguishing feature of ODA. Dropping concessionality could also provide opportunities for undermining the market by using ODA for near-commercial terms loans. Instead, a version of the concessionality mechanisms recently adopted by the DAC for sovereign lending, with an appropriate measure for the grant equivalent and clear thresholds, should be implemented. This would align the proposed changes to the definition of ODA which states flows should be concessional in character and would create consistency in DAC reporting practices.
    b. **Additionality should be independently assessed and the definition strengthened by focusing on 'development additionality' and removing the concept of 'value additionality'.** The current proposal relies on donor self-reporting, meaning the DAC will fail in its core purpose: to provide independent measurement rules to prevent donors mis-reporting, and protect the credibility of ODA. Instead, additionality should be assessed independently. Development additionality should clearly be an integral component of all ODA-supported PSI, not one option among three. 'Value additionality' should not be used: all investors will aim to ensure improvements through non-financial contributions and it is likely that value additionality can be claimed in all cases.
    c. **The proposed changes to reporting guarantees risk inflating ODA, and should be revised to count only a portion of guarantees that are called and to firmly rule out export credits as ODA-eligible.** Export credit schemes are designed to benefit donor firms: they should not be counted as ODA, and the new rules should clearly state this. Functioning guarantee institutions such as the World Bank's Multilateral Investment Guarantee Agency (MIGA) consistently make money: the rationale for all guarantees being counted as 'donor effort' is therefore extremely weak. The current proposals also introduce a perverse incentive to offer guarantees to lower risk projects, where ODA will be counted but the chance of the donors having to pay out as a result of the guarantees are negligible. This change would also undermine the financial additionality provided by these guarantees. A more sensible approach would be to only count a portion of *guarantees that are actually called* as ODA.
    d. **The rationale for an upper limit and discount on reflows from equities needs stronger justification.** Investment is typically made in a portfolio of equities: it is inconsistent to not count losses and gains across the whole portfolio equally.