

New DAC Recommendation on the financial terms of aid

A note by ODI

At the annual High Level Meeting of the Development Assistance Committee (DAC) of OECD, held in Paris, October 16-18, 1972, members adopted a new Recommendation on financial terms. The new Recommendation replaces the one in effect since 1969.

The Recommendation, which (in common with all DAC Recommendations) is not mandatory but depends on mutual persuasion, is to come into effect on 1st January 1973. Its intention is to achieve a softening in the financial terms of Official Development Assistance (oda) provided by DAC members. Oda includes those resource flows from DAC governments to developing countries and multilateral institutions which are:

- i) administered with the promotion of the economic development and welfare of developing countries as their main objective; and
- ii) concessional in character, the grant-element** of each transaction being at least 25% of its nominal recorded value.

The 1972 Recommendation requires each DAC member to:

- i) make all possible efforts to reach and maintain the target of an average grant-element in its oda commitments of at least 84% of their nominal values;
- ii) offer particularly soft financial terms (preferably by way of grants) to the 25 'least developed' countries (as defined by the UN), with a minimum grant-element of, either 86% for each DAC member's total oda commitments to any one recipient, or 90% for each DAC member's total oda commitments to the 'least developed' as a group; and
- iii) to harmonise its financial terms for each developing country with the terms of other donors, fixing terms on a case-by-case review of the circumstances of each recipient, with the overall aim of softening average terms, particularly for developing countries with the severest economic or financial problems:

The single overall financial terms target (i above) replaces the cumbersome formulae of the 1965 and 1969 Recommendations. It provides also a somewhat more ambitious target, though the minimum sought improvement is marginal, at least for the four big donors. In 1971, the aid programmes of

* Italy reserved its position [Add list of members]

** [Add note explaining grant-element concept]

13 out of the 16 DAC member countries met the old (1969) target. But only seven countries - Australia, Belgium, Norway, Sweden, Canada, Denmark and Holland - which met the 1969 target, would also have met the new 1972 target if it had been in effect in 1971. Britain, together with the other big ~~four~~ donors - US, France and Germany - met the 1969 target, but would have failed by small margins to meet the 1972 target. Four countries - Italy, Portugal, Japan and Austria - which would have failed to meet the 1972 target by the widest margins, appear to be covered, however, by an escape clause; ~~this~~ leaves open the date for meeting the target for those countries with a relatively low per caput GNP, or with domestic structural difficulties, or whose aid programmes are of a more recent origin. The remaining DAC country - Switzerland - provides soft-term aid (94% grant-element in 1970) but is not considered as meeting the terms target because its oda commitments, as a percentage of GNP, are well below the DAC average.

The average grant-element in all DAC commitments has fluctuated over the last three years: it was 85% in 1969, 84% in 1970 and 82-83% (estimated) in 1971. The 84% target figure for each country adopted in the new Recommendation is thus set at around the average for DAC members achieved during 1969-1971, and within very easy reach, too, of the four largest donors. While it may provide the additional encouragement for the big four to soften their financial terms a little, and thus raise the average DAC grant-element above 84%, there is a danger in setting individual country targets at around the already achieved DAC average. With the widely disparate terms now offered by different DAC members, this method of encouraging softer terms relies on the continued good-will of those already well above the average to maintain their good performance while waiting for those well below the average to improve theirs.

In view of the special needs of the 'least developed' recognised by the Recommendation, the actual targets for financial terms on oda for these countries appear, surprisingly similar to those for all developing countries. But DAC was unable to recommend that all aid to the least developed should be in grant form (which would have been most logical) partly so as not to embarrass the IBRD/IDA, which can provide only loans. The figure for the harder of the two alternative targets which were adopted - a minimum grant-element of 86% - is in fact equal to the grant-element of ^athe standard IDA loan.

The most important of the three provisions in the 1972 Recommendation is the one dealing with the harmonisation of financial terms for particular recipient countries. Widely disparate terms cause problems for both recipients

and donors. On the donor side, countries providing aid on soft terms tend to be inhibited from softening their terms still further when other donors provide much harder terms to the same recipient. They tend to be inhibited, also, from providing more aid, or debt-relief where appropriate, on the grounds that these merely help recipients to meet their debt service payments to donors providing aid on hard terms. There is evidence of this from the experience of major aid recipients where terms differ markedly as between donors: India, for example, where Consortium aid-terms range from loans with a grant-element of 90% for the softest donor to only 30% for the hardest donor; or Indonesia, where the range is between 81% and 28%. (In both cases loans with a grant-element of less than 25% are excluded, as they do not qualify for inclusion in the oda total). In these, and some score of other countries where there is formal machinery for inter-donor consultation, the DAC 1972 Recommendation on harmonisation of financial terms is likely, in time, to bring additional pressure on hard-term donors to [∨]more closer to the softer-term donors.

In addition to the three provisions on financial terms of aid, the 1972 Recommendation includes also a provision for future consultations within DAC on appropriate methods of approach to export credits for developing countries (official and officially guaranteed), and on the relationship of these credits to aid and development needs. Export credits tend to be a particularly important element in the external debt of many developing countries.

AK/SA

2nd November, 1972.