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## CSO recommendations on the PSI reform

March 2017

### Introduction

The OECD Development Assistance Committee (DAC) aims to promote greater private sector engagement in development by allowing Official Development Assistance (ODA) to be channelled through a wide range of “private sector instruments” (PSI). This means 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 ODA rules for several decades.

### Key recommendations from Civil Society Organisations

In view of the DAC’s upcoming meeting on 9<sup>th</sup> March, this paper summarises some of the key recommendations made by Civil Society Organisations (CSOs) over the past year.

These recommendations respond to the proposals made by the DAC Secretariat in the paper DCD/DAC/STAT(2016)14, which unfortunately has not been made publicly available.

**1. The timeline for the PSI reform should be extended to allow for consultation with stakeholders, and for a careful estimation of its potential impacts.** Donor countries already operate in developing countries through private sector instruments – so far these are usually reported to the DAC as “Other Official Flows” (OOFs). There is however a lack of data on the amounts and development impact of these interventions, and reporting has been patchy. Before changing the rules to allow for PSI to be counted as ODA, DAC donors should take the following steps:

- Improve the current reporting of PSI as OOFs;
- On that basis, carry out a robust analysis of data on existing PSI (volumes, development impact) and produce careful estimates of the potential impacts of counting PSI as ODA.
- Significantly extended the reform’s timeframe to allow all stakeholders – including developing country governments, CSOs, other agencies from the North (such as export credit agencies), and private sector representatives from the south – to input.

Without more time, evidence and public and partner country scrutiny, the potential for mistakes and unintended consequences is significant.

**2. 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.** The following amendments to the proposal would help reduce these risks:

- **Concessionalality should remain a feature of ODA: PSI loans should adopt a similar approach to that used for concessional public loans. Establishing a minimum concessionalality threshold for any PSI to be considered as ODA is essential to ensure a clear, quantitatively-defined distinction between activities performed on commercial terms, and development-focused PSI.** The existing concessionalality criterion sets a clear benchmark in terms of what counts as ODA and what does not. The proposal to drop the concessionalality criterion for ODA channeled through PSI would set a worrying precedent, altering a key distinguishing feature of ODA. It could also risk undermining the market by using ODA for near-commercial terms loans. Instead, a version of the concessionalality 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.
- **The reform should 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.
- **The proposed changes to reporting guarantees risk inflating ODA, and should be revised to count only a portion of guarantees that are called.** 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.
- **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.
- **The additionality requirement for PSI to qualify as ODA is necessary** because without it, donors could be accused of unnecessarily subsidising private partners for no demonstrable reason. However, additionality cannot form the only eligibility criteria; it should be complementary to the concessionalality criteria mentioned above. The current proposal should be strengthened to address the following points:
  - **Both development and financial additionality should be integral components of all ODA-supported PSI.** This means that, when reporting their PSI as ODA, donors would be required to report on their expected development results, in addition to providing evidence of financial additionality. They would thereby be required to demonstrate both financial and development additionality. The « value additionality » criteria cannot replace financial

additionality to justify ODA eligibility of PSI, as is currently proposed:<sup>1</sup> all investors will aim to ensure improvements through non-financial contributions and it is likely that value additionality can be claimed in all cases. Therefore, value additionality should only consist in an optional supplementary provision to development and financial additionality requirements.

- **Donors should work with the DAC to establish a standardised approach to additionality**, designed around common definitions of development and financial additionality, with provisions including :
  - Publicly disclosed assessments using additionality indicators to be monitored ex-ante to demonstrate development additionality – based on agreed criteria.
  - Publicly disclosed financial assessments demonstrating a financial additionality and value-for-money (because there is no other source of finance available to realise the project, avoiding substituting for, and crowding out, the public sector or other investors, assessing costs of different options; include how the transfer of ODA is necessary to leverage the private finance (with an acceptable leverage ratio); and include financial risk safeguards including commercial sustainability of a project)
- **Additionality should be independently assessed.** 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 misreporting, and protect the credibility of ODA. Instead, additionality should be assessed independently.

**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 reform 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 create significant opportunities for donors to increase tied aid, undermining the credibility of ODA and potentially violating EU and WTO agreements on state aid<sup>2</sup>. 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 practice 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.

- In particular, DAC donors should:
  - commit to fully untying all their aid, not just that going to LDCs and HIPC;
  - report on all contracts funded by ODA ex post and ex ante, so that tying status can be verified.
- The OECD DAC will need to significantly improve the monitoring of tied aid, to support this commitment. They should:
  - commit to report annually on tied aid, not biennially; develop better methodologies for verifying tying status against contracts; and during the statistical collection

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<sup>1</sup> In the current proposal for reporting of PSI in DAC statistics, an official transaction would be considered additional either because of its "financial additionality" or "value additionality", combined with its "development additionality"

<sup>2</sup> See 'tied aid and development aid procurement in the framework of EU and WTO law' Annamaria La Chimia, 2013 <https://www.nottingham.ac.uk/pprg/publications/books/tied-aid-development-and-development-aid-procurement-in-the-framework-of-eu-and-wto-law.aspx>

- process, more robustly evaluate the reported untied ODA against the quality of contract notifications reported by the same donor;
- o update the guiding principles, definitions and provide more comprehensive information in the report about which donors are falling short of tying commitments and contract reporting

**4. The PSI reform must establish strong safeguards to ensure aid channelled through PSI complies with development effectiveness standards** – national ownership, results, transparency and accountability. CSOs and academics are concerned that the pursuit of donor-private partnership is contributing to an erosion of aid and development effectiveness standards. To address these concerns, the following proposals should be considered:

- **Stronger requirements for transparency and accountability are needed, including specific guidelines for reporting data to the DAC Creditor Reporting System (CRS).** The institutional assessment framework should include more stringent criteria with respect to transparency and accountability in order for DFI operations to be ODA-eligible. Development Finance Institutions (DFI) should be required to ensure public disclosure of contracts involving ODA unless confidentiality is requested by a party that can establish that confidentiality is necessary to protect business secrets or proprietary information. DFIs should also be required to ensure that accountability provisions relevant to the project exist, such as public oversight procedure, consultation mechanisms, complaints mechanisms and disclosure of the process for how complaints will be resolved, and Free Prior and Informed Consent obtained. Finally, the Secretariat should fully disclose all information reported by donors to the DAC on PSI.

In particular, the minimum information that should be provided on each PSI project deal includes:

- o who all the involved actors are, both public and private;
  - o volumes of funding provided by each actor;
  - o terms of each individual investment – including how much of the public input can be reported as ODA;
  - o instrument(s) that the funding is channelled through;
  - o any facility or fund through which the funding is pooled and channelled to investees;
  - o information on investee entities – public or private, foreign or domestic, as well as their scale (without including specific investee names if this is commercially confidential, but designating by type);
  - o country of intervention;
  - o sector of intervention, including appropriate sub-sector breakdown.
- **DAC peer reviews and the biennial report of private sector instruments must examine alignment of aid to PSI with development effectiveness principles** (national ownership, results, transparency and accountability). These reviews should also examine how the inclusion of private sector instrument in ODA has affected allocations to the public sector in developing countries. We 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.