Under pressure
How private sector instruments are threatening the untying of aid

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The Covid-19 pandemic is much more than a health crisis. Although it has affected all populations around the world, the consequences in richer versus poorer countries differ substantially. The pandemic has affected progress towards gender equality and women’s rights, which have suffered a backlash in the last two years.\(^1\) The impacts of climate change and extreme weather events on the one hand, and an extremely volatile geopolitical situation on the other, are leading to humanitarian crises across the world. In this context, official development assistance (ODA) has a fundamental role to play, notably within the poorest countries.

ODA is the largest source of external financing for Least Developing Countries and a vital resource for supporting key sectors that promote the reduction of poverty and the addressing of inequalities. It is more crucial than ever that ODA funds are used wisely, so that they have the greatest impact possible.

In December 2018, members of the Organisation for Economic Cooperation and Development’s Development Assistance Committee (OECD DAC) agreed provisional reporting arrangements for private sector instruments (PSIs). These are financing instruments that ODA providers can use to make direct investments in private enterprises or in ‘PSI vehicles’, such as development finance institutions (DFIs).\(^2\) Reporting PSIs as ODA risks undermining both the quantity and quality of ODA, and could erode the fundamental ODA criteria of concessionality. In 2022, the provisional reporting arrangements for PSIs are under review and could lead to an updated agreement, which, with the necessary safeguards, could better frame what counts, and what does not count, as ODA in donors’ operations involving the private sector.

This report addresses two closely related but distinct risks that could affect the integrity of ODA, in the context of the reporting of PSIs as ODA.

The first is the risk of increased formally and informally tied ODA (also known as tied aid) through the use of PSIs in development cooperation. The second is the risk that PSIs reported as ODA could be giving firms in DAC member countries a commercial advantage compared to firms from other countries.

This report seeks to demonstrate that recent developments in the use and reporting of PSIs pose serious threats of an increase in tied aid and other forms of commercially motivated ODA, that could affect its definition, as well as its availability.

It also follows on from our November 2021 analysis on tied ODA, “Strings still attached: Unmet commitments on tied aid”.\(^3\) That report estimated that in 2018 the total level of formally and informally tied aid – i.e. ODA that is restricted to the procurement of goods and services of the country providing that ODA through different channels, was at a minimum of \textbf{US$32.3 billion}. One of the main effects often associated with tied ODA is the fact that the costs for the goods and services purchased by the partner country becomes higher.\(^4\) Tied ODA also represents aid resources that could not be used to support local firms in the Global South, thereby potentially developing more sustainable supply chains and stronger local economies (a so-called “double dividend”\(^5\) effect of development aid).

Although, the longer-term costs of tying are hard to quantify, our latest findings estimate, that in 2018 alone, the \textbf{direct short-term price of tying was at least US$2 billion and potentially as much as US$7 billion}.\(^6\) In the long term, the cost of tying ODA relates to the lost opportunity from letting narrow domestic interests distract aid from the chance to support democratically accountable pro-poor procurement systems, rights-compliant and environmentally responsible supply chains, more sustainable local markets and more equitable local economies.

The purpose of this report is to expose a set of ways in which PSIs could threaten to increase tied ODA levels in the years to come. The objective is to support additional and renewed civil society work on both PSIs and aid untying.

The main stated aims of PSIs include supporting economic development, creating jobs and increasing tax revenues in developing countries.\(^7\) Yet in reality PSIs present additional risks that could lead to an increase in tied ODA and/or other forms of commercially motivated ODA operations, compared to other type of ODA flows.
This report identifies and unpacks three overlapping sets of risks that threaten to inflate tied ODA levels in the years to come. They are summarised as follows:

1. Risks linked to the way that PSI spending is managed, with some key stakeholders – particularly some DFIs – facing a potential tension between the objective of contributing to the economic development of countries in the Global South, versus the objective of supporting the expansion of firms from their DAC member country, which affects the governance and ownership of development projects;

2. Transparency risks, which make it hard to get a complete picture of tied ODA or other forms of commercially motivated ODA within PSI spending from the available data sources alone, and make some of the existing safeguards against tied ODA less meaningful in a PSI context;

3. Definitional risks related to potential changes in the rules for reporting PSI, which could bring further tied aid or commercially motivated transactions into the scope of ODA.

This report also highlights three crucial roles for CSOs in tackling the risk of increased tying and other forms of commercially motivated ODA associated with PSIs. These are:

1. Advocacy related actions:
   - CSOs have a vital role to play in putting pressure on DAC members not to let the current provisional PSI reporting rules continue unchallenged – the inclusion of PSI in ODA without agreed implementation details puts at risk its quality and impact on poverty reduction and addressing inequalities, as well as the credibility of OECD statistical data. In the absence of agreed PSI implementation rules that address, the risks identified here as well as much needed safeguards and incentives, amongst other issues, there is a strong case for CSOs to encourage donors to count their investments in PSI as Other Official Flows, rather than ODA.
   - CSOs should maintain the spotlight on the continued need for non-PSI and untied ODA. Spending ODA on PSIs has an opportunity cost, yet there is no evidence that donors have a robust processes in place to support their choice of PSIs over alternative uses of aid. CSOs have a key role to play in making the untying agenda progress and should continue to put pressure on DAC members to address this.
   - CSOs should call for a review of the ODA modernisation process before any new agreement is made. Such a review should look into the expansion of the ODA concept, the corresponding reporting rules and the impacts on its quantity and quality.

2. Collecting case-studies:
   - Given the lack of transparency in PSI spending, case study evidence developed by CSOs has a particularly important role to play. Gathering case studies, involving different forms of tying and different DAC members, in different country contexts, can play a crucial role in demonstrating the negative impact of PSIs, not only for the untying of ODA and the wider quality agenda, but also for the communities in the Global South.

3. Monitoring PSI operations:
   - CSOs should closely monitor PSI operations. notably the achieved development results, alignment with development effectiveness principles, and the allocation implications arising from the inclusion of PSI in ODA. CSOs should also monitor the extent to which donors are reporting in a comprehensive manner on the additionality of their PSI operations – as per the 2018 agreement. Overall, CSOs should keep resisting any erosion to concessionality. If there is a shift from concessionality to additionality, it would not only undermine a fundamental ODA criterion, but contribute to expanding the risk for increased levels of tied aid and other forms of commercially motivated ODA.
Key messages and policy recommendations

With the upcoming review of the provisional reporting methods for PSIs, we recommend that DAC members:

1. Adopt mechanisms to mitigate the risk that governance-related aspects of PSIs lead to more tied aid and/or other forms of commercially motivated ODA by: considering the potential added risks for tied ODA and other forms of commercially motivated ODA “before” making the decision to use PSIs – i.e. when top-level budget allocation decisions are first made. Governments and representative civil society stakeholders from the Global South should be meaningfully involved in this top-level cost-benefit assessment, since they stand to gain or lose the most through the decisions that are made.

2. Clarify that benefits for domestic firms should never be an objective of PSI schemes. DFI mandates and PSI policies should be reviewed to remove any language that suggests domestic firms are expected to benefit from the development finance being channelled, and the project approval process should include checks to ensure firms from outside the DAC member country have been given a fair chance. This does not mean that domestic firms could not benefit incidentally, if this was motivated by other factors reflecting the central objectives of ODA. Furthermore, any programmes and funding windows that currently target domestic firms should be adapted to ensure other firms – particularly smaller firms from the Global South – have a fair chance of winning support.

3. Tackle the transparency risks related to the monitoring of formal and informally tied PSIs, by:
   - Improving transparency related to informally tied PSIs. The DAC should require all DFIs, or other PSI vehicles, to report on procurement contracts awarded by themselves or by their direct intermediaries or investees. The DAC should also investigate how to increase transparency over more complex PSIs that involve not only direct intermediaries or investees, but also longer chains of investments.
   - Developing a time-bound plan to work with all concerned stakeholders – including governments from the Global South and representative civil society organisations – to design and implement stronger controls to monitor arising forms of tied aid and/or other forms of commercially motivated ODA support favouring firms in DAC members’ own countries. A first step would be to ensure consistent transparency over the location of firms engaged as financial intermediaries (i.e. whether these firms are based in the DAC member country or elsewhere), but it is also essential to enhance transparency over the location of firms engaged in PSI transactions as investors or as investees. Even if there is eventually enough evidence to justify moving PSIs from Other Official Flows into ODA, there should remain a presumption that, unless a compelling reason can be given, PSI structures that support companies in the DAC member country should never be ODA-eligible, due to the potential conflict of interest between supporting such firms and maximising impact for countries in the Global South.

4. Tackle the definitional risks related to potential changes in the rules for reporting PSI, by:
   - Reinstating the requirement for ODA to always be concessional, even if this limits the extent to which PSIs could be eligible. Insisting on concessionality is, first and foremost, a crucial matter of principle, to protect the distinctive nature and comparative advantage of ODA. In addition, it is an essential characteristic for preventing the upsurge in tied ODA or other forms of commercially motivated ODA – the expansion of the boundaries of ODA, could potentially lead towards the inclusion of previously ineligible, low-concessionality transactions, including export credits.

While the focus of this report is on the crucial issue of tied ODA and/or other forms of commercially motivated ODA and its potential links to PSIs, we emphasise that this is just one of many aspects that would need to be tackled before we consider that these instruments could be reported as ODA without undermining its quality and impact in reducing poverty, addressing inequalities and achieving the SDGs.

ODA must play a crucial role in tackling the impacts of the current pandemic and arising crisis across the world and continue supporting a recovery centred on human rights, gender equality and a just transition.
1. Introduction

The Covid-19 pandemic is much more than a health crisis. Although the pandemic has affected people around the world, the impact of Covid-19 on populations in richer and poorer countries differs substantially. Added to this are the impacts of climate change and extreme weather events on the one hand and an extremely volatile geopolitical situation on the other. The Covid-19 pandemic has also threatened decades of progress for women and girls, disproportionately impacting women’s incomes, employment, and education opportunities, while increasing pressures of unpaid care and fuelling the ‘shadow pandemic’ of gender-based violence.10

Before the Covid-19 pandemic,11 the world was already facing unprecedented levels of humanitarian crises, with more than 134 million people in need of assistance and protection. Two years on, this figure has more than doubled, with 274 million people in need of humanitarian assistance and protection in 2022.12 The United Nations Conference on Trade and Development (UNCTAD) has estimated13 that the current financial gap to meet the Sustainable Development Goals (SDGs) stands at US$17.9 trillion for the 2020-2025 period. This puts the current annual gap at US$3.6 trillion – more than US$1 trillion wider than before the Covid-19 pandemic. This is without even factoring in the effects of the Ukraine conflict.

In the current context, official development assistance (ODA) plays a fundamental role, notably within the poorest countries. ODA is the largest source of external financing for Least Developing Countries (LDCs) and is a vital resource for supporting key sectors for poverty reduction such as agriculture, education, social services, health and water, sanitation and hygiene – sectors that have a considerable impact on the health, safety and livelihoods of women and gender minorities. Furthermore, ODA has a critical role to play as a key public international resource directed towards climate adaptation in countries that are particularly vulnerable to the impacts of climate change. This means it is more crucial than ever that scarce ODA resources are directed in the most effective way to the places where they have most impact.

Since its creation in 1961,14 the Organisation for Economic Co-operation and Development (OECD)’s Development Assistance Committee (DAC) has worked to improve the effectiveness of aid channelled by the donor community, including the untying of aid – i.e. removing the legal and regulatory barriers to open competition for aid-funded procurement.15 This work culminated in a Recommendation to Untie Official Development Assistance to the Least Developed Countries (adopted by the DAC High Level Meeting in April 2001), which has been updated since then.16 Eurodad’s latest findings on tied ODA, included in the November 2021 report Strings still attached: Unmet commitments on tied aid,17 estimated that, in 2018, the total level of formally and informally tied aid – i.e. ODA that is restricted to the procurement of goods and services of the country providing that ODA, through formal or informal channels – was at a minimum of US$32.3 billion. One of the main effects often associated with tied ODA is the fact that the costs for the goods and services purchased by the partner country become higher.18 Tied ODA also represents resources that could not be used to support local firms in the global south, thereby potentially developing more sustainable supply chains and stronger local economies (a so-called ‘double dividend’19 effect of development aid). Accordingly, the US$32.3 billion figure translates into very real costs for people in the global south. Although the longer-term costs of tying aid are hard to quantify, our latest findings estimate, that in 2018 alone, the direct short-term cost of this practice was at least US$2 billion and potentially as much as $7 billion.20 In the long term, the cost of tying ODA relates to the opportunity cost from letting narrow domestic interests distract aid from the chance to support democratically accountable pro-poor procurement systems, rights-compliant and environmentally responsible supply chains, more sustainable local markets and more equitable local economies.21

In December 2018, DAC members agreed on provisional reporting arrangements for private sector instruments (PSIs) – i.e. financing instruments that ODA providers can use to make direct investments in private enterprises or in ‘PSI vehicles’, such as development finance institutions (DFIs) – government-controlled institutions that invest in private sector projects in countries in the global south.22 Civil society organisations (CSOs) have consistently highlighted the far-reaching implications of reporting PSIs as ODA, which could undermine both its quantity and quality, including the erosion of the fundamental ODA criteria of concessionality. In 2022, the provisional reporting arrangements on PSIs are under review and could lead to an updated agreement, which, with the necessary safeguards, could better frame what counts as ODA or not in terms of donors’ operations involving the private sector.
This report addresses two closely related but distinct risks that could affect the integrity of ODA, in the context of the reporting of PSIs as ODA. The first risk looks at the potential increase of formally and informally tied aid through the use of PSIs in development cooperation. The second risk looks at whether PSI reported as ODA could be giving firms in the DAC member country a commercial advantage compared to firms from other countries. In this case, examples might include offering domestic firms that are operating in developing countries a commercial advantage by financing specific activities or by covering some of the risk of its investments, without offering the same advantage to firms from other countries.

Although these two risks are separate, they have many issues in common. Both overlook the purpose of ODA: namely, that its primary purpose is to support the “economic development and welfare” of countries in the global south. This purpose is fundamental to ODA, and, as we discuss further in this report, is one of the features that help to distinguish ODA from other forms of finance such as export credits. Tied aid and other forms of commercially motivated ODA operations supporting firms in DAC countries subordinate the interests of countries in the global south to narrowly defined domestic economic interests.

Ahead of the review of the provisional reporting methods for PSIs, the purpose of this report is to expose a set of reasons for which PSIs could threaten to increase tied ODA levels in the years to come. The objective is to support additional and renewed civil society work on both PSIs and aid untying.

CSOs have consistently highlighted the far-reaching implications of reporting PSIs as ODA, which could undermine both its quantity and quality.

This report is organised in four sections, following this introduction:

• Section 2 provides a quick overview of the current DAC agreement on PSIs and addresses tied aid and other forms of commercially motivated ODA operations in the context of PSIs.
• Section 3 presents a set of risks for increased tied aid and/or other forms of commercially motivated ODA operations, to take into consideration in the context of the review of the 2018 PSI agreement, and the potential negotiations to update it.
• Section 4 provides some ideas on how CSOs can address work the risks for increased tied aid and/or other forms of commercially motivated ODA associated with PSIs.
• Section 5 provides a set of key messages and recommendations.

Box 1: Definition of ODA

Official development assistance (ODA) is made up of flows to countries and territories on the DAC List of ODA Recipients and to multilateral development institutions that are:

i. provided by official agencies, including state and local governments, or by their executive agencies; and
ii. concessional (i.e. grants and soft loans) and administered with the promotion of the economic development and welfare of developing countries as the main objective.

ODA does not include:

– military aid and promotion of donors’ security interests
– transactions that have primarily commercial objectives e.g. export credits.
## 2. Private Sector Instruments (PSIs)

### 2.1 The current state of DAC agreement on Private Sector Instruments (2018)

As summarised in Eurodad’s 2021 report on PSIs, Time for Action, members of the OECD-DAC have embarked on a set of reforms since 2016 that threaten to increase the extent of tied ODA and/or commercially motivated operations reported as ODA. Following these reforms, since 2018 DAC members can report the use of PSIs – such as loans to the private sector, guarantees, equities and mezzanines finance – as ODA (see Box 2). This report addresses the increased risks to the integrity of ODA as an effective resource for development, resulting from an expanded use of PSIs.

In 2016, DAC members agreed on a set of principles (11 in total) to better reflect their efforts in investing ODA through PSIs. Prior to this agreement, investments in private sector entities, including those from DFIs, were not reportable as ODA. There were two main reasons for this exclusion:

- **Their non-concessional character:** It was not considered desirable to subsidise private sector entities in developing countries because of competition concerns, which excluded the possibility for these investments to be concessional and thus to qualify as ODA.
- **The ‘point of measurement’ rules at the DAC:** These rules tried to avoid internal transactions within donor countries and focus on measuring flows from donor to recipient countries, meaning that investments such as capital injections in DFIs were not reportable as ODA.

The PSI principles agreed by the DAC in 2016 welcomed the reporting of these types of investments as ODA, despite their non-concessional character and despite the ‘point of measurement’ rules, while specifying transparency and monitoring provisions. By doing this, DAC members were taking steps towards effectively removing concessionality as a condition for ODA and opened the door for a revision of the definition of ODA, placing the focus on additionality instead. In December 2018, members of the OECD-DAC took a step forward and agreed provisional reporting arrangements for reporting PSI data from 2018 onwards. The provisionality aspect of this agreement was primarily due to disagreements over the discount rates to be used in calculating the grant equivalent of loans to private sector companies (PSI loans), equity investments, mezzanine finance and guarantees (known as implementation rules). With this temporary agreement many of the principles agreed in 2016 were also pushed aside, including safeguards that have an important role to play in monitoring the risks of blurring the lines between developmental and commercially motivated operations.

### Box 2: What are Private Sector Instruments?

PSIs are financing instruments that ODA providers can use to make direct investments in private enterprises or in ‘PSI vehicles’ – such as development finance institutions, investment funds or other special purpose vehicles – that in turn invest in private entities (e.g. enterprises or investment funds) in developing countries. They consist of official loans to private sector entities, equity investments, mezzanine finance, reimbursable grants and guarantees. In addition, capital contributions to DFIs are also considered as PSIs – whether they are provided as grants or equity investments.

PSIs should not be confused with ODA channelled directly through private sector institutions as project partners or with blended finance, which is a finance structuring approach. PSIs are used by ODA providers to invest in private sector entities (whether directly or via PSI vehicles such as DFIs). With blended finance, ODA providers (or other providers of concessional finance) invest alongside private sector entities or investors and may or may not use PSIs to do so (e.g. they could also use grants or technical assistance, which are not PSIs).

In 2018, DAC members agreed on how to report their 2018 private sector instrument flows in ODA, by applying either the institutional or instrument approach:

- **Institutional contributions:** Donor’s transaction to a vehicle (such as a DFI, investment fund or other special purpose vehicle), which in turn provides finance in the form of PSIs to private sector entities in developing countries (donor’s effort is measured on a cash-flow basis at the point of transfer of funds).
- **Instrumental contributions:** Donor’s transaction (project) level between the PSI vehicle and the private sector entity receiving the funding and/or cashflow in the partner country (donor’s effort is measured on a cashflow basis).

In the first half of 2021, the OECD-DAC Secretariat developed an analysis of the provisional reporting methods for PSIs and their impact on ODA, which was well received by DAC members, who confirmed their commitment to review the provisional reporting methods for PSIs. A summary was presented to CSO members of the DAC-CSO Reference Group in April 2021 addressing issues related to ODA integrity due
to the combination of grant equivalent and net disbursement reporting, the comparability of PSI activities (following the two approaches to report them), transparency and effectiveness. The official review of the provisional reporting methods of PSIs started in February 2022 and is due to include consultations with several stakeholders, including the Export Credit Community, the Business Community at the OECD, DFIs, think tanks and CSOs, among others. This review could lead to an improved agreement or the negotiation of permanent reporting methods for PSIs.

Since the agreement of the provisional reporting arrangements for PSIs in 2018, CSOs have been highlighting the need for DAC members to resume negotiations in order to reach a permanent agreement that addresses not only the pending reporting methods, but that also addresses safeguards and incentives/disincentives regarding the use of PSIs in development cooperation. CSOs are also looking to clarify issues related to how additionality is defined – for example, how to better integrate the difference between an export credit and ODA operation.

2.2 Tied ODA and other forms of commercially motivated ODA operations in the context of PSIs

PSI arrangements are diverse and often complex. When using PSIs, DAC members in their capacity as donors – or their DFIs – may interact with private sector actors in many different ways. In fact, often several of these interactions would be involved in any single PSI. Thus, in the interaction with the private sector, members of the DAC could do as follows:

- Use PSIs to ‘mobilise’ investment from private sector actors – for example, by offering to guarantee an investment in a partner country in the global south.
- Contract a private sector actor to act as a financial intermediary on their behalf – for example, by providing finance to a bank, which in turn uses this finance to invest in individual businesses in a partner country in the global south.
- Invest directly in other private sector actors operating in countries in the global south – for example, by buying shares.
- Support procurement by private sector actors – for example, by providing a loan to one firm, for the specific purpose of enabling that actor to procure machinery from another firm.

These different types of interactions are summarised in Figure 1.
Of the four types of interactions, only the fourth – support to procurement by private sector actors – would potentially fall within the scope of tied ODA. At first sight it might seem puzzling that procurement by private sector actors, as opposed to government actors, could be tied. However, DAC members and their DFIs can still tie procurement activities implemented by private sector actors, by including this in the terms attached to their finance. For example, in 2019, out of the ODA reported as PSI – a total of US$3.1 billion (net ODA) – US$6.88 million were reported as tied ODA.\cite{footnote}

In contrast, the other three types of interactions – mobilising finance; use of financial intermediaries; and investment – would not normally fall within the scope of tied ODA. But in all three types of interactions, there is still a risk that DAC members and their DFIs could choose to give preference to firms from their own country, to respond to their own commercially motivated interests. In fact, it is partly because of this diversity of interfaces (which fall outside the scope of tied ODA monitoring processes) with private sector actors that we decided the risks of DAC members using PSIs in commercially motivated ways deserved particular examination in this report.

It should also be noted that, in a complex PSI that involves several different forms of engagement with private sector actors, there is a risk that ODA operations that are commercially motivated – including tied ODA – ‘cross contaminate’ one form of engagement with the private sector to another. For example, if a DAC member already invests in a firm from its own country, this gives it a vested interest in seeing that firm succeed. This vested interest could make the DAC member more likely to favour that same firm when it comes to procurement. This risk is hypothetical at this stage in a PSI context. However, in the context of public-private partnerships, similar phenomena have already been documented.\cite{footnote} The same broad incentives could apply to PSIs. This means that, in extreme cases, the risk that ODA operations become commercially motivated, including tied ODA, could sometimes be the start of a domino effect: once one risk materialises, it may then be replicated in other parts of the PSI structure.

In the following sections, we delve further into the various risks that potentially tied ODA and/or other forms of commercially motivated ODA operations in the context of PSIs could present. Throughout the analysis, we specify which type of commercially motivated ODA flows are at stake – whether the risks in question relate to tied ODA, to other forms of commercially motivated ODA operations, or both.
In principle, there is no reason why PSIs should involve tied ODA or other forms of commercially motivated ODA operations. The main stated aims of PSIs include supporting economic development, creating jobs and increasing tax revenues in developing countries. While much depends on context, these aims are often best supported by directing ODA to firms in the global south, to create a virtual cycle of reinvestment in the local economy. Therefore, tied ODA or any other ODA operation that is commercially motivated would intrinsically likely be in tension with such an approach.

However, in reality PSIs present additional risks that could lead to an increase in tied ODA and/or other forms of commercially motivated ODA operations, compared to other types of ODA flows. Thus, the outcomes of a potential PSI negotiation (see Section 2) could have important implications for the credibility and integrity of ODA and the underlying statistical framework. The following sub-sections identify three overlapping sets of risks that could lead to increased levels of tied ODA in the years to come:

- Risks linked to the way that PSI spending is managed, with some key stakeholders — particularly some DFIs — facing a potential tension between the objective of contributing to the economic ‘development’ of countries in the global south, versus the objective of supporting the expansion of firms from their DAC member country — affecting governance and the ownership of development projects.
- Transparency risks, which make some of the existing safeguards against tied ODA less meaningful in a PSI context.
- Definitional risks related to potential changes in the rules for reporting PSI, which could bring further tied ODA or commercially motivated transactions into the scope of ODA.

The following sections unpack these risks in more detail. Box 3 at the end of this section then illustrates two examples of how the risks have already materialised in practice.
It is also important to keep in mind that, in a context of Covid-19 economic recovery, some donors may see opportunities for the promotion of their domestic companies through the development cooperation envelope and PSIs provide opportunities to do so (see for example the opinion shared at the French National Assembly regarding the role of French development cooperation). A recent study assessing Principled Aid – through an index that measures the balance that 29 bilateral donors strike between advancing the values of global solidarity and protecting their national interests – observed that DAC donors became less principled on average and this trend could be further accentuated by the Covid-19 pandemic and related crisis. The most problematic countries include the newer DAC members within the Eastern European region, but also countries such as Italy, Spain, France and Portugal.

Potential tension with the expectations placed on DFIs

Until recently DFIs have been outsiders in the development discourse. Today, however, increased amounts of aid are being channelled through these institutions. There is no doubt that DFIs have a strong positive impact in some areas, including the provision of capital to innovative sectors or credit to constrained micro, small and medium-sized enterprises. However, some DFIs’ mandates and strategic objectives include expectations or aspirations to engage with domestic firms (from the provider country). This is the case, for example, for the DFIs in Belgium, Germany, the Netherlands, Norway, Spain or the UK (see Table 1). The combination of both the developmental mandate of DFIs and the expectations or aspirations for them to engage with domestic firms could lead to increased levels of tied. Many DAC member countries have their national DFIs in the frontline of their PSI operations. Table 1 provides examples from DFIs’ mandates and strategic objectives that make explicit reference to the expectations or aspirations to engage with firms from the provider country. Although illustrative, this table is not exhaustive.
Mandates, objectives, expectations

While the UK DFI, CDC Group – to be renamed British International Investment from April 2022 – is not required to deliver the 2020-2024 Corporate Plan of Canada’s DFI, FinDev Canada, states that: “While FinDev Canada does not have an obligation to consider Canadian commercial interests in the transactions it supports, it is interested in building relations and partnerships with Canadian businesses with which it has converging interests. As such, FinDev Canada will focus on industry sectors that match Canadian capabilities.”

While Germany’s DFIs – KfW development bank and DEG – are not required to deliver benefits for German companies, DEG’s website envisages that such companies will be among its important partners: “DEG finances and advises German and local companies active in developing and emerging countries.”

Austria’s DFI, the Oesterreichische Entwicklungsbank (OeEB), says in its strategy for 2019-2023 that, alongside its mandate of financing sustainable investments in the private sector of ‘developing’ countries, “we also take Austrian foreign policy and foreign economic interests into account in our work” and “we acknowledge our responsibility towards the Austrian economy and aim to harness its comparative strengths to implement the SDGs in developing countries”. The strategy contains multiple references to potential benefits for Austrian companies, and this appears to have been a factor in OeEB’s choice of thematic focus areas and its geographic emphasis on Middle Income Countries. The Act establishing Finnfund, Finland’s development finance institution, says that one of Finnfund’s objectives is to “finance companies, in which a Finnish interest is involved, to be established and operating in developing countries”.

Canada’s DFI IFU is no longer formally required to work in cooperation with Danish trade and industry – as had previously been the case until 2016. However, IFU’s most recent strategy still refers to IFU’s strong relationship with the Danish business community, which is expected to lead to mutually beneficial opportunities to invest in countries in the global south. The strategy also envisages an “increased focus on creating synergy between IFU’s investment activity and [the Ministry of Foreign Affairs’] development and export promotion activities”. The 2020-2024 Corporate Plan of Canada’s DFI, FinDev Canada, states that: “While FinDev Canada does not have an obligation to consider Canadian commercial interests in the transactions it supports, it is interested in building relations and partnerships with Canadian businesses with which it has converging interests. As such, FinDev Canada will focus on industry sectors that match Canadian capabilities.”

Denmark’s DFI IFU is no longer formally required to work in cooperation with Danish trade and industry – as had previously been the case until 2016. However, IFU’s most recent strategy still refers to IFU’s strong relationship with the Danish business community, which is expected to lead to mutually beneficial opportunities to invest in countries in the global south. The strategy also envisages an “increased focus on creating synergy between IFU’s investment activity and [the Ministry of Foreign Affairs’] development and export promotion activities”. The Act establishing Finnfund, Finland’s development finance institution, says that one of Finnfund’s objectives is to “finance companies, in which a Finnish interest is involved, to be established and operating in developing countries”. In its 2017 peer review of Finland, commenting on Finland’s use of PSIs, the DAC noted that “Finland’s ... high share of untied aid may be jeopardised in an environment where links to Finnish business are a requirement”,

For all these reasons, it would be misleading to suggest that all the DFIs in Table 1 are also subject to clear objectives on achieving ‘sustainable development’ impacts in the global south. Some DFIs have recently moved away from a formally tied model – as the example from Denmark shows. The examples in the table cover a wide spectrum. At one end of the spectrum, support for firms “in which a Finnish interest is involved” is one of the explicit objectives of the legislation establishing Finland’s DFIs. At the other end of the spectrum are much more subtle general aspirations that firms from the DAC member country will be involved in some of the DFI’s projects. What is more, DFIs handle a wide range of finance, and not all of it is ODA. This means that even if some transactions favour domestic firms, those may not necessarily be transations reported as ODA.

For all these reasons, it would be misleading to suggest that all the DFIs analysed are engaged in ODA operations that are commercially motivated, including tied ODA. Still, prima facie, the existence of an expectation that domestic firms may derive some support from DFI operations suggests that, at least in some cases, commercial factors may enter into decision making on PSI operations. In some cases, this may in turn foster an environment where some decision makers may be more likely to design PSIs in ways that give domestic firms a commercial advantage.

It is worth noting that we do not analyse here the case of the United States’ major new DFI, the Development Finance Corporation (DFC) – among other reasons, this is because the US has not yet reported any activity of the DFC as PSI ODA. The DFC was established in 2019 and has a total investment limit of US$60 billion. The DCF is required by law to “give preferential consideration to projects sponsored by or involving private sector entities that are United States persons”. If related PSI spending of this new DFI is reported as ODA by the US in future, this could potentially lead to a substantial increase of tied ODA and/or other forms of commercially motivated ODA operations.

Table 1: DAC members’ expectations of domestic firms’ benefits from PSIs

<table>
<thead>
<tr>
<th>DAC member</th>
<th>Total PSI ODA, 2018-2020 (US$ million)</th>
<th>Mandates, objectives, expectations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>78</td>
<td>Austria’s DFI, the Oesterreichische Entwicklungsbank (OeEB), says in its strategy for 2019-2023 that, alongside its mandate of financing sustainable investments in the private sector of ‘developing’ countries, “we also take Austrian foreign policy and foreign economic interests into account in our work” and “we acknowledge our responsibility towards the Austrian economy and aim to harness its comparative strengths to implement the SDGs in developing countries”. The strategy contains multiple references to potential benefits for Austrian companies, and this appears to have been a factor in OeEB’s choice of thematic focus areas and its geographic emphasis on Middle Income Countries.</td>
</tr>
<tr>
<td>Canada</td>
<td>643</td>
<td>The 2020-2024 Corporate Plan of Canada’s DFI, FinDev Canada, states that: “While FinDev Canada does not have an obligation to consider Canadian commercial interests in the transactions it supports, it is interested in building relations and partnerships with Canadian businesses with which it has converging interests. As such, FinDev Canada will focus on industry sectors that match Canadian capabilities.”</td>
</tr>
<tr>
<td>Denmark</td>
<td>62</td>
<td>Denmark’s DFI IFU is no longer formally required to work in cooperation with Danish trade and industry – as had previously been the case until 2016. However, IFU’s most recent strategy still refers to IFU’s strong relationship with the Danish business community, which is expected to lead to mutually beneficial opportunities to invest in countries in the global south. The strategy also envisages an “increased focus on creating synergy between IFU’s investment activity and [the Ministry of Foreign Affairs’] development and export promotion activities”.</td>
</tr>
<tr>
<td>Finland</td>
<td>211</td>
<td>The Act establishing Finnfund, Finland’s development finance institution, says that one of Finnfund’s objectives is to “finance companies, in which a Finnish interest is involved, to be established and operating in developing countries”. In its 2017 peer review of Finland, commenting on Finland’s use of PSIs, the DAC noted that “Finland’s ... high share of untied aid may be jeopardised in an environment where links to Finnish business are a requirement”.</td>
</tr>
<tr>
<td>Germany</td>
<td>807</td>
<td>While Germany’s DFIs – KfW development bank and DEG – are not required to deliver benefits for German companies, DEG’s website envisages that such companies will be among its important partners: “DEG finances and advises German and local companies active in developing and emerging countries”.</td>
</tr>
<tr>
<td>UK</td>
<td>3,406</td>
<td>While the UK DFI, CDC Group – to be renamed British International Investment from April 2022 – is not required to deliver benefits for UK companies, its new strategy includes an aspiration that UK companies will be among its key partners: “We will invest in or with British businesses that operate in developing and emerging economies and who share our aims”.</td>
</tr>
</tbody>
</table>
Risk 2: Transparency safeguards weakened

As part of its agenda to untie ODA, the DAC requires members to report granular detail on their ODA procurement patterns – both ex ante and ex post. This data can help to detect informal ODA tying – that is, tying that gives domestic firms an advantage through unofficial barriers in the procurement process that do not allow firms from other countries a fair chance to compete for contracts. If the data on procurement patterns shows that a very high share of contracts is being awarded to domestic firms in a DAC member country, this is proxy evidence that informal ODA tying may be taking place.

While the data on procurement patterns is not fully complete – particularly in the case of ex ante reporting, the fact that it is at least collected allows a basic level of scrutiny over DAC members' use of informal ODA tying and an opportunity for this not to go unnoticed. This data is reported in the DAC’s periodic Report on the Recommendation on Untying ODA, and in the Global Partnership for Effective Development Cooperation’s monitoring reports. The results are also used for scrutiny by external stakeholders, including Eurodad’s recent analysis on untying ODA. These reporting and scrutiny processes in turn allow poorer performers to be named and shamed, which could discourage DAC members from using informal tying.

In contrast, PSIs present serious challenges when it comes to capturing the same level of detailed data on procurement patterns and on other forms of engagement with private sector actors that could lead to other forms of commercially motivated ODA operations.

These challenges fall into two groups. The first relates to the way current tied ODA reporting conventions intersect with the DAC’s provisional PSI reporting arrangements (see Section 3.3 below). The second group of challenges relate to the increasingly diverse range of ways in which DAC members are engaging with private sector actors through PSIs (see Figure 1), and the lack of comprehensive data on the types of private sector actors that are involved in such relationships (see Section 3.4 below).

These transparency challenges mean that, within the PSI context, it is harder for external stakeholders – and even governments in the global south – to monitor the levels of tied ODA and/or other forms of commercially motivated ODA operations. The lack of external scrutiny could make it easier for DAC members to engage in tied ODA and/or other forms of commercially motivated ODA operations without being held to account. And, in principle, could encourage higher levels of tied ODA and/or other forms of commercially motivated ODA operations in the context of PSIs, compared to other ODA modalities where transparency may, at least in some respects, be stronger.

Transparency over PSI-financed procurement

This risk relates to tied ODA in the traditional sense (i.e. it relates to procurement relationships) and the level of information available that allows the monitoring of the possibility of formal or informal tied ODA in PSI operations.

As noted above, DAC members’ reported data on their contract awards can be a key source of evidence on the extent to which their ODA is really untied in practice. Yet in the case of PSIs, these data tend to be less readily available for three main reasons:

First, under the current PSI reporting arrangements, DAC members can choose whether to report PSIs on a transaction level (the instrument-specific basis) or at the point of transfer of funds to a PSI vehicle such as a development finance institution (the institutional basis). Where DAC members opt to report their PSI activity under the institutional basis, granular data on the details of their transactions are scarce, undermining the possibility to monitor whether the related ODA flows are contributing towards promoting the economic development and welfare of countries in the global south. As Figure 3 illustrates, between 2018 and 2020, the annual share of PSI spending reported on an institutional basis was above 40 percent – 60 percent, 49 percent and 42 percent respectively – a very substantial share, even if it is decreasing. Considering an important part of PSI activity is carried out by DFIs, this lack of transparency is consistent with a wider pattern of transparency challenges across DFIs’ reporting more generally. And, although, PSIs accounted for only 1.9 percent of total ODA in 2019 (or 2.4 percent of bilateral ODA) or US$3.1 billion (net ODA), in the years to come, it can be expected that PSI will increase. In fact, some donors have already stated their ambition to allocate additional resources to PSIs. The outcome of the current PSI review (see Section 2.1), may lead to increased amount of PSIs flows reported as ODA.
Second, even if DAC members opt to use the instrument approach, in practice most DFIs – the main channel for PSI spending – do not have the obligation to report to the DAC any data related with the implementation of the DAC Recommendation on Untying.\textsuperscript{73} Third, certain DAC members only report data on contracts that fall within the scope of the Recommendation on Untying – i.e. data on contracts for projects in LDCs, HIPCs and (for future years’ reporting rounds) other Low Income Countries and IDA-only countries and territories.\textsuperscript{74,75} Yet in practice PSI spending tends to be concentrated in middle-income countries and upper middle-income countries (see Figure 4).\textsuperscript{76} While this is only true for a minority of DAC members, it is liable to lead to some further gaps in data on contract reporting in the context of procurement-related PSIs.

Only a small share of PSI spending will be covered by DAC members’ contract reporting as required by the DAC Recommendation on Untying, compared to other forms ODA spending.
Changes in the nature of engagement with private sector actors

This risk relates to tied ODA and other forms of commercially motivated ODA operations and raises concerns about the insufficient data available that could allow the monitoring of the possibility of formal or informal tied ODA or identifying other forms of commercially motivated ODA.

As mentioned above, PSIs often involve many different forms of interactions with private sector actors, which may involve investors, financial intermediaries or investees, as well as suppliers.

While the DAC’s mechanisms for reporting on contract awards offer important – albeit incomplete – data on DAC members’ support to suppliers in their own countries, no comparable reporting mechanism exists for the other kinds of interactions with private sector actors – for example, within the context of PSIs. In other words, for engagement with private sector actors as investors, intermediaries or investees, there is currently no systematic source of data that allows stakeholders outside the DAC to track comprehensively whether firms in DAC member countries, or firms in the global south, are benefiting from PSI relationships. This in turn means that, if other forms of commercially motivated ODA operations – and supporting firms in DAC member countries – beyond tied ODA, increase substantially with the growth in PSI operations, it would be hard to detect this increase from the current data that DAC members provide.

As a starting point, DAC members could draw from the Arrangement on Officially Supported Export Credits or the Agreement on Untied ODA Credits Transparency, both of which provide disciplines and transparency measures for untied ODA and aim to address some of the tied ODA concerns.
Box 3: Examples of PSIs that raise red flags for tied ODA

It is too early to assess how some of the risks presented in this report will materialise in practice, as PSI levels are still a small share of total ODA. However, in 2019, out of the PSI ODA reported – which was of US$3.1 billion (net ODA), a total of US$6.88 million were reported as tied ODA used in the following sectors: US$2.06 million in Business & Other Services; US$1.09 million in Industry; followed by US$0.82 million in Education.\(^79\)

Despite these complications, the following two examples of PSI projects may involve de facto tied ODA. These examples are a telling demonstration of how difficult it is to get full assurance that tying is not present, given the complexity of the cases involved, the diversity of ways in which DAC member companies can gain an advantage, the limitations on publicly available data, and the trend to increase PSI transactions in the years to come, which will require additional scrutiny.

**Example 1: Investment-related**

None of the PSI ODA from France is reported as tied.\(^80\)
Yet, in 2018, Business France and the Agence Française de Développement (AFD) signed a partnership agreement that aimed at better connecting French companies with the activities of the AFD in developing and emerging countries. This creates a potentially fertile environment for tied ODA and/or other forms of commercially motivated ODA operations.

In Mexico, Proparco is financing six renewable energy projects to develop two wind farms and four photovoltaic solar power plants. With the information that is publicly available, it is not possible to say definitively in this specific case whether preferential treatment was given to Engie – to whom the loan was allocated, compared to other similar companies around the world. However, we know about the partnership agreement between AFD, of which Proparco is a subsidiary, and Business France.

Proparco allocated a US$60 million loan to Engie to develop this project, in partnership with Tokio Gas. These assets were planned to be spread out from early 2019 to mid-2020. Data available in the OECD Credit Reporting System shows that a total of US$48.6 million was reported as PSI committed ODA in 2019 for this project. Data for 2020 is not yet available.

**Example 2: Investment-related**

None of Finnfund’s ODA spending is reported as formally tied.\(^81\) However, as noted in Table 1, one of Finnfund’s objectives is to “finance companies, in which a Finnish interest is involved, to be established and operating in developing countries”.\(^82\) This creates a potentially fertile environment for tied ODA and/or other forms of commercially motivated ODA operations. And Finnish companies are widely involved in Finnfund’s ODA projects, including the following examples. However, with the information publicly available, it is not possible to say definitively whether preferential treatment for Finnish companies was granted in these specific examples. However, we do know that Finnfund’s strategy says “Finland’s interests” will be among the criteria used to select projects, and also that it is desirable to transfer the “expertise” of Finnish businesses to countries in the global south.\(^83\) Finnfund’s decision to invest in the projects below took place within the framework of this strategy.

Finnfund has invested €1.8 million in the €58 million Toplana Zenica power plant project in Bosnia and Herzegovina. The project is a joint venture between Finnfund, ArcelorMittal Zenica, the City of Zenica and Finnish company KPA Unicon. KPA Unicon will design and deliver the power plant.\(^84\)

Finnfund has invested €4 million in Fortum Charge and Drive in India – a business offering charging services for electric vehicles.\(^85\) Fortum is a company headquartered in Finland.\(^86\)
Risk 3: Blurring the boundaries of ODA

This risk relates to both tied ODA and other forms of commercially motivated ODA operations and relates to the shift from concessionality to additionality and what counts as ODA and what does not. How likely this risk could materialise will very much depend on the outcomes of potential new negotiations on PSIs, notably around the definition of additionality and the inclusion of safeguards to preserve the integrity of ODA.

As mentioned above, DAC members agreed a set of 11 principles to better reflect their efforts in investing ODA through PSI. At this meeting, DAC members decided that, unlike other forms of ODA, PSIs would be eligible for ODA, even if they had no or only minimal concessionality. Departing from the non-concessional character of PSIs, their ‘ODA characteristic’ will be conveyed by the additionality of the finance provided, as well as the primary development objective of the investment. By doing this, DAC members effectively removed concessionality as a condition for ODA and opened the door for a revision of the definition of ODA, placing the focus on additionality instead. Yet concessionality should remain the defining characteristic for flows reported as ODA and this is key for maintaining a clear distinction between ODA and commercial transactions (see Box 1). These new rules also allowed the reporting of ODA for donors’ support to their DFIs – the ODA amount self-assessed as ODA eligible. These decisions represent a fundamental departure from the previously accepted definition of ODA. Another key concern from CSOs has been the threat of diverting concessional resources away from their core mandate of eradicating poverty and reducing inequalities, as well as from the essential importance of strengthening and growing public sector investment for these purposes.

As discussed in Section 2, the agreements made in 2016 have not been fully implemented, as the DAC has yet to agree a final set of reporting rules for PSIs. In the interim, a concessionality threshold still applies to PSI loans under the instrument approach – thus, for loans to private sector entities in developing countries. However, this specific threshold does not apply to equity investments or to ODA reported as lump-sum contributions to DFIs or other private sector instrument vehicles (all of them PSIs too).

If negotiations on PSIs resume, the outcome of these discussions could see the 2016 decision to remove the concessionality threshold for PSI fully put into practice, which could potentially open the door for additional tied ODA and other forms of commercially motivated ODA operations to be reported within ODA. This was made clear by some DAC members during the discussions ahead of the 2018 PSI agreement: “the HLM Agreement on ODA Modernisation of Private Sector Instruments is challenging the original distinctions between aid and public export credits provided on commercial terms […] To qualify as ODA, a PSI activity needs to be developmental and additional, but not concessional.” In the framework of this paper, it is relevant to stress that the decision to fully remove the concessionality thresholds for PSI loans could affect the way that export credits are currently classified and reported. Back in 2016, some members of the DAC stressed the need for safeguards that ensure a clear boundary between commercial ODA-eligible PSIs and commercial non-ODA eligible export credits. This remains relevant in the context of the current PSI review and potential related negotiations.

Export Credit Agencies (ECAs) are institutions governments use to support domestic private companies doing business overseas through credits to export. They provide official credit or credit guarantees to public or private buyers, often in the global south. There are similarities in the way that export credits and tied ODA work, since both can involve providing finance to entities in the global south in return for the purchase of goods or services from firms in the DAC member country providing the finance. Figure 6 provides an overview of basic trends in the volume of export credits from official sources that were provided by OECD member countries during the period 2009-2019, with the intention for readers to assess the scope of the risk.
How private sector instruments are threatening the untying of aid

As things currently stand, two key features distinguish export credits from tied ODA and/or other forms of commercially motivated ODA operations. First, the definition of (at least in principle) the primary objective of ODA, even when tied or commercially motivated, that is “the promotion of the economic development and welfare of developing countries” (see Box 1). Whereas the primary objective of export credits is not to promote the economic or social interests of countries in the global south but rather to support and enable export trade for their country of origin. For this reason, Eurodad and its allies have long advocated that export credits have no place in ODA (see Box 4, overleaf). Second, whereas most ODA must meet minimum concessionality thresholds, export credits generally operate on or near market terms. It is not yet clear how future changes to the PSI reporting rules could affect the treatment of export credits; the complex interactions between the PSI rules and the OECD’s Arrangement on Officially Supported Export Credits or the Agreement on Untied ODA Credits Transparency are some of many areas the DAC would still need to address and resolve in the current review and potential negotiations on PSIs. If these challenges are not properly addressed, there is a risk that, by reducing or even removing the concessionality threshold for PSI ODA eligibility, more transactions that previously would have been directly classed as non-ODA export credits would then meet the necessary criteria to potentially be reported as ODA. Considering that export credits are by their nature tied to the activities of the companies of their country, we could see reported as ODA operations that under ODA rules would be considered tied and/or commercially motivated ODA.
How private sector instruments are threatening the untying of aid

Box 4: The longstanding case of why export credit debt relief should be excluded from ODA

Even before the negotiations on the PSI reporting rules began, some export credit-related spending was already included in ODA in the form of debt relief. Export credits play a substantial role in the accrual of unsustainable debt burdens that divert public resources from other purposes that are essential to the realisation of human rights and social and ecological justice. When DAC members offer relief on such debts, in principle this debt relief may be reportable as ODA.101 (This is just one of many problems with the DAC’s policy that debt relief can be counted as ODA, which Eurodad has discussed elsewhere).102

Eurodad and its allies have long argued that export credit-related spending should never belong in ODA. Export credits, by their nature, are guided by the interests of the exporters and their home countries, rather than those of countries in the global south. This does not mean that export credits cannot bring economic benefits to the country receiving the export – but such benefits are incidental, and not export credits’ raison d’ être. Furthermore, export credits sometimes do substantial harm to people in the global south, including through large-scale support to fossil fuel projects103 and through support for projects that involve human rights violations.104 Export credits thus not only fail to meet the definition of ODA – i.e. that the main objective must be to promote the economic development and welfare of developing countries – but sometimes actively work against it.

Since export credits do not meet the basic criterion that ODA should have “the promotion of the economic development and welfare of developing countries” as its main objective.105 They should in principle be out of ODA’s scope, irrespective of the rules on concessionality (past or future). However, in practice, if a transaction combines the objective of supporting domestic firms while potentially benefiting the economic development in the global south, the basic definition of ODA becomes blurred and open to interpretation, which is an unreliable basis for an ODA eligibility decision.

The potential removal of the concessionality criteria could substantially blur the boundaries between export credits and PSI ODA, at the risk of bringing export credit operations into ODA. This could inevitably increase levels of tied ODA and other forms of commercially motivated ODA operations.

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Eurodad and its allies have long advocated that export credits have no place in ODA

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This report has sought to show both the risks that the DAC’s provisional or eventual permanent reporting measures for PSIs could lead to an increase in tied ODA or other forms of commercially motivated ODA, and the considerable transparency challenges in monitoring how far these risks could be materialising already. Although currently the DAC community is in the process of reviewing the current PSI provisional reporting methods, it is unclear whether this exercise would lead to the resuming of negotiations.

It is important to note – and very welcome – that many DAC members themselves recognise the flawed nature of this whole process. Some DAC members fear an outcome worse than those that the current interim rules define. Some wonder if spending so much time and attention on defining how to report a still relatively small proportion (approx. 2 percent in 2020\(^{106}\)) of ODA (previous PSI negotiations took 18 months to get to the current provisional rules of 2018) is the best use of DAC resources.\(^{107}\)

For the months and years ahead, in the current context, the findings from this report point to three key areas in which CSOs can act:

1. **Putting pressure on DAC members to revise current provisional PSI reporting rules:**

   It is urgent that the risks to tied ODA and other forms of commercially motivated ODA highlighted in this report, many of which are inherent to the current PSI provisional reporting methods, are addressed by the DAC community. CSOs have a vital role to play in putting the pressure on DAC members to revise the current provisional PSI reporting rules.

   The inclusion of PSI in ODA without agreed implementation details risks undermining the quality of ODA and its impact on poverty reduction and addressing inequalities, as well as the credibility of OECD statistical data. In the absence of agreed PSI implementation rules that address the risks identified here, as well as much-needed safeguards and incentives, there is a strong case for CSOs to encourage donors to count their investments in PSI as Other Official Flows, rather than as ODA.

2. **Producing evidence and analysis**

   The findings on transparency show that it is hard to get a complete picture of tied ODA or other forms of commercially motivated ODA within the PSI spending from the available data sources alone. This means that case study evidence has a particularly important role to play. The examples in Box 3 illustrate the kinds of risks for tied ODA and other forms of commercially motivated ODA that are already coming to light in the context of PSI operations. Gathering more such case studies, involving different forms of tying and different DAC members, in different country contexts, can play a crucial role in demonstrating the negative impact of PSIs, not only for the untying of ODA and the wider ODA quality agenda, but also for communities in the global south. This in turn can help build the pressure for a rethink in the DAC’s current approach to PSI reporting and the many risks to increased tied ODA and other forms of commercially motivated ODA that it poses.

3. **Defending the integrity and quality of ODA**

   The existing concessionality criteria set a clear benchmark in terms of what counts as ODA and what does not. Within PSIs, the shift from concessionality to additionality, if fully implemented, could represent a fundamental shift from the current ODA concept (see Box 1). CSOs should closely monitor PSI operations, notably in terms of the achieved development results, alignment with the development effectiveness principles and the allocation implications arising from the inclusion of PSI in ODA. Furthermore, under the current temporary PSI agreement, each PSI activity reported in ODA (instrumental approach, as well as outflows from DFIs capitalised with ODA) needs to be reported on its additionality. CSOs could also closely monitor the extent to which such information is reported in a comprehensive way and whether its quality is satisfactory.
At the same time, CSOs should keep resisting any erosion of concessionality. Should the shift from concessionality to additionality be fully implemented, it would not only undermine a fundamental ODA criterion, but contribute to expanding the risk for increased levels of tied ODA and other forms of commercially motivated ODA.

Last but not least, CSOs should continue to highlight the need for non-PSI and untied ODA. Spending ODA on PSIs has an opportunity cost, yet there is no evidence that donors have a robust process in place to support their choice of PSIs over alternative uses of aid. While the global narrative supporting private sector engagement in development focuses on the overall scale of SDG funding gaps, it fails to recognise that some critical gaps – such as the annual US$125 billion gap in health, education and social protection – will not (and should not) be filled by private capital, which furthermore risks contributing to an increased privatisation of public services.

It is critical that these new additional risks are resisted if discussions and (eventually) negotiations on PSI resume. Through concerted pressure on DAC members, CSOs have a key role to play in shaping the untying agenda progress (see Section 5 for related messages and recommendations).

Last but not least, more broadly, CSOs should call for a review of the ODA modernisation process before any new agreement is made. This review should look into the expansion of the ODA concept, the corresponding reporting rules and the related impacts into the quantity and quality of ODA.

CSOs should continue to highlight the need for non-PSI and untied ODA
5. Key messages and policy recommendations

The Covid-19 health emergency has created an unprecedented worldwide economic shock, triggering a global recession. According to World Bank figures, the pandemic led to 97 million more people being in poverty in 2020 and represents a historically unprecedented increase in global poverty. Although poverty figures may have started to decrease in 2021, the recovery taking place will not be sufficient to close the gap the pandemic is estimated to have caused in 2020. Also the recovery will not be equal for all. Low-income countries and countries in sub-Saharan Africa have likely seen further increases in poverty in 2021. Hand in hand, climate and conflict-related crises continue to undermine the achievement of the SDGs. Now more than ever, it is crucial that scarce ODA resources are directed to where they have most impact and in the most effective way.

In light of the current and potentially increasing demands for ODA, it is particularly important to prevent PSIs from being used or reported in ways that undermine the development effectiveness of ODA. This report demonstrates how recent developments in the use and reporting of PSIs pose serious threats of an increase in tied ODA and other forms of commercially motivated ODA that could affect the definition of ODA, as well as the availability of ODA to be directed where is most needed. It has also raised concerns about current transparency challenges within the reporting of PSIs that obscure the possibility of monitoring whether these risks could already be materialising.

Three sets of risks were identified, which in many cases may overlap and compound each other:

1. PSIs tend to be governed, through various vehicles associated with donor-country institutions, including DFIs, with only limited involvement of governments in the global south that would have no vested interest in using commercial interest ODA to support firms in DAC member countries. And some key stakeholders – particularly some of the donor DFIs – have mandates and strategic objectives that include expectations on engagement with domestic firms in DAC member countries. While expecting to benefit domestic companies absolutely does not equate to tied ODA or other forms of commercially motivated ODA, still such expectations might, in the case of some DFIs and in some circumstances, risk creating an environment where tying and/or commercially motivated uses of ODA might seem more tempting.

2. While the DAC exercises some oversight over the risk of informal tying through supplementary transparency requirements, there is a risk that such requirements might be more readily bypassed in the case of PSIs, due to specificities in the way that PSIs are used and reported. Moreover, while the DAC’s transparency requirements focus on procurement relationships with private sector actors as suppliers, a comparable level of transparency does not exist for the many other kinds of relationships with private sector actors that may be involved in PSIs – for instance, engaging private sector actors as investors, intermediaries or investees (see Figure 1). Overall, these various transparency gaps mean there may be little effective ex ante deterrent of commercial interest ODA in a PSI context. At the same time, it would be very hard to detect these higher levels of tied ODA or other forms of commercially motivated ODA ex post. Transparency and provision of comprehensive data are essential.

3. In principle, the DAC has agreed that, within the PSI context, the definition of ODA should be expanded, to reduce or even completely remove the requirement for ODA to be concessional. Although no final decision has been made on how and/or when this could materialise, it is important to highlight that this would be a fundamental change in the definition of ODA that could possibly open a door for export credits to potentially be reported as PSI ODA. Such an outcome would have many worrying implications from the point of view of ODA quality – for example, it could lead to a potential increase in tied ODA and other forms of commercially motivated ODA, since export credits are, by their nature, driven by commercial interests. In this context, upholding the concessionality character of ODA is critical to maintain a clear distinction between ODA and other commercially motivated transactions. Moreover, additional safeguards are needed to maintain an explicit separation between development finance and export credits – the current temporary PSI agreement includes some safeguards (e.g. ODA eligibility self-assessment on PSI vehicles), but they are still insufficient. The final goal here must be to maintain the integrity of ODA – as per its definition.
Taken together, these risks suggest there is every chance that tied ODA and other forms of commercially motivated ODA levels might escalate in the coming years, undermining the quality of aid, unless urgent preventative action is taken. The DAC’s forthcoming PSI review and potential negotiations is the first available opportunity to take such action. It will require strong political will to address these issues meaningfully.

Eurodad’s 2021 report on PSIs Time for Action113 recommended that, “While the evidence [that justifies the inclusion of PSIs in ODA] is insufficient, CSOs should continue to advocate for PSIs to be reported as Other Official Flows.” In addition to the lack of evidence that justifies the reporting of PSIs in ODA, there is also much to be done to address the risks identified in this report that could compromise the quality of ODA.

With the upcoming review of the provisional reporting methods for PSIs, we recommend that DAC members should:

1. Adopt mechanisms to mitigate the risk that governance-related aspects of PSIs may lead (to an extent) to a greater risk of tied aid and/or other forms of commercially motivated ODA, compared to other types of ODA, by:

   - **Considering the potential added risks for tied ODA and other forms of commercially motivated ODA before making the decision to use PSIs, instead of other type of instrument – i.e. when top-level budget allocation decisions are first being made.** As our analysis sets out, PSIs may carry additional risks that could lead to increased levels of tied ODA and/or other forms of commercially motivated ODA. Once the decision to use PSIs is made, these additional risks are locked in: so, it is essential that these implications are taken into account from the outset, as part of a comprehensive analysis on the costs and benefits of using PSIs. Governments and representative civil society stakeholders from the global south should be meaningfully involved in this top-level cost-benefit assessment, since they stand to gain or lose most through the decisions that are made.

   - **Clarifying that benefits for domestic firms should never be an objective of PSI schemes.** DFI mandates and PSI policies should be reviewed to remove any language that suggests domestic firms are expected to benefit from the development finance being channelled, and the project approval process should include checks to ensure firms from outside the DAC member country have been given a fair chance. This does not mean that domestic firms could not benefit incidentally, if this was motivated by other factors reflecting the central objectives of ODA. However, stating an explicit expectation on involvement by domestic firms runs the risk of putting conflicting pressures on decision makers. Any programmes and funding windows that currently target domestic firms should be adapted to ensure other firms – particularly smaller firms from the global south – have a fair chance of winning support. DFI internal communications – including from senior staff – should emphasise the importance of engaging in a way that does not give domestic firms an unfair advantage. And if an expectation of benefits for domestic firms is written into a DFI’s governing legislation, steps should be taken to start working towards a legislative amendment.

2. Tackle the **transparency** risks related to the monitoring of formally and informally tied PSIs, by:

   - Improving transparency over informally tied PSIs. The DAC should require all DFIs, or other PSI vehicles, to **report on procurement contracts awarded by themselves or by their direct intermediaries or investees**, in the same way that development agencies report on procurement spending financed through their grants to CSOs.114 This should be required irrespective of whether their PSI spending is recorded using the instrument-specific basis or the institutional basis. The DAC should also investigate how to increase transparency over more complex PSIs that involve not only direct intermediaries or investees, but also longer chains of investments. This would mirror a recommendation in the DAC’s own 2020 Report on the Recommendation on Untying ODA, which suggested that in future the DAC should “investigate the geographical sourcing through the overall supply chain, from lead contractors down to smaller suppliers”.115

   - Developing a time-bound plan to work with all concerned stakeholders – including governments from the global south and representative CSOs – to **design and implement stronger controls to monitor arising forms of tied ODA and/or other forms of commercially motivated ODA support favouring firms in DAC members’ own countries**. A first quick win would be to ensure consistent transparency over the location of firms engaged as financial intermediaries (i.e. whether these firms are based in the DAC member country or elsewhere), but it is also essential to enhance transparency over the location of
firms engaged in PSI transactions as investors or as investees. Even if there is eventually enough evidence to justify moving PSIs from Other Official Flows into ODA, there should remain a presumption that, unless a compelling reason can be given, PSI structures that support firms in the DAC member country should never be ODA-eligible, due to the potential conflict of interest between supporting such firms and maximising impact for countries in the global south.

3. Tackle the **definitional** risks related to potential changes in the rules for reporting PSI, by:

- **Reinstating the requirement for ODA always to be concessional**, even if this limits the extent to which PSIs could be eligible as ODA. Insisting that concessionality is, first and foremost, a crucial matter of principle, to protect the distinctive nature and comparative advantage of ODA. In addition, it is an essential characteristic for preventing the upsurge in tied ODA or other forms of commercially motivated ODA. The expansion of the boundaries of ODA could potentially lead towards the inclusion of previously ineligible, low concessionality transactions, including export credits. Finally, this report has focused on the crucial issue of tied ODA and/or other forms of commercially motivated ODA and its potential links to PSIs. However, we would like to emphasise that this is just one of the many aspects that would need to be tackled before we consider that PSIs could be reported as ODA without undermining the quality of aid and its impact on reducing poverty, addressing inequalities and achieving the SDGs.

ODA must play a crucial role in tackling the impacts of the pandemic and resulting crisis around the world and continue supporting a recovery centred on human rights, gender equality and a just transition.
The opinion is originally in French and has been translated.

The quote comes from paragraph 6 of the document.

The point of measurement rule would exclude civil society organisations / non-governmental organisations, considering their non-profit character.

Concessionality being the softness of a credit, which is used by the DAC to reflect the benefit to the borrower in comparison to a loan at market rate.

The rules define additionality according to three dimensions (financial, value and development). To be additional, an official transaction must fulfill either financial or value additionality, combined with development additionality.

Principle v stated: “At the same time there is a need to avoid blurring the lines between developmental and commercially-motivated operations (trade and investment) with the private sector, hence a need for safeguards (see principle vi).”

For further information on PSIs, see the following publication: Caio, C. & Craviotto, N. (2021). Time for action: How private sector instruments are undermining aid budgets. Eurodad: Belgium: https://www.eurodad.org/time_for_action

See, for example, Convergence’s description of blended finance here: https://www.convergence.org/blended-finance

Table 1 in Oxfam (2017) Private-Finance Blending for Development: Risks and Opportunities, provides an overview of the most common instruments used to blend, which include both PSIs and other instruments, such as grants and technical assistance. Available at: https://www.cdf-oxfam.org/s3fs-public/wp-private-finance-blending-for-development-130217-en.pdf


For further information about the DAC-CSO Reference Group, see: https://www.dac-csoreferencegroup.com

Source: Source Credit Reporting System data for 2019 in https://stats.oecd.org/


For example, OECD DAC, 2016, High Level Meeting Communiqué, paragraph 6.

For more on these arguments, see Meeks, 2017. Unravelling tied aid: why aid must never be tied to donor country companies at the expense of women and men living in poverty, pp. 3-4. A similar argument was made by Charlotte Petri-Gorriztka, when Chair of the DAC in a 2017 op-ed where We must be serious about unravelling aid for the sake of credibility and private sector engagement (In-Depth News, accessed 26 September 2021), although her argument placed the emphasis on the merits of incentivising promoting competition, rather than in supporting the development of the private sector in the global south.


The delivery channel refers to the implementing partner of the ODA channelled through the bilateral donor. Among others, it distinguishes between public and private implementing partners and whether their origin is with the provider country, the recipient country or a third country.


Opinion submitted by Deputy Amélia Lakrafi (La République en Marche!) in relation to the discussion on the 2021 French National Budget, document available here: https://www.assemblee-nationale.fr/dyn/15/rappports/cion_afetr/l15b3403-tvi-rapport-as�_Toc2a000035. The opinion is originally in French and has been translated into English by the authors.


Ibid. 48.

ITUC (2016). The development effectiveness of supporting the private sector with ODA funds. ITUC: Belgium: https://www.ituc-csi.org/DFI-study; Plus our own review of the current mandates for the related DFIs – Bio, for Belgium, DEG for Germany, FMO for the Netherlands, Norfund for Norway, CoFides for Spain or the CDC Group
OECD DAC Working Party on Development (2020). Report on the DAC Recommendation on Financed-by-development investment decisions was beyond the scope of this report, but would be a valuable area for future research that includes case studies.


It is true that elements of this information could be derived from the CRS database – for example, the ‘channel of delivery’ field gives some information on whether ODA was channelled through the DAC member’s own private sector or the private sector in the global south. However, the fields on CRS do not give scope to capture comprehensively and unambiguously the full range of private sector actors engaged in PSI transactions, particularly in more complex structures that may involve more than one layer of intermediation.

For further information, visit: https://www.oecd.org/trade/topics/export-credits/


Ibid, 80.


For further details we recommend reading section 3.1 (p12) of the Eurodad report for time action: how private sector instruments are undermining aid budgets p9f11. Eurodad: Belgium: https://www.eurodad.org/time_for_action

How private sector instruments are threatening the untying of aid


97 See note 18 above. In addition, in the case of tied ODA, the OECD’s Arrangement on Officially Supported Export Credits specifies a higher concessionality threshold for most transactions, of 35 percent or 50 percent for LDCs (Source: OECD Trade and Agriculture Directorate (2021). Arrangement on Officially Supported Export Credits, Article 35: https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=tad/pg(2021)6


104 For example, Halifax Initiative and others (2015). Export credit agencies and human rights: failure to protect: https://www.ecawatch.org/sites/default/files/Failure%20to%20Protect_0.pdf


106 Source: Analysis of OECD DAC Table 1 data, extracted 29 December 2021. Data are stated on grant equivalents, constant prices. 2020 data is based on preliminary figures.

107 Ibid. 27, p.36

108 Ibid. 8


113 Ibid. 27.


116 Ibid. 9