**McLeod Group Blog**

**Lending for private sector-led development**

**--- another false start?**

For decades development practitioners, including CIDA, have recognised the critical role of the private sector of developing countries in creating jobs for the poor.

We did not need the 2012 House Report to confuse the issue of strengthening the role of that local private [sector](http://www.mcleodgroup.ca/2012/12/04/how-can-the-private-sector-deliver-sustainable-poverty-reduction-2) with the promotion of Canadian offshore investment. Now, just as the very name CIDA is scratched from Canada’s international face to be replaced by the ugly acronym DFAT**D**, there may be plans afoot to revive aid **loans**.

This seems to be a lose-lose option. Lending ODAable dollars to such as the [IFC](http://www.ifc.org), the World Bank’s private sector arm, or as part of Canadian bilateral aid is not the sort of ‘innovative’ financing the world’s poorest need. It would not even meet the Harper government’s objective of helping the Canadian private sector. The only clear winner would be the institutions through which the money is channeled, giving them a competitive boost by ‘blending’ low-interest Canadian aid loans with their market borrowings.

Regardless, anxious to look more private sector-friendly, Canada is already test-driving aid loans, having abandoned them in the 1970s. Part of the reasoning then was to avoid re-creating aid debt in least-developed countries whose loans Canada had just written-off. Part was driven by a fiscally-conservative Treasury Board that judged it irresponsible for CIDA to record such risky loans as off-budget ‘assets’ that the Crown notionally expected to recoup.

Within the government’s new self-interested aid philosophy, it seems important to create privileged benefits for Canadian companies. This is hard to do while still respecting the ODA Accountability Act’s mandate of poverty reduction.

An IFC-type loan option would seem a poor choice. The World Bank’s own 2011 [evaluation](http://www.brettonwoodsproject.org/art-568574) said IFC had largely failed to focus on poverty reduction.

The donor role is indirect. An IFC-type loan is untied and does not go to an offshore investor, but rather to local intermediaries, often an investment bank. There is no direct cash benefit to any Canadian company. The attraction to the foreign investor, whether Canadian or Thai, is more diffuse. The country gets a gold star for being open to reliable foreign investors. The IFC helps by checking out the institutional and regulatory environment viability of the country and the individual project. Cheap IFC financing can make the investment more financially viable, i.e. profitable for its private owners.

But why wouldn’t a Canadian company with a reliable local partner building, say, a hotel or a garment factory, simply take a tied loan from Canada’s own exporter-supporting agency, [EDC](http://www.edc.ca) or a private multi-national bank? Why muddy the water with a questionable use of aid money or the technicalities of borrowing from a local bank? And why risk breaking OECD understandings that ban trade subsidies?

Where is the benefit for the Canadian taxpayer in this complex process to leverage a presumably already viable foreign investment? Is the real merit for the Harper government simply cosmetic? One possible attraction is that it can use millions of dollars of tax-payer guaranteed loans, financed off-budget, to make it look as if helping private investors is now driving our development agenda.

But an IFC is hardly likely to wave the Canadian flag over its projects. Unlike today’s Canada, IFC cannot pick favorites, political or sectoral, especially given its international board which ranges from G8 giants and China to tiny African nations.

Key in the larger equation is the weakness of Canada’s private sector. Other than in extractives and banking, we have few internationally competitive companies seeking investment opportunities in developing countries. Many of the extractives, although legally resident in Toronto or Vancouver, are often substantially owned by foreigners. Trade Minister Ed Fast and the ‘T’ experts in the new DFA**T**D are painfully aware of past failed attempts to increase that shallow pool of Canadian offshore investors.

Reversing this is critical to Canada’s future. But it needs a new breed of assertive entrepreneurs able to partner with the private sector in developing countries. This is hard! Too often success stories are short-lived, tied to subsidies or corruption. Giving ODA money to an IFC is not the answer.

So how might the new coherence-seeking DFATD combine both poverty reduction and broader Canadian private sector engagement? The answer lies in reverting to old approaches. Success is not measured by the number of minor trade agreements signed. We might emulate countries like Sweden and Denmark by capturing market niches or new openings in green technology. We need to re-establish a reputation for being serious about partnership rather than opportunistic. Our too few, strong offshore investors already listen to local needs and work with emerging local entrepreneurs. Moreover, seeming dependence on DFATD, ‘T’ or ‘D’, does not impress prospective local partners.

It would help if we were seen as pressing for fairness in foreign investment, not privileged protection from local government regulations. The debate now is about greater transparency. This means no secret ‘beneficial ownership’ through offshore subsidiaries, fairer tax codes and transparent transfer pricing by foreign investors. These issues were all discussed at the recent G8 Summit, but sadly, Canada was amongst those arguing for delays.

What is certainly not needed is a new wave of aid **loans.** ‘Innovations’ designed to boost our offshore investments, rather than for enhancing poverty alleviation, are a false start.

Lead:

Loans for aid will take Canada back to the 1970s, when we gave them up as debt-crisis inducing in low-income developing countries. Now they are coming back in fashion as showing our aid is private-sector friendly. But they are another false start, a ‘lose-lose’ option. It’s no real help to the poor who need entry-level jobs from local SMEs. The loans are also no direct help to Canadian businesses who need to be internationally competitive.. not seen as subsidy-dependent. Read more….

Tags:

Loans, private sector, transparency

Image:

