A BACKGROUNDER ON CANADA'S DEVELOPMENT FINANCE INITIATIVE

The Conservative government's final budget announced the creation of a Canadian development finance "initiative". In the name of "coherence and effectiveness", the former government stated that it has established the new initiative to enhance private sector development, achieve meaningful development outcomes, and raise people out of poverty. Details remained scanty. Since the election of the new Liberal government in October 2015, there has been no news, not even a mention of this new initiative. Its formation remains a blank slate. As the Trudeau government contemplates what to make of this initiative, or whether to scrap it, it will be important to reflect on what came before.

Despite claims from the then Development Minister Christian Paradis about advancing "new", "innovative", and "blended" financing by involving the private sector, there's nothing new about the idea of involving business in development efforts. Beginning with the World Bank's first *World Development Report*, published in 1978, experts have written extensively about the need to encourage private investment and to improve market and business potential in low-income countries.

Also, the multitude of private sector actors in developing countries is so complex and wide-ranging that it is almost impossible to talk about "the private sector" with any clear idea of what is being discussed. The private sector includes informal urban shopkeepers, massive multinational corporations, small entrepreneurial start-ups, cooperatives of subsistence farmers, small savings-and-loans groups, and various financial lenders, including banks and microfinance institutions. Indeed, the private sector provides the majority of employment and income opportunities not only for the world's poor, but also for the wealthy and middle class.

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Recent attention to the private sector by the Canadian government is, therefore, perplexing. Canada's development efforts have long supported private sector actors in developing countries in various ways: building the resilience of farmers to climate shocks by providing them with the needed knowledge and inputs to help them improve their agricultural output and earn more to support their families; supporting education systems to help improve literacy rates and build the human capital necessary for smarter and stronger societies; improving health delivery and health systems to help create a healthier and stronger work force; and improving gender equality to empower women's participation in society, the family and the workplace.

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SO WHAT DOES A DFI HAVE TO DO WITH ALL OF THIS?

Development finance institutions (DFIs) are publicly owned, private lending institutions. Unlike private banks, DFIs are guided by the need to generate profit for their stakeholders and by public policy objectives. Often these public policy objectives include support to development priorities, foreign policy, trade and business interests. In most cases, DFIs also operate without net costs to taxpayers, meaning that governments can treat DFIs as "free" development spending.

As many commentators have pointed out, Canada is the only G7 country without a DFI.[1] This is presented as if Canada is just a little behind. It would be more accurate to state that Canada is several decades behind. For example, the UK established its development finance institution in 1948, originally called the Colonial Development Corporation, to improve development standards for "colonial peoples" and to help rebuild British global power following World War II. Aptly renamed the Commonwealth Development Corporation, the UK's CDC has evolved significantly through the years and today manages a portfolio of about $4.2 billion with the explicit mandate to improve the lives of the poor and create jobs in Africa and South Asia.

And to say that Canada is "new" to such investment mechanisms is also incorrect. The Investment Cooperation Program (INC) – founded in 1978 as CIDA's Industrial Cooperation Program (CIDA-INC) – mimicked elements of a DFI in that it sought to support Canadian businesses with operations in the developing world. While INC was designed to support the use of foreign aid to promote private sector development, its purpose was ultimately to "encourage Canadian private sector to establish long-term business relations". A 2007 internal evaluation, which looked at the program's almost 30-year history, found that CIDA-INC did not align with CIDA's priorities, despite having disbursed over $1 billion during that period – much of it counted as official development assistance (ODA). Of the 8,138 projects that were approved between 1978 and 2005, fewer than 1,000 were implemented, and fewer than 9% of these projects were in line with Canada's development priority countries or sectors. The evaluation also found that just 15.5% of those implemented were successful.[2] The bulk of the money and projects went to middle-income countries – with China accounting for almost one third of all funded projects. The evaluation also noted that the program gained an image within Canada's business community as bureaucratic and slow moving. In other words, it failed both Canadian businesses, as well as development priorities – a lose-lose scenario.

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The results of the evaluation saw CIDA-INC rebranded and transferred to the Department of Foreign Affairs and International Trade (DFAIT), where it fit much better within DFAIT's mandate to support Canadian trade interests, and where it no longer had to serve the development priorities of CIDA. DFAIT conducted its own evaluation in 2012, which found that the program remained undersubscribed, having disbursed less than 20% of its $20 million annual budget. The evaluation also uncovered "irregularities". The minister of international trade subsequently suspended the program, and the police opened an investigation.[3] The evaluation's sole recommendation was that DFAIT "not restart the INC Program in its current form".[4]

LESSONS

Canada's poor track record in this field should raise serious concerns about the establishment of a new institution, and it provides several lessons. One is that a DFI should not tap into ODA funding. Private investment is no substitute for ODA, nor should ODA be a substitute for private sector investments. Previous programs have aligned poorly with Canada's development priorities and have been focused away from low-income countries where the need for investment is greatest. Given that Canada's aid budget has dropped significantly, it is more important than ever to safeguard existing ODA funds. Another concern is that the government has located this new financing instrument within Export Development Canada (EDC). EDC – as Canada's export credit agency – aims to expand Canadian firms' competitiveness and reach across the globe. EDC's sole mandate, inscribed in its legislation as a crown corporation, is to support and develop trade between Canada and other countries and improve Canadian competitiveness in the international marketplace. To do this, EDC already provides subsidized loans and guarantees to Canadian firms operating abroad, as well as to foreign firms purchasing Canadian goods. These activities allow EDC and the Canadian government to take on risk that private lenders are unwilling to shoulder.

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Many export credit agencies have no development mandate, but they do have a massive development impact. A 2011 report by EURODAD found that 80% of developing country debt to other governments is created by export credit guarantees, such as those provided by EDC.[5] Export credit agencies also receive significant transfers from aid budgets every year as a result of export credit debts cancelled by donor countries and paid with official development assistance funds.

While the 2015 omnibus bill gave the EDC authority to "provide development financing and other forms of development support" (see amendments not in force[6]), simply adding it to legislation does not give EDC the staff or capacity to carry this out. Reliance on EDC for the initiative's establishment is expedient and prevents the creation of an entirely new corporation or institution, yet it may not be the best choice. EDC has little or no experience working towards development objectives such as poverty reduction. Furthermore, EDC's goal is to foster Canadian business abroad in foreign markets, whereas a DFI needs to foster the growth and health of local private sector firms and financial institutions. As such, a Canadian DFI, unlike EDC, must be not be limited to working with Canadian firms alone.

The final lesson is that a Canadian DFI should seek to expand business opportunities in regions and sectors that have been ignored or neglected. For example, global foreign direct investment has hovered around US$1.3 trillion over the past few years, yet less than 3% went to Sub-Saharan Africa – the bulk of which was concentrated in a few natural resource-rich countries.[7] This is not always due to a lack of bankable opportunities, but to misperceived risk assessments by private investors wary of emerging markets.

Canadian private sector activity in Africa is negligible and it is restricted to a few sectors. Of Canada's $285 billion in exports, just 1.3% is destined for Africa, and of Canada's $350 billion in imports, just 3% is sourced from Africa, primarily Algeria, Nigeria and South Africa. Overwhelmingly it consists of trade in natural resources (gold, petroleum, diamonds and copper). From a foreign policy standpoint, Canada has not prioritized the region either. Canada maintains just 15 foreign missions in Africa, charged with serving 54 countries.

As details of Canada's new DFI continue to emerge, policy makers should be cognizant of past endeavours in this area, and heed the lessons and failures of programs and projects that have gone before. Any new institution should complement ODA and local investments, not displace them. Private sector investment is certainly needed to address important investment gaps throughout the developing world, but it is no silver bullet, nor is it a substitute for ODA. Doing it right will entail careful planning, ensuring that vulnerable aid budgets are not further diminished, and that any new lending mechanisms incorporate human rights, gender equality, environment and governance considerations.

The new Liberal government has an opportunity to make the most of this new institution and ensure that development objectives, as set out in the Minister of International Development's mandate letter, [8] are central to this initiative: to ensure that this DFI is a complement to ODA funds and not a substitute, to foster the growth of local and foreign private sectors as well as Canada's, and to focus on the poorest and most vulnerable regions in the world most in need of publicly backed investments.

NOTES

[1] James Haga and Brett House, "Time for Canada to get into the business of development", *Toronto Star*, June 2, 2014, www.thestar.com/opinion/commentary/2014/06/02/time_for_canada_to_get_into_the_business_of_development.html.

[2] CIDA, "Executive Report on the Evaluation of the CIDA Industrial Cooperation (CIDA-INC) Program", December 2007, http://www.oecd.org/derec/canada/CIDA-Industrial-Cooperation-Program.pdf.

[3] James Munson, "Past failure not deterring CIDA minister from business partnership model", *iPolitics*, December 4, 2012.

[4] Foreign Affairs, Trade and Development Canada, "Evaluation of the Investment Cooperation (INC) Program", September 2012, www.international.gc.ca/department-ministere/evaluation/2012/inc_pci12.aspx?lang=eng.

[5] European Network on Debt and Development, *Exporting goods or exporting debts? Export Credit Agencies and the roots of developing country debt*, December 2011, www10.iadb.org/intal/intalcdi/PE/2011/09458.pdf.

[6] Government of Canada, Justice Laws Website, Export Development Act (Amendments Note In Force), http://laws.justice.gc.ca/eng/acts/E-20/nifnev.html.

[7] OECD, "FDI in Figures", February 2014, http://www.oecd.org/investment/FDI-in-Figures-Feb-2014.pdf.

[8] Justin Trudeau, "Minister of International Development and La Francophonie Mandate Letter", http://pm.gc.ca/eng/minister-international-development-and-la-francophonie-mandate-letter.

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