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Chair

The Honourable Robert Nault

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● (0845)

[*English*]

The Chair (Hon. Robert Nault (Kenora, Lib.)): Colleagues, pursuant to Standing Order 108(2), the study of Canada's development finance initiative, we'll commence this morning.

Good morning. It's good to see you all.

In front of us for the next hour is Marc-Yves Bertin from the Department of Foreign Affairs, Trade and Development. He's the director general of international economic policy.

Good morning, Marc-Yves.

Colleagues, just before we get started with Marc-Yves, you'll notice a notice of motion by Hélène on inviting one of the ministers, based on this study. I just want to remind everybody that, as per usual, the witness list is open. It fits right in. We'll move the motion as normal, but as you well know, around here we've left the witness lists open so that people can add to them as we go. If they feel that based on what they heard they'd like to hear from someone else, it makes perfect sense to me. I wanted to remind all my colleagues of their ability to continue to add to the list as we go, as long as it fits into the slot of how many days we have available for witnesses and the study we're looking at.

With that, I'm going to turn the floor over to Marc-Yves, and he's going to give us opening comments. Then we'll go into our usual Q and A.

Marc-Yves, the floor is yours.

[*Translation*]

Mr. Marc-Yves Bertin (Director General, International Economic Policy, Department of Foreign Affairs, Trade and Development): Thank you, Mr. Chair.

I am delighted to be here today to support the committee in its study of Canada's development finance initiative.

My comments this morning focus on two ideas: first, the private sector's role in international development; and second, the positive contribution that development finance institutions, or DFIs, can make in supporting growth and prosperity directed by the private sector.

While public development assistance has contributed to major gains in international development, more resources are needed than what governments can provide in order to achieve the goals of the United Nations' 2030 agenda for sustainable development.

According to the World Bank, there is an annual shortfall of \$2,500 billion to meet the needs of developing countries in essential sectors such as infrastructure, clean energy and agriculture.

There is a growing consensus in the international development community that the private sector has an important role to play as the key driver of economic growth and development.

The Addis Ababa action agenda, a foundation working towards the achievement of the 2030 agenda, recognizes that private and public investments are very important for the financing of infrastructure, in particular through development banks and development financing institutions. In fact, the 17 sustainable development goals recognize the need to mobilize additional resources for developing countries from multiple sources, including the private sector.

At the same time, developing countries themselves are turning their attention to increasing private investment, in addition to public development assistance, of course. Direct foreign investment and other private capital currently exceed development assistance by a ratio of five to one.

[*English*]

Yet the private sector is very often unable or unwilling to make what are seen as risky investments in such countries without support. For this reason, international donors have acted to optimize the contribution of private investment to development, with development finance institutions, DFIs, often being the most visible form of support.

DFIs respond to the specific challenge faced by companies operating in developing countries in getting the financing they need to grow their operations and their businesses. In doing so, DFIs provide an innovative, cost-effective financing tool to support economic growth in developing countries. According to some estimates, for example from the Overseas Development Institute, $1 invested by a DFI has the opportunity or possibility of crowding in an additional $12 in private investment, depending on the product, of course. In addition, DFIs are self-sustaining over time because they balance the risk and focus on sustainable business ventures. In turn, these profits can be recycled and reused to further fund projects that have development outcomes. DFIs also complement, not substitute, private investment and ODA, official development assistance.

With respect to Canada's DFI, I note that the new crown corporation will be headquartered in Montreal and established as a subsidiary of EDC. It will be capitalized at $300 million over its first five years of operation and will operate in countries eligible to receive ODA.

I'm sure committee members will have numerous questions about that. As such and in closing, let me simply say that DFIs can play a catalytic role when it comes to supporting private sector-led growth in developing countries, a role that fosters increased investment and development outcomes, leverages additional private finance and expertise, promotes policy objectives such as green growth and women's economic empowerment while creating jobs, and complements traditional aid, which remains important.

With that, I would be happy to take your questions.

● (0850)

The Chair: Thank you very much, Mr. Bertin.

I'll go to Mr. Allison.

Mr. Dean Allison (Niagara West, CPC): Thank you very much, Mr. Chair.

To our guest here today, thank you for taking the time to meet with us.

When we were in government, one of the things we talked about was trying to get the private sector more involved. You alluded to it in a couple of your comments. I would ask if you could expand on this a little bit. We realize that there's a limited amount of ODA that governments can spend in the world. The private sector, however, and certainly direct foreign investment, is considerably larger. I don't know if you said it was 5:1 in the world versus a 12:1 ratio.

Will you expand a little bit more on the types of projects and investments you see a DFI trying to create?

Mr. Marc-Yves Bertin: To anchor that comment a bit further, it's useful to take a look at private flows versus ODA for the year of 2014. With flows going into developing countries, private investment was situated at around $420 billion a year, and ODA was at $180 billion. There's a lot of money in play, but still it pales in comparison to the $2.5 trillion in financing deficits.

As I mentioned, a number of countries have gone out there, with DFIs being a notable expression of the desire to bring the private sector into play and to deal with some of the challenges.

Let me give you a couple of project examples of what other DFIs are doing in the world. Swede Fund has financed the growth of a network of private women's hospitals and clinics, nursing schools, and other projects in developing countries. These countries often lack the track records required to receive bank loans. By being able to fill this gap through patient capital, they're able to establish themselves and establish a track record, which enables them to be sustainable and then to go to commercial lenders over time.

Another really good example is one from FMO in the Netherlands. The Netherlands has provided a mix of loans and equity investments to agricultural service companies in developing countries in order to build up the capacity to produce fertilizer. By producing fertilizer locally, you're reducing the transportation costs and the local access to that fertilizer in these countries. Therefore, you're enabling the agricultural sector to take off while fostering food security locally. This includes countries such as Nigeria, countries that face a lot of conflict.

Mr. Dean Allison: Explain a little bit how this would differ from an infrastructure bank. I assume DFI could make investments in infrastructure, or is it limited in scope? We've seen a number of other countries.... We're a little bit later to the dance on this one.

In scope, where do you see this? What are the recommendations on what we should allow this DFI to do here in Canada?

Mr. Marc-Yves Bertin: The priorities for this DFI will need to be set out in a corporate plan, after having received direction from the government in terms of what the priorities are. Already, we can see that the government is favouring green growth and climate change, as well as support for youth and women entrepreneurs. At this point, these are the early signals. We'll have to wait for more to come on that front. However, in terms of the areas where it could work, I think we're talking about an organization or a new crown corporation that will be able to work in the gamut of areas that have high development impacts, such as infrastructure, agriculture, water or what have you, climate change, and green growth. The question will become an issue of emphasis and not necessarily of exclusion.

With regard to the second point you mentioned, we're late to the dance. Obviously, being late to the dance has its opportunities, its advantages. Otherwise, discovering VHS a couple of years later is probably not the most innovative thing. What we've been able to do is to learn from others. We learned a lot of things from the other DFIs, a lot of things not to do. We looked at a number of the debates that occurred domestically in those countries, for example, in the U. K. and the United States where they only had certain instruments as opposed to the full gamut of instruments. What we were able to do was to develop a robust suite of recommendations as to how to structure this that gleaned all these best practices.

What we've learned is important is that we actually have the gamut and not just, for example, offer alms. The private sector, depending on the deals, may require loans in order to get off the mark, but over time may take an equity stake in order to keep an operation sustained. This is an institution that will have an ability to adapt to the various needs of its client groups.

The other dimension that is important is that some countries actually have a national benefit dimension to their work. Our American friends very much tie their DFI's operations to domestic commercial interests or domestic firms. In contrast, the British have taken the opposite approach. In both instances, reviews in those countries yielded the revelation that they should be focusing on development outcomes, not necessarily on the client group. Therefore, much like these two DFIs and the new directions that they have gone in, this DFI will be able to work with any private sector entity, whether it's a local foreign entity in a developing country or a Canadian firm. The emphasis will be on the expertise in the projects.

● (0855)

Mr. Dean Allison: You mentioned women and women entrepreneurs, so microfinance could be part of this. I mean, the government has done microfinance in the past, but this could be a vehicle to deliver microfinance.

Mr. Marc-Yves Bertin: Absolutely.

Mr. Dean Allison: I'll move on to my last question then.

Three hundred million dollars was the amount that our government committed, the same amount that this government is going to commit to. Do you see that being able to grow? I mean, internally, you see it obviously trying to attract other money. The $300 million will get other money involved, maybe not in the DFI specifically, but certainly on a project-by-project basis. Do you see that being able to grow? I'm assuming that you want us to see some returns or some sustainability piece other than the fact that governments from time to time may want to increase.

Do you see that being able to grow by just the natural nature of doing good deals?

Mr. Marc-Yves Bertin: I have just two comments on that question.

The first is that in the initial years—over the next five years—the DFI will have a steady flow of capitalization basically injected by the current capital base of EDC. That will enable it to have a good stable foundation upon which to plan its deals. The government will have to make a determination in the future, depending on the track record of the organization and the government's objectives, as to whether or not that capitalization will be grown, whether through further injections, through further capitalization, or by borrowing. That's a question that people need to revisit in the future.

In terms of returns, the objective, of course, is to have a self-sustaining DFI. DFIs have actually demonstrated a high ability to be self-sustaining, depending on the DFIs and their composition, and their shareholders, in particular. Some DFIs actually have a mixed public-private shareholder model. Depending on whether or not there is a private entity presence or private sector presence in the capitalization, you will see in those DFIs a higher return sought. Other DFIs that are purely public-owned go for lower margins or break-even sustainability. I think this DFI will need to structure its portfolio to balance out risks and to pursue the government's objectives, obviously, in terms of alignment with what it's trying to achieve, but in doing so be able to balance that out. Basically, it will need to take a portfolio approach, counterbalancing higher risk with more stable deals.

Mr. Dean Allison: Thanks, Marc-Yves.

The Chair: Thanks, Mr. Allison.

Mr. Fragiskatos, it's your turn, please.

Mr. Peter Fragiskatos (London North Centre, Lib.): Thank you very much, Mr. Chair.

Thank you for being here today.

You mentioned in your presentation every dollar invested has the opportunity to yield $12 from private sources. You talked about crowding in. What are some examples of best practices to ensure the maximum is reached?

● (0900)

Mr. Marc-Yves Bertin: This figure is based on an Overseas Development Institute study. I believe they may be some of the witnesses to appear here.

When it comes to best practices and the approach, it comes down to an assessment of the deals themselves: are they in the right sectors in terms of high impact? The DFI will need to develop an investment decision-making framework that tries to properly assess on the one hand the development outcomes it's seeking and the risks associated with that, taking a look at the sector and the potential impacts both financial and developmental, the partners themselves and their track records, and the people they are working with as well as the context within which they are operating.

As part of the crafting of its investment decision-making framework the DFI is going to have to figure out how it wants to appreciate, if I can use that term—a bit of a French term—how it wants to gauge and act upon its assessment of these different considerations.

Mr. Peter Fragiskatos: Internationally speaking, the experience with DFIs is not new. Britain's experience goes back to 1948. In the United States it goes back to Nixon in 1971.

Could you talk about the success of these initiatives or lack thereof. How effective a policy tool have they been for either Britain or the U.S.? I think you mentioned Sweden and the Netherlands, if I'm not mistaken, or any other examples you would like to cite.

Mr. Marc-Yves Bertin: There's success in two ways. I think there's the success of the enterprises within themselves. As I mentioned earlier, DFIs have demonstrated a high degree of sustainability and an ability to not only get returns on the investments they are making and to fulfill their organizational fiduciary responsibilities, but they have been able to reinvest those sums into development.

That's an important contribution, and it's a contribution and a success that's borne out by the fact that all the projections suggest that DFIs are only going to take on more of a role. Just how much of a role they will take over the next decade remains to be seen, but investment in DFIs has increased significantly. Just over the past three years there have been notable increases in the level of capitalization and portfolios of these DFIs. I think that speaks to the first issue.

The second issue is the service they provide and the success that has been. DFIs are situated, if you will, in the spectrum between international development grants, which are concessional. There are loans, of course, that are concessional that are offered by regional development banks for example, and private sector banks and the commercial terms they have. Therefore, the DFIs have played a significant role in being able to generate economic activity where on the one hand the development enterprise doesn't permit it. For example, under Canadian laws Canadian development cannot support for-profit initiatives. That's a significant handicap in the manner that the government could go about in supporting economic growth in countries and supporting the development of firms in developing countries.

On the other hand, of course, you have the banks that are on the one hand unable to appreciate and gauge the actual risks on the ground because they are not necessarily present there, and therefore unwilling to offer the financing that's needed for these companies.

Through their ability to appreciate risk on the ground much more effectively, through their more patient capitals, DFIs have had a remarkable track record in being able to unlock this ability to assume the risks in a manner that the private sector needs.

Mr. Peter Fragiskatos: I have one final question for you. The legislation governing the Overseas Private Investment Corporation in the United States, its development finance institution, requires that it give “preferential consideration” to projects in countries with per capita incomes below $984.

Is there a certain threshold where success and a lack of success can be measured? I'm thinking of the lowest developed countries. Perhaps they don't have the existing and necessary resources and infrastructure in play to maximize potential investments. You have mentioned experiences, and I think you have touched on what's happened in the United States in part. How critical is it to target investments in states where there is a great need, but does that also bring a certain danger in maximizing investment? What has the experience been?

● (0905)

Mr. Marc-Yves Bertin: The experience has demonstrated the wisdom of taking a portfolio approach. On the one hand, there's no doubt that these arm's-length organizations want to ensure their sustainability, but they also want to obviously pursue the policy objectives of their governments.

Within that context, it may be that there are some huge development impacts to be had in a riskier area of activity, and of course they're going to be looking at this on a transaction-by-transaction basis, but within the context of that transaction. There may be significant development gains to be had, but the risks may be riskier, and—

Mr. Peter Fragiskatos: Not to interrupt you, but I think my time is running out.

In summary, there is evidence to suggest that projects focusing on the poorest countries yield important benefits.

Mr. Marc-Yves Bertin: Absolutely.

Mr. Peter Fragiskatos: They're viable there.

Mr. Marc-Yves Bertin: Absolutely.

It depends on the project and the considerations around it. The management of that project, from the financial sustainability perspective of the organization, just needs to be balanced out with less riskier initiatives and projects.

Mr. Peter Fragiskatos: Thank you.

The Chair: Thank you, Mr. Fragiskatos.

Next we have Monsieur Aubin, please.

[*Translation*]

Mr. Robert Aubin (Trois-Rivières, NDP): Thank you, Mr. Chair.

Mr. Bertin, thank you for being here this morning.

I was struck by something you said in your introductory remarks, namely, that there are no risky investments without support. It seems that you said that to justify the importance of Canada's Development Finance Institute, which will have the power to support part of the risk of private investments.

My first question pertains to the $300 million over five years. Is that amount taken from Minister Bibeau's international development budget and transferred to international trade, or does it come from the government's consolidated revenue fund?

Mr. Marc-Yves Bertin: Neither. This capital will not come from the international assistance envelope or from the fiscal framework. This capital will come directly from the budget, that is, from EDC's capital.

Mr. Robert Aubin: This $300 million is to help Canada achieve the objectives of the 2030 agenda, which are very ambitious. How have we determined that we need $300 million to play our part internationally?

Mr. Marc-Yves Bertin: There are two parts to that question.

With a $300 million investment, Canada will be in the same range of investment as other DFIs, in particular those in Sweden, Switzerland, and Finland. So that investment will give Canada credibility.

The DFIs that we consulted in designing the project recognize the importance of starting off on a solid footing, walking before we run. As I said, the $300 million for the institute is to be provided over five years. There are other DFIs that have existed for several decades. We could of course evolve over time.

Mr. Robert Aubin: Thank you.

In terms of transparency for these amounts, will Canada's Finance Development Institute be subject to scrutiny by the Parliamentary Budget Office, or will it be a crown corporation exempt from the PBO's review?

Mr. Marc-Yves Bertin: I am not an expert on dealings with this officer of Parliament. I can tell you, however, that the institute will be wholly subject to the Financial Administration Act, and as such it will have reporting requirements and have to produce an annual report that will be tabled in Parliament.

● (0910)

Mr. Robert Aubin: During discussions and in your introductory remarks, you mentioned the example of the United Kingdom. The tool we want to establish to attract private capital will have to appeal to potential investors. We know that the United Kingdom has already reached the goal of 0.7% of their GDP for international development assistance, while Canada is lagging behind in this regard at just 0.26%, which is below the average.

Will the fact that Canada invests so little prevent us from achieving the objectives we have set for ourselves in creating this institute?

Mr. Marc-Yves Bertin: The international and Canadian experts with whom we have discussed the matter—some of whom you will also meet throughout your study—have said they will welcome the DFI that Canada is creating with open arms. They are ready for us and people are very excited about this project. Moreover, since we have been able to draw lessons from others, we will be very flexible about the clients with whom we work. A whole range of instruments will be available to work with other DFIs in a very complementary way.

If DFIs wish to work on a project together or, in some cases, if they have equity tools only and are looking for a partner who can offer guarantees or loans, Canada could be a key partner in such discussions. Canada's expertise is consistent with the government's strategic directions.

Mr. Robert Aubin: In my opinion, the partners understand quite well that additional resources are always welcome. The difficulty we see is the following. Will Canada's Development Finance Institute be an additional resource, or will it make it possible for the government to withdraw or fail to increase its investment of public funds in international development? That is the question, and the proof will be in the pudding, I expect.

How specifically do you foresee the financing method of this DFI for countries that are going through or emerging from a crisis, such as South Sudan or the entire Horn of Africa?

Will it be possible for private companies to become involved, given that it will be more difficult to get a return on investment?

Mr. Marc-Yves Bertin: That will depend on the situation. We are not saying of course that this organization's mandate is to replace that of Global Affairs Canada. Global Affairs Canada will still be responsible for stabilizing areas in crisis or establishing the foundations for good institutional and political governance in a foreign country.

To the extent that there are private investors or business opportunities with significant social, environmental or international development benefits, this new crown corporation will be able to step in to offer help.

Will it be a silver bullet?

No. In Canada we know very well that this structure was not built on silver bullets or miracle solutions. It is made up of many pieces, which are organizationally complex, including the use of public and private funds. We are adding something very innovative to the tool box.

Mr. Robert Aubin: If Canada becomes a key partner in achieving the objectives of the 2030 agenda, how do you foresee the management of the projects submitted to the bank?

Once they have been submitted, will they be assessed on their merits to decide whether or not we will become involved?

If not, will the approach be more philosophical, with a focus on various geographical regions, problems or themes?

How will these matters be addressed?

● (0915)

Mr. Marc-Yves Bertin: That is a very good question.

First, it will be up to the government to determine the main direction of the institute. As I mentioned earlier, we already know the priorities. They pertain to renewable energy, young entrepreneurs and women. We already know that the government is starting to indicate the entity's direction. Will the government add other priorities? We will see that in due course.

Then, once the entity's areas of focus have been defined, it will in a sense market its objectives and its services, nationally and internationally.

The entity will promote its directions and abilities to other DFIs, regional banks, and, as I said earlier, to clients, that is, to the private sector in Canada and abroad.

It will be able to cultivate its relationships. Through those relationships, it will also be able to develop its pipeline. That is the term we use for the list of potential projects and investments. That means that the entity will be required to and will do a lot of networking, as all banks do, in any case.

The entity will also liaise with key government departments, such as Global Affairs Canada and the Business Development Bank of Canada as regards trade and development. The BDC has a good list of potential clients. In particular, SMEs might be interested in international trade or trade with developing countries that offer development benefits.

[*English*]

The Chair: Thank you, Mr. Aubin.

We'll go to Mr. Levitt.

Mr. Michael Levitt (York Centre, Lib.): Good morning.

When this committee studied international development early last year, we heard of some of the challenges we have in getting our ODA money into the places it was needed most, the challenges of not having access to local actors, of not being able, where women and children are concerned—and this committee travelled to Guatemala—to get the money into the right hands. It's a struggle.

Can you tell us a little bit about the challenges and opportunities this type of initiative will have in trying to better meet those needs? How are we going to advance our development goals through this type of an approach?

Mr. Marc-Yves Bertin: Inherent in your question is the focus on ODA. This is not ODA. This complements and is additional to ODA. What we're talking about is an initiative that will seek to partner up with the private sector and enable the private sector, in its pursuit of growing its businesses, to have a high development impact where development outcomes are most needed.

Earlier, for example, I alluded to a Nigerian project and FMO. The same could be said for Guatemala. This new entity could very well establish a Guatemalan-based investment fund that can support job creation and wealth creation in the country's agricultural sector. It could place emphasis on certain client groups: youth, women, entrepreneurs, and farmers or agricultural producers. This way you are helping these individuals to build a livelihood through commercial pursuits while building the agricultural market locally, which will in turn support greater food security in the country.

Mr. Michael Levitt: I was saying that getting ODA where it needs to be has significant challenges, as we found out, including the difficulty in accessing local players on the ground who have the ability to get the money where it needs to go. My colleague MP Aubin raised risk aversion. There are other experiences of using this type of approach. Other countries are doing it. Risk aversion, whether it's in areas coming out of conflict or in areas where local actors are hard to access, is a problem in getting the money where it needs to be.

How does the private sector, in your experience, react to these challenges? Is this a more effective way than ODA to meet those needs, or does it run up against the same walls?

● (0920)

Mr. Marc-Yves Bertin: It's important to distill it down to its essence. In many respects, the private sector.... These are individuals. These are human beings. These are human beings who actually don't know a lot about these markets, so ignorance is a huge issue to overcome, on the one hand. On the other hand, there are real risks that the private sector faces in these countries.

What does the DFI do, and what have DFIs been able to do? By having a local presence, this DFI will be able to leverage because it will be working with EDC as a wholly owned subsidiary of that crown corporation. It will be able to leverage its expertise as well as its network around the world, which is present in certain developing countries and therefore gives it access to regions. It will also work with other DFIs, which will obviously have offices in some of these countries. Over time, it will need to establish its own operational footprint globally.

It will be interesting to see how this evolves, but I can tell you that by being on the ground, you dispel and deal with the ignorance factor. By the same token, by being on the ground, you're actually able to more properly appreciate and gauge the risks—political or otherwise—by knowing who the actors are, knowing the regulatory and governance contacts, and so forth. You are then able to cost your services in the appropriate manner.

If I can draw a comparison with a commercial bank, commercial banks tend to want to see the return over a certain period of time, whether that's a three- or five-year horizon. DFIs have tended to use loans in a very patient manner, so this notion of patient capital—expecting a return after 15 years, so the time horizons are quite far—is the type of support that these organizations require. They are operating in fluid situations, if we can call it that, in developing country contexts and so forth, and they need that type of long-term support and partnership.

Mr. Michael Levitt: This DFI is going to be coming into an arena where, again, you have other key Canadian development actors—Global Affairs, obviously, the IDRC, and lots of NGOs—working in this space to achieve positive outcomes.

Talk to us a little about the relationship. How's that going to work? What will be the level of co-operation? Is it formal? Regarding NGOs in particular, you have private finance that's going to be coming in, that has certain mandates. What, in other jurisdictions, has that relationship between DFIs and NGOs been like? We know they are a key contributor to success on the ground. What does that look like, in your estimation?

Mr. Marc-Yves Bertin: Let me break that down into two: first, the Government of Canada community, if we can call it that, other government departments or agencies; and second, the issue of non-governmental organizations and civil society organizations.

On the other government departments, the relationship will need to be variable, and it will be variable for at least two reasons. The first is that this is an organization that will be privy to great market intelligence and therefore great opportunities that need to be relayed and shared, but it also is going to want market intelligence that exists in other parts of the Government of Canada family.

When I think of the trade commissioner service, and even at times when we look at development programs in other countries, for instance, it may come across in consultations with the governments in Africa that they want to build an electricity grid. That type of information is a development issue, but it's the type of thing that can be beneficial to give a line of sight to a broader community of players in Ottawa.

The trade commissioner service is obviously on the ground and is working with the private sector trying to find business-to-business opportunities. You have EDC out there as well, and BDC domestically, looking at SMEs. You have a community of departments that's going to want to bring in this new DFI and create a community of interest around it. I think, on the one hand, from a market intelligence perspective, there's going to be a strong desire amongst the federal family to bring this new member of the family into the fold.

I say “variable” relationship because this is an organization that, from a development perspective, can be—and obviously, we're talking about it here—a huge partner for the development program.

One of the things we're going to be working on over the near term is more of an institutionalized relationship between the development programming at Global Affairs Canada and this new DFI, new crown corporation, over the issue of technical assistance. Technical assistance is something that Global Affairs Canada does extremely well. It knows where to find expertise that can be brought to bear to help bring about, and buttress perhaps, the development outcomes—environmental outcomes, for example—of a given project that the DFI might want to be pursuing, or that the DFI, in pursuing something, may want to augment and amplify, and therefore, would go over to Global Affairs Canada to seek that. We'll have to formalize that arrangement and codify it in some manner.

With respect to NGOs, generally speaking, DFIs work with the private sector, and NGOs are not-for-proft organizations. However, within that context CSOs, have been able to work closely with DFIs. Just as I mentioned from a technical assistance perspective, CSOs, particularly Canadian CSOs, have tremendous expertise in various areas, whether that's environmental issues, gender issues, social policy issues, and so forth, that they can bring to bear to complement a private sector initiative on the ground. It's not something that would be “part of”, but definitely coordinated and paralleled with the activities of DFI.

● (0925)

The Chair: Thank you, Mr. Levitt.

Mr. McKay, please.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, Mr. Chair.

Thank you for your testimony.

You're putting $300 million into this, over how many years?

Mr. Marc-Yves Bertin: Five.

Hon. John McKay: Over five years, so that's $60 million a year.

Whose money is it? Is it the Department of Finance's money, or is it Foreign Affairs?

Mr. Marc-Yves Bertin: It's neither.

It's EDC, so we are—

Hon. John McKay: But EDC reports to Finance.

Mr. Marc-Yves Bertin: EDC, in law, actually reports to the Minister of International Trade. It is an arm's-length crown corporation. It has its own financials, its own books.

Basically, the capitalization is being taken from the existing capital base of EDC.

Hon. John McKay: It's not actually fresh money; it's EDC money.

Mr. Marc-Yves Bertin: It's EDC money that's taken from the fruits of their activities.

Hon. John McKay: There's no actual money being transferred from the general revenues of the federal government to EDC. EDC has to find its own money.

Is there a separate board?

Mr. Marc-Yves Bertin: The governance will need to be defined as part of the corporate planning process. That said, we are talking about a new crown corporation, a wholly owned subsidiary of EDC, but a crown corporation in itself. As such, it will need to have its own board, a “fit for purpose” board.

Hon. John McKay: Who will appoint the board—EDC or the government?

Mr. Marc-Yves Bertin: EDC would appoint the board given that it's a wholly owned subsidiary.

Hon. John McKay: How will the criteria for board members be determined?

Mr. Marc-Yves Bertin: That is something that will be set out in the parameters for designing this organization and conveyed to EDC in consideration—

Hon. John McKay: How will it line up or not with government priorities?

Mr. Marc-Yves Bertin: This is a commercial crown corporation, which means that it's an arm's-length entity. It's arm's length so that it can behave in an independent manner and have the credibility to engage with private sector entities without others perceiving a potential risk of interference.

That being said, this is an agent of the crown and because of that, the governance around it has specific touchpoints at which ministers are able to provide strategic direction to the entity.

Hon. John McKay: In theory, the crown could blow off the government if it decided that its priorities were different from those of the government.

Mr. Marc-Yves Bertin: No. Let me explain that.

The process for ensuring alignment with a crown corporation involves three notable events in terms of governance. The first one is a statement of priorities and accountabilities. The Minister of International Trade upon consultation with the Minister of International Development will send to the board of directors its priorities. It's basically giving them their homework.

In response to that, the board needs to generate a corporate plan. That corporate plan is provided to the ministers for consideration and they basically say, “Thank you for the statement of priorities and accountabilities. We've done our homework, and here's how we propose to deliver on the mandate you've given us.”

That corporate plan needs to be approved by the Treasury Board and it is the issue of an order in council such that an order in council is required in order for the corporation to actually execute that mandate.

● (0930)

Hon. John McKay: I'm not so much worried about the board itself. I'm more concerned about the government's priority. You'll be aware that the Auditor General has been highly critical of international aid priorities. Those seem to be changed as often as people's socks. His 2009 report was extremely critical of the lack of focus and poor priority setting, etc. If in fact the entity has to file a plan consistent with the government's priorities, and the government's priorities seem to change with some regularity, it is going to be very difficult to run a financial institution if in fact your major shareholder changes its priorities with every change in minister.

Mr. Marc-Yves Bertin: I can't speak to or defend the government's priorities. I think those are questions that are probably more appropriately posed to a minister of the crown.

Hon. John McKay: Is there an expected return on equity?

Mr. Marc-Yves Bertin: The organization will need to be self-sustaining. The speed with which it attains that self-sustainability remains to be determined. It will depend on the portfolio that it constructs, and of course, the returns that it generates.

Hon. John McKay: BDC and Farm Credit have bounced around in their priorities. Over the years, I think they've sort of settled down to an expected return on equity. Do you expect a similar pattern with respect to this entity?

Mr. Marc-Yves Bertin: I think it remains to be seen. I wouldn't want to speculate. It doesn't even exist yet.

Hon. John McKay: Finally, with respect to how this entity will function, will it be primarily a financial lending institution or will it be in effect an insurance entity?

Mr. Marc-Yves Bertin: That's a good question. In law, it will have access to all the instruments, so it will be able to do loans, take equity stakes, and provide guarantees. The extent to which it uses these instruments, so the degree to which and the sequencing over time, will depend on the organization itself. For example, loans tend to be less operationally intensive and, therefore, they can be done more quickly in terms of operationalizing than can other forms of transactions.

That said, there's nothing excluding it from doing equity earlier on rather than doing loans.

Hon. John McKay: Mr. Allison raised the issue of it, in effect, being a microenterprise lender, which from an aid standpoint is a really good idea. From an administrative standpoint it's a disaster, because it costs so much to get these microloans out.

Is it realistic for a corporation centred in Ottawa to actually engage in microloans to various entities around the world?

Mr. Marc-Yves Bertin: Honestly, it depends. I can see that you could deal with this issue and structure microloans in various different ways, including providing funding to fund the funds. Now I'm getting technical, but there are various ways of dealing with this and—

Hon. John McKay: In theory, you could lend to the Grameen Bank, for instance.

Mr. Marc-Yves Bertin: That remains to be seen.

Hon. John McKay: Yes, okay.

Thank you.

The Chair: While we're on the governance discussion, can you give us a sense of how it will be reporting? Will it be reporting through Export Development Canada, because it's a whole subsidiary, or will it have its own reporting mechanism, for example, an annual report or something of that nature?

● (0935)

Mr. Marc-Yves Bertin: As a wholly owned subsidiary, its financials will be consolidated with EDC's financials, which means that from a reporting perspective the two will need to go hand in glove. You won't want to separate these financials, nor will you want to separate out the approvals, because that then creates a degree of risk in terms of the overall management of EDC and the DFI.

That said, the organization in advancing its corporate plans or its annual reports will do so in a joined-up manner and the organization will issue, therefore, its own annual reports. It will have its own independent look and feel, if I can call it that, and it will be required to establish a distinct presence, a presence that speaks to its results—obviously its objectives, and over time, its results.

The Chair: Thank you.

We'll go to Mr. Kent, please.

Hon. Peter Kent (Thornhill, CPC): Thank you, Chair, and thank you very much.

You've already addressed many of my questions. I think EDC has a sterling reputation abroad, much so of political comment, more than BDC domestically, in terms of risk taking within certain areas. There would seem to be an overlap of some elements of the portfolio of the new organization within EDC and I'm wondering about the practicalities, how that will work together and whether manpower will be shared between the two. How will risk be managed out of EDC, if you will, into the new organization, or not?

Mr. Marc-Yves Bertin: There are two really, one conceptual and one very pragmatic or practical issue of bodies and services. Let me take them in reverse order.

The DFI will have to establish its own team over the coming months. The government will work closely with EDC to define the core functionalities of the DFI, and its core team headed by a CEO, or a head, for the organization. It will therefore need to figure out what its core mission is and what type of work it could actually “outsource”, if I could use that term, to EDC, things such as IT systems, HR, potentially even treasury functions.

You know, the scenario where through a service-level agreement EDC is actually providing back-office support, if I can put it that way. This has the virtue of accelerating the speed with which the organization can be stood up, rather than starting from scratch, as well as leaning on therefore a stable foundation and the institutional foundation and know-how that exists currently in EDC.

That was definitely part of the rationale for pursuing this model.

The other issue, though, is the relationship between EDC and the DFI on the ground, and the issue of risk. What I find interesting is that in many respects the trade mandate, and what's important here with the DFI is that the trade mandate needs to be and continue to be.... The integrity of the EDC trade mandate needs to be preserved and protected at all costs. We don't want EDC doing the types of things that DFI would do, because basically we would be running up against trade rules and being inconsistent with our obligations under the WTO. That's not to say that EDC isn't active in certain emerging markets, developing market contacts, but this is a different instrument that would be able to complement that.

The extent to which EDC takes on more risk, so long as it's consistent with trade rules and so forth, is a good thing, particularly from a development perspective.

Hon. Peter Kent: What about staffing numbers, both at headquarters and in terms of working abroad doing assessments and investigating potential projects?

Mr. Marc-Yves Bertin: During the Prime Minister's announcement on May 5, when he announced that the organization would eventually find its headquarters located in Montreal, he noted that the organization would generate 100 full-time jobs. It remains to be seen. We have to, as public servants and as the eventual employees of this new crown corporation, figure out the plan. That's where we are. We'll have to figure out how many FTEs we need, depending on functionalities, core function, and so forth, versus the back-office support you would get from EDC. You need to think about what you need per the rhythm of capitalization to ensure that you're managing these funds appropriately and effectively. All this is to say that it remains to be seen; the plan has to be planned.

● (0940)

Hon. Peter Kent: Is there a file containing probable first projects in existence now, or would this be a matter of a year or two of preparation and investigation?

Mr. Marc-Yves Bertin: Ideally, given the government's desire to see this organization up and running and active by January 2018, there will have to be a degree of planning and activity going on in parallel. Just how that happens is the question of the moment.

Hon. Peter Kent: Would the new organization accept suggestions from Global Affairs?

Mr. Marc-Yves Bertin: As I was mentioning, I think there is going to need to be a community of interest created whereby market intelligence is shared because there will be, whether through the trade commissioner service window or through our development programming window, development needs or market opportunities that we'll want to bring to the attention of the organization. The organization will need to evaluate these based on its own investment decision-making framework, both in terms of gauging the development outcomes but also the risks and returns associated.

Hon. Peter Kent: Thank you.

The Chair: Thank you very much, Mr. Kent.

That wraps up our discussions with Mr. Bertin.

I want to thank him very much for his presentation. We're looking forward to the official kickoff of the DFI, and of course, its connection to the development system strategy that is going to be announced sometime soon, I hope.

With that, I want to thank you very much for your presentation.

Colleagues, we're going to take a small break and then we'll go to our next witness.

● (0940)

——————————(Pause)——————————

● (0945)

The Chair: Colleagues, we'll now reconvene and start our second hour of discussion.

Before us on video is Mr. Brett House, who is the deputy chief economist of Scotiabank. Mr. House is a macroeconomist who writes on sovereign debt, international finance, development aid, trade and growth.

Welcome to Mr. House.

What we will do is allow Mr. House to say a few words, make a presentation, and then we'll go right to our Q and A.

Welcome again, Mr. House, and the floor is yours.

Mr. Brett House (Deputy Chief Economist, As an Individual): Thank you very much for the kind introduction.

My thanks, as well, go to the honourable members for the opportunity to speak with you about the proposal for a Canadian development finance institution.

[*Translation*]

I am very pleased to have this conversation with you today.

[*English*]

It is I think a terrific mark of the openness of this government that it has decided to reconfirm the proposal for the Canadian development finance institution that was brought forward in the 2015 budget under the previous government, and which has been, as you know, a topic of discussion for some 40 years in development circles in Ottawa. I salute both the government and its predecessor for bringing forward what I believe is a proposition that should receive support from all sides of the political spectrum.

In doing so, I should note that I am speaking in a personal capacity here, rather than on behalf of Scotiabank. The development finance institution proposal is one that I wrote on long before joining Scotiabank six months ago, and one that I will continue to engage on, and I hope to support your process as you go forward in pinning down design considerations on the DFI.

Really, design considerations will be the focus of my remarks today, given that the logic of private-public partnership in development assistance has probably already been well discussed by members of this committee and by members of all parties in the lead-up to this discussion.

I also want to say at the outset that I see the discussion of the Canadian DFI as one that needs to be grounded in a precursor understanding that it is additional to existing official development assistance. ODA is not a substitute, nor is the DFI a substitute for ODA. In fact, we should see them as complements, and, really, the creation of a Canadian DFI should be brought forward in the context of and in conjunction with a scaling up of Canada's development assistance.

At our current ODA levels, trying to do more with less is really a recipe for failing to meet our global obligations. Aid and market financing really do different things. There are some public goods that only aid and public resources can provide, and market financing, either alone or in conjunction with public support, complements those public goods rather than replaces them.

I should also note that the logic of engaging in a public-private partnership for development is driven by some very clear math. That math says that overseas or official development assistance will not be enough. Even if all OECD countries were to meet the 0.7% target of GDP articulated by Lester B. Pearson, total ODA would amount to about $350 billion to $375 billion U.S. per year, when at the same time, good estimates of what is required to reach the sustainable development goals, at a minimum, are around $500 billion additional in financing per year and go upward to around $3 trillion in additional dollars per year, depending on the extent to which you include things such as climate change mitigation and adaptation in your figures.

The need to bring private sector financing into the development process is ineluctable. There is no way to avoid it. ODA cannot be enough. I think the things we need to focus on today are about how we design a potential Canadian development finance institution to be as effective, as complementary, and as additional as possible to the existing work being done by other development finance institutions, and under bilateral and multilateral aid budgets.

Here, I think one of the key things we need to focus on is the need to help direct finance into places where it is currently not going. About 40 to 50 countries in the world receive almost no direct financing in the form of capital or investment from abroad, outside of their resource sectors, so the first objective of a Canadian DFI really is to be focused on catalyzing investment and capital flows into the places where such flows currently don't happen.

● (0950)

The Chair: We'll just take a minute here.

Apparently there's no translation on the French side. We'll give it a second and see if we can sort it out.

Mr. House, let's give it another try and see how it goes. The floor is yours.

Mr. Brett House: If I may, I'll recapitulate a few of my initial points so that they can be interpreted for everyone in the room.

First, I want to emphasize that a Canadian development finance institution needs to be additional to existing official development assistance. It needs to add to the total envelope of financing that Canada provides to developing countries, either in partnership with the private sector or in the form of grants that come from the public sector. Aid and private financing are complements to each other. There are some public goods that can be provided only through public financing. There are other, complementary activities that are germane to public-private partnerships. A Canadian DFI should be an additional source of financing on top of official development assistance, not a substitute for that assistance.

At the same time as we commit to bringing in a Canadian DFI, we should also be concerned with ensuring that Canada's official development assistance is increased toward the long-term goal of 0.7% of GDP. That said, even if every OECD country were to raise official development assistance to Pearson's 0.7% goal, development assistance in that form would not be enough to reach the sustainable development goals. At 0.7%, total ODA flows would be at about $350 billion to $400 billion U.S. per year. Most estimates of what is required to hit the SDGs imply that somewhere between $500 billion and $3 trillion U.S. extra in financing are needed annually between now and the SDG target year of 2030.

Engaging the private sector and catalyzing private capital for development assistance are really not things about which we have a choice. We absolutely must do what we can to ensure that capital begins flowing to the 40 or 50 countries that receive almost no foreign direct investment at the moment outside of their resource sectors. That, to me, is the global case for Canada engaging in public-private partnerships for development.

The rest of my remarks will focus on design considerations for a Canadian development finance institution.

First, you may reasonably ask why Canada needs a DFI. Why has it been under discussion for almost 40 years, yet we haven't followed through on the creation of a DFI? I'll leave the question of why we haven't followed through to those who understand the ways of Ottawa better than I do. The logic of a DFI is inescapable. Every other G7 country has one. Almost every OECD country has one. Put bluntly, by not having a DFI, we are leaving good money on the table for others to benefit from.

Other countries' DFIs have a long history of making profits by doing good. Britain's Commonwealth Development Corporation hasn't drawn on the public purse for over 15 years in its development financing. The United States Overseas Private Investment Corporation, OPIC, estimates that it earns $8 for U.S. taxpayers for every $1 invested in its overhead. In the case of the world's DFI, the International Finance Corporation, which is part of the World Bank, we know that its profits get recycled directly back into expanding its lending portfolio.

A DFI for Canada makes a lot of sense because it provides an opportunity not only to do more, but to actually finance doing good in a way that does not imply further drains on the public purse.

Looking specifically at the design of a Canadian DFI, I want to recapitulate and essentially repeat a few messages from my submission to the pre-budget consultations in which I participated in 2014. The logic and the design considerations for a DFI have not changed in the intervening two and a half years.

First, I am heartened to see that it is being considered as a subsidiary institution under EDC. It is critical that it have an independent-minded and risk-loving board, perhaps more risk-loving than EDC's board, because of the nature of the financing in which it would be engaging: in more difficult circumstances and more challenging countries, and in sectors where the returns may have a much longer horizon than in the areas in which EDC traditionally invests.

● (0955)

On sizing the Canadian DFI, I should say at the outset that the government's inclusion of a $300-million, five-year capitalization in its budget proposal needs further fleshing out. If $300 million is considered the initial capital overhead to set up the offices and the operations of the DFI, then I'm encouraged that we're speaking about the DFI in an appropriate scale and size. But if that's meant to be the lending portfolio over the next five years, then it's woefully inadequate. Of course, in any context about development assistance, you're going to hear people saying we need more. Now, I'm not simply adding a voice to that chorus and saying, “More, more, more.” I'm adding what I think is a very practical point, which is that for $50 million a year, the overhead to do a lot of small projects would not justify the impact of that small-scale lending. The $300 million really ought to be the basis to get this institution going and provide the underlying overhead or framework by which this institution goes out and catalyzes substantial additional financing.

To give you a sense of the scale we're talking about, the six existing G7 DFIs provide annual commitments equivalent to about 3.3% of their countries' private capital flows to developing countries, or about 0.024% of their national GDPs. Translated into Canadian terms, that implies an annual lending portfolio somewhere between $350 million and $500 million Canadian. That looks at an annual commitment that is larger than the five-year commitment that has been articulated in the budget.

My deep concern is that at $300 million over five years, we don't have enough committed to even launch what is going to be a successful pilot or proof of concept. We need to look at a much greater scale. The way to do so, I believe, is to ensure that the DFI's lending portfolio is financed largely out of capital-raising through private markets, that is, through the issuance of debt or bonds, or private placements in international capital markets, much as EDC does right now, though likely at a much longer maturity and with perhaps contingent payback valuations or provisions to reflect the impact aspect of the financing the DFI is providing.

The DFI could also be involved in issuing debt into local and developing capital markets that don't currently have established benchmark yield curves, much as the World Bank did in places such as South Africa and Greece in the nineties. That provided a benchmark by which public institutions could then also go into capital markets, and private companies could also raise debt.

The DFI should also be empowered to retain the profits that it makes from its lending operations. We may not see returns for several years, but if we are to grow the institution, much as its corollary institutions in other G7 countries have done, those profits should be largely recycled back into, first, paying off the initial capital commitment from the Canadian government, and then expanding its existing portfolio. This is what happens with other G7 DFIs. Other G7 DFIs, such as KfW in Germany, issue debt in the way that I'm proposing. I believe this is the way to ensure that we have an institution that operates on the scale that's needed to have true impact and to ensure the ratio of overhead to returns is appropriate.

Thirdly, I want to focus on what activities a Canadian DFI should engage in. Looking at 30 or 40 years of activities of other DFIs, we see that a few salient findings have come to the fore, two of which are really critical here.

One is that unless the development, impact, and financial imperatives of the DFI are written firmly into its governance from the outset, into the DNA of its board and into the incentives provided for its staff, the development impact will always play second fiddle to the financial imperative. We need to ensure that the entire institution is built to balance those two imperatives.

● (1000)

Second, a Canadian DFI needs to be substantially more risk loving than other DFIs. One of the consistent findings of review of existing DFIs is that they tend to invest in sectors that are already receiving foreign investment: the fifth cellphone provider in Ghana, the 12th luxury hotel in Nairobi. This is not the way to have impact nor to justify the expense and the effort of creating a Canadian DFI, which needs to be focused on higher-risk lending in places where no other investors will go.

To do so effectively, it needs a full range of financial instruments, everything from loans to the ability to take equity shares, provide guarantees, and provide risk insurance. The multilateral provider of risk insurance, MIGA, under the World Bank Group has shown in its annual reports that it has a very small payout rate on its insurance policies.

In one way that would be an indication that it's writing incredibly good policies. I take it as an indicator that it's not providing insurance in the places that truly need it, where there is truly great risk. That leaves open a huge swath of the developing world where a Canadian DFI could provide guarantees for insurance that draw very little on its balance sheet or its portfolio, yet at the same, have great impact.

A Canadian DFI, unlike some others, should also be unconstrained by nationality. It should be able to work with the best investors, the best projects, and the best ideas, regardless of which passports they hold, be they Canadians, members of the Canadian diaspora, or foreign companies.

The Overseas Private Investment Corporation in the United States has found its hands substantially bound by a requirement to only work with U.S. companies. It has found ways to get around that by declaring a U.S. company to be anyone that has a substantial degree of activity on American soil. But why create an institution that needs to engage in such gymnastics to do good work? Let's be as open as Canada is in every other way to good ideas, good people, and good capital in constructing the DFI to work with anyone who meets its standards.

As I mentioned earlier, our DFI should be focused on the regions and sectors that are not receiving financing in a substantial way. It should always be judged by not only whether it is meeting its development and its fiduciary impacts but whether it is also going where other institutions will not go.

Lastly, and this may sound like a small point—even a pedantic one—in talking about nomenclature, but in the discussion of this project three different terms have been used between the previous federal government and the current one in describing it. The 2015 budget referred to a development finance initiative. The 2017 budget referred to a development finance institution. The May 5 announcement that the institution or initiative would be located in Montreal, referred to it as an institute. Those three words in this space define very different things.

An institute is denoting something like a research body or think tank. We don't need another research body or think tank in this space. Other organizations and countries have already developed a huge body of best practice that we can implement. We know where the gaps are. We know which countries and sectors are not getting financing. We know which ideas are not able to move from conceptualization to implementation. We don't need another institute.

An initiative, under the 2015 budget, bespoke something with small ambitions. There is no reason for Canada to play small in this space. We should be leveraging our strengths and doing something truly impactful.

As the 2017 budget said, I think this should be a development finance institution. We should see it as a thriving subsidiary to EDC with an independent, risk-loving board able to invest in areas that are not receiving support at the moment, leverage good ideas, and complement what I hope is an expanding envelope of official development assistance, and it should be able to receive support from all members of the House in going forward.

Thank you. I look forward to your questions.

● (1005)

The Chair: Thank you very much for those opening comments, Mr. House.

I'm going to go straight to Mr. Allison.

Mr. Dean Allison: Thank you very much, Mr. House. It's good to have you back here. Congratulations on your new job, although I'm a little late.

Based on your experience at the IMF and World Bank and all these things, you've had a great 40,000-foot view in what's required and where the gaps are, if you will. I have two questions.

We talked about capitalization, and you talked about debt and private placements and capital markets. If the governance structure is set correctly, do you anticipate that this DFI could attract outside money for capital markets? You talked about our issuing our own debtor bonds, etc., to capitalize but how do you see that relationship? Is it possible? There is obviously a ton of competition out there already. Is this mostly something you see as being financed internally or creating the opportunity? I realize that when investments are made other players may invest in specific projects, but how do you see the original or ongoing capitalization?

Mr. Brett House: I see in the Canadian discussion of a DFI, in some ways, too much focus on how much money is being provided for initial capitalization. In some ways, that number could be almost any number. What is important is how much is provided in an annual lending portfolio.

I'd like us to look at the $300 million that has been mentioned over five years in the budget as the money to capitalize the overhead and operation of the institution for its first five years. We can then look at issuing debt to finance the lending portfolio, or the financing portfolio, for the insurance guarantees or equity placements of the institution. On that front, you mentioned that there is competition, but I think there would be enormous demand for the paper issued by EDC in the name of the DFI.

Why? Canada is now one of only about nine or 10 AAA credits in the world. We are a sought-after sovereign issuer. The DFI would have the full faith and backing of the Canadian government behind it. If you look at countries like the U.K., or even Mexico, they've been issuing at maturities of 50 to 100 years, in what is historically an incredibly low interest rate environment. That provides a context in which we would actually be able to raise private financing through bond issues at the kinds of maturities that are consistent with the long-horizon lending that the DFI would need to provide for projects that might not see substantial returns for five to 10 years. There's a really rare opportunity to align private and public capital markets at this point.

What share of financing for any one project or portfolio of projects would come from the DFI? It ought to be relatively small. Our financing ought to be catalytic. It ought to be the thing that tips a project toward being financeable from not being financeable. It ought to provide financing in that missing middle size of organization, and in the process of bringing a project to market from the initial angel investor stage to an IPO or a debt issuance, or some kind of partnership agreement where there are clear stages that need to be financed but are difficult to finance.

It may also partner with local governments in financing operations. It should be something that helps stimulate local engagement rather than simply providing outside financing.

When you look at some of the other major DFIs, the share that they provide in some projects can be as low as 5% or 10%, but what is important is that they often take the first loss risk. They have, in some ways, the least senior financing in the project, and by taking that risk out of the process of financing a project or an activity, they are able to catalyze private sector money to come in.

I see the private capital engagement here on two fronts. One is financing the equity, loan, guarantee, or insurance participation by the DFI itself, and the other is coming in beside that financing.

● (1010)

Mr. Dean Allison: I have a last question, then.

In terms of opportunities, I appreciate the fact that a DFI is not a silver bullet. You said it well; it's complementary. It doesn't displace other things. My thought has always been that there's so much private capital in the world, that flows forever, but ODA does not. It's limited by budgets, constraints, the economy, etc.

Could you give us some examples of projects you may have seen over the years? I would agree that a luxury hotel is probably not something we want to help finance, but talk to us about some of the critical infrastructure projects—or projects in general—that you see, where there is a gap that the DFI could fill.

We've heard about possible electricity grids, and these kinds of things. What would be some of the other things you have seen, where the gap exists, and why does this help fill that gap?

Mr. Brett House: I would say, as a precursor, there is nothing wrong with financing the fifth cellphone provider or the 12th luxury hotel. To drive business, capital cities need good places for people to stay. They need good cellphone networks.

The point I'm making is not so much about the nature of the investment in terms of the type of project the money is going toward. Rather, it's about the fact that it's already a crowded space. If you want to finance a hotel, which I think is a legitimate thing to help catalyze investment, think about doing it in N'Djamena, Niamey, or Ouagadougou, rather than Nairobi or Accra, which are already attracting a lot of that kind of investment.

As to the sorts of projects that can be really game-changing, it varies from country to country. As an easy example, consider Haiti, where I did a lot of work with the UN in the wake of the earthquake that was so devastating. Rebuilding there is substantially constrained by the fact that there is only one cement plant. You simply cannot build infrastructure when you have only one source of cement in the country. You have to look at key bottlenecks like that.

Often the transportation grid or network between ports and capital cities is inadequate in some form or another. There may not be a decent road. There may not be electricity along that road. The port itself might not be great. There might not be a cold supply chain from the interior to the port. Those are all key bottlenecks.

If you look at the Democratic Republic of the Congo, they have the potential for such massive hydro development in the south of the country that they could be supplying electricity to all of southern Africa and most of east Africa. There are some pieces of the grid there that, if filled in, would permit that kind of network effect to take place.

It is useful to look at projects that relieve bottlenecks and allow a lot of other complementary aid-financed and private sector activity to flourish, because such projects provide a way for a DFI to have a truly major impact for a relatively small amount of catalytic financing.

● (1015)

Mr. Dean Allison: Thank you.

The Chair: Thank you, Mr. Allison.

Mr. Saini.

Mr. Raj Saini (Kitchener Centre, Lib.): Good morning, Mr. House. Thank you very much for coming here this morning.

I'm going to ask you three questions, but I am first going to refer to one of your quotes. You mentioned during your preamble that there is anywhere from $500 billion to three trillion dollars' worth of annual aid required to reach these sustainable development goals. We also know, according to some experts, that there is about $22 trillion in dead money locked in the capital reserves of many corporations.

In one of your briefing notes, you wrote that developing countries need patient capital, not hot money looking for a quick return. How do we harmonize business interests with what we're trying to do with aid, so that profit generation is equivalent to poverty reduction? How can we do that?

Mr. Brett House: Would you like me to respond now or go through all the questions?

Mr. Raj Saini: We'll do it one by one.

Mr. Brett House: I think the important thing here is, first off, to align the financing terms we're providing with a likely horizon for financial returns from any project. As I mentioned, issuing debt right now at very long tenors would allow us to provide financing in a way that is consistent with the likely return profile on the projects we're looking at.

Secondly, in aligning impact, the most important thing, I believe, is setting at the outset clear metrics and clear processes for measuring performance on those metrics that are just as rigorous as the fiduciary or financial metrics we might set beside them. In economics there is a tradition of thought and modelling known as principal-agent theory, which essentially means that the incentives you provide yield the activities you want in accordance with your initial targets and measurements. If we measure or target the wrong things, we will get the wrong things back.

Unfortunately, one of the salient critiques of most existing DFIs is that they do a good job of setting financial targets on their projects but not such a good job of setting development-impact targets, which they often fail to establish and measure. Reaching development-impact targets requires incentives equal to those required for reaching financial targets. They need to be baked right into the DNA of the institution when it comes to how the board sets its goals, how the staff at the project level designs the expectations for financing opportunities, and how that staff's performance is evaluated.

Mr. Raj Saini: We're blessed in this country to have a large multicultural society with certain mature communities. People have come over and become successful. Do you think we're doing a good job leveraging those links in terms of trade and development for those people who have knowledge on the ground and experience in the countries that they originally came from, but may not have access to capital or may not have access to insurance or loan guarantees to do something?

Mr. Brett House: The numbers imply that we're not. The share of Canadian foreign direct investment in some of the strongest centres of growth in the world, in Asia, Latin America, and Africa is in 10ths of percentage points compared with the vast majority of our foreign direct investment that is located in developed markets and some of the largest emerging markets.

Take India for instance. A tiny fraction of our total FDI has been put into India, despite the fact that we obviously have a large diasporic and ethnic historical Indian community within Canada. We don't seem to be exploiting those potential cultural, familial, and historical roots in a way that leads to dollars following them. We certainly are not using them in non-traditional areas, the 40 or 50 countries I mentioned in the world that receive almost no foreign direct investment from the rest of the world.

● (1020)

Mr. Raj Saini: I want to talk about.... Sorry.

Mr. Brett House: I was just going to add that I do think the Canadian DFI is a great way to potentially improve upon that track record. It really provides a way to convene the conversations, the activities, and the potential flow of capital with Canadian cultural expertise and direct personal links that will allow it to be successful.

Mr. Raj Saini: I want to talk to you a little bit about geopolitics and the 40 or 50 countries that you mentioned. The 40 or 50 countries will be, in most cases, fragile states politically or economically. You may have other sovereign powers that may decide they want to invest there. If we set up some sort of partnership between the DFI and a private investor or private sector business, and they decide to go into that country, there's going to be an imbalance. The imbalance is going to be that one sovereign power may have a different way of conducting their business interests, and because we follow Canadian law and Canadian regulations, we may have a different approach to development there.

How do you see us aligning and making sure that there's not competition within that fragile state? How do you see us deploying our aid with private sector partners when they may be at a disadvantage in terms of their business interests as compared with other countries that may have a different outlook towards how they want to deploy it and their private sector interests?

Mr. Brett House: That's a danger that we face in every context, whether it's in the context of providing development assistance, in our trade relationships, or in our private investment flows. The existence of a Canadian DFI will not change that dynamic, but I think what it will do is provide an additional incentive for a lot of governments to treat either the projects that we're involved with or others on a more even-handed basis.

We still have backstopping, the kind of investment that Canadian DFI would be providing, and international dispute settlement mechanisms like ICSID under the World Bank Group, which would provide some investor protection here. The success of private sector investment in higher risk countries always relies on strong personal and institutional relationships. We would not, I think, be engaged in spraying Canadian investment in these 40 countries in a willy-nilly fashion. It would need to be based on a strong understanding of the context and good relationships with the local environment.

Mr. Raj Saini: Do you feel that maybe because of the uncertain political environment in these 40 or 50 countries, aid does not flow there as much as in the more middling countries or middle-income countries where there might be some structure to governance, whether it be business structure or political structure? If we want to make sure that our companies invest in those countries that need the aid more significantly than the other countries, is that where we should focus and try to provide some sort of governance or infrastructure improvements?

Mr. Brett House: Yes. You're speaking to the distinction that I was making earlier between the public goods that aid is ideally suited to help create and finance, and the private goods or other market-driven activities that private capital is more ideally suited to finance. Building legal institutions, helping to reinforce the rule of law, building regulatory agencies on finance, and ensuring that regulation in individual sectors is provided in a way that's even-handed are all the things that ODA is ideally suited to provide to create the environment in which private capital flows will be more likely to come in.

These 40 or 50 countries I'm mentioning do receive aid dollars in decent numbers, not as much as they probably should and in proportion probably too little compared with the very large emerging markets that still receive a disproportionate amount of international aid. These 40 or 50 countries receive almost no private capital aside from investment in their resource sector, and that's the flow that I'm hoping a Canadian DFI would help stimulate.

● (1025)

Mr. Raj Saini: Thank you.

The Chair: Thank you, Mr. Saini.

We'll go to Mr. Aubin, *s'il vous plaît.*

[*Translation*]

Mr. Robert Aubin: Thank you, Mr. Chair.

Thank you, Mr. House, for being here with us this morning and for sharing your expertise.

I completely agree with you when you said at the outset that this DFI would be in addition to the investment of 0.7% of GDP in international assistance, even though not all countries have reached that level.

That is exactly what my first question is about. Since Canada invests approximately 0.26% of its GDP in international assistance, which is very far from 0.7%, does that send a signal to potential DFI investors that this is not a very a attractive sector?

Mr. Brett House: Honestly, I don't think so, because the two always complement each other. There are cases, however, that call for more private than public investment, just as there are cases that call for the two types to complement each other.

It is not at all necessary for public assistance to be a precursor to private investment. We must bear in mind, however, that public assistance always complements investment.

Mr. Robert Aubin: Thank you.

In this regard, you said in your presentation that you hope that Canada will reach the target of 0.7%.

There is currently no plan to do that. Drawing on the experience of the United Kingdom, do you know what steps Canada could take to achieve that objective and balance out these two avenues for supporting international development?

Mr. Brett House: What happened in the United Kingdom is impressive. The government reached the 0.7% target while the country was in the midst of the global financial crisis of 2008. The government maintained its objective. That tells me that there is never a good time to define the 0.7% target. We have to set the objective and have a plan to achieve it. It is always a good time to do that.

Mr. Robert Aubin: Thank you.

Depending on their point of view, some people might think that $300 million for a DFI is a vast sum of money. You seem to be saying, however, that it is not enough. That amount is spread out over five years, although you mentioned several times the need for tolerance of investments.

With $60 million per year, I sense there is not have a lot of room for tolerance. Would that $60 million per year be invested to create a tool that would make us look good without really have the necessary resources to achieve its purpose?

[*English*]

Mr. Brett House: I'm going to respond in English, only because I will discuss a couple of accounting notions concerning which my vocabulary is a touch weaker.

The important notion of the $300 million as capitalization, I believe, resides in its accounting treatment for the Canadian government. It ensures that the $300 million does not add to the public debt and is essentially outside of the budget because it's treated as an investment. That's great, and I think it's appropriate, because that $300 million could easily be repaid over time through the returns of the institution, if we were to look at the experience of other DFIs at all.

If $300 million means $50 million per year in portfolio commitments, we are looking at an institution that's unlikely to catalyze private investment for infrastructure, for any large-scale projects, for the kind of catalytic bottleneck-relieving investments that I mentioned earlier. Yes, it may be able to invest in small and medium-sized enterprises, but it's unlikely to bring forward the truly large-scale investment into impactful projects that I think we have the opportunity to engage in and that I would hope for the institution.

● (1030)

[*Translation*]

Mr. Robert Aubin: I would like to get back to the combination of the DFI and international development assistance. The DFI is part of Export Development Canada. In your opinion, do these two vehicles operate in parallel? What might be the relationship between International Development and La Francophonie and this DFI?

Mr. Brett House: I think these two vehicles work more or less in parallel, but they also complement each other. One supports the other. Some projects and activities involve more private financing, while other projects and activities can better be achieved through public financing.

Moreover, certain public assets do not offer enough return on investment to be of interest to the private sector. They must therefore be subsidized through public assistance, but that also supports the environment for private investment.

Mr. Robert Aubin: In your experience, what would the main obstacles be for the DFI? Would it be local capacity and infrastructure, the uncertainty in certain regions or something else? What are the main obstacles that existing DFIs currently face?

Mr. Brett House: I think the first obstacle is finding professionals with expertise in both development and financing. That means professionals who can achieve both developmental and financial objectives.

Mr. Robert Aubin: Thank you.

I have one last question. What role do public-private partnerships play in broader development efforts? Can you name a project that was carried out in that way in the poorest countries?

Mr. Brett House: The issue is that there is not a lot of money for projects in the poorest countries. The problem with current institutions is that they provide financing to countries that are already developing. I think we would have to concentrate on countries that are less developed, that are not yet in a virtuous circle that could help them grow, that do not have the necessary conditions to create the private investment that is needed for sustainable growth.

Mr. Robert Aubin: Thank you.

The Chair: Thank you, Mr. Aubin.

[*English*]

We'll go to Mr. Sidhu, please.

Mr. Jati Sidhu (Mission—Matsqui—Fraser Canyon, Lib.): Thank you, Mr. Chairman.

Thank you, Mr. House, for sharing your knowledge with the committee this morning.

The World Bank estimates that the global economy needs to create 600 million jobs by 2027 and 90% of those jobs must be in the private sector, in order to maintain the current employment rates given the current demographic trends. Moreover, the World Bank underscored the importance of creating better jobs, in order to achieve goals of shared prosperity.

How do you envision the role of the public-private partnership evolving to achieve this goal and provide support to meet the current and future development challenges?

● (1035)

Mr. Brett House: I think one of the things that the financing provided by a Canadian DFI could focus on is sectors, activities, and projects that are particularly labour-intensive and that really do require large-scale involvement by people, in either their realization or their day-to-day conduct.

When we look at the history of development across the last 200 years or so, no country has moved into the middle income ranks without basing, from its early stage, development in agriculture and then very labour-intensive manufacturing, and then later in some more sophisticated and higher-tech industries. I think we need to look at those sectors as some of the places that can be most likely to generate jobs in low-income countries and that provide the stepping stone upward to higher value added.

When we look at the history of development across most of east and southern Asia, we have seen what some economists call the flying geese model of development, where early developing areas have seen wages go up to the extent that some of their activities are no longer affordable. They then move to other neighbouring areas that have a greater supply of labour, more unemployed people, and as a result, lower wages.

We continue to see those shifts, whether it's from China's coastal regions that have become relatively high wage, moving some industry inland where wages are lower, or moving some of their activities to neighbouring countries like Bangladesh or Burma, or in some cases, into lower income countries in Africa as well. That kind of chain, or moving geese pattern—where rather than trying to jump multiple rungs up the ladder too quickly, but instead focusing on a deliberative process of moving up the value chain—I think is one of the best ways that we've seen over decades to create jobs.

At the same time, we need to ensure that basic labour rights and basic standards in the conditions of those working environments are respected. Those should not be ways in which countries or companies compete on cost, and that's where we can play a substantial role through our engagement through multilateral bodies to ensure that's the case.

Mr. Jati Sidhu: Are you saying that we need to start with a bottom-up approach and that good-paying jobs won't happen just from the start?

Mr. Brett House: I think it's important to remember that what we mean by a good-paying job differs from country to country. The cost of living in many countries is substantially lower than they are in a place like Canada. What constitutes a living wage in those environments is substantially lower than it would be here.

That's not to say that we look at those standards as ones that we wish to remain in place for anything more than a moment. Our hope is that those wages and those living conditions will improve, but there's no free lunch by jumping to a much higher wage level simply by mandating it.

Mr. Jati Sidhu: Thank you.

You've spoken extensively on the merits of aid and private, profit-driven investment working as an integral and innovative manner to help towards goals of poverty alleviation. Can you underscore a few factors that would prove essential to determining whether or not our proposed development finance institution succeeds and what they would be?

Mr. Brett House: The critical thing in my mind, to define whether it has been successful, is whether it has both met our development impact objectives and been at least self-financing, so that it is truly able to return the amounts invested and perhaps a bit of premium on top of it to the Canadian purse, and recycle that into future financing.

Certainly, if we look at the experience of other DFIs, we see that they've been pretty good at the financial imperative. As I mentioned, the British CDC has not drawn on the public purse for 15 years. OPIC earns about eight dollars for every dollar invested in its budget by the U.S. government on an annual basis.

I'm advocating that we go into riskier situations, and into riskier projects and sectors. That means our returns probably aren't going to be as high, but I think that if we were able to ensure that we're at least returning to the DFI that which it has put in, with a slight premium to finance its operations, we'll be doing extremely well.

The other thing is that if we are taking the development impact objective as seriously as the financial impact, that may also reduce our returns. OPIC, CDC, and other DFIs have been criticized—rightly, I think—for not putting enough emphasis on setting, monitoring, and incentivizing those development objectives. If we actually do so, that's going to be a mark of our success. That will be a mark of our distinctiveness. It may somewhat reduce our fiduciary returns, but if it's a question between earning two or three dollars on every dollar we put in, rather than the eight dollars that OPIC gets out, I actually think that's a pretty decent trade-off, and a reasonable and very responsible use of the public purse.

● (1040)

The Chair: Thank you, Mr. Sidhu.

We're going to go to Mr. Fragiskatos, please.

Mr. Peter Fragiskatos: Thank you, Chair, and thank you, Mr. House, for your very interesting presentation.

You mentioned OPIC. I have a question about its mandate and the different ways that DFIs can be structured. OPIC's mandate, as you know, includes the promotion of the U.S. private sector, especially small business, and we can compare that with the CDC that does not require support for UK business.

Could you speak about that distinction and what approach could be more effective? Let me emphasize that last point—effectiveness defined as success for achieving development goals.

Mr. Brett House: I think that at the outset, the success of the Canadian DFI should not be measured by the extent to which it benefits or drives business to Canadian companies. Canadian small, medium, or large businesses should be competing for financing from the DFI on more or less equal footing with other organizations, people, or investors.

We're not going to generate the best projects, the best ideas, and the best returns by limiting the DFI to working only with Canadians or with a subset of Canadian businesses. That hasn't been a recipe for success with other DFIs, and in the case of OPIC, they've actively worked to step around the requirement for the local mandate.

The German company Siemens qualifies as a U.S. institution or organization for work with OPIC because, as I mentioned, they've kind of elastically defined “U.S.” to include any company that operates with a substantial amount of activity on American soil. I think that kind of disingenuous..., which congress has forced on OPIC, shouldn't play any part in setting up a clean institution from scratch. We should be clear that a Canadian DFI is meant to work with the best ideas and the best capital to produce impact for those developments and those financial objectives I mentioned.

Inevitably, a Canadian institution based in Montreal and staffed largely by Canadians is going to be one that Canadian companies and investors are able to access relatively easily, and where Canadians will have a cultural advantage in working with that institution. They will have networks of relationships. They will have sensitivities to the environment of that institution that exceed those of foreigners. I don't think we need to put our finger on the scale and provide them with additional advantages, and I don't think that we should try to commeddle regional or sectoral development in Canada with the objectives of international development under this institution and an adequate financial return to ensure that it's self-financing.

Mr. Peter Fragiskatos: I have one last question for you.

In your previous comments, when Mr. Sidhu was asking you questions, you stated that you would advocate that the DFI focus on “very risky situations”. Wouldn't that have to be written into the mandate of a Canadian DFI? If left on its own, I don't think the private sector would tend to focus on those risky situations in terms of an investment focus.

Is that what you're calling for, for that to be expressly written into the mandate of the institution?

● (1045)

Mr. Brett House: In short, yes. I do think that the DFI's mission and vision, and then the articulation by which those will be operationalized, should have that risk-loving focus written into their DNA from the start. It should be there to the extent that it even is defined in some ways in complementary or even oppositional terms to the work that other DFIs are doing, to ensure that it truly is, in a way, expanding on the realm of financeable possibilities that other DFIs do. It should not be replicative.

Mr. Peter Fragiskatos: Are there other DFIs that have that written into their mandates—to focus on the LDCs most in need of investment?

Mr. Brett House: There are rhetorical references to this in different parts of their founding or operational documents. Where it then needs to actually be complemented is in the development objectives and in the finance objectives, the metrics by which the DFI's performance is measured, to ensure that it gets translated into actual activity. Otherwise, it's words on a page.

Mr. Peter Fragiskatos: Thank you very much.

The Chair: Thank you very much, Mr. Fragiskatos.

Thank you very much, Mr. House.

Our time has lapsed again.

As I understand it, colleagues, the bells will start at 11:05 a.m., so you will have plenty of time to get yourselves to the House.

On behalf of this committee, Mr. House, I want to thank you very much. I've noticed over my 18, almost 19 years in Parliament that mandates and what we call the design of these institutions are extremely important, so we very much appreciate your comments today. It brings to mind the federal development bank of Canada. When it first started, it was supposed to be a bank for high-risk and/or risk-loving lending because, of course, in regions like mine, you couldn't get loans from the regular banks. However, they changed the mandate over the years. It became just like a regular bank; in many ways, it was not prepared to take any risk.

The design of this institution is extremely important, and I appreciate the opportunity to use your expertise to explore that somewhat. I'm sure the committee will do more of that over the coming discussions with other witnesses. Again, thank you. We very much appreciate the opportunity to dialogue with you today.

Colleagues, that will wrap it up for today. We'll see you on Thursday. It's been a good meeting with good questions.

The meeting is adjourned.