HOUSE OF COMMONS
CHAMBRE DES COMMUNES
CANADA

FOCUSED, INDEPENDENT, AND PATIENT
Building a World-Class Canadian Development Finance Institution

Report of the Standing Committee on Foreign Affairs and International Development

The Honourable Robert D. Nault, Chair

MARCH 2018
42nd PARLIAMENT, 1st SESSION

FOCUSED, INDEPENDENT AND PATIENT: BUILDING A WORLD-CLASS CANADIAN DEVELOPMENT FINANCE INSTITUTION

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Hon. Robert D. Nault
Chair

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NOTICE TO READER

Reports from committee presented to the House of Commons

Presenting a report to the House is the way a committee makes public its findings and recommendations on a particular topic. Substantive reports on a subject-matter study usually contain a synopsis of the testimony heard, the recommendations made by the committee, as well as the reasons for those recommendations.

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THE STANDING COMMITTEE ON FOREIGN AFFAIRS AND INTERNATIONAL DEVELOPMENT

has the honour to present its

SEVENTEENTH REPORT

Pursuant to its mandate under Standing Order 108(2), the Committee has studied Canada's Development Finance Initiative and has agreed to report the following:

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LIST OF RECOMMENDATIONS

As a result of their deliberations, committees may make recommendations which they include in their reports for the consideration of the House of Commons or the Government. Recommendations related to this study are listed below.

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FOCUSED, INDEPENDENT AND PATIENT: BUILDING A WORLD-CLASS CANADIAN DEVELOPMENT FINANCE INSTITUTION

INTRODUCTION

The House of Commons Standing Committee on Foreign Affairs and International Development (the Committee) concluded a study on Canada's forthcoming Development Finance Institution (DFI). DFIs are publicly-funded financial institutions that support economic development in developing countries by investing in initiatives that have high development impact. Similar institutions have been established by many aid donor countries and multilateral institutions to complement the work of their respective international development agencies and programs.

The Government of Canada announced that it would launch its DFI in its 2017 federal budget. The government indicated that the DFI would be established as a wholly owned subsidiary under Export Development Canada (EDC), would have a capitalization of $300 million over five years, and would support sustainable development and poverty reduction in developing countries.[1] A recent Order in Council brought into force amendments to EDC's enabling legislation, which expanded the purposes of the institution to include the provision of development finance.[2] The government subsequently announced that the headquarters of the DFI would be located in Montreal and that it expected it to launch operations in January 2018.[3]

Beyond the information noted above, little was publicly known about the proposed DFI at the time the Committee commenced its study. This enabled witnesses to think broadly about the role that the DFI should play in Canadian international development policy, what investment strategy it should pursue and how it should be structured. Indeed, a major theme of the Committee's study concerned the design and policy considerations that witnesses believed should guide policymakers in Canada as the DFI takes shape. The Committee heard from a variety of witnesses, including academics, development practitioners and members of civil society organizations, over the course

1 Government of Canada, *Building a Strong Middle Class*, Budget 2017, 22 March 2017.

2 *Export Development Act*, R.S.C., 1985, c. E-20, s. 10(1)(c).

3 Government of Canada, "Canada's new institute to grow private investment in developing countries to be based in Montréal," News Release, 5 May 2017; Global Affairs Canada, "Frequently Asked Questions," *Canada's Feminist International Assistance Policy*.

its study.[4] It also heard from the Honourable Marie-Claude Bibeau, Minister of International Development and La Francophonie, and from the CDC Group – the United Kingdom's (UK) development finance institution.

While a range of opinions were presented to the Committee regarding how Canada should design and operate its DFI, there was broad consensus that the new institution should strive to be innovative and prioritize development impact when making investment decisions. Witnesses encouraged Canada's DFI to seek out investment opportunities in underserved and underdeveloped markets that private investors generally avoid. By doing so, witnesses told the Committee that Canada's DFI could demonstrate the viability of such projects, and potentially catalyze private investment in areas that promote inclusive economic growth and poverty reduction. In order to achieve this, witnesses emphasized that Canada's DFI must be willing to accept a higher degree of financial risk as part of its investment strategy.

The following report sets out the Committee's key findings based on the testimony it heard, and makes six recommendations for the Government of Canada to consider as it launches its DFI. The report begins with a discussion of the current development financing landscape and the role of development finance institutions. It then looks specifically at Canada's DFI and addresses issues relating to the characteristics that should guide the design of the institution, and the strategic and operational decisions that it will have to make.

This report is the Committee's second on the subject of Canadian international development policy during the 42nd Parliament. It follows the Committee's November 2016 report entitled, *Development Cooperation for a More Stable, Inclusive and Prosperous World: A Collective Ambition*, which addressed the former policy direction to concentrate Canada's bilateral development assistance in selected "countries of focus."[5] It is the Committee's hope that, together, these reports contribute to the body of knowledge about how best Canada can support poverty reduction and its

4 See: House of Commons Standing Committee on Foreign Affairs and International Development [FAAE], *Evidence*, 1st Session, 42nd Parliament, 16 May 2017; FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017; FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017; FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017; FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.

5 In June 2017, the Government of Canada released its new feminist international assistance policy. That policy stated that Canada "will discontinue its "countries-of-focus" approach, which concentrated development assistance on a fixed shortlist of countries." Instead, the policy indicated that Canada would adapt its approach by increasing support to least-developed countries. According to the policy, "Canada will ensure that no less than 50 percent of its bilateral international development assistance is directed to sub-Saharan African countries by 2021-22." See: Government of Canada, *Canada's Feminist International Assistance Policy*.

other development objectives abroad. The Committee will continue to remain seized of this subject, and looks forward to a comprehensive response by the Government of Canada to this report.

THE DEVELOPMENT FINANCE ENVIRONMENT

The design of Canada's DFI, the decisions that must be taken regarding how it will operate, and what investment strategy it should pursue, must be informed by the environment in which it is being created. As Jerome Quigley, Senior Vice-President, Programs, Mennonite Economic Development Associates of Canada noted, "this is the first DFI to be created in the last 20 years."[6] Canada's DFI is therefore being created in an environment unlike that experienced by any of its counterparts in other countries. Simply put, the world has changed and the design and operation of Canada's DFI must take this into account.

1. Meeting the Development Financing Challenge

The international development landscape has changed dramatically over the past two decades. In 2000, development assistance was largely provided by traditional donors from the Organisation for Economic Co-operation and Development's (OECD) Development Assistance Committee (DAC), and multilateral institutions. Today, the aid landscape has become much more diverse and complex. Non-OECD DAC countries such as China, philanthropic foundations such as the Bill & Melinda Gates Foundation, and financing mechanisms such as the Global Fund to Fight AIDS, Tuberculosis and Malaria, have all emerged as key players in the international development sphere. Moreover, the private sector, civil society organizations, diaspora communities, social impact investors and many others are all playing a much more prominent role as donors than they were at the start of the millennium.

While development assistance funding globally has grown significantly since 2000, the gap between the needs of developing countries, and the financing pledged to meet these needs, remains vast. This financing gap has become all the more apparent within the context of the United Nations (UN) *2030 Agenda for Sustainable Development* and the accompanying Sustainable Development Goals (SDGs). The 2030 Agenda is a blueprint for global efforts to end poverty, address inequality, promote human dignity and protect the environment. The 17 SDGs are the core of the Agenda, and are meant to build on the progress made under the Millennium Development Goals (MDGs) and to

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6 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

complete "unfinished business." Indeed, Sustainable Development Goal 1 – to end poverty in all its forms everywhere – speaks to the scale of the SDG's global ambitions.[7]

Discussions about attaining the SDGs are taking place within a broader debate about development financing. The Committee heard from several witnesses that the financing necessary to realize the SDGs vastly exceeds annual flows of official development assistance (ODA) from traditional donor governments. While figures vary, Brett House, a macroeconomist who writes on international finance and development, told the Committee that estimates for meeting the SDGs range from $500 billion to $3 trillion required in additional financing each year until 2030.[8] He noted, however, that even if all OECD countries were to meet the UN-prescribed target of spending 0.7% of gross domestic product (GDP) on ODA, it would be nowhere near sufficient to meet the needs of developing countries. Indeed, in 2016, total ODA from all OECD DAC member countries totalled US$142.6 billion.[9] According to Mr. House, if all OECD countries were to meet the 0.7% target, total ODA would amount to about $350 billion to $400 billion per year, a figure well short of the financing required to meet the SDGs.

The fact that ODA alone is insufficient to meet the SDGs is well appreciated by most in the development community. Indeed, prior to the adoption of the 2030 Agenda, governments adopted the *Addis Ababa Action Agenda* at the Third International Conference on Financing for Development in July 2015. The Addis Ababa Agenda addressed the mobilization of public and private resources for development. Specifically, it noted the importance of the financial resources, knowledge, expertise and technology that stakeholders in the private sector and elsewhere can bring to bear in complementing the efforts of governments and supporting the achievement of the SDGs.

The essential role that the diverse range of development stakeholders, including the private sector, must play if the SDGs are to be attained was highlighted throughout the Committee's hearings. Despite the significant progress that has been made to eradicate extreme poverty over the past two decades,[10] Aniket Bhushan, Principal Investigator,

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7 The Sustainable Development Goals (SDGs) replaced the Millennium Development Goals (MDGs) as of 1 January 2016. The MDGs, which were developed in 2000 and had a deadline of 2015, included 8 goals and 17 targets that focused on a set of development objectives, which included efforts to reduce poverty and hunger, increase access to primary schooling, and prevent child and maternal mortality.

8 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

9 OECD, *Development aid rises again in 2016 but flows to poorest countries dip*, 11 April 2017.

10 According to the World Bank, nearly 1.1 billion people were lifted out of extreme poverty between 1990 and 2013. Estimates indicate that in 2013, approximately 767 million people lived on less than $1.90 a day, compared to 1.85 billion in 1990. The World Bank, "Overview," *Poverty*.

Canadian International Development Platform, told the Committee that the world faces "the hardest mile" of achieving SDG Goal 1 of ending all poverty. Mr. Bhushan explained that global poverty is now concentrated in the "most stubborn pockets" of the world that are "the hardest, costliest, and riskiest to reach."[11] This challenge is exacerbated by the fact that many traditional donor governments are facing serious resource constraints. As Mr. Bhushan underlined, the combined effect of constrained budgets and continuing demands brought on by frequent, costly and complex emergencies has put significant pressure on donor governments.

It is therefore clear that, while ODA remains an indispensable tool – particularly for least-developed countries (LDCs) and those emerging from conflict – the mobilization of other types of financial resources is essential. A positive development is that private capital is already flowing to developing countries in significant amounts. However, even when combined, current ODA and non-ODA flows are insufficient to meet the needs of the SDGs. Consequently, it is critical that new mechanisms be explored that can harness private finance as a means of achieving development outcomes. As Brett House argued, "The need to bring private sector financing into the development process is ineluctable. There is no way to avoid it. ODA cannot be enough."[12]

2. A Changing Developing World

As Daniel Runde, William A. Schreyer Chair and Director, Project on Prosperity and Development, Center for Strategic and International Studies, noted, "[t]his is not your grandparents' developing world. It's richer, freer, more capable, and with more options."[13] In the decades since the term "developing countries" has been in use, countries categorized in that group have been doing just that. In real terms, GDP per capita in developing countries has almost doubled in the last twenty years, while developing economies as a whole have gradually increased their share of the world

11 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

12 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

13 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

economy.[14] In 2016, developing economies accounted for 32% of global GDP, compared to 20% of a significantly smaller world economy in 1997.[15]

The incredible economic progress made by developing countries cannot be ignored. Countries in the developing world have not only become richer, they have continued to close the gap in terms of technical ability. Exports of manufactured goods deemed "high-skill and technology-intensive" by developing economies nearly matched those of developed economies in 2016.[16] This is in sharp contrast to twenty years ago when the value of such exports by developed economies was two and a half times greater than those in the developing world. These advancements can also be seen in the investments made by developing countries and economies. China, Taiwan and South Korea all invest a higher percentage of their GDP in research and development than Canada does.[17] Countries that twenty years ago were seen as needing technical assistance from Canada are now leaders in research and development that Canada is encouraged to emulate.[18]

Capital flows into the developing world have also changed a great deal in the last two decades. While ODA has more than doubled in real terms, flows of foreign direct investment (FDI) into developing countries have more than quintupled.[19] The greater sustained growth of FDI compared to ODA, means that it has taken on an increasingly important role in overall economic development. Estimated at US$765 billion in 2015, FDI into developing countries was nearly five times greater than the aid sent in the same year.[20]

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14 In 2005 US Dollars, gross domestic product (GDP) per capita in developing economies was US$1,664 in 1997, compared to US$3,247 in 2016. United Nations Conference on Trade and Development (UNCTAD), "Gross domestic product: Total and per capita, current and constant (2005) prices, annual, 1970-2016", *UNCTADSTAT*.

15 In 2005 US Dollars, world GDP was US$37.2 trillion in 1997, of which US$7.7 trillion was from developing economies. This compares to world GDP of US$61.4 trillion in 2016, of which US$19.7 trillion was from developing economies. Ibid.

16 In 2016, exports of "high-skill and technology-intensive manufactures" in developed economies were US$2.4 trillion and US$2.2 trillion in developing countries that same year. UNCTAD, "Merchandise trade matrix – product groups, exports in thousands of dollars, annual, 1995-2016", *UNCTADSTAT*.

17 In 2014, spending on research and development as a percentage of GDP in Canada was 1.6%; 2% in China; 3% in Taiwan; and 4.3% in South Korea; OECD Data, *Gross domestic spending on R&D*.

18 Barrie McKenna, "Canada is falling behind global leaders in R&D," *The Globe and Mail,* 16 November 2014.

19 In 2015 US Dollars, total ODA grew from US$70 billion in 1997 to US$171 billion in 2016, OECD iLibrary, *OECD International Development Statistics.* In current US Dollars, inward flows of DFI to developing countries increased from US$147 billion in 1996 to US$752 billion in 2015, United Nations Conference on Trade and Development (UNCTAD), "Foreign direct investment: Inward and outward flows and stock, annual, 1970-2015", *UNCTADSTAT*.

20 Ibid.

Though remarkable, these advances have not been shared evenly. In fact, it is becoming increasingly difficult to consider the developing world as a single entity. High-income developing economies, such as China, Malaysia, and Thailand, continue to modernize and integrate with the global economy, looking more and more like traditional advanced industrialized countries. At the other end of the spectrum are low-income developing economies, such as Cambodia, Chad, and Sierra Leone, which have failed to close the gap and risk falling even further behind. Per capita incomes in least developed countries are little more than 20% of the developing world average, and 11% of the average per capita income in high-income developing countries.[21] These ratios have changed little over the last twenty years as the absolute difference between incomes in LDCs and the rest of the developing world has continued to grow.[22]

This economic disparity extends to international investment as well. FDI flows into the 47 LDCs was 2% of the global total, while these countries are home to 13% of the world's population.[23] The US$35 billion estimated to have been invested in LDCs in 2015 was significantly less than the amount invested in Canada during the same period and little more than a tenth of US$322 billion invested in China and Hong Kong.[24]

3. The Role of Development Finance Institutions

The Committee heard throughout its hearings that there is significant untapped potential to better direct and leverage private capital for development outcomes. Indeed, there is an understanding that going beyond ODA is necessary and that private capital must be harnessed in support of development. The real question that the donor community faces is how to do so. It is in this context that development finance institutions step in.

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21 The United Nations maintains a list of 47 least developed countries (LDCs). LDCs are low-income countries that are confronting "severe structural impediments to sustainable development" and are considered to be "highly vulnerable to economic and environmental shocks." United Nations, *Least Developed Countries (LDCs)*. In 2016, GDP per capita in developing countries was US$4,977, while it was US$1,065 in LDCs. By contrast, GDP per capita in high-income developing countries was US$9,513 in 2016. UNCTAD, "Gross domestic product: Total and per capita, current and constant (2005) prices, annual, 1970-2016," *UNCTADSTAT*.

22 In 1997, GDP per capita in developing countries was US$1,492, US$300 in LDCs, and US$2,594 in high-income developing countries. Ibid.

23 UNCTAD, *World Investment Report 2016: Investor Nationality: Policy Challenges*; UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States, *LDCs in Facts and Figures*.

24 FDI inflows to Canada were estimated at US$49 billion in 2015, UNCTAD, *World Investment Report 2016: Investor Nationality: Policy Challenges*.

DFIs are publicly funded financial institutions that support economic growth in developing countries. Unlike a private bank or corporation, DFIs are normally guided by a need to both generate profit for their shareholders and to achieve development outcomes, such as poverty reduction. As the Committee was told, this dual mandate allows DFIs to occupy a space between ODA and private investment. The products and services offered by DFIs, along with the fact they are provided at a profit, means they operate in many respects like private financial institutions. At the same time, the objectives of DFIs – like working to achieve the SDGs – place these institutions squarely within the world of international development.

This dual nature of DFIs – as both a development and a financial institution – allows them to complement the work of both international assistance agencies and private firms. DFIs open up profitable investment opportunities for private firms to which they otherwise would not have access. They do so in the pursuit of development outcomes, like inclusive economic growth and poverty reduction, that support the work of aid agencies. Marc-Yves Bertin, Director General, International Economic Policy, Global Affairs Canada, spoke to the potential of DFIs:

> …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.[25]

The Committee was told that DFIs can fill a specific gap in developing countries that most aid agencies do not address. Many developing countries lack investment-grade sovereign credit ratings, and banks or commercial investors often perceive the risks of potential investments as being too high. DFIs fill this gap by providing financial products in developing countries for projects that would otherwise fail to attract support on reasonable terms. These products can include loans, equity investments, guarantees, risk insurance and other forms of financing.

Catalyzing investment and unlocking capital in support of macro-economic development in developing countries is the core function of DFIs. The Committee was informed that every $1 invested by a DFI has the potential to catalyze an additional $12 in private investment.[26] Because of their public funding and development mandate, DFIs behave differently than private firms. They can take on more risk and exhibit more patience with respect to financial returns than their private sector counterparts. Jessie Green, Director,

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25 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

26 Ibid.

Investment, Développment International Desjardins, identified some of the main advantages of working with DFIs:

> They're patient investors. They tend to take more risk than private investors. We can often get larger amounts from DFIs than from private investors. They tend to be the ones who stay when things go less well. In an economic downturn, private funding tends to disappear whereas DFI funding will often stay. They provide investments in local currency, which we find essential in developing countries.[27]

Several witnesses pointed out that DFIs provide a potentially cost-effective way of supporting economic growth in developing countries as they are generally financially self-sustaining. Brett House, for example, noted that the UK's CDC has not drawn on the public purse for over 15 years, and that the United States' Overseas Private Investment Corporation (OPIC) estimates that it earns $8 for U.S. taxpayers for every $1 invested in its overhead. Mr. House also indicated that the World Bank's International Finance Corporation regularly recycles its profits directly back into its lending portfolio.[28]

The fact that DFIs have a strong financial track record, while at the same time catalyzing private sector growth in developing countries, explains why their lending portfolios have expanded rapidly in recent years. Between 2002 and 2014, total annual commitments by all DFIs grew from approximately US$10 billion to US$70 billion.[29] Daniel Runde, Center for Strategic and International Studies, noted that over the same period the amount of ODA has only doubled.[30] While DFI commitments are currently about half the size of ODA, Aniket Bhushan indicated that DFI investment could surpass ODA within a decade.[31]

The Committee was told that DFIs are not, and should not be seen as, a competitor to traditional forms of aid. Instead, a number of witnesses emphasized that DFIs serve as a complement to, not a substitute for, ODA and aid agencies. Minister Bibeau indicated that Canada's DFI would be a "complement to [its] traditional development efforts, but ODA will continue to be critical to building inclusive and sustainable growth in

27 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

28 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

29 For more information on the growth in DFI financing, see: Center for Strategic and International Studies, *Development Finance Institutions Come of Age: Policy Engagement, Impact and New Directions*, October 2016.

30 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

31 According to Mr. Bhushan, DFI commitments grew more than 10 times as fast as ODA between 2002 and 2014. Brief submitted to the Committee by Aniket Bhushan (Canadian International Development Platform), 8 June 2017.

developing countries."[32] As the Committee heard, aid agencies and DFIs work very differently in terms of generating opportunities and supporting outcomes such as job creation or poverty reduction. At the same time, one of the main advantages of DFIs is their ability to both collaborate with traditional aid agencies and to support projects where aid agencies are unable or not best placed to invest. Brett House articulated this point clearly:

> 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.[33]

While DFIs occupy a space between public aid and private investment, witnesses underscored that a distinction needs to be made between those initiatives best suited for DFI investment and those most appropriate for ODA. In this regard, several witnesses argued that DFIs should not be pushed to act more like aid agencies, and less like institutional investors, as their expertise and capacity is not appropriate for every development-related challenge. Aniket Bhushan, for instance, spoke to the danger of pushing DFIs to cover a wider development mandate, or as he referred to it, "asking the leopard to grow stripes."[34]

DFIs are well suited to invest in potentially profitable projects in countries and sectors where risks are perceived to be too high for commercial lenders, but where development impact is potentially strong. By investing in markets and projects that private firms avoid, DFIs reduce the risk related to these investments and help to demonstrate their viability, which can then catalyze private investments. This "crowding in" of private capital is key for DFIs to contribute to poverty reduction and economic growth as it can shift large amounts of capital into areas that demonstrate higher development outcomes. The Committee heard that it is this valuable work that DFIs should focus on, leaving other forms of development assistance to better positioned development actors.

32 FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.

33 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

34 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

Though DFIs have a number of characteristics in common, their mandate and structure can differ significantly.[35] In addition, both bilateral and multilateral DFIs often differ in terms of their regional or sectoral focus, as well as with respect to the kinds of financial instruments that they offer. The Committee heard directly from Diana Noble, the then-Chief Executive Officer of the CDC, who spoke about the UK's experience in development finance. CDC is the world's oldest DFI and has a mandate to support development in low-income countries through private sector investment. Ms. Noble informed the Committee that CDC works in Africa and South Asia, where the majority of the world's poorest live.[36] In these regions, CDC provides capital to businesses and entrepreneurs by way of loans, debt equity, guarantees and other financial arrangements in priority sectors such as infrastructure, agribusiness, and manufacturing, among others.

The mandate and scope of operations of CDC differs from that of OPIC, another DFI that the Committee heard much about over the course of its study. Instead of engaging directly with partners in developing countries, OPIC provides funding and services to U.S. firms wishing to engage in business in the developing world. OPIC's mandate includes the promotion of U.S. economic interests and supporting its private sector, particularly small businesses, and requires that projects it supports have a "meaningful connection to the U.S. private sector."[37] The experiences of CDC and OPIC provide instructive and useful examples of policy choices related to mandate, governance and operations that must be made in establishing a DFI. Canada can learn from these experiences as it designs and builds its own development finance institution.

CANADA'S DEVELOPMENT FINANCE INSTITUTION

Canada's DFI will be entering markets already populated by significantly larger and more established DFIs, and other institutional investors, in an overall investment context very different from that faced by CDC, OPIC or other DFIs during their start-up phase. As noted above, the amount of private finance flowing into developing countries has increased significantly over the past two decades, as has the amount of capital being deployed by DFIs. The Committee heard from witnesses, for example, that Canada's DFI

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35 For a list of the multilateral development finance institutions (DFIs), as well as the bilateral DFIs among the Organisation for Economic Co-operation and Development's (OECD) members, see: OECD, *Development Finance Institutions and Private Sector Development*. By total portfolio commitments, the United States' Overseas Private Investment Corporation (OPIC) is the world's largest bilateral DFI. The largest multilateral DFIs by total portfolio commitments are the International Finance Corporation of the World Bank Group, and the European Bank for Reconstruction and Development.

36 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

37 OPIC, *U.S. Connection Requirements for OPIC-Supported Projects*; Committee on Foreign Relations and Committee on Foreign Affairs, *Legislation on Foreign Relations Through 2008*, p. 122.

will be entering into an already "crowded space," and a market for investment projects that is "getting close to saturation."[38]

Given this context, Canada must make some difficult choices in the design and operation of its DFI as it seeks to find its niche, while balancing the dual objectives of development impact and financial self-sufficiency. The large, and increasingly private, amounts of capital flowing into the developing world means that finding those truly catalytic opportunities that also provide a reasonable financial return is harder today than it was twenty years ago. Sectors and markets that were once under-developed and capital-deprived are now mature and robust, and the private sector is increasingly investing in places it was once afraid to go.

In her testimony, Diana Noble acknowledged that the role of DFIs "is definitely getting harder", while arguing that "there is still a big gap where DFIs are needed."[39] The Committee heard that the rationale and need for the services that DFIs provide is especially important in least developed countries. Several witnesses stated that private investors often find working in these countries too risky. As Daniel Runde put it, "[i]f you're going to be investing in Mali, it's a very different conversation from investing in Brazil."[40]

While investing in these countries is challenging, DFIs are "particularly useful" in such contexts, according to Simon Maxwell, Senior Research Associate with the Overseas Development Institute. Mr. Maxwell noted that many private investors find it difficult to obtain information about commercial opportunities in some of the world's poorest countries and fragile states. He explained that "[h]aving the imprimatur of the DFI" can lend credibility to a project, which can encourage the private sector to invest.[41]

In starting fresh, Canada's DFI may be positioned to meet these needs better than more established DFIs. As Brett House put it:

> 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

38 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017; FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

39 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

40 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

41 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

> the effort of creating a Canadian DFI, which needs to be focused on higher-risk lending in places where no other investors will go.[42]

While witnesses encouraged Canada's DFI to take on more risk and to focus on markets and countries genuinely in need of the institution's services, they also acknowledged that this was easier said than done. Jerome Quigley testified: "the work of investment is more risky and more difficult the further into poverty you want to reach, and I think that requires creative and innovative approaches."[43]

The proposed size of Canada's DFI must also be factored into its design and operation. One witness described the proposed capitalization of $300 million over five years for Canada's DFI as "puny" when compared to the investment portfolios of other DFIs.[44] Even the DFI's future parent corporation, EDC, will likely continue to have larger operations in the developing world than the DFI for the foreseeable future. In 2016, EDC conducted $866 million of business in emerging markets, up 37% from the previous year.[45]

According to Jerome Quigley, the relative size of Canada's DFI requires it to act differently. He explained, "at the initial $300 million over five years, we believe this DFI is too small to act like other DFIs. OPIC is investing about $1.6 billion annually. CDC has net assets of somewhere in the neighbourhood of $5 billion. To be meaningful, the Canadian DFI at that level must be bold."[46] Unlike larger DFIs, Canada's DFI will not be able to balance out higher risk ventures with a broader portfolio of safer, but less impactful, investments. Consequently, in order to be viable, Canada's DFI will have to develop a unique investment strategy that unlocks new opportunities in under-serviced areas.

In light of all of this, a choice must be made. Canada's DFI can either pursue a strategy that is likely to make the institution financially self-sustaining in the short- or medium-term through lower-risk investments, or it can pursue a strategy that is likely to lead to significant development impact. Testimony has convinced the Committee that Canada's DFI cannot do both. The financially safe option means pursuing strategies which have low overhead costs and can be put in place relatively quickly. This would mean following the lead of established DFIs and other investors, leveraging their experience and knowledge to earn a safe rate of return. Canada's DFI would be a junior partner in a

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42 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

43 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

44 Ibid.

45 Export Development Corporation [EDC], *Changing Trade: Annual Report 2016*.

46 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

portfolio of worthwhile investments, but it would struggle to demonstrate the achievement of truly catalytic development impact. The alternative – going to "places where no other investors will go" – means building investments from the ground up and taking on higher levels of risks. This approach would make achieving financial self-sufficiency unlikely in the short- or medium-term, and have a much higher risk of failure. However, the potential for meaningful development impact would likely be greater.

The Committee believes that Canada should strive to establish an institution that is world-class and innovative, one that makes a valuable addition to the world of development finance initiatives. As Brett House argued, the "logic of a DFI is inescapable." Every other Group of 7 country has a DFI, as do almost all OECD countries. The Committee agrees with Mr. House that by not having a DFI, Canada is "leaving good money on the table for others to benefit from."[47] At the same time, as Jerome Quigley testified, "[t]he world does not need another baby DFI that competes with other DFIs and private capital for low-risk, high-impact investments in low-income countries. Doing so, or trying to do so, would make it a lightweight, pale duplicate of what all the other DFIs are doing."[48] Instead, the Committee heard that Canada's DFI should not duplicate existing work, but rather pursue a higher risk, higher development impact strategy. This will require the prioritization of development impact over financial sustainability in the short- to medium-term.

Recommendation 1

The Government of Canada should design its DFI to prioritize the achievement of impactful and sustainable development and to strive to develop innovative solutions to current development challenges, while working to anticipate and adapt to future challenges.

1. Design Considerations

The design of Canada's DFI – the mandate it is given, the composition of its board of directors, the type of staff it recruits, and its relationship to the government and EDC – should be informed by the context in which the institution is being established and the objectives it seeks to achieve. If Canada's DFI is to be innovative and seek out investments that are truly catalytic, it should be designed to achieve this mandate. It should also be given the tools that enable it to attract the talent required to achieve its goals. As Diana Noble put it, "[y]our aim at its core is to build a high-quality investment

47 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

48 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

organization, with everything that is implicated in that statement."[49] In order to establish such an institution, the Committee heard that Canada's DFI should be designed with three core principles in mind. Canada's DFI should be focused, independent, and patient.

a. Focused

In order to be effective, Canada's DFI must have a clear and focused mandate, and its board and corporate structure must be designed with that focus in mind. Witnesses highlighted the importance of a properly defined mandate, given the dual nature of a DFI's mandate, as both an international development and financial organization, is "inherently hard."[50] The mandate must be focused on tasks that DFIs are adept at achieving, and should not include unnecessary supplementary development objectives. It should also determine the desired balance between the DFI's development and financial imperatives.

(i) "Limited use case"

As previously discussed, DFIs can be effective tools when they are deployed in pursuit of objectives for which they are well suited. Aniket Bhushan put it succinctly:

> There is this danger of pushing DFIs to act more like aid agencies than like institutional investors. We should try to remember or at least keep in mind, when we're thinking about mandate, what we are aiming for here. Are we aiming for another aid agency, and if so, why? Or are we aiming for what DFIs really do? They catalyze private finance, which is a limited-use case.[51]

A DFI's mandate should therefore focus on achieving this objective, while recognizing that it is a complement to, not a substitute for, official development assistance. By catalyzing private investment, DFI's promote development at a macro-economic level over the long term. As Aniket Bhushan testified, "We need to remember that with the macro impact of DFIs, there's a potential to move the needle in terms of driving investment, driving productivity, and driving growth over the long term. That ought to be the focus, rather than looking to just celebrate projects."[52]

In his testimony, Marc-Yves Bertin provided some examples of projects by other DFIs that achieved this objective. Swedfund, the Swedish DFI, for example, invested in "a

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49 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

50 Ibid.

51 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

52 Ibid.

network of private women's hospitals and clinics, nursing schools, and other projects in developing countries," that did not have the track record needed to get private financing.[53] Because of the DFI's investment, these organizations were able to demonstrate the viability of their operations and receive the additional capital they needed from commercial investors. Mr. Bertin also spoke about the Dutch DFI's investment in fertilizer production in developing countries, which improved local access to fertilizers and fostered food security.

(ii) "Do not Christmas-tree"

A related point made by witnesses was that even within the "limited-use case" parameter of catalyzing private finance, DFIs can be asked to achieve a number of objectives that can draw it away from its core function. Rohinton Medhora, President of the Centre for International Governance Innovation, warned governments not to "[c]hristmas-tree" DFIs "with lots of vague objectives that don't add up."[54] It can be tempting to add additional objectives to a DFI's core economic development mandate, but this can reduce the DFI's overall effectiveness by further limiting the scope of acceptable projects. As previously discussed, the realities of achieving development impact in a manner that will be financially self-sustaining means the DFI will already have a narrow focus on countries and markets that demonstrate the desired characteristics. Adding additional development objectives only narrows this field further.

Diana Noble cautioned against making the DFI's already difficult mandate "too hard" by requiring it to work in specific sectors or achieve objectives outside its core mandate. As Paddy Carter, Senior Research Fellow with the Overseas Development Institute, pointed out, there is a finite number of investment opportunities which meet the development and financial criteria of DFIs. When governments limit this field further, DFIs "started subtracting ones that they don't do. They don't add extra ones that they can do."[55] While such limitations are seen as furthering worthy objectives, they may reduce the overall development impact of a DFI's investment by putting in place additional criteria that exclude investments with a higher potential impact.

According to Aniket Bhushan, this concern is particularly relevant to smaller DFIs as they are less able to demonstrate a given focus within their existing portfolio. "[S]ome of the bigger DFIs, their portfolios and their footprints, as it were, are so large that if you wanted to show a focus on women and girls, or if you wanted to show a focus on

53 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

54 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

55 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

climate, or if you wanted to show a focus on agriculture and climate, it would be pretty easy to show that."[56] Smaller DFIs do not have this luxury and could potentially be forced to invest in less impactful projects in an effort to demonstrate a given focus.

One objective which witnesses expressly stated should not be part of a DFI's mandate is that of providing a benefit to the domestic Canadian economy or business. The Committee heard how domestic benefit criteria can unnecessarily complicate a DFI's mission and undermine its effectiveness. According to Brett House, "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… I don't think we need to put our finger on the scale and provide them with additional advantages."[57] In her testimony, Minister Bibeau confirmed that working with Canadian companies will not "be a prerequisite."[58]

(iii) A "risk-loving focus written into their DNA"

Several witnesses emphasized the importance of achieving the right balance between a DFI's development and financial objectives, and urged Canada's DFI to place a stronger focus on development impact through the acceptance of higher investment risk. According to Brett House, Canada's DFI "should have that risk-loving focus written into their DNA from the start…to ensure that it truly is, in a way, expanding on the realm of financeable possibilities that other DFIs do."[59] As already noted, achieving significant development impact in the modern global economy means going into capital-deprived markets and countries that are inherently riskier. As Daniel Runde put it, "[t]here's an implicit expectation that it's going to be taking on a higher level of risk than if it were investing in telecom projects in Brazil or Turkey or China."[60] Simply put, prioritizing development impact means accepting higher risk.

The Committee was told that development focus and risk tolerance must be embedded in the mandate, as DFIs "are prone to drift away from their developmental purpose and more to financial and commercial purposes."[61] One of the difficulties with focusing on development impact is that it is more challenging to measure outcomes. Financial goals are easier to measure and quantify, which can create an incentive for their prioritization

56 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

57 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

58 FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.

59 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

60 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

61 Ibid.

over development goals. A mandate that accepts risk and promotes development objectives would help to counter this potential bias and orient the institution toward the desired balance from the start.

This is not to suggest that financial imperatives should be ignored. Rather, such an approach would recognize that one of the ways that Canada's DFI can innovate is by altering the traditional balance between finance and development. As Rod Lever, Vice-President of Cowater International, informed the Committee, with the right balance, Canada's DFI will "be forced to innovate to find strong, developmentally impactful and additional deals that on a portfolio basis…are not loss-making."[62] This balance extends to the structure of a DFI and the skills it seeks to recruit. Diana Noble emphasised the "commercial judgement" required to make sound investment decisions as a core trait of a successful DFI, a skill which is in high demand and whose acquisition should be a priority.[63]

Recommendation 2

The mandate of Canada's DFI should focus on the core objective of catalyzing private investment for international development; clearly state the institution's objective of balancing development goals with financial returns; affirm that the DFI is a complement to, not a substitute for, official development assistance and aid agencies; and acknowledge that an emphasis on development impact requires the acceptance of greater financial risk.

b. Independent

Independence was a second core characteristic that was identified by witnesses as being critical to the success of Canada's DFI. The Committee was told that independence from government and its parent corporation will be crucial to the DFI's ability to recruit and retain the talent it will require, starting with its board of directors. The Committee also heard that independence was key for the DFI to develop and implement a bold and innovative investment strategy, and to remain accountable for delivering on its mandate. Being established as a subsidiary crown corporation of EDC will provide Canada's DFI with a significant degree of independence from the start. This independence needs to be further fostered through complementary policies that allow the DFI to pursue its

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62 Ibid.

63 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

mandate in a genuinely autonomous fashion. Rohinton Medhora recommended that the DFI be created as a standalone crown corporation not under EDC.[64]

(i) Recruiting the Right People

If Canada's DFI is going to succeed in unlocking the potential of markets in some of the world's most difficult environments, it needs leaders and staff with the necessary experience, talent and dedication to meet this significant challenge. In order to attract and retain such talent, the Committee heard that the DFI must have the independence to implement its mandate free from interference. This means framing its mandate in a manner that allows room for discretion and innovation. As Diana Noble put it, "the ultimate success of the institution is as much down to the calibre of the people you are able to attract as to the precise strategy and mandate they are given. My advice is to leave some flexibility for them to set the strategy they think they can execute."[65]

The first step to meeting this challenge is to appoint a board of directors with the expertise required to implement the DFI's mandate. Brett House testified that: "[i]t is critical that it have an independent-minded and risk-loving board", while stating that the DFI as a whole must be built to balance the two "imperatives" of development impact and financial return. An independent board that has balanced expertise in development and finance is critical to the independence of the DFI. In the words of Ms. Noble, an independent board provides "that extra buffer … between what the executive need in terms of continuity to keep going, and to have those conversations with government and politicians who might have short-term agendas."[66] This role would be undermined were the board to lack the necessary independence, for example, by being made up of public officials or EDC directors, ultimately responsible to the government or EDC instead of to the DFI.

The need for independence extends through the entirety of the institution. The success or failure of the DFI as a whole depends on the sum of the individual investment decisions taken by its staff. As Diana Noble put it, Canada's DFI will "need to attract people who are extremely high calibre.… These people do exist…but they don't exist in great numbers. You have to find them and then set a culture where these people will stay." One means of doing so is to foster an independent environment in which staff are empowered to make individual investment decisions and trusted to implement the DFI's investment strategy.

64 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

65 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

66 Ibid.

Recommendation 3

The DFI's board of directors should be made up of independent professionals that provide the institution with balanced expertise related to both financial management and international development.

(ii) Empowering the Board to set the Agenda

The Committee was told that once the DFI's board of directors and senior staff have been recruited, they must be given the freedom to pursue the institution's mandate in the manner they deem the most likely to succeed. This begins with the mandate itself, which as previously discussed, should be focused on the DFI's core function of catalyzing private investment, free of additional objectives, but broadly stated to allow the DFI the independence it needs to be effective. This independence also extends to the DFI's relationship with EDC and the government. The DFI must be allowed to follow the strategy it deems best, independent of government policy or EDC's priorities.

Some witnesses argued that requiring the DFI to align its investment strategy with government processes, while potentially creating synergies in the pursuit of complementary objectives, is ultimately counter-productive if it is imposed in a manner that inhibits innovation and discourages new ideas. As Rohinton Medhora asked, "[i]f everything is homogenous, where do the new ideas come from?"[67] By fostering innovation through an independent approach, Mr. Medhora argued that an area not in "Canada's mainstream… might become an ODA priority because of something small and interesting and successful that the DFI did 10 years previously."[68]

The Committee heard that an emphasis on development effectiveness and independence are not mutually exclusive. Several witnesses argued that, as a stakeholder in Canada's wider international development landscape, the DFI should meet the highest development standards. In this regard, Jerome Quigley said that development impact and additionality should be at the top of the DFI's mandate.[69] In addition, Francesca Rhodes, Women's Rights Policy and Advocacy Specialist with Oxfam Canada, testified: "the DFI's mandate should align with development effectiveness principles and focus on additionality. In order to ensure alignment with sustainable

67 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

68 Ibid.

69 Ibid.

development, the DFI should conform to the principles of development effectiveness, particularly country ownership, transparency, and accountability."[70]

Given its size and the fact it is entering a well-established space, Canada's DFI will need to develop new ideas both to achieve success in its own operations and to make a meaningful contribution to the broader development agenda. Mr. Quigley suggested, "Given its size, the DFI might consider a sectoral or geographical focus. For instance, it would be innovative to de-risk private capital for investments in environmental infrastructure or women-led businesses or health."[71] An empowered and independent board and senior staff should be focused on developing and implementing these new ideas, not trying to link their operations to the broader objectives of the government or EDC. Diana Noble highlighted how an independent board of directors contributes to the CDC's effectiveness:

> Although we have one shareholder—the British government—they devolve responsibility to an independent board. They don't have anyone sitting on the board, and they also don't have anyone sitting on the investment committee, so they have no involvement in investment decisions. The board consider themselves responsible and fully accountable for the execution, and for ensuring that the executive team, myself included, fulfill our mandate and execute our strategy as well as possible.[72]

Allowing the DFI to focus on innovation and delivering on its core mandate will ensure that the board and senior management remain accountable for their decisions and the operations of the institution.

Recommendation 4

The Government of Canada and Export Development Canada should allow the new DFI to pursue its mandate in an independent manner, free from requirements to align its operating processes with broader government or corporate policies. At the same time, the DFI should ensure that it operates in a way that is not discordant with Canadian values and interests.

c. Patient

Patience was a third core characteristic that the Committee heard will be essential for the new DFI. A number of witnesses underlined that it will take time to develop an innovative approach to development finance, and to implement an investment strategy

70 Ibid.

71 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

72 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

centred on catalyzing private investment in higher risk environments. Indeed, an ambitious mandate that favours development impact means accepting higher financial risk, making financial sustainability harder. Investments will take longer to set in motion, they will be more likely to fail, and the ones that succeed will take longer to do so. Canada's DFI will therefore have to be patient, both in terms of establishing an investment strategy and beginning operations, as well as achieving financial sustainability.

(i) Time to sow

With an ambitious mandate, the amount of time needed to establish and operationalize the DFI will be longer. Daniel Runde counselled patience in allowing the DFI to "demonstrate its worth" and "get its sea legs."[73] He explained, "There's going to be a period of time, three to five years, to stand this institution up, to create an investment track record, to create various processes for making decisions...."[74] The Committee was told that the time required to build the institution will depend upon how it wants to invest. DFIs that follow a more indirect investment strategy can stand up more quickly than those that wish to invest directly. This is especially true in underdeveloped markets, which as Aniket Bhushan indicated, require DFIs to "invest fairly significantly in what we call a ground game. It needs to know who to partner with, what deals are viable, and so forth."[75]

Simply put, developing an innovative investment strategy that focuses on achieving substantial development impact in difficult environments will take time and cost money. In other words, the Canadian DFI's first investment must be in itself. It must first establish an investment strategy worthy of a world-class institution before seeking out investments abroad.

Even when this stand up phase is complete, the DFI cannot rush into making investments. Several witnesses highlighted the need to develop a "pipeline" of projects that meet the DFI's criteria, allowing staff to determine where to invest by evaluating a number of viable options. Diana Noble advised Canada's DFI to "start reasonably cautiously and see how it goes."[76] She commented that investment professionals should

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73 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

74 Ibid.

75 Ibid.

76 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

not "feel that they have to do something because they don't have a strong enough pipeline and enough choices."[77]

The time it takes to develop this pipeline will also be conditioned by the DFI's mandate and investment strategy. Working in difficult environments and underdeveloped markets requires greater patience to find and develop investable opportunities. Speaking of CDC's experience in underdeveloped markets, Diana Noble said: "A lot of the things we invest in take a year or two years from when we first see them, when they're totally uninvestable, to the point of saying that we've now shaped it well enough that we can put our money behind this."[78] As highlighted by several witnesses, this process may include partnering with other organizations to provide project partners with the technical assistance and other forms of aid it needs in order to become investable.

Given this, it is important that Canada's DFI be given the time it needs to stand up the institution and develop a pipeline of projects that meets its mandate and investment strategy. This will require financing the operations of the DFI throughout the initial stand up and operational phases and demonstrating patience in terms of timelines for the scaling up of investment commitments.

(ii) Time to grow

Patience is not only required to establish the DFI and develop its pipeline of projects, but is also required throughout its work. Witnesses repeatedly emphasized "patient capital" as one of the critical characteristics of successful DFIs. According to James Haga, Vice-President, Strategy and Investment, Engineers Without Borders Canada, "we are looking at 10 or 15 years out, as opposed to thinking about year one, year two, or year three. That kind of patient model is paramount."[79] This patience is a key distinction between DFIs and private investment institutions. As Marc-Yves Bertin pointed out, "commercial banks tend to want to see the return over a certain period of time, whether that's a three- or five-year horizon."[80] By contrast, DFIs look for a return on investment over a longer time period, providing private enterprises in maturing markets the time and space to grow.

This patience is all the more critical when working in difficult environments. As James Haga pointed out, "it took Coca-Cola, one of the largest and most efficient companies in

77 Ibid.

78 Ibid.

79 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

80 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

the world, over 12 years to break even in its operations in sub-Saharan Africa...”[81] Patient capital provides fledgling businesses with the stability they need to navigate dynamic environments and uncertain markets. By enabling the conditions businesses need to succeed, patient investments can help to demonstrate the viability of industries in areas where capital had previously been unwilling to invest. As Diana Noble noted, this patience also extends to the realization of development impact: “We think in decades, not in years, and therefore stakeholders of the DFI need to have the expectation that results, both in terms of financial return and impact, are going to take a long time to come through.”[82]

Once Canada’s DFI has been given its mandate and the freedom to pursue it, it must be allowed the time to demonstrate both the financial and development viability of its strategy. As Diana Noble put it, “[t]o lose patience halfway through, say after five years, would be disastrous.”[83]

Recommendation 5

The Government of Canada should provide the DFI with a minimum period of 10 years to demonstrate that it can fulfil its mandate in a financially sustainable manner, and commit to providing additional funding to the institution during this period, as necessary.

2. Investment Strategy

Once the basic structure of Canada’s DFI has been put in place and its mandate has been established, the DFI will need to develop an investment strategy and make related operational decisions. Witnesses highlighted a number of critical choices that the DFI will have to make in determining how it will achieve its mandate. These choices inform one another, as decisions in terms of investment strategy will help to determine operational choices.

Witnesses discussed a number of choices that Canada’s DFI will have to make in developing its investment strategy. This includes decisions on the size and types of investments the DFI will make, whether it will have a geographic or thematic focus, and determining the types of partnerships in which the DFI wishes to engage.

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81 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

82 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

83 Ibid.

(i) What to offer

Canada's DFI must determine what services it intends to offer. Several witnesses, including Brett House, advocated for the provision of a broad range of services. Mr. House stated, "[the DFI] needs a full range of financial instruments, everything from loans to the ability to take equity shares, provide guarantees, and provide risk insurance."[84] The exact mix of services and financial instruments to be provided, particularly the balance between debt and equity investments, should be decided based on how best to achieve the development objectives of a particular project in light of relevant operational considerations. As Marc-Yves Bertin noted: "[t]he 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."[85] Canada's DFI will benefit from its connection with EDC in this regard, allowing it to draw on EDC's expertise in providing a variety of financial services in an international context.

In addition to deciding what types of financial services to offer, Canada's DFI must also decide what size of investments to make. Several witnesses suggested that the DFI differentiate itself from other DFIs by making smaller investments. For example, Jessie Greene, Director of Investment at Développement international Desjardins, spoke about the difficulty that Développment International Desjardins has had in obtaining smaller investments from DFIs. She explained, "We were looking for less than a few million dollars, and the DFIs told us that was just way below their minimum ticket size. Most of them start at $7 million or higher. That makes it almost impossible for start-ups and for innovative new initiatives to find funding from DFIs."[86] Providing smaller investments would potentially be one way that Canada's DFI could be innovative, while also diversifying its risk by increasing its total number of investments. As Paddy Carter testified, "If you are quite a small entity, one way of coping with risk is to have lots and lots and lots of very small investments so they don't all fall over at the same time, whereas if you had some chunkier investments, obviously your risk exposure would be a lot higher."[87]

A strategy of pursuing smaller investments does, however, have limitations given that smaller investments will likely have larger relative overhead costs. If the time and cost of

84 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

85 Ibid.

86 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

87 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

pursuing a $1 million investment and a $10 million investment are essentially the same, the smaller investment will need a much higher rate of return in order to be financially sustainable. As Simon Maxwell put it, "[w]ith the amount of money you have available, you're not going to be a retailer."[88] While pursuing investments smaller than those traditionally sought by other DFIs may be a viable strategy for innovation and achieving development impact, there will nonetheless be a minimum threshold under which investments will not be financially sustainable. For example, if the DFI were interested in investing in microfinance initiatives, it would invest in the institutions which provide this type of financing instead of making small loans directly. Paddy Carter suggested this type of "intermediaries" based business model as a means of providing support to women, young entrepreneurs and small farmers.[89]

(ii) Where and with whom to invest

Given its relatively small size, one way that Canada's DFI may be able to maximize its impact is by specializing in certain sectoral or geographic areas. As Aniket Bhushan put it, "Canada's DFI will be small, and therefore by definition needs to find a niche."[90] By limiting the scope of operations to specific countries or sectors, the DFI could potentially limit some of the operational costs associated with an ambitious mandate. Such an approach could also reduce the investment required to develop the expertise and local knowledge necessary to engage in higher risk environments.

A mandate that prioritizes development impact through truly catalytic investment is likely to limit the geographic scope of operations regardless of a specific investment strategy. As previously discussed, there are fewer countries and markets genuinely in need of a DFI's services than twenty years ago. As a result, Canada's DFI is likely to exclude projects in upper-middle and high-income economies, which would omit most of Latin America and large parts of Asia.[91] This reduction in scope could be concentrated further by deciding on a specific group of countries where Canada's DFI believes the best potential exists to implement its mandate.

While witnesses generally recommended a focus on the poorest countries and populations, several offered other potential targets. Speaking about her organization's experience, Lauren Ravon, Director of Policy and Campaigns with Oxfam Canada, testified, "Oxfam has moved from investing only in the poorest countries to looking at

88 Ibid.

89 Ibid.

90 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

91 World Bank, *World Bank Country and Lending Groups*.

the criteria of inequality.... As we see those gaps widen, inequality in those countries is actually of greater concern in the long run than only focusing on poverty where it is today."[92] Jessie Greene discussed how Développment International Desjardins targets countries based on the demonstrated need for the service to be offered: "On the way we choose our countries, basically we're looking for countries where access to finance is low…. We believe the need is high. This is a social impact opportunity but also a business opportunity."[93]

Several witnesses, including the Minister of International Development and La Francophonie, highlighted the importance of the DFI aligning its investment strategy with Canada's new Feminist International Assistance Policy. Francesca Rhodes told the Committee, "As Canada's new feminist international assistance policy focuses on a feminist approach to ending poverty, the DFI should complement this and do the same."[94] She further argued for the need to ensure that "the DFI has the capacity and expertise for mainstream gender equality throughout its work and also to provide targeted investments that benefit women and girls." Ms. Rhodes continued, "In designing any development policy or program, a gender analysis is essential to ensure that both women and girls benefit, and that gender inequality is not inadvertently reinforced." James Haga highlighted the importance of a gender lens, noting that "systemically, women entrepreneurs in developing countries the world over face many more challenges and are discriminated against in that pursuit."[95]

Witnesses also recommended a number of sectors where Canada's DFI could support high development impact projects with a potential for financial return; many of these, such as agriculture, have traditionally been ignored by DFIs. For example, Rob Lever recommended focusing on sectors where enterprises "are viable and have the potential to scale up in a financially sustainable way. Examples include the renewable energy sector, the water sector, and small infrastructure."[96] A number of witnesses also highlighted opportunities to invest with female entrepreneurs and women-led businesses, a focus which would align with Canada's feminist international assistance policy.

92 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

93 Ibid.

94 Ibid.

95 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

96 Ibid.

A strategic focus limited to certain countries or sectors differs from the “Christmas tree” issue of tacking on additional objectives to the DFI’s mandate that was discussed earlier. The purpose of a strategic focus is to target projects in countries and sectors that demonstrate the best chance of success related to both development impact and financial return. This differs from adding objectives that draw away focus and potentially make achieving the DFI’s core mandate more difficult.

(iii) How much to offer

A number of witnesses questioned the relatively small financial capitalization of Canada’s DFI, noting that its size could make it difficult to be sustainable and impactful in the long-term. While the current proposed size may be adequate during its initial operational phases, Canada’s DFI will have to consider how the scale of its overall investment portfolio aligns with its long-term investment strategy. As Rohinton Medhora put it, “I think a small size is fine to begin, but this is not a long-term sustainable model. In the long term, there is going to have to be a difference in ratio, and the way to change that ratio is not by having fewer staff but by having larger lending activities.”[97]

The Committee heard about two broad options for increasing the size of the DFI’s overall investment capitalization. One is simply to request more funding from the government or EDC. Daniel Runde testified that he “would not be surprised if the DFI comes back to this committee and to Parliament and asks for more than $300 million. If you're going to ask them to go to more difficult places, you're going to have to accept higher risk…you're probably going to be asked for some additional capital.”[98] If the DFI determines that the additional capital is required at a similar scale to the initial commitment, further funding out of EDC’s annual income could be a viable option.

Assuming EDC maintains net income near current levels, additional commitments of similar size to the government’s initial commitment would not place an undue burden on the DFI’s parent corporation.[99] In her testimony, Minister Bibeau described the initial capitalization as “start-up,” and suggested the government would be open to providing additional capital later, should it be required.[100]

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97 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

98 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

99 EDC reported a net income of $1.072 billion in 2016, an increase from $925 million in 2015. EDC, *Changing Trade: Annual Report 2016*.

100 FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.

If Canada's DFI determines that it will need to scale up operations significantly, another option to increase the size of its portfolio would be to issue debt. Brett House, for one, advocated for a DFI of "much greater scale… 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."[101] Given the current global financial environment, Mr. House believed there "would be enormous demand for the paper issued by EDC in the name of the DFI", ultimately backed by the Government of Canada.[102]

(iv) With which partners

Witnesses emphasized the importance of developing effective partnerships as a means of reducing the risk that the DFI takes on and to increase development impact. These partnerships could take a variety of forms. Partnering with other DFIs or similar institutions could help to spread out risk and reduce costs, while collaborating with the business community at the early stages of a project can help ensure the crowding in of private sector dollars. Aid organizations and civil society groups are also important partners. These organizations can provide local knowledge garnered from direct contact with beneficiaries and community groups, as well as expertise related to the economic and development environment in a particular country.

Technical assistance and other forms of traditional aid were frequently highlighted by witnesses as critical to developing projects to the level where a DFI's investment was viable, particularly in under-developed markets. Rod Lever stated clearly, "[s]uccessful development finance institutions combine their financial instruments with grant-based technical assistance… which is fundamental to providing the capacity the beneficiary needs."[103] Likewise, James Haga pointed out that "technical assistance and the whole suite of business support services that need to be made available to entrepreneurs are of great importance."[104] Speaking of the development of micro-finance, Jessie Greene highlighted that "[m]any grants were made throughout the world …Initially, it wasn't seen as something to invest in. Because the infrastructure was built up, eventually they created investable institutions."[105] Ms. Greene cautioned against ignoring this initial phase, "[o]ften what we see now is that, in new sectors or in new geographical areas

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101 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

102 Ibid.

103 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

104 Ibid.

105 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

where these institutions don't exist, investors come in without having in mind the fact that there was such a long history of building up that infrastructure initially with grants."[106]

While Canada's DFI should be independent of the government, Global Affairs Canada (GAC) is likely to be the institution's closest partner. Witnesses noted the potential for a mutually beneficial relationship between GAC and Canada's DFI, where GAC would provide assistance to develop a pipeline of investable projects. Giving the example of the Mennonite Economic Development Associates of Canada's successful investment collaboration with GAC, Jerome Quigley recommended "that the DFI should consider working with Global Affairs Canada to offer sidecar technical assistance to augment and enhance its investments."[107] According to Mr. Quigley, Canada's DFI "will quickly learn that the impact of its investments can be greatly enhanced with targeted additional support from Global Affairs Canada."[108] From the government side, Minister Bibeau confirmed the possibility of GAC providing technical assistance to the DFI's projects, especially where such assistance would support gender equality.[109]

Witnesses also recommended that Canada's DFI partner with the Canadian private sector and local diaspora communities as a means of taping into existing Canadian expertise and knowledge. Rod Lever suggested, for example, that the "DFI set up a mechanism to work with the Canadian private sector to identify pipeline projects with strong developmental impact in the success of which Canadian expertise can play an instrumental role."[110] Paddy Carter noted that "evidence shows that the vast majority of businesses in fragile and conflict-inflicted states are run by a returning diaspora."[111] Brett House pointed out that the numbers suggest that Canada currently is not taking advantage of diaspora communities to promote trade and investment relationships. He stated, "We don't seem to be exploiting those potential cultural, familial, and historical roots in a way that leads to dollars following them."[112] As the DFI builds its portfolio of

106 Ibid.

107 Regarding the project, INFRONT, Mr. Quigley testified that it "is a pioneering Global Affairs Canada-funded blended finance project with $15 million of de-risking capital from the Canadian government paired with $5 million in technical assistance" to businesses that are "genuinely concerned about issues such as poverty, the environment, and women's participation." FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

108 Ibid.

109 FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.

110 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

111 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

112 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

projects, it should ensure that it draws on the range of expertise that groups, such as diaspora communities in Canada, can provide.

3. Operational Decisions

Once an investment strategy has been established, Canada's DFI will have to make a number of decisions in order to get the institution up and running. Choices will need to be made regarding the operational design of the institution, its project approval process, its method of measuring development impact, as well as its accountability and transparency structures. These decisions will be informed by the DFI's mandate and investment strategy, with operations designed to achieve the DFI's objectives.

(i) Building Corporate Infrastructure

Canada's DFI must build the corporate structure required of a financial institution, and determine the various ancillary services that are needed to conduct its investment operations. In building this structure, the DFI will need to determine its level of integration with EDC. As Marc-Yves Bertin of Global Affairs Canada pointed out, Canada's DFI will "need to figure out what its core mission is and what type of work it could actually "outsource"…to EDC, things such as IT systems, HR, potentially even treasury functions."[113] Mr. Bertin said that this outsourcing may have "the virtue of accelerating the speed with which the organization can be stood up, rather than starting from scratch, as well as leaning on … the institutional foundation and know-how that exists currently in EDC."[114] The potential benefits of this strategy would need to be weighed against potential drawbacks, including the reduced independence of the new institution and a potentially more complicated organizational structure.

The DFI will also have to determine the scope of its international operations, specifically the need for and potential size of a permanent presence overseas. This decision will be particularly influenced by the investment strategy, as the types of investments to be pursued and the geographic scope of operations will be critical factors in determining the necessity and viability of overseas offices. While costly, witnesses highlighted the importance of developing local knowledge in order to succeed in difficult environments. As Rohinton Medhora put it: "If you want to be effective in the development sphere, you need on-the-ground expertise. … how are you going to get the local nuance? Is it going to be by being in Montreal, or is it going to be by having a network of informants and professional staff around the world? It's likely the latter." Here as well, Canada's DFI has

113 Ibid.

114 Ibid.

the potential to leverage existing EDC capacity, using its existing presence in the developing world to maintain representation with lower overhead.[115]

(ii) Identifying Investment Opportunities

Canada's DFI will have to establish a decision-making process that facilitates the identification, evaluation and approval or rejection of projects. The strength of this process will determine to a significant extent the ability of the institution to implement its mandate and investment strategy. As Diana Noble testified, "[y]ou need to be clear about what you're going to say yes to and what you're going to say no to" because without a strict approval process "your team will be able to justify any investment, because any investment in a hard place achieves some impact."[116] The principles and objectives of the mandate must, therefore, be operationalized in a coherent and consistent manner that furthers the strategic direction of the institution.

Ms. Noble highlighted the need to properly evaluate the risk versus the return of an investment. "[S]takeholders think about impact, impact, and impact. They don't, at the front of their minds, think about the risk that they assume in order to deliver that impact." To counter this, Ms. Noble recommended hiring professionals "with commercial judgment, people who can look at a situation and understand the risk that they're taking, and mitigate it, and structure it, but who can also say no." She continued that to support these people, DFIs need "really good processes around risk." Speaking of CDC, Ms. Noble testified: "[w]e have a risk committee. We have a risk structure. We built this all from the bottom up. We talk about it a lot. Risk is our business, and we have to do it well."[117]

The Committee was told that decision-making procedures must also reflect the types of investments the DFI wishes to make and the environments in which it will operate. Jessie Greene described DFIs as being "a little inflexible and bureaucratic" and that working with them can involve "long delays and complicated legal negotiations" that can impede development outcomes.[118] Speaking of working with local organizations with limited legal capacity, Ms. Greene said "a DFI comes with a 50-page loan agreement, they'll just sign and not understand everything that's in there, all the consequences that it can

115 EDC maintains a branch Office in Singapore, as well as representatives in Canadian embassies and consulates in Brazil, Chile, China, Colombia, Germany, India, Indonesia, Mexico, Peru, Russia, South Africa, Turkey, the United Arab Emirates, and the United Kingdom.

116 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

117 Ibid.

118 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

have. This is not a development approach. This is an institution trying to cover all the bases for every possible legal eventuality in a country where really the legal system is, let's say, not Canada's."[119]

(iii) Measuring Development Outcomes

Given the dual nature of a DFI's mandate, its performance will be judged by both the development outcome that it achieves and the financial return that it generates. Minister Bibeau stated this clearly when she noted that the success of the DFI "will be measured by its ability to generate long-term development results while becoming financially self-sustaining over time."[120] Canada's DFI will therefore need to develop a means of measuring the development impact of its investments in order to demonstrate the fulfilment of its mandate. While DFIs report on the achievement of their development mandate, according to Brett House, "they often fail to establish and measure" the underlying development outcomes adequately.[121] Lauren Ravon criticized DFIs in some countries for the "very little evidence' they provide to demonstrate the development impact of their operations. She urged Canada's DFI to "show the same level of accountability" as other Canadian development actors, which must provide "a considerable amount of evidence" of the results of their work.[122]

While existing DFIs have been criticized for their lack of rigour in measuring development impact, Rob Lever noted that "established methodologies" exist to allow Canada's DFI to "build a robust results-management framework based upon best private sector practices in the sphere of international development."[123] Aniket Bhushan recommended that the DFI go beyond measuring immediate impact by also measuring "mezzo- and macro-level impacts" and their "contribution to second-order growth in activity and investment and their impact, however indirect, on poverty reduction."[124]

Other witnesses were more sceptical of applying methodologies from other types of development organizations to Canada's DFI, noting the differences in their mandates and intended outcomes. According to Paddy Carter, unlike traditional aid projects which try "to achieve quite a well-defined effect on quite a well-defined group of people", the

119 Ibid.

120 FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.

121 FAAE, *Evidence*, 1st Session, 42nd Parliament, 16 May 2017.

122 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

123 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

124 Ibid.

benefits of a DFI's investment are diffuse and long term.[125] Given that "the accumulation of investment is what takes a poor country from being unproductive and poor to being wealthy and productive", Mr. Carter expressed "confidence that a DFI is contributing towards a sustainable development goal." He noted, however, that measuring and articulating the contribution that DFIs make toward sustainable development remains a "difficult problem."[126] Jessie Greene made similar comments, stating "the DFI should be requested or required to report on its outputs and activities." However, while underlying the importance of putting in place systems to support poverty reduction, Ms. Greene noted that "poverty is very complex," and that measuring outcomes is not always easy.[127]

(iv) Promoting Transparency and Accountability

Measuring development impact is one element of the broader accountability and transparency decisions facing Canada's DFI. Francesca Rhodes noted that there have been increased calls for "much greater transparency and accountability of DFIs."[128] Paddy Carter stated that Canada's DFI had "an opportunity to lead the world in terms of the transparency of the DFI's operations" as established DFIs try to adjust procedures in response to the criticism they have faced. Elaborating on this point about transparency, Mr. Carter said:

> …it should be possible for Canadian citizens to look at where you have invested; to understand the rationale for that investment; if there are questions to be asked about the tax arrangements of those investments, to be able to see what the taxation arrangements are; and also to be able to see beneficial ownership.[129]

In the same vein, Francesca Rhodes noted the importance of "putting in place accountability mechanisms" for the DFI. She specifically recommended that Canada's DFI implement a mechanism similar to that established by the Netherlands' DFI. According to Ms. Rhodes, the Netherlands has put in place an independent mechanism "where communities affected by investments made by the [Dutch DFI] can take any concerns or complaints."[130] Complaints submitted through the mechanism are handled by an

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125 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

126 Ibid.

127 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

128 Ibid.

129 FAAE, *Evidence*, 1st Session, 42nd Parliament, 13 June 2017.

130 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

independent expert panel.[131] Jessie Greene also recommended that Canada's DFI make a particular effort to recognize and report on their projects that fail: "I would be so pleased to see a DFI share its failures. This is something that's taboo in development but very common in investment."[132] Strong accountability and transparency mechanisms and procedures will be critical to maintaining the legitimacy of Canada's DFI and its ability to fulfil its dual mandate of supporting development outcomes, while remaining financially self-sufficient.

Minister Bibeau confirmed in her testimony that Canada's DFI would have a corporate social responsibility policy, informed by the best practices of other DFIs, as well as frameworks regarding ethics and transparency.[133]

Recommendation 6

Canada's DFI should put in place transparency and accountability mechanisms that match or exceed the standards currently set by DFIs in other countries.

CONCLUSION

The Government of Canada's decision to establish a development finance institution comes at pivotal moment for international development cooperation. The *2030 Agenda for Sustainable Development* and the Paris climate accord have reaffirmed the importance of international cooperation to meeting the global challenges of the 21st century and have mobilized people and groups around the world. These calls to action have also made clearer the dynamics of the modern international system. There is no longer a sharp dichotomy of the developed versus developing world, as emerging economies have asserted themselves on the world stage. At the same time, non-state actors from civil society and the private sector are increasingly affecting change on a global scale. Meeting today's development challenges means drawing on the experiences, expertise and resources of all of these stakeholders.

It is within this context that Canada is launching its DFI. The Committee heard throughout its hearings that DFIs can play a pivotal role in this new environment, acting as a bridge between traditional development actors and the private sector, and building partnerships that harness necessary new resources. As both a development and financial institution, DFIs have a unique role to play in supporting commercial ventures

131 FMO Entrepreneurial Development Bank, *Independent complaints mechanism*.

132 FAAE, *Evidence*, 1st Session, 42nd Parliament, 15 June 2017.

133 FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.

with high development impact that are lacking private or public sector funding. Indeed, as the global community works to fulfill its international development commitments, DFIs will be an indispensable tool in catalyzing and unlocking private sector growth and capital. In the words of one witness, “DFIs are in the space where the puck is going.”[134]

The Committee believes that the new Canadian DFI can play a meaningful role in development finance and contribute to Canada’s broader development efforts. However, in order to do so, it should not simply duplicate the work already being done by larger, well-established DFIs. Nor should they compete with the services and support provided by traditional donors. Instead, Canada’s DFI should be innovative and concentrate its efforts in areas that show the promise of truly catalyzing private investment in support of development outcomes. This will be difficult and the DFI will have to accept higher financial risks that will make its goal of financial sustainability harder. The Committee believes, however, that with a focused, independent and patient outlook and strategy, Canada’s DFI can develop into an innovative, world-class institution that achieves tangible results.

134 FAAE, *Evidence*, 1st Session, 42nd Parliament, 8 June 2017.

APPENDIX A
LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
As an individual	2017/05/16	62
Brett House, Deputy Chief Economist		
Department of Foreign Affairs, Trade and Development		
Marc-Yves Bertin, Director General International Economic Policy		
As an individual	2017/06/08	66
Rod Lever, Vice-President Cowater International		
Daniel Runde, William A. Schreyer Chair and Director, Project on Prosperity and Development Center for Strategic and International Studies		
Canadian International Development Platform		
Aniket Bhushan, Adjunct Research Professor and Principal Investigator Norman Paterson School of International Affairs, Carleton University		
Engineers Without Borders Canada		
James Haga, Vice-President Strategy and Investment		
As an individual	2017/06/13	67
Paddy Carter, Senior Research Fellow Overseas Development Institute		
Simon Maxwell, Senior Research Associate Overseas Development Institute		
CDC Group		
Diana Noble, Chief Executive Officer		
Centre for International Governance Innovation	2017/06/15	68
Rohinton Medhora, President		

Organizations and Individuals	Date	Meeting
Développement international Desjardins	2017/06/15	68
Jessie Greene, Director Investment		
Mennonite Economic Development Associates of Canada		
Jerome Quigley, Senior Vice-President Programs		
Oxfam Canada		
Lauren Ravon, Director of Policy and Campaigns		
Francesca Rhodes, Women's Rights Policy and Advocacy Specialist		
Department of Foreign Affairs, Trade and Development	2017/09/28	72
Hon. Marie-Claude Bibeau, Minister of International Development and La Francophonie		
Elissa Golberg, Assistant Deputy Minister Strategic Policy		
Diane Jacovella, Deputy Minister International Development		

APPENDIX B
LIST OF BRIEFS

Organizations and Individuals

Canadian International Development Platform

Runde, Daniel

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings* (Meetings Nos. 62, 66, 67, 68, 72, 79, 83, 84 and 87) is tabled.

Respectfully submitted,

Hon. Robert D. Nault
Chair

SUPPLEMENTARY OPINION BY THE OFFICIAL OPPOSITION THE CONSERVATIVE PARTY OF CANADA'S THOUGHTS ON CANADA'S NEW DEVELOPMENT FINANCE INSTITUTE

Introduction:

Over the course of the past ten months, the Standing Committee on Foreign Affairs and International Development (FAAE) has studied the implementation of Canada's new Development Finance Institute (DFI), first introduced in Budget 2015, by the previous Conservative Government and subsequently re-announced in Budget 2017 under the current Liberal Government. Both budgets earmarked an investment of $300M over 5 years as the initial capital to set up a DFI in Canada.

It is the opinion of the Conservative Party Members of the Standing Committee that the report tabled has not accomplished the goal of balancing witness testimony with respect to risk, re-investing in the DFI and the report has failed to provide recommendations on how the DFI should be structured.

The Conservative Party of Canada (CPC) Members would like to extend their thanks to all witnesses who took part in this study and wish to submit the following supplementary opinion with additional recommendations for consideration by the Government in setting up Canada's new DFI.

Structure of the DFI

The report as presented by the Committee has failed to provide recommendations to the Government regarding how the funding ($300M over 5 years) should be spent and how the DFI should be structured.

Risk Taking and Risk Assessments

Committee Members heard through witness testimony that the initial investment of $300M over 5 years earmarked by the Government of Canada should have "growth and expansion of the DFI…in-built from the start"[1]. Ultimately, the end goal of the DFI is for the Institute to become self-sustainable, with the ability to re-invest earned capital in order to allow it to grow. The Conservative Party Members support the Government's investment of $300M over 5 years (as was initially announced in the previous Conservative Government in Budget 2015), however, it is their opinion that initial investments made by the DFI should seek to take a lower risk so as to ensure that the DFI can build on its initial $300M investment. The DFI should then begin to take on higher risk investments once new earned capital is gained.

[1] Committee Testimony – June 15, 2017

As stated by Diana Noble (CEO, CDC Investment Works):

"Remembering that unless businesses are successful, no impact happens is incredibly important. Pushing into white unoccupied space sounds great in principle because they're white, but they're also white because other people think they're too hard."[2]

It is therefore the view of the Conservative Party of Canada's Committee Members that recommendation 2 should be amended to read:

Recommendation 2

The mandate of Canada's DFI should focus on the core objective of catalyzing private investment for international development; clearly state the institution's objective of balancing development goals with financial returns; affirm that the DFI is a complement to, not a substitute for, official development assistance and aid agencies; and acknowledge that it must grow to reach profits where it is strong enough to take on an emphasis on development impact with an acceptance of greater financial risk.

Re-Investing in the DFI after the first 5 years

Committee Members heard throughout testimony that the DFI should be provided with ample time to prove itself. Witnesses testified that a timeline of 10 years would be a recommended amount of time for the DFI to prove its effectiveness. The Conservative Party Members of the Committee are in agreement that the DFI should be given time to prove its' concept, however, are reluctant to agree that additional funding should be earmarked after the initial investment of $300M over 5 years has ended. A fulsome assessment is recommended prior to reinvestment to ensure that appropriate additional funding is needed. That is, a re-investment may not require an additional $300M over 5 years given that much of the initial overhead costs will have been used from the original investment.

Additionally, one example provided by Rohinton Medhora, President of the Centre for International Governance Innovation (CIGI) suggested that in order to expand the DFI without relying on the taxpayer, "one thought is that over time a higher proportion of the EDC revenues might be devoted to the DFI"[3].

Protecting the rights of all potential investors

In recent months, the Liberal Government has introduced a values test for organizations applying for funding under the Canada Summer Jobs program. The policy places many applicants in the unacceptable situation of having to choose between their deeply held beliefs and receiving support from the government for projects that are important to Canadian society. As no change

[2] Committee Testimony – June 13, 2017
[3] Committee Testimony – June 15, 2017

has been made since this values test was introduced, it is clear that other Government funding opportunities may be subjected to the same values test. The Conservative Party of Canada believes that all Canadians should be treated equally by their government, regardless of their faith or conscience. The right to freedom of belief and opinion is guaranteed by Canada's Charter of Rights and Freedoms and values tests such as these should have no place in a multicultural society such as Canada.

As a result of recent events, the Conservative Party Members of the Committee are concerned with the final sentence of the Committee's recommendation 4 of the report which states: "**At the same time, the DFI should ensure that it operates in a way that is not discordant with Canadian values and interests.**"

Therefore, the Conservative Party Members of the Committee recommend the following changes to Recommendation 4 to read:

Recommendation 4
The Government of Canada and Export Development Canada should allow the new DFI to pursue its mandate in an independent manner, free from requirements to align its operating processes with broader government or corporate policies. At the same time, the DFI should ensure that it operates in a way that is not discordant with Canadian values and interests including the right to freedom of belief and opinion as guaranteed by Canada's Charter of Rights and Freedoms.

Supplementary Opinion of the New Democratic Party

The New Democratic Party generally agrees with the report and recommendations, however we feel compelled to express our disagreement with recommendation 4. We base this decision on the compelling testimony given by a number of witnesses who recommended stronger linkage to government commitments, in particular to sustainable development goals. Others recommended independence for the Development Finance Institution (DFI) from the EDC.

Recommendation 4 provides that the DFI should be allowed to pursue its mandate in an independent manner, free from requirements to align its operating process with broader government or corporate policies. The only exception added is for the DFI to ensure it operates in a manner consistent with Canadian values and interests.

A number of witnesses recommended a different approach. They recommended that the DFI could deliver its role in reducing extreme poverty more effectively if its programs serve to compliment and supplement Canada's Official Development Assistance (ODA) policy, including delivering on Canada's commitments to the sustainable development goals (SDG 2030). As Minister of International Development, Marie-Claude Bibeau testified:

> "As we know, in 2015, the international community adopted a new set of global sustainable development goals, or SDGs, to continue to address poverty and inequality. It is always really important to keep in mind that the goal of our new feminist policy, as in the case of sustainable development goals, is to fight poverty....The private sector's involvement is key to achieving development results in order to end poverty and inequality.
>
> Those new objectives are based on the idea that all parties and resources related to development must be mobilized. We know that official development assistance has helped generate significant gains over the past few decades. However, it is clear that public sector resources alone will not enable us to reach the sustainable development goals by 2030.
>
> This is where the private sector comes in… This is where Canada's new Development Finance Institution can play a key role…It has been shown that DFIs, in addition to supporting economic growth in developing countries, could successfully support our international development priorities.
>
> The new institution will prioritize activities in areas such as action on climate change, clean energy, agrifood and infrastructure, including infrastructure related to water management and treatment. Financial services and businesses run by women and young people will also be a priority." [1]

The Canadian Council for International Co-operation (CCIC) similarly expressed concern with an approach that focused solely on profit maximization over development impact:

> “A disproportionate degree of investments have subsidized OECD country companies working in Middle Income Countries, with DFIs prioritizing profit maximization over development impact. In 2010, 50% of DFI investments went to the financial sector (financial intermediaries) who aren’t gearing their funding to local investments. And many of these investments pass through secrecy jurisdictions. Finally, transparency around financial leverage and development impact is still sorely lacking.” [2]

As Oxfam Canada’s Francesca Rhodes testified,

> “The new DFI is an opportunity to be innovative and to leverage finance for poverty reduction and gender equality. Canada will need to be bold in how it is designed in order to ensure that these goals are met. Higher finance should never be a replacement or substitute for aid. However, if designed carefully and in alignment with Canada's new feminist international assistance policy, the DFI could add important contributions toward achieving these same goals.”[3]

Of particular importance the DFI should give particular attention to supporting women-led small and medium-sized enterprises (SMEs). Using Canada’s Feminist International Assistance policy as guide would provide the DFI with the important niche identified above. As CCIC noted, “micro- and small enterprises account for the bulk of employment [in developing countries], even middle income countries. Yet there is a $850 billion shortfall in credit for SMEs, and women consistently face barriers in accessing such capital.”

By taking an approach which compliments and supports Canada’s ODA policy the DFI will be more effective in its core purpose of reducing extreme poverty in countries in the greatest need of assistance. If the DFI takes an approach which is not aligned with Canada’s policies its small level of funding will prevent it from making a significant impact on poverty reduction.

Some witnesses recommended that the DFI could more effectively deliver its mandate within a bold and innovative investment strategy if it was established as a separate standalone entity rather than under the thumb of the EDC.[4] They submitted that independence from government and its parent corporation, EDC, will be crucial to the DFI’s ability to recruit and retain the talent it will require, starting with its board of directors.[5] Others suggested that if the DFI remained under the umbrella of the EDC its independence could be further fostered through complementary policies that allow the DFI to pursue its mandate in a genuinely autonomous fashion. As Rohinton Medhora (President Center for International Governance Innovation) testified:

> “Here I should sound a cautionary note that the institutionalization of the DFI within the EDC is not ideal.

The main reason it's not ideal is that the corporate culture of the promotion of trade and export is not the same as the banking culture, and it's not the same as the development culture. The skill sets, the ethos, and the objectives that each of these requires is different, and I fear that if care is not taken to situate the DFI appropriately within the EDC, it might not be fully effective.

I've been following—and associated with in some ways—the development of the DFI for some time. My first reaction was that this is a situation that cries out for a crown corporation set-up, which Canada does so well. Crown corporations are independent, and they provide good governance, diversity in partnerships, and effectiveness, all of which are built into their boards and operating structures."[6]

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1 FAAE, *Evidence*, 1st Session, 42nd Parliament, 28 September 2017.
2 Canadian Council for International Co-operation written submission to FAAE June 22, 2017
3 FAAE, *Evidence*, 1st Session, 42nd Parliament,15 June 2017
4 FAAE, *Evidence*, 1st Session, 42nd Parliament,8 & 15 June 2017
5 FAAE, *Evidence*, 1st Session, 42nd Parliament,8 & 15 June 20
6 FAAE, *Evidence*, 1st Session, 42nd Parliament,15 June 2017