Joint Submission to the House of Commons Standing Committee on Finance:

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Recommendation: That the Government of Canada should establish a publically-owned, profit-driven Development Finance Institution to partner with business on near-market terms to build markets and reduce poverty in developing countries. Specifically, we recommend that the Government commit $50 million over the next 3−5 years to provide the overhead for this institution with lending capital to be raised in fixed-income markets.

I. Executive Summary

We are pleased to have the opportunity to submit our recommendation to the Standing Committee on Finance as part of its pre-budget consultations.

Based on the Government of Canada's commitment in the *Global Markets Action Plan* to create "deeper trade and investment ties with many of the largest, most dynamic and fastest-growing markets in the world," we encourage the Standing Committee on Finance to endorse the following recommendation:

> *That the Government of Canada should establish a publically-owned, profit-driven Development Finance Institution to partner with business on near-market terms to build markets and reduce poverty in developing countries. Specifically, we recommend that the Government commit $50 million over the next 3−5 years to provide the overhead for this institution with lending capital to be raised in fixed-income markets.*

Private sector investment is the key driver of economic growth: it's essential to creating new businesses that provide jobs, earn profits and generate tax revenue, as well as other benefits to society. But some promising enterprises in many low- and middle-income countries—and Canadian companies that work in these regions—can't access the long-term financing they need to grow and reduce poverty.

Canada provides roughly $5 billion in official development assistance—namely grant aid and support for concessional loans—to poor countries every year. Still, Canada is the only G7 country that doesn't have a commercially driven Development Finance Institution (DFI) that can partner with the private sector to build markets in developing countries.

A Canadian DFI wouldn't disburse grants: it would only provide loans and equity finance on near-market terms for profit-making activities that also help to reduce poverty in developing countries. It would complement aid provided by the Department of Foreign Affairs, Trade and Development (DFATD) for public goods—not substitute for it.

The experience of the other G7 countries shows that such partnerships can combine doing good with earning a profit. These profits could be used to stretch our Government's development dollars further, allow our aid money to be concentrated in the poorest countries, build our business links to the BRICS (Brazil, Russia, India, China, South Africa) and other emerging middle-income countries, and increase Canada's impact in the global fight against poverty.

II. Context and background information:

1. Development assistance to build markets works

- Development assistance has helped to produce huge gains in the fight against extreme poverty: in 1981, 52% of people in the developing world lived on less than US$1.25/day; by 2012, less than

20% lived below this poverty line. Well-targeted development assistance in conjunction with the development of markets works.

- Finishing the battle against extreme poverty will require more resources than governments can provide through Official Development Assistance (ODA) grants.
- Building markets and providing public goods (e.g., vaccinations, anti-malarial bednets, etc) are different tasks and require different financing models.

2. Canada is the only G7 country that lacks a DFI

- All other G7 countries have created publically-owned, profit-driven **Development Finance Institutions (DFI)** to partner with business on near-market terms to generate jobs, growth, profits and poverty reduction (Table 1).
- Most other OECD countries also have successful DFIs. The Netherlands and Spain provide two particularly successful examples. It's time for Canada to follow their lead and learn from their experiences.
- Some emerging markets are also developing DFIs and the BRICS New Development Bank (NDB) may also provide commercially-oriented products that would overlap with the DFI space.

Table 1. G7 Development Finance Institutions (DFIs) 1/

Country	**France**	**Germany**	**Italy**	**Japan**	**UK**	**USA**
DFI name	**PROPARCO**	**DEG**	**SIMEST**	**JBIC**	**CDC**	**OPIC**
DFI incorporation date	1977	1962	1991	1999	1948	1969
DFI capital base, USD mn	556	992	217	17	1,236	50
DFI total portfolio, USD mn end-2012	4,101	7,937	1,123	155	3,879	16,400
DFI new commitments, USD mn 2012	969	1,703	151	42	627	3,600
DFI net profit, USD mn 2012	51	173	17	1	352	273
DFI return on investment, in %, 2012	1.3	2.2	1.5	0.4	9.1	1.7
National private flows to dev'ing countries, USD mn 2012	18,078	21,383	8,161	32,494	48,500	107,200
DFI new commitments, % total private flows	5.4	8.0	1.8	0.1	1.3	3.4
GDP, USD bn	2,612	3,427	2,014	5,961	2,484	16,240
DFI new commitments, % GDP	0.037	0.050	0.007	0.001	0.025	0.022

1/ Sources: National DFI websites, OECD.

III. What is a DFI and what problem does a DFI address?

DFIs occupy a space between public aid and private investment. They are public, profit-driven financial institutions that partner with business on near-market terms to generate jobs, growth, profits and poverty reduction. They provide capital to build markets in developing countries and regions where access to private sector funding is limited for Canadian, international, and most acutely, local companies.

DFIs fill a gap in financial markets. Most low-income countries do not have investment-grade sovereign credit ratings. This makes it impossible for some international investors to invest in these countries—either in their government debt or in their companies. Local capital is limited. As a result, entrepreneurs and companies, particularly small- and medium-sized enterprises, find it hard to borrow the money they need to grow. This creates a "missing middle" in many developing countries: the businesses with the greatest potential to create jobs have the least access to capital.

Similarly, Canadian and international companies often find it hard to raise capital to work in low- and middle-income countries. Diaspora communities that intimately understand developing countries often lack the credit histories and business track records needed to access bank lending in Canada.

DFIs invest in countries and sectors where short-term risks are too high for banks or other commercial investors—but where long-term returns are potentially strong. DFI lending can allow Canadian, international and local businesses to flourish in countries and sectors where they otherwise would never have got off the ground.

IV. Key characteristics of successful DFIs

- **Build on precedent** with sixty years of history in developing best practice.
- **Focused** on profitable commercial support to businesses building markets in developing countries.
- **Broad range of financial instruments:** loans, equity investments, guarantees, risk insurance, *etc.*
- **Catalytic financing:** small amounts of public finance strategically designed to mobilize private capital.
- **Unconstrained by nationality**: able to work with businesses and entrepreneurs from any country.
- **Protected against domestic political influence** to ensure commercial & poverty-reduction priorities.
- **Distinct from other public development efforts:** not a grant provider or a channel for industrial policy. DFIs are most successful when they are clearly grounded in commercial principles, separated from aid activities.
- **Profitable and self-sustaining**: profits are retained to finance the DFI's operations.
- **Patient capital**: backed by government, able to borrow at low rates and invest in long-term returns.
- **Additionality**: a complement, not a substitute, for Official Development Assistance (ODA). Canada's $5 billion ODA allocation should be unfrozen in 2015 and expanded at least as quickly as the rate of inflation.

V. Why Canada would benefit from a DFI

As the only G7 country without a public institution to provide risk capital to enterprises working in developing countries, Canada is missing a major opportunity to leverage the know-how of our companies, our diaspora communities and our international partners. A Canadian DFI would dovetail naturally with Canada's stated interest in building global markets in pursuit of sustainable economic development.

It's reasonable to ask why Canada needs its own DFI, especially when we already provide commercial development finance through the world's DFI, the International Finance Corporation (IFC), which is part of the World Bank Group.

Put bluntly, without a Canadian DFI, we're leaving money on the table for others. DFIs have a long history of making profits by doing good. Britain's CDC Group hasn't drawn on the public purse for over 15 years. The United State's Overseas Private Investment Corp. earns $8 for U.S. taxpayers for every $1 they invest in its overhead. And the IFC's profits get recycled back into new deals.

About half of the world's total output and annual growth now come from emerging and developing countries. Canada needs to deploy every tool possible to participate in the rise of these markets. A Canadian DFI would allow us to reduce poverty, extend our influence and earn a profit all at the same time.

Canada should build a DFI with a distinctively Canadian mandate, capital, skilled workforce, financial instruments and ties to other agencies needed to ensure Canada has a greater impact on poverty reduction. A Canadian DFI would allow us both to focus our continued grant aid on assisting the poorest in very low-income countries that have no access to international capital markets and also remain engaged in fighting pockets of extreme poverty in middle-income countries through the development of private business and markets that produce jobs and higher incomes.

All other G7 countries have created a clear line between their aid activities and their assistance to for-profit actors in the private sector, which they support through profit-driven DFIs. It's time for Canada to follow their lead, learn from their mistakes and improve on their examples.

VI. Possible institutional models for a Canadian DFI

- A Canadian DFI could be created through a range of different institutional models: a stand-alone Crown Corporation, a subsidiary in an existing Crown Corporation, a special agency, a unit within an existing Government Department or a public-private partnership.
- The option to create a DFI-like mechanism within an existing Government Department should be discounted: no existing Department has the appropriate skills mix for a DFI-like mechanism, it would be difficult for a Department to enter into the appropriate contractual arrangements, and it would be nearly impossible to recruit appropriately skilled staff under existing PSC rules.
- Other countries' experiences augur for a stand-alone institution or a distinct entity within an existing Crown Corporation whose mandate is appropriately adjusted to accommodate DFI-style functionalities and appropriate risk-taking.

VII. Sizing a Canadian DFI

- On average, the 6 existing G7 DFIs provide annual commitments equivalent to about 3.3% of their country's private capital flows to developing countries and about 0.024% of their national GDPs. For a prospective Canadian DFI, that implies annual commitments of between CAD $350mn and $500mn.

VIII. Financing a Canadian DFI

- Aside from initial overhead, a Canadian DFI should be budget-neutral for the Federal Government. Annual lending should be raised through international fixed-income markets by leveraging Canada's AAA credit rating. A Canadian DFI should be provided with debt-issuance capacities under review of the Federal Government.
- A Canadian DFI may wish to issue in foreign local debt markets with the aim of assisting in building reference yield curves and enhancing local market development.

IX. Activities and risk profile of a Canadian DFI

- A Canadian DFI should be mandated with a higher risk appetite than other existing DFIs, including the IFC, and more in line with a typical high-quality private-equity fund.
- It should also engage in distinct sectors, geographies and skill areas that are under-served and have high opportunity.

APPENDIX 1 – About Engineers Without Borders

Established in 2001, Engineers Without Borders is a movement of over 50,000 professional engineers, development experts, students, staff and committed supporters across Canada and Africa, working together to outsmart poverty. We undertake our work in the systemic way you would expect from engineers, focusing not on symptoms but on tackling the root causes of why poverty persists.

In our 6 countries of operation in Africa, EWB builds the capacity for bottom-up innovation in African organisations– businesses, governments and NGOs – enabling them to prototype, pilot and scale operations that improve access to clean water and infrastructure, improved (and profitable) agricultural markets and more effective, representative governance systems.

APPENDIX 2 – About the Centre for International Governance Innovation

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (Blackberry), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

For more information, please visit www.cigionline.org.