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Briefing: How can CDC use DFID's planned funding of £3.5bn to deliver the Sustainable Development Goals?

The CDC Group is a Development Finance Institution owned by the UK Government and overseen by the Department for International Development (DFID). CDC works with the private sector in Africa and South Asia, investing Overseas Development Assistance (ODA) provided by DFID to achieve a financial return and development impact. It invests directly by providing equity, debt and guarantees to businesses, as well as indirectly through financial intermediaries such as private equity funds.

As a Catholic development agency, CAFOD has decades of experience working with its partners and communities on economic development, including through the private sector. CAFOD monitors the work of CDC because it spends ODA and is a key part of the international development architecture in the UK and globally.

DFID sees CDC as a crucial component to implement its Economic Development Strategy. In October 2017 it published a business case to invest £3.1 - £3.5bn[1] via CDC over the period 2017-2022, after the Commonwealth Development Corporation Act, approved in February 2017, increased the cap on DFID funding for CDC from £1.5 billion to £6 billion, potentially rising to £12 billion.

DFID recognises that there are risks to CDC implementing its new 2017-2021 strategy, which outlines how it will support job creation in Africa and Asia: "CDC will certainly face a significant management challenge in managing the growing commercial portfolio, delivering against the increased ambitions and commitments of the new strategy, and expanding higher risk investment." But it concludes "we are confident that CDC has the right processes in place to manage and mitigate these risks so it can expand and innovate further."

We welcome the links the new CDC strategy makes with the Sustainable Development Goals (SDGs). CDC now needs to provide more detail on how it will contribute to this agenda in practice as it receives an additional £3.5 billion in ODA. Putting the right processes in place to deliver on this ambitious strategy is particularly important given CDC's commitment to increase investments in risky environments, such as fragile and conflict states, where it will be imperative to do no harm.

A crucial first step will be to update how investment decisions are made. Currently, potential social and environmental risks are assessed and plans put in place to manage them. As it is not always possible to manage risk, CDC should now go further than this and demonstrate how each investment is expected to contribute to, and not undermine, the SDGs. In effect, it must ensure that delivering the SDGs is central to the business case for each and every investment. This should be complemented by robust systems to monitor the positive or negative impact of investments.

Our overall expectation is that all CDC investments need to reach the highest standards of transparency, accountability and poverty reduction impact, as well as contribute to the Leave No One Behind agenda to ensure the marginalised benefit first. This could be a gold standard model for other Development Finance Institutions to follow.

Priority 1: Ensuring CDC can deliver the new strategy: Investment decisions

Recommendation: CDC should make a decision to approve or reject an investment based on a rigorous assessment on whether it will positively contribute to the Sustainable Development Goals.

The business case makes it clear that: "sustainable and inclusive economic growth is essential for overcoming poverty and achieving the UN's Global Goals." It is good to see the strategy linked with the Sustainable Development Goals because this establishes an integrated framework for CDC to ensure all its investments contribute to these Goals by having a positive social, environmental and economic impact.[2] It is also encouraging to see a wider commitment to quality jobs; new CAFOD and Christian Aid research highlights the importance of an integrated approach and finds that green and decent jobs are a key priority to achieve the SDGs.[3] Another positive is that CDC's Code of Responsible Investing (updated in March 2017) explicitly references the UN Guiding Principles on Business and Human Rights, which the UK government has already committed to implement. It is also good to see the new strategy references the need for CDC's investments to address climate change and facilitate women's economic empowerment.

This is a much broader set of objectives than CDC has sought to achieve with its investments in the past. Whilst CAFOD recognises the growing expertise held within CDC, to deliver this ambitious strategy will require changes to how CDC operates if it is to make its positive statements a reality on the ground and to ensure tax-payer's money is used effectively. In addition to financial return, CDC also needs to develop clearer development impact measurement (both pre and post investment) towards positive social and environmental outcomes. This should explicitly factor in human rights impacts. Updating how CDC operates will be particularly important as:

- CDC works to absorb the capital increase of between £3.1-3.5 billion, in addition to recycled returns which between 2012-2016 reached £1.4 billion.[4]
- CDC has committed to increase investments in fragile and conflict states, and therefore will need to consider any impacts on political economy to assess how investments affect these complex environments.

One key issue is around priorities and the type of investments CDC will make. Currently all CDC investments must make a return, to be recycled back in to new investments (CDC also has experience where it has invested but not received a financial return for several years, highlighting that it does not need to receive returns immediately[5]). CDC has reported strong results. As the business case notes sterling financial returns, whilst varying year by year, averaged 12.8% per annum over the last 5 years. If a core objective is for investments to make a return it could lead to a softening of sustainable development objectives. In this regard it is a good signal that as part of the high-risk portfolio, with a goal of investments worth $300 million annually, the business case notes there will be "tolerance for higher financial risks and lower returns" in order to "achieve high development impact".

Key questions:
1) How will the investment process, including the use of screening and investment committees, be reoriented to ensure that each investment contributes to the SDGs? For example, towards poverty reduction, quality jobs, mitigation of greenhouse gas emissions and protection of biodiversity?
2) How will staff be incentivised to ensure investments achieve social and environmental goals, including respect for human rights, alongside financial returns?

Priority 2: Measuring broader development impact: learning from other programmes

Recommendation: CDC should learn from other experiences about how investments can successfully reduce poverty and protect the environment, including how these objectives can be measured.

CDC will now go beyond job creation to measure the broader development impact of its investments. It is good to see that CDC is taking a "proactive approach to the management of development impact at the investment level, exploring opportunities for more value addition

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activities."[6] CAFOD looks forward to engaging with CDC as its "approach to defining, tracking and supporting development impact" in its priority sectors is finalised over the coming months, in particular to ensure its investments have the highest possible impact in reducing poverty and safeguarding the environment. This will require a robust theory of change that establishes a strong link between CDC's investments, economic growth, job creation and poverty reduction.

It is crucial to ensure CDC's investments lead to development impact, as just one year ago a National Audit Office report concluded: "it remains a significant challenge for CDC to demonstrate its ultimate objective of creating jobs and making a lasting difference to people's lives in some of the world's poorest places."[7] In a similar observation the Public Accounts Committee inquiry into CDC, published in April 2017, concluded that neither DFID "nor CDC can set out a coherent picture of CDC's development impact".[8] This is in a context where CDC has faced criticism for past investments in online retailing and gambling, as well as luxury hotels and shopping malls.[9]

The business case sets out that CDC will now take on legal responsibility for the Impact Programme which aims to catalyse the markets for impact investment in Sub-Saharan Africa and South Asia (this entails taking on the remaining £638 million already committed). The pro-poor approach of the Impact Programme has relevance for both CDC's high-risk and commercial portfolio. It focuses on people living on between $2.50 and $4 a day who have low access to affordable, quality basic goods and services such as education, health, energy, water and food; have insecure income and vulnerability to income shocks; live in under-served areas with inadequate infrastructure such as dense slums; and have limited access to markets.[10] This pro-poor approach is one we would like to see replicated across CDC's wider investments to ensure investments make concrete improvements to the lives of the poorest.

In the case of the UK government's climate public-private partnership (CP3), which invests via private equity funds, previous research by CAFOD highlighted that the way the funds were set up did not generate learning about what did and did not work.[11] This weakened the opportunities for stakeholders, including the UK government and civil society, to understand if CP3 was using ODA to deliver pro-poor and sustainable development impacts and to incorporate learning.

Financial institutions are one of the seven economic sectors prioritised in the new investment strategy. According to CDC's 2016 annual accounts, financial services made up 21% of the underlying portfolio. There are lessons on the difficulties in measuring development impact that CDC can learn from the International Finance Corporation (IFC), the World Bank's private sector arm. CDC should consider following the lead of the IFC which recently reported it had reduced its high-risk investments made via financial intermediaries, and has more dedicated staff to oversee environmental and social risk management for these types of investments.[12]

A crucial component of increasing pro-poor impact will be adequate monitoring and evaluation, including transparency about positive and negative impacts. The 2015 DFID business case noted that CDC's monitoring and evaluation systems were "still nascent".[13] The new business case highlights the importance of monitoring and evaluation. We welcome the proposed activities, including a £20 million evaluation budget and a focus on learning from development impact assessments (potential and actual), that will "enable feedback loops into CDC's future investment decision making and activity."

Key questions:
1) CDC focuses on job creation as a key indicator of development impact. How will CDC measure and prove poverty reduction and sustainable development impact?
2) How will CDC ensure its investments on the whole create quality jobs and are accessible to marginalised groups such as the old, people with disabilities, ethnic and religious minorities, women and girls? How will CDC actively contribute to women's economic empowerment?
3) How can CDC work towards creating quality jobs that are also green?

Priority 3: Strengthening transparency

Recommendation: CDC should publish a plan, including a timeline, on how it will regularly ensure high quality reporting to the International Aid Transparency Initiative.

It is good to see that CDC is committed to greater transparency, that it is already reporting to the International Aid Transparency Initiative and that in future it will have more information on its website about each investment. One key area where more transparency can support greater development impact is in the use of offshore financial centres. In 2013 an estimated 118 out of 157 of CDC's fund investments were routed through jurisdictions that feature in the top 20 of Tax Justice Network's Financial Secrecy Index.[14]

This lack of transparency makes it very difficult to prove how an investment has led to sustainable development impact. This also makes it difficult to ensure that public officials have transparent oversight of social, human rights and environmental safeguarding, which are all crucial to measure progress towards achieving the SDGs. CDC states it uses offshore financial centres to reduce the cost of investments and as a means to invest in complex environments that do not have domestic systems in place. However, given the controversial role of offshore financial centres in reinforcing inequality and undermining the ability of poor states to collect taxes, highlighted again by the release of the Paradise Papers[15], CDC should instead commit to investing directly in companies in Africa and South Asia as a means to contribute to broader development impact in country, even if this means an increase in costs.

Key question: How will CDC reduce use of offshore financial centres and address transparency?

Priority 4: Leadership in meeting the Paris Agreement commitments

Recommendation: CDC should publish a plan, including a timeline, on how and when it will track and report on the carbon footprint of its investments. This should be a first step to setting targets to reduce its emissions and to ensuring its energy investments are reducing poverty and supporting low carbon development.

DFID has said: "Through its investments, CDC can help countries to meet their Paris Climate Agreement commitments."[16] The business case highlights that "CDC will begin to monitor, track and report on indicators for renewable energy" including installation of clean energy and avoided greenhouse gas emissions. To ensure CDC's investments are aligned with the UK's commitments under the Paris Agreement and the SDGs, CDC should track and report on its portfolio emissions, in line with all Multilateral Development Banks and most high-impact companies[17]. Given the role of energy sector emissions in climate change, its current energy portfolio should prioritise renewable energy and energy efficiency in all stages of energy delivery, and also prioritise the delivery of SDG7, which focuses on ensuring universal access to energy for all.

Overall UK support is lagging behind[18], and according to new research, global financing flows committed for energy access are inadequate[19]. It is important that this support goes beyond the household level to energy for local economic development that benefits the poorest. We are interested to see how CDC will develop a reporting framework for its investments that tracks how it is supporting low carbon investments, reducing poverty and reducing its carbon footprint.

Key question: How will CDC ensure its investments reduce greenhouse gas emissions and increase energy access for the poorest people and communities?

Next steps

This briefing has set out CAFOD's response to DFID's business case to increase capital investment in CDC. Whilst we welcome that CDC's new strategy links to the SDGs, the key test now is how CDC will deliver on this agenda. CAFOD will continue to engage actively in this agenda.

For more information contact:
Dario Kenner, Lead Analyst – Sustainable Economic Development: **dkenner@cafod.org.uk**

References

[1] DFID business case October 2017: Capital increase to CDC

[2] CDC Group Sustainability Review 2016-2017

[3] Towards decent, green jobs for all, CAFOD and Christian Aid discussion paper, October 2017

[4] CDC Group Annual Accounts 2016

[5] Investing in conflict affected countries is challenging but necessary, Devex, 25 October 2017

[6] DFID business case October 2017: Capital increase to CDC

[7] National Audit Office 2016

[8] House of Commons Committee of Public Accounts, Department for International Development: investing through CDC, April 2017

[9] £3.5bn UK aid top-up to create jobs in developing world, The Times, 17 October 2017

[10] The Impact Programme

[11] Investing in our future? Making the UK's public-private partnership fit for purpose, CAFOD 2015

[12] Here's how the IFC is working with financial institutions, Devex, October 2017 / Re-examining our work with financial institutions, Medium, April 2017

[13] DFID Business case 2015 – Capital increase to CDC

[14] Development Finance Institutions and Responsible Corporate Tax Behaviour, Eurodad, November 2016

[15] Paradise Papers: Special Investigation, The Guardian, November 2017

[16] CDC Group Sustainability Review 2016-2017.

[17] Among the main development banks, the IDB, EBRD and EIB are reporting on their portfolio emissions. The Asian Development Bank has gone a step further and set a target to reduce those emissions. WBG President Jim Kim announced recently the Bank would report from next year. According to Carbon Disclosure Project, 85% of the 1,089 high-impact companies that disclosed data for their 2016 report have set targets for emissions reduction .

[18] See UK support for energy in developing countries 2010-2014, CAFOD, 2016

[19] Only 1% for distributed renewable electricity, the most cost-effective way to reach the majority of the 1 billion electricity poor. SE4ALL, September 2017