

FINANCING DEVELOPMENT

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Built to last

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Indispensible
policy principles

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Three daunting dimensions

The developmental principle of sustainability is about three important objectives: a prospering economy along with environmental stability and social equity.

By Hans Dembowski

“Sustainability” is a term with an eventful history. The concept of sustainable development was elevated to a global principle at the UN Conference on Environment and Development in Rio de Janeiro in 1992. Before the “Earth Summit”, work carried out in the 1980s by the United Nations’ North-South Commissions under Willy Brandt and Gro Harlem Brundtland had laid the foundations.

The Rio conference emphasised that all future generations must have the same opportunities as we do today. Furthermore, the deep divide

between rich and poor should not be accepted as a permanent state of affairs. Accordingly, sustainable economic development has to be socially just and ecologically stable. The Earth Summit resulted in the Framework Convention on Climate Change, the Convention on Biological Diversity and a number of other international treaties on the environment. It was also established that advanced nations must help developing countries to escape from poverty.

The principle of sustainable development has not been seriously challenged since. However, opinions do vary as to what tangible steps need to be taken to live up to it. In the 1990s, business papers like *The Wall Street Journal* or *The Economist* sometimes gave readers the impression that “sustainable development” basically meant uncurbed economic growth.

However, the concept of sustainable development really is multi-dimensional. The cross-functional challenges require

- investments and employment to lift economic productivity to a sustained level allowing all people a life free from substantial hardship (economic sustainability),
- the preservation of natural resources for subsequent generations and the fight against global environmental risks such as climate change (ecological sustainability) and
- the fight against absolute poverty, the creation of just living conditions and the maintenance of peace within a nation and between nations (social sustainability).

These three elements are important guidelines for development policy. For example, the Millennium Development Goals, which were resolved at the UN Summit in 2000 to reduce global poverty, reflect the sustainability principle, emphasising the need for adequate food and universal primary education but also demanding fair conditions for trade, a healthy environment and similar matters.

Acting on behalf of Germany’s Ministry for Economic Cooperation and Development (see box), KfW Entwicklungsbank implements programmes in financial cooperation which contribute to bringing



Mark Edwards / Linear

Indigenous participant at Earth Summit in Rio de Janeiro in 1992.

about structural change in poor countries. In doing so, the Bank is always aware of sustainability's three dimensions. Success thus depends on

- capable partner agencies,
- financially viable operations,
- awareness of – and concern for – the needs of the target groups,
- sector-wide approaches and
- observance of ecological limits.

Institutions must be properly managed and employ competent staff if they are to carry out demanding tasks in the long term. Sadly, these requirements are often not met at first, so KfW Entwicklungsbank always invests in strengthening the capacities of the local partner agency. Depending on partners' demands, KfW supports training and ongoing briefings. The goal is to enable agencies to find solutions for any problems that may arise by applying their own know-how.

Market orientation is generally necessary for financial sustainability in the long term. Often, it has proven to be successful to charge user fees. It is no coincidence that free services, which governments sometimes promise, are typically of poor quality, short-lived and unreliable in general. Whoever demands payments, must justify doing so through performance. User fees, of course, help to encourage economic use of scarce resources.

The needs of the target groups must be identified when considering sustainability and, equally important, the environmental effects of all projects supported are subject to a joint review with the project partners. This two-pronged approach allows KfW Entwicklungsbank to ensure that appropriate consideration is given to environmental demands for the sake of ecological sustainability.

If development cooperation is to be effective in the long run, it cannot remain restricted to individual projects and programmes. Change must occur systematically and structurally because every individual measure needs an environment which allows it to succeed.

The various aspects of sustainability are complexly inter-related. It is impossible to address them all in a linear manner at the same time. KfW experts say that sustainability must be strived for in "dynamic processes and in an integrated manner".

KfW Entwicklungsbank makes a commitment, with the approaches and instruments it uses, that the projects it supports adequately consider all

Policy objective: Sustainability

Germany's Ministry for Economic Cooperation and Development (BMZ) defines "sustainability" as "lasting development". The principle is about "satisfying current needs in such a way that the opportunities of future generations are not restricted." The Ministry points out: "This has been accepted as a guiding principle throughout the world since the UN Conference on Environment and Development in Rio in 1992." Sustainability is, accordingly, the basis for any policy decisions on how natural, societal and technical resources should be treated.



The principle runs like a golden thread through all policy devised by Heidemarie Wieczorek-Zeul, Germany's development minister. BMZ puts the principle into practice in the projects it supports in the context of German development cooperation, be it in the area of climate protection, the eradication of poverty and AIDS, support of women or ensuring peace in crisis regions.

three dimensions of sustainability from start to finish, from planning, through implementation to operation.

In addition, KfW Entwicklungsbank regularly reviews whether it actually meets the demanding goals of sustainable development. For that purpose KfW Entwicklungsbank works with an independent evaluation unit directed by Prof. Dr. Eva Terberger from the University of Mannheim since late 2006. Every second project is subject to an ex-post evaluation several years after completion. The success rate of all programmes for which an ex-post evaluation has been undertaken since 1988 is 73%.



Ron Gilling / Linear

Workers should be protected from harm – not only in Ghanaian ports.

“Learning from past mistakes”

KfW Entwicklungsbank's evaluation experts review every other project a few years after operations have started. The idea is to check whether the desired development effect has been achieved; and whether it is likely to be sustained in the long run.



Eva Terberger is professor of business administration at the University of Mannheim, and heads KfW Entwicklungsbank's independent evaluation unit ("FZ E" – Financial Cooperation – Evaluation).

Interview with Eva Terberger

What does KfW Entwicklungsbank understand by the term “sustainability”?

Projects promoted with financial-cooperation funds are called “FC projects”. They are sustainable if they have a lasting impact in terms of reducing poverty in our partner countries. We want our partners, who carry out projects and programmes with KfW Entwicklungsbank's backing, to be able to carry on the project themselves in the long term once external support comes to an end. We want societies to be able to ensure on their own efforts that poverty goes – and stays – down. Sustainability is thus a key criterion for our evaluation unit, which assesses the success of FC projects. We are, of course, also interested in ecological consequences, because it is essential to protect the environment – to make sure, for example, that everyone has access to clean drinking water, and to control diseases in the long term.

But the core issue is whether a project is successful in business terms?

No, it is not. Financial sustainability is important, but it is not the only bottom line. No impact is permanent if the balance sheet is not right. But what kind of funding is needed to cover expenses depends on the nature of a project. In the case of a microfinance project, for example, we expect the partner institution to settle the balance in the medium-term without external assistance. For a health

station, however, some state funding would certainly be appropriate. On top of being financially viable, a project must contribute to reducing poverty.

The impact of a project does not only depend on smooth operations. Societal problems – ranging from widespread corruption to state failure or even civil war – can cause the best-planned projects to fail.

That is correct; and it is, of course, the very nature of FC projects to take risks that a private-sector investor would shy away from. If we want development success, we must accept the risk of failure. Even technological progress can throw a spanner in the works. A water supply project in Rwanda is an example of a project with unsatisfactory results despite good professional work. At the end of the day, it did not really contribute to the lasting reduction of the health risks from unclean water in the project region.

What went wrong?

There were radical changes in Rwanda after the pre-project appraisal in 1989. Civil strife in the early 1990s and the genocide in 1994 resulted in a human tragedy and enormous material losses. Implementation of the water supply project was delayed considerably because of the war. In the end, the population of the region the new water-supply system covered was much lower than originally forecast. An attempt was made to reduce the central water supply but, nonetheless, the plant was used so little that, because of its fixed costs, the price per litre of safe drinking water was very high. Standard rates were charged for this safe drinking, only partially covering the actual costs. Nevertheless, poor households that had fallen even further into subsistence farming due to the strife were still unable to pay them. Despite the low

charges, very little water was drawn from the taps. Many households preferred to continue drawing all or at least some of their water from the traditional, hygienically questionable water sources. They might have to go some distance to get that water, but it did not cost them any money, and these people have little money at the best of times. The problem of cost recovery for the new facility intensified. All summed up, there were not enough consumers able and willing to pay an appropriate price to allow the continued operation of the plant.

What did you learn from that experience?

Nowadays, we promote technically less complex, local solutions for rural water supply, so appropriately trained user groups can operate them pretty much on their own. This is not only so in Rwanda, but in many other African countries too. The appropriate approach in highly uncertain situations is to find solutions based on flexible, modular components, such as, for instance, wells with pumps. That kind of system can be expanded if necessary. Such solutions also fit in better with the policy of partner countries that favour decentralisation, and thus shift responsibility to the village- and community levels. That similarly applies to other sectors, not only the water sector. These examples show that KfW Entwicklungsbank – and indeed development agencies in general – are well advised to learn from mistakes. That allows us to assess risks better, and to insulate them, if running them is inevitable. Therefore, evaluation of impacts is essential, and it requires us to take a critical approach.

How do you do that?

The independent evaluation unit at KfW Entwicklungsbank conducts an ex-post evaluation of every other project, and that is unusual among our peers. No other development agency in Germany has such a high evaluation rate, nor am I aware of any development agencies elsewhere that would examine their own performance that thoroughly. We are not content with the fact that a project has been implemented well, but look at everything once more after the entire scheme has been operational for some time. As a result, we have particularly comprehensive in-depth knowledge. Our focus is not only on business data – we look at the societal and economic environment too.

You evaluate 50 % of KfW measures three to five years after completion. Isn't that too early to judge whether success is permanent?



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Evaluating results in a Namibian office.

Three to five years is a sensible span of time. If we waited ten years before conducting an ex-post evaluation, it would be very difficult to retract all the relevant people who were involved in implementing the project for interviews. Trends can be identified after three to five years of operation. With a power station, for example, we can assess not only how it is maintained and whether the book-keeping is correct, but also whether the intended target groups are connected to the grid and enjoy reliable power supply. It is, of course, particularly important whether the intended target group was reached. That is something developmental impact depends on.

The societal and economic environment is, so to say, an “act of God”. Projects and programmes are at its mercy. Is it worthwhile assessing something you cannot control?

Absolutely – you see, we want to learn from failures, so we need to know what succeeds or fails. We must not over-estimate the influence of an individual donor agency, of course. No individual project can completely change society – putting an end to corruption, for example. Therefore, it is important that donors work together. They should speak with one voice and not become divided. Donors gain influence by cooperating. At the same time, we must gear ourselves towards partners’ needs. This is another reason for donor harmonisation being more than merely sensible: it is absolutely essential.

How do you evaluate sector-wide approaches with joint, programme-based funding from several partners? You probably have to review the entire health system of a whole country, such as Tanzania or Ghana.

Budget support programmes and basket funding, in which many donors are involved, are still very young. The first cases are about to reach the stage where evaluation makes sense. However, it is widely accepted that sector-wide approaches will never be completely finished, so regular interim reports and status reports must be carried out rather than an ex-post evaluation. From the methods viewpoint, it is not easy to appraise entire sectors or the whole economy. However, I believe that we are facing a great opportunity. By tackling issues at the sector level, we will be more likely to find out things that have been troubling us for a while, but that we didn't consider in depth because doing so would have been beyond our scope.

Please give an example.

Think of the HIV/AIDS pandemic in Africa. This issue is normally only taken into account to a limited extent, for example, when a school project is evaluated. Such an evaluation may show that there are not enough qualified teachers because of the pandemic, with the consequence that, even if new classrooms are built, there is not much hope for more or better learning. However, school

evaluations hardly pick up the fact that, even if education is quite successful, it does not promote development because too many graduates are dying from AIDS. Or consider an even more extreme example. We may support a project which is completely successful in itself, but, in terms of the national budget, its main result is to free up financial resources the government then invests in arms. That is something you can identify by looking at the entire budget, but you won't notice it by focussing on the microcosm of individual projects. In our job as evaluators, we will always have to keep on learning in order to contribute to identifying what thwarts development and what makes it happen.

Questions by Hans Dembowski.

Link:
www.kfjw-entwicklungsbank.de/EN_Home/Ex-post_Evaluation_at_Kfjw/index.jsp



In brief

Profitability enhances developmental sustainability

The 440 enterprises that enjoy support from DEG (German Investment and Development Company) directly employ 600,000 people. Moreover, there are more than one million further jobs with their suppliers or – in the case of financial-sector firms – clients. DEG is the branch of the KfW Bankengruppe which lends to private-sector businesses in developing countries. DEG-clients contribute some € 1.4 billion to tax revenues, and generate € 5.9 billion in net foreign-exchange income. These sums make a positive difference in economies that typically suffer from high budget deficits and massive unemployment.

DEG only funds projects that make sense in terms of development and are environmentally and socially sustainable. These are inalienable principles. DEG's guidelines for social responsibility are in line with international standards such as those of the International Labour Organisation (ILO). Moreover, DEG supports certi-



The telephone service provider Celtel/Zain is one of the DEG's great success stories in Africa.

fication of companies according to internationally recognised environmental and social standards. Whenever possible, DEG cooperates with partners on complying with standards that go beyond the minimum level required by law.

Several years ago, DEG introduced a tool known as GPR (short for „Geschäftspolitisches Project Rating“ – corporate-policy project rating). GPR is an internal instrument that measures the developmental success of projects. On top of that, it takes account of long-term profitability, DEG's role and the return on equity. The GPR has

shown that most DEG-supported businesses are successful, as 66 % received a grade of between 1 and 3 in the overall evaluation of the four GPR yardsticks. That means that they are “unreservedly successful”. As for development results, an astounding 73 % of projects are “unreservedly successful”.

Profitability and developmental success are not mutually exclusive. To the contrary, the GPR results show that enterprises with good credit worthiness and solid corporate governance are the ones that are the most likely to have sustainable impacts.

A link to the world

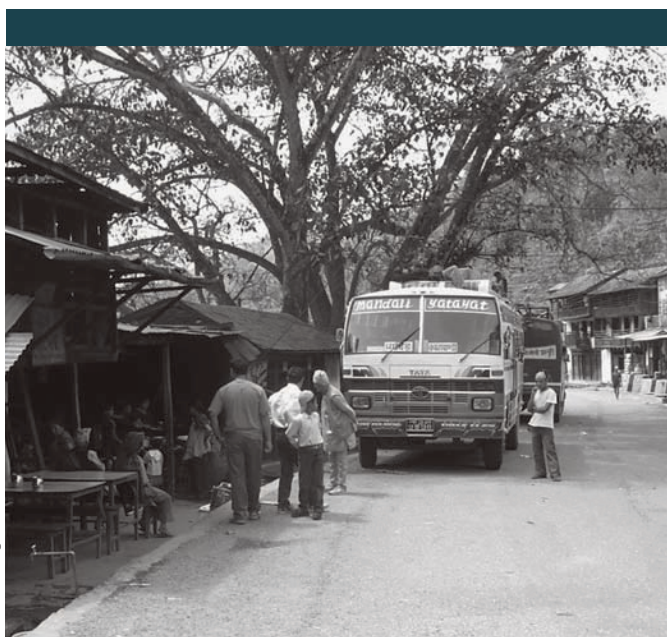
A new road in a remote district of Nepal has provided the local people with access to markets, schools and health services. Seven years after the construction was completed, there are signs of long-term success.

Dhading Besi is a district capital in Nepal's mountains. It is only 18 km away from a national highway. Nonetheless, this town was practically cut off from the world in the past. In the monsoon season, the unsealed road became an impassable mud pit. Two rivers had to be crossed by ferry, causing further delays. Even in dry weather, it took a whole day to make the 90 km trip to Kathmandu, Nepal's capital city.

Since 2001, the travelling time has been reduced to only three hours thanks to the Kaloo-Pandey road, which was funded by KfW Entwicklungsbank. Many new links to surrounding villages have been built in the meantime. Traffic in the district has doubled overall compared to forecasts made during the project's planning stage. That became evident in the ex-post evaluation of the project. Many families now own motorbikes. Buses and collective taxis run their routes several times a day. Turnover increased correspondingly, so tickets only cost half of what they used to.

New mobility creates new opportunities. Farmers are now selling their products at market, which gives them a new source of income. They were not able to do so in the past because fruit and vegetables would start to rot while being transported. Conversely, more goods now reach Dhading Besi. Furthermore, the road has given rural people the chance to commute to work; and many people in the region can no longer rely on farming alone for an adequate livelihood.

"Better road links help to achieve development objectives in remote regions," explains Reiner Koblö, sector economist for the KfW Entwicklungsbank. They also make a difference in terms of health care and education. Students travel to and from school by bus, so expensive boarding schools are no longer the only option to get a formal education. The trip to a doctor or hospital has become manageable, and money earned at the market allows simple farmers to pay for such services. On the other hand, teachers and doctors are more willing to work in a provincial town if it is linked to the rest of the nation. Two doctors have settled in Dhading Besi, whereas there were none in town before 2002.



KfW Entwicklungsbank

Dhading Besi has more traffic.

Experience shows that particularly women benefit from good transport connections which reduce travelling time and allow safe journeys. Due to their dual burden of looking after the family and working in agriculture women are under constant time pressure.

There are also downsides to improved connections with the outside world. Research by the KfW Entwicklungsbank showed some isolated negative side-effects. For example, some local goods no longer sell as well as they did before because cheaper articles have become available. "KfW Entwicklungsbank is working with local people on how to rise to the new challenges appropriately," reports Koblö. That can be done by generating income from trade with the new products, for example, or by adjusting local production to the new environment.

In order to last in the long run, roads need regular maintenance. That is normally the task of public authorities. In the past, however, they have often not been up to the job. KfW Entwicklungsbank therefore encourages the creation of national road-maintenance funds, that involve representatives of private-sector transport companies in decision-making. These funds are financed through KfW and fuel taxes. It remains to be seen whether this model will work in Nepal in the long run – the country has been rocked by political crises, after all. The evaluation results, in any case, inspire hope. (cir)

Water - an issue of survival

Sewage treatment plants bring relief for Jordan's precarious water balance.

Water scarcity is an acute problem in the Near East and Middle East. Jordan's annual per capita amount of renewable fresh water, for example, is only 180 cubic metres. The World Bank defines 500 cubic metres as the "water-poverty line". Jordan's agriculture consumes two thirds of the resource.

Experts have been arguing that water scarcity might lead to war for some time. If Israel and its Arab neighbours are to live in peace in the long term, they must all get enough water. This will be possible only if precious water resources are protected and used sparingly. Waste water must be treated and reused, but that is only rarely done in the Arab World.

In close cooperation, Germany and Jordan have drafted a water management plan to tackle this issue. The plan combines major institutional reforms with necessary infrastructure investments. A project supported by the KfW Entwicklungsbank has upgraded waste-water disposal in the town of Irbid and its surroundings. Two sewage treatment plants were built and the sewage systems extended. These measures help to ensure the long-term drinking water supply in the area. Before the work was done, drinking water supply lines were often contaminated because of leaks. The ground water was polluted too due to inadequate sanitation. As a result, many people fell ill.

Today, 90 % of households are connected to the sewage system, compared with only 23 % before the project was implemented. Waste water from industrial and manufacturing plants is purified too. Toxic substances such as phosphorous and nitrogen are reduced to a harmless level, and so are various pathogens. The health situation has improved substantially. The purification capacity of the plants in Irbid complies not only with Jordan's minimum standards for discharge into waterways, but also with those which apply in Germany. The ex post evaluation of the project showed that the treated waste water can be used for agricultural irrigation without any concerns.

Many farmers still have reservations about this practice, but such obstacles are gradually overcome thanks to awareness raising. The University of Irbid is leading by example. It uses water from the treatment plants to irrigate its orchards and campus. The amount of fresh water saved by doing so corresponds to the drinking-water needs of 1000 people.

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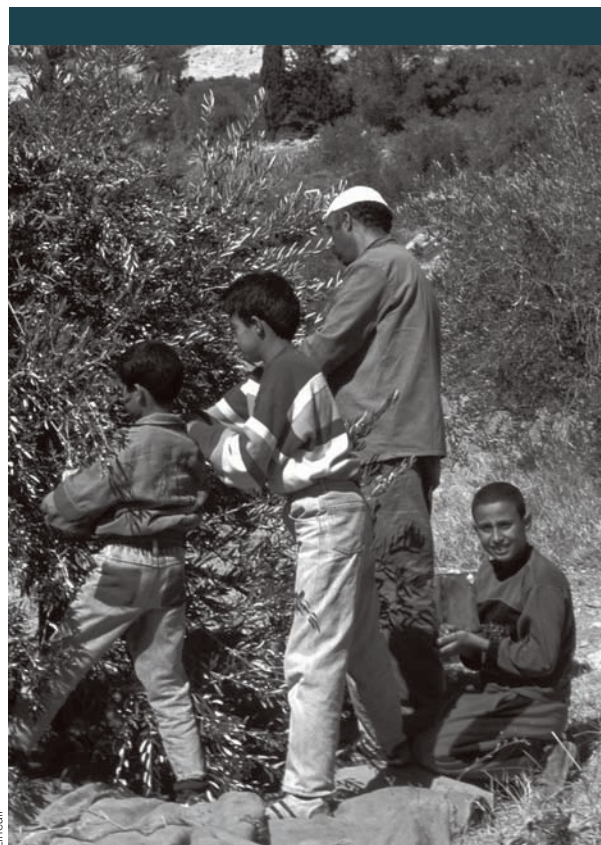
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Linear

For olive trees, treated sewage water will do.

The waste-water disposal system is operated by a semi-autonomous local unit of Jordan's water authority. It works in accordance with commercial principles, and its financial situation has improved noticeably during project implementation. Staff was trained to operate more efficiently. The day-to-day costs are now covered by user fees. Accordingly, long-term operations are a safe bet.

The example of Irbid shows that it is important to tackle issues across an entire sector. In isolation, neither the improved infrastructure nor more efficient management would have had a sustainable impact. Both are necessary. Basic reforms, in which the KfW Entwicklungsbank and other partners provided support to Jordan, have brought new laws and realistic tariffs, contributing to making Jordanians aware of the economic value of water. (rb)