FINANCING DEVELOPMENT

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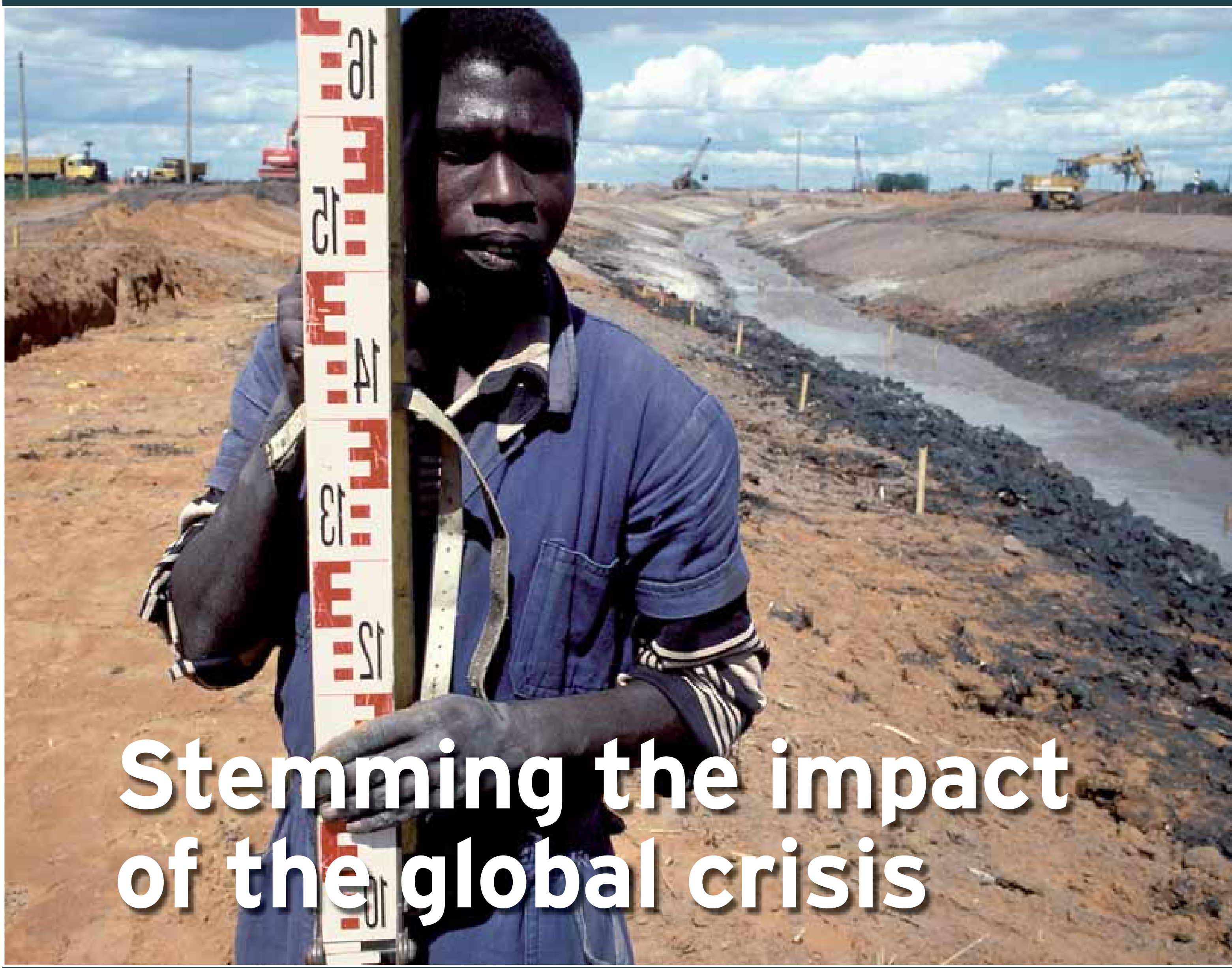

Stemming the impact of the global crisis

[Climate protection]
KfW gives scope to smart investments

[Foreign trade]
Financial support for export companies

[Microfinance]
Allowing small entreprises to grow

Double effect

The global financial crisis is hurting national economies throughout the world. Developing and newly industrialising countries are feeling the pain in particular. KfW Entwicklungsbank is using well-established programmes as well as additional ones to help stabilise economies which, on their own, could hardly do anything to counteract the global turmoil.

The global financial crisis came in two waves. First, the banking system collapsed, and then economic difficulties affected trade and industry. The more a country is integrated into the global financial system, the more rapidly it was hit by the crisis.

The first economies to be affected were those with banks that held many toxic assets – in other words, the established industrial nations. However, other nations felt the impact, too, because the loss of confidence in the financial sector prompted many investors to withdraw funds from developing and newly industrialising countries.

Stage two of the crisis is about the real economy. Export nations above all are noticing the decline in demand in major national economies. Fewer consumer goods and commodities are being sold on the world market – and these goods are exported mainly by poorer nations. Prices for commodities, including internationally traded foodstuffs, fell by about one third between mid-2008 and mid-2009.

Falling demand has led to production cutbacks and even to the closure of raw material facilities in countries like the Democratic Republic of Congo and others. At the same time, private remittances from migrants to their families are dwindling because people are earning less money. The World Bank estimates that relatives' remittances from abroad dropped by some $ 2 billion in sub-Saharan countries in 2009. Moreover, revenues from tourism and foreign direct investments are also falling.

The International Monetary Fund is forecasting a growth rate of only 1.2 % in sub-Saharan Africa this year. However, the region's population growth amounts to about 2.5 % per annum, so per capita earnings will decrease. In previous years, economic growth of five to seven percent was the norm. Countries with low incomes are especially vulnerable to the golbal crisis since their economic basis is weak and financial space is small. Weak economies, falling social spending and low remittances particularly affect poor people. Many will fall below the poverty line.

In this scenario, experts consider official development assistance (ODA) a stabilising element. It can help to economically counteract the crisis and to mitigate its impact. Today, development banks have an important role to play. They do not only focus on returns, but rather take into account poverty reduction and macroeconomic effects. As other sources of finance are drying up, the relevance of financial cooperation with developing countries is growing.

Among other things, liquidity in the financial system must be safeguarded. KfW Entwicklungsbank as well as other bilateral and multilateral donor agencies must ensure that banks of local

Policy objective
Healthy microfinance

Germany's Federal Government is supporting multilateral efforts to stem the impact of the global financial crisis. The coalition of Christian Democrats and Social Democrats, that was in power until October, took measures to save banks and revitalise the economy through massive stimulus packages. The second stimulus package specifically earmarked funds to support the economies of developing countries.

Microfinance providers, who enable people to start and expand small-scale businesses with microloans, are of particular relevance. Earlier this year, therefore, the Federal Ministry for Economic Cooperation and Development (BMZ) and the World Bank decided to establish the Microfinance Enhancement Facility with a target volume of $ 500 million. It is designed to safeguard the liquidity of microfinance institutions. The BMZ appointed KfW Entwicklungsbank to manage the facility (see interview on p. IV). KfW Entwicklungsbank is also taking other measures to strengthen the economies in poor countries on behalf of the BMZ. Parliamentary debates in recent months confirmed across party lines that stabilising the economy in the global financial crisis is of worldwide importance.

Font page: Construction worker in Mozambique. **Photo:** Ron Giling/Lineair

and regional relevance in developing countries do not run out of money (see interview with KfW board member Norbert Kloppenburg on p. IV).

In early 2009, KfW Entwicklungsbank and the International Finance Corporation (IFC), a World Bank subsidiary, launched a fund to stabilise microfinance institutions. It also proved useful that KfW had already been supporting deposit insurance schemes in countries like Armenia, Azerbaijan and Bosnia-Herzegovina. In times of crisis, these systems protect the savings of many bank customers.

It is also necessary to tackle the effects of the financial crisis on the real economy of poor countries. Huge economic stimulus packages of wealthy nations did a part of that job by boosting demand for imported goods and raw materials. On top of that, however, it matters that the governments of developing countries take steps themselves to revitalise their economies and absorb social impacts. On behalf of Germany's Federal Government, KfW Entwicklungsbank is protecting governments' ability to act through programme-based funding, with several donors pooling funds in support of the budgets of developing countries.

Infrastructure investment is a classic field of governments' economic stimulus policies. This is particularly useful in terms of future growth ("double dividend") in countries with bad roads, inadequate water supply and low electric-power capacities. Climate change, of course, makes it even more urgent to modernise the energy sector. On behalf of the German Ministry for Economic Cooperation and Development, KfW Entwicklungsbank has at all times been active in these areas and is expanding its engagement in view of the global crisis.

There are first indicators of economic stabilisation internationally, and forecasts are predicting a global recovery for next year. In view of the crisis' sheer dimension, however, this cannot be taken for granted. Developing countries and emerging economies have to prepare for a tougher global business environment.

The high rates at which export revenues and capital inflow grew in recent years are unlikely to return any time soon. Therefore, additional efforts from development banks will stay necessary even after the peak of the crisis this year. Developing countries and emerging economies deserve support while adapting to the new global economic reality. *(cir)*

Ron Giling/Lineair

Demand for commodities has fallen: miners in Bolivia.

Imprint

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"A solid foundation"

Every national economy feels the immediate impact of the global financial crisis in direct proportion to the extent it is integrated into the global economy. The second wave of the crisis, however, is also felt by economies with low degrees of integration, for example, when demand for the commodities they export drops. In the countries concerned, KfW Entwicklungsbank and KfW subsidiary DEG (German Investment and Development Company) are active.

KfW Entwicklungsbank

Norbert Kloppenburg
is a member of the Managing Board of the KfW Banking Group.

What do you do to support economic stabilisation in poor countries?
First of all, we must distinguish between measures that take effect immediately, and those which matter medium to long-term. In the short run, the financial sector needs liquidity and capital in order to stay operational. In the long run, stable and transparent structures must be set up, so that similar problems will not arise again.

How do you ensure liquidity in the financial sector?
Financial institutions need money, to put it bluntly. Last year, our commitments for this sector totalled € 1.4 billion, that was nearly twice as much as in 2007. For two reasons, I find microfinance particularly relevant:

- First, these institutions provide loans to small and medium-sized firms, the operations of which tend to be labour-intensive.
- Second, microfinance institutions take up deposits from savers and thus locally contribute to the accumulation of capital. It matters that savers do not lose confidence. If they started hoarding money under mattresses again, their savings would become practically useless in economic terms.

For both reasons, we must prevent microfinance institutions from being sucked into the maelstrom of the global financial crisis. KfW Entwicklungsbank and the International Finance Corporation (IFC), the World Bank subsidiary, have therefore set up the Microfinance Enhancement Facility.

Tell us more about the facility.
Its target volume is $ 500 million, and the facility is designed to support the liquidity of microfinance institutions. It was launched at the beginning of the year by the World Bank president and the German Federal Ministry for Economic Development and Cooperation. KfW has already made available about € 100 million of its own funds. Additionally, the Federal Government will contribute a further € 25 million from its budget. Very soon after the crisis erupted, we were able to ensure that there were still loans for small enterprises and that savers did not lose confidence. Our numerous other efforts in the area of microfinance are of course relevant as well.

Nevertheless, the microfinance sector alone is not enough to stabilise national economies.
True, and in a difficult economic crisis, a government's ability to act is particularly important. At this level, the catchphrases "budget support" and "programme-based funding" are important. In these programmes, several donors jointly make money available to the government of a partner country, enabling it to implement sensible reforms which all involved agree on. Last year, we disbursed € 600 million in programmes of this kind on behalf of Germany's Development Ministry.

Hasn't the authority of the West suffered considerably because of the financial crisis?
Indeed, many of those representing the partner countries are saying "you got us into this". But it is nonetheless true that the financial sector needs a solid foundation everywhere – and such foundations are exactly what we are working on in our long-term cooperation with banks in partner countries. All financial institutions must manage their risks, and that holds true for those in emerging economies and developing countries, too. We satisfy capacity-development demands according to the needs of a wide range of countries. Many of our partners are involved in building up banking know-how. Such know-how does not only matter to corporate giants that operate across borders. When dealing with a microfinance institution in Afghanistan, the relevant issues are of course not as complex as in the case of an internationally active Brazilian bank.

Risk management by banks has become the subject of international policy. Is your work influenced by debates within the G20, the group of the world's 20 most important economies?
There is increasing international control over the regulatory framework of the financial industry. Banking supervision, minimum reserves et cetera play a large role in the discussions with our partners. Aid for Trade is another example of how the G20 influence our work. The KfW Banking Group listens, and we follow the rules our Federal Government agrees internationally with its partners.

What does Aid for Trade do?
At the G20 summit in London, the commitment was made to ensure support for trade finance in the global crisis. A sum of $ 250 billion will be devoted to this important objective. Essentially, it involves guarantees for trading operations, and advisory services are also offered. The issue is important because world trade is based on guarantees that financial institutions grant trading operations. Most exporters would require advance payments without these "credits" or "promises to pay", so everything would take much longer. If theses promises to pay are provided by local banks, their acceptability must be ensured in a crisis. We do so in connection with our activities in export and project financing. This is a fundamental matter of trust in world trade.

What else do you do to stem the real-economy effects of the financial crisis?
The classic domain for governmental stimulus programmes is to build and expand infrastructure. The problem is that this does not have an impact at short notice. Plans must be drafted and passed before they can be implemented. The only thing to stimulate aggregate demand immediately after a crisis erupts is to implement systematically everything which has already been prepared. Such investments must not be delayed just because loans have suddenly become scarce – that would only exacerbate the downwards pull. In view of climate change, moreover, it is especially true in the energy sector that delay is no option.

That is easier said than done. How will developing countries be able to act if donors cut back development aid, as Italy has already announced it will do.
I agree, and that shows how important it is to avoid cuts, in spite of the crisis. We are cooperating with the IFC on an Infrastructure Crisis Facility. It will be designed to ensure infrastructure funding in developing and newly industrialising countries. Many of these projects are suffering due to the financial crisis, as investors are no longer able to get money from banks. This is where we come in. We are making a total of € 900 million available through KfW Entwicklungsbank with support from the Federal Government and our subsidiary, the DEG. Our subsidiary KfW-IPEX-Bank, moreover, is also continuing to fund infrastructure investments in the countries concerned despite the crisis, and is thereby making a contribution towards closing the financial gap.

Questions by Hans Dembowski and Claudia Isabel Rittel.

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During the crisis, it is particularly important to implement infrastructure projects without delay: road construction in Mali.

Time for renewal

Innovation requires courage, money and expertise. Money and courage, however, are in particularly short supply in times of crisis. Because of climate change, investment in energy efficiency and renewable energies makes sense. And in view of the global business slowdown, the economic momentum of such investments is particularly welcome.

In Eastern and Southeastern Europe, fossil fuel consumption is still very high – partly because many governments there subsidise energy. However, the potential to save energy is also considerable, and it could be done easily by tapping up-to-date technology. Tensions between Russia and Ukraine, moreover, have made it crystal clear that alternative energy sources and efficient use of energy are also relevant to securing supply.

"Everyone knows that energy efficiency is a promising market," says Anja Fourie of KfW Entwicklungsbank. Nonetheless, there has been little investment in the region so far. Even renewable energies have failed to generate much demand. Wind turbines and solar roofs are still very rare. "People normally overestimate the costs and underestimate the savings," Fourie notes.

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Insulation investments make sense – in business and environmental terms.

KfW's specialist in environmental financing is especially proud of one new project – a credit line offered by KfW Entwicklungsbank supported by funds of the German Government and the EU to local banks in Kosovo, Bosnia-Herzegovina, Montenegro, Serbia, Turkey, Ukraine and Russia for funding investments in energy efficiency and renewables. The credit line allows partner banks to grant loans to families or medium-scale enterprises for viable investment projects. The total funding volume already exceeds € 200 million.

To cooperate with KfW and actively approach potential clients, the partner banks need special expertise. "We do not only hand out money," Fourie explains. The partner banks are supported by a – normally five-strong – team of experts, which includes banking specialists and engineers. The experts convey the necessary expertise to frontline colleagues and help develop a monitoring system for the loans granted.

Results can already be seen. Thanks to the KfW credit line, CKB, a bank in Montenegro, was able to grant an investment loan to a client company that operates a hotel. The company spent € 200,000 on modernising its building. Today, most of the hot water for hotel guests is heated by a solar system, so operating costs have fallen by more than € 3,000 a month. The bank's client and the hotel staff were surprised by the amount. Such news spreads and encourages others. CKB now has several more enquiries for similar loans.

It was "good timing" to provide the new credit line in the midst of the financial crisis, Fourie says. Investments have a particularly welcome impact on any economy with slack capacities. And when the investment climate improves once the economic crisis is over, the banks will be able to issue energy-relevant loans on an even larger scale. As the credit line has proven a success, KfW Entwicklungsbank is now drafting a concept for an energy-efficiency fund, to which private and government donors could contribute. *(cir)*

Financier in the background

Latin American food producers feel the global economic slump. Thanks to re-financing by DEG, a member of the KfW Banking Group, local and regional banks can continue to offer such clients attractive long-term loans.

The Peruvian company Copemur exports bell peppers, asparagus and artichokes to Europe – especially to Spain. Normally, clients pay in advance. But as money grew scarce at the end of 2008, banks capped Spanish importers' credit lines, so they were unable to pay up front.

This was not an isolated incident. In the global financial crisis triggered by the crash of Lehman Brothers, the New-York based investment bank, credit became virtually unobtainable because banks no longer trusted one another. Nonetheless, the Peruvian vegetable exporter survived. "Copemur was already our client and we were able to cushion the impact," says Daniel Araujo, regional vice president of Latin American Agribusiness Development Corporation S.A. (LAAD). The agricultural development bank has been extending loans to small and medium entreprises involved in exporting agricultural goods since 1970. Today, LAAD is active in 16 countries across the continent.

LAAD

Packaging papayas for export.

One reason why LAAD can support small companies in difficult times is that it cooperates with development financiers – institutions like the International Finance Corporation, which is a member of the World Bank Group, or DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, a KfW Banking Group company. As a general rule, development financiers are at least in part publicly owned. Their focus is largely on promoting long-term national economic interests, rather than maximising their own profits.

Development financiers play a particularly beneficial role when private-sector banks shy from granting loans in times of crisis. Development financiers continue to offer long-term credits, which partners like LAAD can then pass on to their clients. According to Araujo, this is particularly important in agriculture, because three or even more years can pass after an investment before the first harvest is brought in. Commercial banks are not keen on time horizons that long.

DEG has the developmental mandate to support promising private-sector businesses in developing countries with a view to improving their economic performance and, accordingly, people's standard of life. DEG employs a variety of tools:

- it issues direct loans to private companies,
- it provides credit for local banks so they can provide investment capital for SMEs, and
- it invests directly in promising companies.

Last year, DEG agreed to advance capital totalling around € 1.2 billion.

On top of all that, LAAD executive Araujo praises the DEG for "opening our eyes to new ideas". As examples, he cites advices on the environmental impacts of production or on how managers best interact with employees. DEG has been cooperating with LAAD since 2001 and, in 2006, acquired more than eight percent of this partner's voting shares.

"DEG crisis managers were very quick to contact clients in partner countries," said outgoing DEG board chairman Winfried Polte at a conference in September on the role of development financiers in the light of global turbulence. LAAD executive Araujo is similarly proud: "We have reacted well," he says. Nonetheless, he believes that the really difficult times still lie ahead. According to him, LAAD will need to invest in expertise and support its clients. And the bank has the opportunity to do so after DEG recently put an additional $15 million at its disposal. *(cir)*

Coordinated donors

KfW Entwicklungsbank has teamed up with international partners to create a microfinance fund for Africa. This fund will help to curb the consequences of the global economic crisis.

The launch of REGMIFA in December is good news. The investment fund will enable many African banks to issue loans that will help small and microenterprises expand their business. The provision of microloans is a well-tested method to support income generation and the creation or protection of jobs and thus push back poverty and misery, all of which is particularly important in view of the global economic crisis.

The idea of REGMIFA – the acronym stands for "Regional Micro, Small and Medium Enterprises Investment Fund for sub-Saharan Africa" – was born during the Heiligendamm summit of the group of eight leading economies (G8) in 2007. At that summit, a resolution was passed to do more to help small businesses in sub-Saharan Africa. Germany's Federal Ministry for Economic Cooperation and Development (BMZ) assigned KfW Entwicklungsbank to draft a concept.

Only two years after the G8 summit, the new fund is ready to become operational. This speed was possible thanks to KfW's extensive experience in the field among other things (see box below). REGMIFA is modelled on EFSE, the European Fund for South East Europe, which bundles several finance initiatives that have been providing Balkan banks with funds for small loans since 1998. Until 2005, some 30,000 jobs were created in small and medium-scale enterprises.

Like EFSE, REGMIFA is a public-private partnership registered in Luxembourg. But whereas EFSE was forged from a number of programmes already in existence, the fund for Africa starts from scratch. According to Karl-Heinz Fleischhacker of KfW Entwicklungsbank, sights are set on making additional funding worth around $ 200 million available by the end of 2014. Like EFSE, REGMIFA is a joint initiative promoted by a consortium of donors and public development banks. This time, partners from Austria, Spain, France, Norway and the Netherlands are involved. Other partners are the African Development Bank, the European Investment Bank and the World Bank Group.

One special thing about REGMIFA is that up to 85 % of funds will be made available in local currencies. Accordingly, the local banks that use the money for small and microloans will not be exposed to major exchange-rate risks. They will not need to think about how to cope with fluctuating dollar or euro exchange rates. Without REGMIFA, such risks would make their debt burden considerably heavier. *(dem)*

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Bank employee in Senegal.

In brief

Global commitment

Experience has shown that a broad-based sector of small and medium-scale enterprises is more important for a nation's economy to thrive than a hand full of big corporations. However, small companies normally struggle to secure finance for their business ideas. That is why microloans are particularly important for poverty reduction.

Muhammad Yunus, the founder of the Grameen Bank in Bangladesh, won international acclaim for such ideas. In 2006, he was awarded the Nobel Peace Prize for his services to microfinance. In Germany, local savings banks and cooperative banks have performed comparable functions since the late 19th century.

On behalf of the German government, KfW Entwicklungsbank promotes the microfinance sector internationally. KfW Entwicklungsbank supported Yunus in the early years of the Grameen Bank, it is a shareholder of the internationally successful microfinance group ProCredit and it works through funds such as EFSE and REGMIFA (see above) to boost the microfinance sector in many countries.

In response to the global financial crisis, KfW teamed up with the World Bank Group to organise a $ 500 million facility for microfinance institutions. Around a quarter of the money will come from Germany (see interview on page IV). *(dem)*