

## Materials on Development Finance

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### Municipal development: Overview of KfW Development Bank's promotional approaches

From schools, kindergartens and hospitals to markets, water supply and waste disposal to the registration office and land registry – a functioning administration ensures access to key services for all citizens and is therefore a fundamental prerequisite for the capacity of any state to act. Municipalities are key authorities and regulators for participatory and sustained local development and an important basis for regional economic development. KfW supports municipalities in overcoming local and global challenges, strengthening capacity, efficiency, sustainability and civic participation.

Municipalities are central players in addressing current and future national and global challenges at local level. Good governance, capacity to act, efficiency and transparency at local level and citizen participation contribute to peace and social cohesion.

KfW supports municipalities in meeting their responsibilities and overcoming their challenges, primarily by

- financing municipal infrastructure and improving local public services;
- promoting local climate resilience and efficiency;
- strengthening communities in the face of refugee crises;
- implementing conflict prevention programmes, and by
- supporting digitalisation processes. How KfW Development

Bank places municipalities at the heart of development

Against the backdrop of the challenges outlined above, in recent years KfW has continuously developed its promotional approaches to supporting municipalities. The most recent commitments (2017–2021) are also far above those of previous years; the annual commitments for municipal development projects in the period 2012–2016 were around EUR 121 million p.a., the average value for the period 2017–2021 of around EUR 546 million is nearly five times as high, albeit with sharp fluctuations (see Figure 1).

In view of the division into individual promotional areas, KfW's current municipal development portfolio at the end of 2021 comprises a total of around 210 projects with a total financing volume of more than

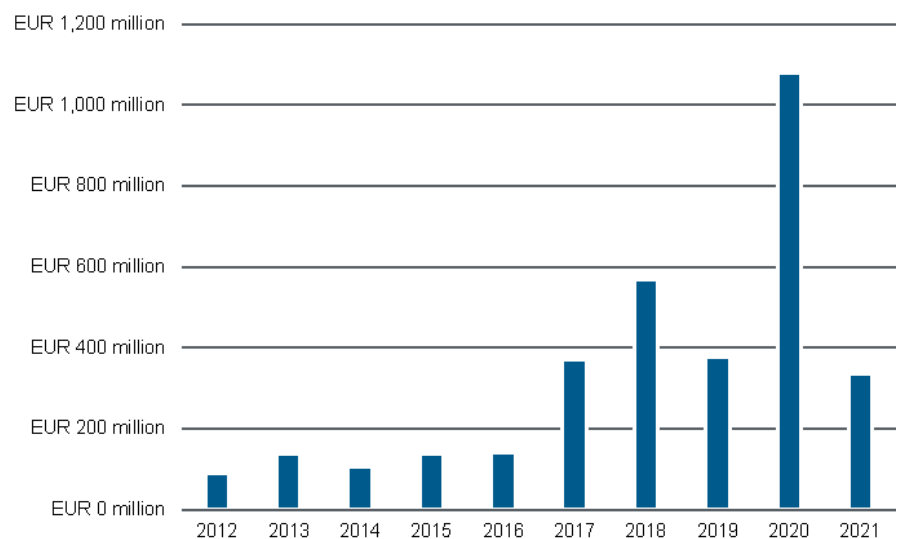
EUR 4.35 billion (see Figure 2 for sectoral distribution).

Among other things, these projects contribute to the following key objectives<sup>1</sup>:

- Poverty reduction (> 91%)
- Gender equality (> 72%)
- Peace and security (> 52%)
- Adaptation to climate change (> 18%)
- Mitigation of climate change (approx. 7%)
- Digitalisation (approx. 6%)

The impacts of municipal development projects can be very diverse and range from directly improving the living conditions of local citizens (and hosted refugees), environmental and climate action, reclamation

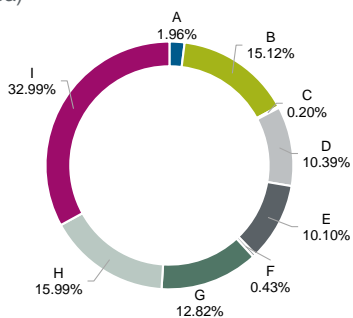
Figure 1: Commitment development for municipal development projects



<sup>1</sup> Basis: Number of projects

**Figure 2: Current municipal development portfolio 31/12/2021**

(Commitment volumes by promotional area)



A = Democratic participation and civil society  
 B = Decentralisation, promotion subnational territorial authorities  
 C = Reduction of disaster risks  
 D = Rural development  
 E = Management of public finances  
 F = Mobilisation of own revenue  
 G = Public policy and administration  
 H = Urban development and management  
 I = Civil peace development, crisis prevention, conflict resolution

and more sustainable use of agricultural land, strengthening civic participation, to state building and political stabilisation. The impacts resulting from the use of created or rehabilitated municipal infrastructure are the easiest to measure (see Box 1). KfW's promotional approaches mentioned at the beginning are described in more detail below.

### Municipal infrastructure and local public services

The quality and quantity of public facilities in municipalities is a key location factor for companies and citizens. In partner countries, people are directly confronted with the challenges of a lack of infrastructure, lack of safety, poor public services and the consequences of climate change, which adversely affects their living conditions. Municipalities' responsibility for providing appropriate public services results in the sometimes considerable need for investment at municipal level (schools, administrative and health facilities, water supply and waste disposal, roads, markets, public transport, safety, etc.). However, it is not just a matter of providing the necessary infrastructure, but above all about strengthening local capacities so that all relevant societal groups are actively and decisively involved in decision-making processes, and that representative decisions, including those for prioritising infrastructure investments, are made and implemented transparently and effectively.

KfW supports municipalities by providing funds for municipal infrastructure projects in conjunction with strengthening decentralised administrative bodies, participatory processes and transparent and efficient implementation arrangements. Funding is provided for social and economic infrastructure measures that are chosen with the participation of citizens, whether in advance via participatory development planning or by elected or appointed representatives in the local council. When financing economic infrastructure, the aim is to improve the underlying conditions for local economic development, for example in markets or the creation of transport capacities that facilitate local mobility, value creation and local trade.

Strengthening the partners' ownership and the necessary capacities is an important factor in the implementation of the prioritised infrastructure projects. Depending on their performance capacity, local authorities are more or less autonomously responsible for the planning, implementation and subsequent operation of the investments and are supported in the application of transparent and efficient procedures.



Rwanda: Markets and other events can be organised under hall roofs in an open stand design. Source: KfW / Rendel Freude

The priority area of the corresponding KfW portfolio is in Sub-Saharan Africa and, at the local level, reinforces municipalities to which sovereign functions have been delegated as part of the decentralisation processes. However,

national institutions that cooperate with the municipalities are also involved, for example through municipal development funds, regional development agencies or national transfer mechanisms, which assist the municipalities in fulfilling their functions by providing financing or advisory services.

### Municipalities in climate change – Climate action and adaptation to climate change as a new challenge

Municipalities and cities are key players in climate resilience and climate efficiency. They can make a contribution to climate action and must adapt to the consequences of climate change. Larger municipalities and cities are experiencing particularly high economic damage and human losses due to climate-related weather events and natural disasters caused by population density and the corresponding infrastructure. Climate change impacts exacerbate and accelerate existing problems and shortcomings in government services. This mainly affects residents of informal settlements, as they are often located in areas that are particularly threatened by climate change due to a lack of alternatives.

#### Examples of impacts of FC municipal infrastructure measures

- Newly developed irrigation areas: approx. 10,000ha
- Area of protected or sustainably managed natural terrestrial ecosystems: approx. 14,000ha
- People who benefit from measures related to terrestrial resource conservation: 270,000
- People who receive first-time or improved access to a modern energy supply: approx. 2 million
- People with new or improved access to drinking water: approx. 3.7 million
- People whose resilience to the effects of heavy rain and floods has been strengthened: approx. 100,000
- Improved transport connection: construction or restoration of approx. 1,000km of rural tracks and roads
- Improved healthcare services for approx. 2.5 million people
- Improved educational services (primary and secondary schools) for over 140,000 children
- More than 1.4 million refugees, internally displaced persons, returnees and residents of host communities reached through new commitments in 2020/2021 alone

(Basis: ongoing portfolio as at 31 December 2021 excluding projects in final inspection or ex post evaluation)

At the same time, however, municipalities and cities also make a significant contribution to greenhouse gas emissions due to the focus on buildings, industry and transport. Inadequate waste management and untreated wastewater pollute the environment to a significant extent. In addition, there are high levels of lo-

**Project example: MDLF municipal development programme in the Palestinian territories**

The semi-governmental Municipal Development and Lending Fund (MDLF) strengthens the institutional capacities of municipalities in the West Bank and Gaza for more sustainable service provision with improved accountability. The FC measure includes incentive-based grants for municipal investments and capacity building in the municipalities. Through the MDLF, municipalities receive allocations for municipal investments, which were prioritised into “Strategy Development and Investment Plans (SDIP)” using a participatory planning process. The allocations per municipality were calculated as 30% on the basis of the number of inhabitants, 20% on the basis of need and 50% on the basis of governance performance, measured at the beginning of the project cycle using 21 performance criteria. The implemented measures mainly comprise road construction, as well as public buildings, citizen centres, waste management, water and wastewater, solar energy and municipal warehouses. In addition to the investments, measures to build up municipal capacities are being funded.



Street restoration and lighting at an entrance to the town of Jannatah. Source: KfW / Hannah Linnemann

cal air pollution and particulate pollution due to inadequate traffic management. Progressive growth will continue to boost energy consumption and emissions in the future, but it also offers opportunities to use energy more efficiently and minimise greenhouse gas emissions.

By investing in climate-friendly and sustainable waste management, greener mobility and local public transport, as well as improved building energy efficiency of public infrastructure, KfW is supporting the municipalities in putting their climate

**Project example: Strengthening social infrastructure in municipalities affected by the refugee crisis II**

Many municipalities in Serbia have inadequate social infrastructure and struggle with providing both the local population and transit migrants with access to this infrastructure. The supply situation is particularly difficult for members of vulnerable groups, who are potential migrants and who should be given better prospects of staying. Vulnerable groups include minorities such as Roma or Albanians, socially vulnerable people and returnees. The project “Strengthening social infrastructure in communities affected by the refugee crisis” is rehabilitating, expanding or constructing new facilities for social infrastructure in communities with weak structures or those affected by migration movements. The aim of the FC measure is to enhance community infrastructure services for the local population, including vulnerable groups and minorities such as Roma, Albanians and returnees. Where relevant, access to social infrastructure services for transit migrants in the programme communities is also to be improved. The aim is to reduce the emigration pressure of the local population and to reduce the potential for conflict between migrants and the local population. Measures may include, among others: construction, rehabilitation and maintenance of kindergartens, schools, youth training centres, healthcare facilities, public spaces and parks, procurement of refuse collection vehicles and medical equipment, and investments in public transport and community housing. The inclusion and access of vulnerable groups (particularly Roma) to the

protection potential to use and reducing their environmental footprint.



Urban traffic in Bangladesh. Source: KfW/photothek.net

Many municipalities are unable to finance climate action and climate change adaptation programmes from their current budgets. Instead, the need for investment and the long-term perspective will require additional financing alternatives. KfW Development Bank supports municipalities and cities in making their contribution to climate action and increasing their resilience to climate risks.

Investments in improved rainwater management, flood prevention, river bank stabilisation and grey and green infrastructure to protect against landslides, for example, are financed. Significant improvements in quality of life can be achieved by investing in climate-resilient infrastructure such as all-weather roads and bridges, which also guarantee access to basic services such as schools, health centres and markets in times of heavy rainfall or in flood zones.

The investments are complemented with training for local authorities in the sustainable operation of infrastructure, the establishment of early warning systems in risk zones and the development of climate-adapted land use plans. This will enhance the living conditions of people in particularly vulnerable areas, secure their income opportunities and shape the development of settlements taking climate change into account.

**Refugee crisis, population dynamics and migratory pressure – complex challenges for host communities**

In view of the growing population, the ongoing trend of urbanisation and, in many regions, growing movements of refugees, many municipalities are facing extreme challenges. In Africa alone, the population will double by 2050; only a small part will remain in rural areas, the majority will push into smaller and larger cities. In many countries, the



challenges for municipalities are exacerbated by the refugee crisis. Around the world there are currently approx. 85 million people fleeing, most of whom remain close to their home region. Developing countries host 85% of international refugees; around two thirds of those who have left their homes are internally displaced within their home country. The host communities are faced with the challenge of additionally providing services to migrants and refugees with the already heavily burdened and inadequate utilities infrastructure. The direct consequences are overburdened water, sanitation and energy supply systems, overcrowded schools and healthcare facilities as well as a shortage of living space and rising rents. In order to safeguard acceptance within communities and to prevent conflict situations from developing between the local population and the refugees, the capacities of the local utilities infrastructure must be quickly adapted to the required scale.

This is why KfW finances community-based social and economic infrastructure measures. In its activities, KfW works with responsible municipal bodies wherever possible so that they are able to operate the utilities infrastructure themselves over the long term. In addition to financing the utilities infrastructure (schools, health stations, rural roads, bridges, markets, water supply facilities, agricultural irrigation facilities), training measures are also financed to enhance the quality standards of the services offered. The employment-intensive implementation of projects and the priority recruitment of local workers can also make a contribution to income creation and integration. KfW also promotes measures for the professional training of internally displaced persons and funds grants for setting up a business and potentially also favourable loans for the acquisition of a modest residence.



Jordan: lesson in a refugee camp. Source: KfW / Rüdiger Nehmzow

### **Conflict prevention and informal settlements – togetherness for development and safety and against violence at the local level**

Informal settlements are often places where residents and visitors are exposed to particular dangers and safety risks. Particularly in poor districts of the city, unemployment and a lack of prospects, increasing population density and weak state structures promote a readiness to use violence. The lack of safety with regard to the legality of the housing situation, poor living conditions in makeshift accommodation, and insufficient or lack of access to public services further exacerbate the problem.

Municipalities are required to develop informal settlements and provide a secure basis for much-needed housing. Legalisation of the use of land for settlement, connection to the road network and municipal utilities and infrastructure are important prerequisites for improving the living conditions of predominantly poor population groups. In addition, the creation of advisory and training services and the strengthening of the potential for self-help are also important starting points with regard to social cohesion and the prevention of violence. KfW is making a contribution to the prevention of violence in public institutions, in the urban environment and in the family sphere by improving the public space and living conditions as well as strengthening municipal services. Financing is provided for investments in transport infrastructure, energy supply and drinking water and wastewater systems, in municipal institutions such as schools, community centres, sports and leisure facilities and the provision of security-relevant infrastructure in the public and semi-public space. In addition, advisory and care services are set up, micro-measures initiated by residents are funded and support is provided for youth development programmes in the area of the labour market and social skills as well as corresponding infrastructure measures. Strengthening local organisations accompanying the project, which, in cooperation with the municipal authorities, reinforces the potential for self-help and social cohesion, making a further contribution to creating prospects and preventing conflict.

### **Smart Cities – promotion of digitalisation at local level**

The use of modern information and communication technologies (ICT) provides great opportunities to increase government effectiveness, efficiency and transparency and to improve citizen participation. This also applies in particular to the municipal levels, which become more capable of acting through the use of new technologies and the digitalisation of their administration, and are able to provide their services in a more needs-based and transparent manner. It is equally important that municipalities can better network with other levels of government and administration in the state, be it for municipal financing in an integrated system of public finances, or for resident registration or tax administration. The lack of networking between ministries and decentralised administrative bodies means that existing IT applications in the area of public finances, e.g. for budget planning or awarding of contracts, are only used to a limited extent. Data is frequently exchanged on paper or off-site, which is prone to error and causes significant delays in case processing.

The prerequisite for e-governance is for broadband networks between different institutions to be expanded. Special software and data systems are also needed to make the work of public authorities more transparent, efficient and demand-driven. Then it will also be easier to detect abuse, for example in tax and financial administration. Particularly in structurally weak areas, digitalisation enables certain services that would otherwise be difficult to provide, for example through digital registration (“e-Identity”). It can also help to better link government and society and facilitate participation in political decisions (“e-participation”), for example through feedback systems for citizens via SMS or email. The increasing availability of digital solutions opens up new avenues for improved governance at municipal level. At the same time, however, new challenges are arising, such as issues relating to data security, which need to be addressed.

### Project example: Conflict prevention – South Africa

Corrugated iron huts with no electricity or water, dirty toilets, young people with no education, work or hope; Khayelitsha, the poor township just outside Cape Town, is characterised by violence and a lack of prospects. The social and economic consequences of the apartheid are especially clear to see here. The former township for black members of the population has long been neglected and criminality is widespread.

On behalf of the German Federal Government, KfW Development Bank is supporting Cape Town's municipality with measures to improve the range of services and public spaces on offer, as well as to strengthen the potential for self-help. This will make an important contribution to the prevention of violence in the family sphere and to increased safety in the community. The three main pillars of the project are (i) crime prevention appropriate to the situation (based on the idea that beneficial changes to the real environment lead to greater safety in the long-term) by creating new facilities and so-called "active boxes" (preventive occupation of spaces perceived as hazardous by residents of the neighbourhood), (ii) social crime prevention by preventing sexual violence, legal advice, patrols, a library and schools; and (iii) institutional crime prevention through project

KfW Development Bank supports partner countries by financing broadband networks for public institutions and the development, introduction and modernisation of IT solutions. This helps to promote transparent, efficient and democratic governance systems and better safeguard human rights. KfW supports digitalisation processes by financing the development of digital skills, the establishment of web platforms, management information systems, geo-information systems (GIS) and databases, the development and introduction of digital applications and blockchain-based implementation processes ("TruBudget"), digital learning software/e-learning as well as the IT equipment and telecommunications infrastructure required for this.

### Project example: PBF Municipal Management Reform Programme I and II in Peru

Following hyper-centralism under Fujimori's autocracy (1990–2000), Peru has undergone a successful democratisation process. Substantial reforms to decentralise and modernise state-building and public administration have been put in place in order to enhance the supply of public services, particularly at sub-national level.

The FC project supports the Peruvian government's efforts to modernise the institutionally very fragile regional bodies through political reforms. The efficiency of municipal governments is being increased with a view to decentralisation, social cohesion and civic participation. As regards public financing and accountability, municipal finance management is promoted through improved revenue structure and transparency, accountability and monitoring. By consolidating public finances at sub-national level and improving the performance capacity of government services, sub-national governments are strengthened financially and ad-



Malawi: The use of digital technology facilitates municipal services such as this one in a programme to support the socially disadvantaged. Source: KfW / Jonas Wresch

### Different situations – different approaches to promotion

KfW can employ different funding instruments and implementation arrangements in all of the above-mentioned areas. The respective priority areas, as well as the general conditions in the country, determine the appropriate scale for achieving long-term impacts in terms of sound governance.

The **project approach** is usually chosen for more complex infrastructure projects, but also when there are difficult underlying conditions and comparatively weak partner structures. These include, for example, the building of an administrative school or a larger package of infrastructure investments, for example, to strengthen climate resilience, in a

municipality or in a few select municipalities. KfW Development Bank provides intensive support for each individual step starting with the project concept through to implementation all the way to operation to ensure that funding is also used properly in challenging conditions.

Comprehensive programme approaches with many smaller investment measures are frequently implemented or funded as **open programmes or municipal development funds**. As a rule, citizens make indirect decisions (i.e. through elected or appointed representatives) as to whether the funds should be given priority for primary education, healthcare centres or economic infrastructure measures. Well-established municipal development funds are frequently supported by various donors and then offer the advantage of harmonised procedures and greater broad-based impact.

Effective partners in countries with more stable underlying conditions can often implement comprehensive programmes largely on their own. The prerequisite is the application of transparent and efficient procedures, in particular when awarding contracts, but also in the technical design and execution, taking into account the social and environmental compatibility and sustainability of the infrastructure projects. Depending on the performance capacity of the municipalities and municipal oversight, the municipal development funds not only provide financing resources, but also take on functions as part of the implementation of the individual infrastructure measures, which are delegated to them by the municipalities as building owners, or they support and advise the municipalities in the process.

**Policy-based financing (PBF)** is also used in more advanced countries with a high willingness to reform and effective institutions. PBFs take action at the level of the underlying conditions and support the development of policy reforms (e.g. in the area of decentralisation, municipal financing and administrative strengthening of municipalities). They usually include a package of high-level policy dialogue, technical support in the design and implementation of the reforms and large-

volume financing to support implementation. Depending on the level of development and performance capacity of the partner country, policy-based financing uses grant or soft loans. Since the funds are transferred to the state budget after the agreed reform steps have been implemented, an adequately functioning public finance system is a prerequisite for the use of this instrument.

### **Conclusion: The right promotional offer for a wide range of needs**

Municipalities are key players for peaceful and sustainable development and make a major contribution to achieving the Sustainable Development Goals (SDGs). Promoting municipalities and supporting them in the efficient and sustainable provision of public services can provide decisive impetus for improving the living conditions and the economic, social and political participation opportunities of the population. Without the contribution at municipal level, it will be impossible to overcome the challenges posed by climate change and refugee crises.

Through its projects, KfW Development Bank contributes to promoting good governance at the local level and reinforces municipalities in their contribution to overcoming local, regional and global challenges. It can draw on a wide range of funding instruments, each of which enables needs-based and efficient solutions for different existing situations and environmental conditions.

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