Development Finance

Tailored and innovative solutions

Development cooperation projects and programs have to be financed. But by whom and with which funds? As an important donor organisation, KfW participates in the debate on this issue, offering financing from its own funds and seeking to mobilise others. Despite the increasing importance of private donors, official development assistance for poorer countries remains indispensable.

Current situation

Development needs money. But how much? Simply determining the need is difficult enough. Despite the successes achieved in combating poverty around the world, many people still live in harsh conditions. Global challenges such as population growth, climate change, epidemics and wars have a disproportionately negative impact on developing countries.

And from where are the funds for development to come? In international statistics published by the Organisation for Economic Cooperation and Development (OECD) headquartered in Paris, how much the industrialised nations contribute to supporting the developing countries is recorded as ODA. ODA stands for "Official Development Assistance". This includes government-funded grants or loans that trigger the economic development of countries and/or improve the living conditions of the local population. Grants are donated money, but loans have to be repaid, although they are awarded at particularly low rates of interest.

The ODA ratio is that between Official Development Assistance and gross national income (GNI). In the 1970s already, the industrialised nations set themselves the goal of raising the ODA ratio to 0.7%. However, in 2013 the German ODA ratio was just 0.38 of GNI and thus the average for the donor countries. But in absolute terms, Germany was the third most important donor in 2013.

Alongside the "traditional" donor nations, major emerging economies such as China and Brazil are now also becoming actively involved in development cooperation. Moreover, there are increasingly other sources of finance on which the developing countries can draw, such as private funds, which are constantly gaining in importance. Such institutions as the Bill & Melinda Gates Foundation or non-governmental organisations now manage huge sums of money. Commercial enterprises too have discovered the developing countries for their investments and in this way promote economic development on a large scale.

The drawback of these private commercial funds is their high volatility over time. ODA monies therefore continue to be very important. They are a reliable and essential element of development finance. It is primarily the poorer countries that remain chiefly reliant on official development aid to achieve their development objectives.

The KfW development approach

KfW Development Bank has devised its own approaches to increase development aid. An unusual feature here is that it does not just use public-sector budgetary resources to finance projects, but also raises funds in the capital market. For as a state bank, KfW can obtain funds in the capital market at particularly favourable rates, thus also mobilising non-public monies for development cooperation. This increases the volume of financing significantly.

In 2013, KfW Development Bank made commitments of EUR 5.3 billion. KfW mixed the market funds with money from the German federal budget. In this way, tailored solutions are developed and scarce German federal budget funds employed as effectively as possible. The

offers are adjusted to the country and the project created. This makes financing by KfW Development Bank especially efficient.

Though its mix of grants and loans, KfW Development Bank ensures a high level of flexibility. If offers everything from non-repayable grants and interest-subsidised loans to credit on near-market terms. By contrast, many other donors do not offer loans.

This mix of financing has a positive impact on the partner countries, promoting commitment and self-responsibility. This is because those countries act particularly responsibly when using money from loans that are to be repaid one day. Additionally, the partners acquire all the abilities needed to independently raise funds in the market later on.

Moreover, KfW is developing new kinds of financing solutions. To access more private resources for development projects, it has created funds that both state actors and private investors can pay into. KfW Development Bank's response to currency risk is a particularly noteworthy innovation. Loans are made to the partner countries in their local currency rather than in euros. With exchange rates subject to fluctuation, this greatly benefits the borrowers.

Micro loans stimulate growth: a grocer in his shop Source: KfW photo archive / photothek.net

Southeast Europe – An innovative fund

Small-scale entrepreneurs and individuals with small financial needs have always found it difficult to raise funds in the capital market. Micro loans were created as a way of tackling this. An innovative fund initiated by KfW in 2005 provides monies enabling financial institutions in 16 countries in Southeast Europe, the Caucasus, Ukraine and Belarus to offer micro loans locally. With a volume of EUR 760 million, the "European Fund for Southeast Europe (EFSE)" is the largest of its type anywhere in the world. Seven European donor countries and the European Union, six financial institutions and a number of private investors participate in the fund. KfW Development Bank contributes close to EUR 10 million on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ).

The financial institutions involved give loans to small and medium-sized enterprises as well as to individuals wishing to renovate their homes. The structural mix of public and private money marks this fund out as especially innovative. An ingenious sliding scale of risks means that it is possible to mobilise an unusually large amount of private capital.

The fund was awarded first prize at the G20 summit in 2010. It is a striking example of how to stimulate qualitative growth that enhances people's lives. Other similar funds in different regions have taken the EFSE as their model.

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