KfW Development Bank

»» Current Topics

Reform Financing

Driving the development strategies of the partners

Reform financing means that international donors pledge policy-based grant financing or policy-based loans to partner countries, depending on their performance capacity, to support their national policy reforms. KfW's partner countries have already demonstrated their willingness to undertake reforms in advance. Before a contract is concluded, intensive political dialogue is conducted to define development policy objectives. Disbursements depend on tangible progress and are linked to the current reform phases. KfW Development Bank also provides technical support to partner governments, for example by providing advice on public financial management.

Context

Individual and isolated projects, such as the construction of a school or a hospital, are often not sufficient to create development opportunities for the local populations in KfW's partner countries. Instead, structural measures and comprehensive reforms are needed to ensure that funds are used effectively for sustainable development.

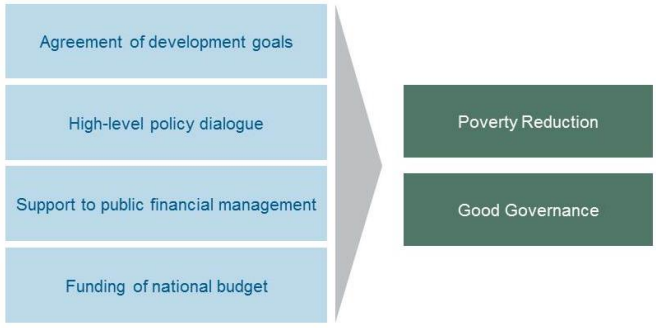
The Paris Declaration adopted in 2005 defined five principles for increasing the impact of development cooperation: ownership, alignment, harmonisation, management for results and mutual accountability. For a long time, what is known as budget support was seen as the most consistent instrument for putting these principles into practice. However, it was also increasingly the subject of criticism and faced accusations of encouraging corruption and mismanagement. The instrument of reform financing was developed on the basis of budget support models and good experiences with policy-based loans. Reform financing provides financial support to partner countries to help them implement their national reform strategies which have already been adopted at political level.

For reform financing to work, it is important that national monitoring mechanisms, such as SAIs, work effectively. Parliament and civil society must also be involved so that government action is transparent and the government can be held accountable. Reform financing does not mean just showering money on a country with no limits. It is only granted to partner countries willing to reform and is linked to the implementation of these reforms.

The KfW development approach

Depending on the performance capacity of the partner countries, reform financing is made available in varying degrees of funding quality: grant financing for poorer countries and loans with different concessionality levels for more advanced countries. Political dialogue plays a special role in the process. This happens before the contract is concluded. The implementation steps and conditions precedent to disbursement agreed in this contract are defined together with the partner and other donors in a policy matrix.

Reform Financing
Across-the-board impact



Source: own data

KfW also assesses in advance whether minimum standards are being upheld in public finance and in anti-corruption efforts. This mitigates what are known as fiduciary risks, i.e. the risk that funds will not be spent as planned. In addition to financial support, KfW Development Bank also provides its partner countries with specialist and technical support.

Successful reforms are intended to improve general conditions for government services. KfW benefits from the lessons learned from other financial cooperation projects carried out at the same time as reform financing, such as the expansion of the energy and water supply system. Policy dialogue also makes it possible to address sensitive issues such as corruption or human rights at the highest political level.

Technical support focuses on (sectoral) reform concepts and their implementation. At the same time, weaknesses in public finance are often addressed by appropriate accompanying measures, e.g. to strengthen the capacities of supervisory bodies such as audit courts or anti-corruption authorities or to make tax administrations more efficient. Reform financing can thus indirectly mobilise additional resources available to alleviate poverty and make partner countries less dependent on donor funds.

Source: KfW photo archive/ photothek.net

PBL financial sector – investment partnership

Even eight years after the revolution, Tunisia is still undergoing a democratic process of reform which aims to consolidate its institutions. Inefficient banking and financial sector structures and a low level of financial inclusion are hindering Tunisia's willingness to invest, as well as its economic development.

Reform financing is part of the German-Tunisian reform partnership that emerged from the “Compact with Africa” (G20 Initiative). It supports the Tunisian government in implementing Tunisia's reform efforts in the financial and banking sectors and in capital market development in the short- to medium-term and in stabilising public finances.

The project concentrates on the one hand on selected measures that are based on Tunisia's central reform programme. Additional measures in the financial sector/capital market are also intended to help improve the general conditions for private investment and micro, small and medium-sized enterprises (MSMEs) and to leverage synergies with the ongoing and planned development cooperation portfolio in the country.

By selectively supporting the Tunisian government in the further design and implementation of reforms in the financial sector and in capital market development, reform financing contributes to improving economic sustainability and the investment climate as well as to reducing unemployment in the country.

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