

Water – fundamental for development



ANNUAL REPORT 2008 ON COOPERATION WITH DEVELOPING COUNTRIES

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Concentrating, so as not to waste a single drop

Record result – in spite of the crisis

The financial crisis is also hitting the developing countries, which need reliable support more than ever before. For this reason we at KfW Entwicklungsbank did everything possible in 2008 to expand our activities further. With approximately EUR 3.7 billion in new commitments, we clearly exceeded the record level of the year before and achieved the best result in our history.

DEG – a partner with experience

The weakness of the global economy is putting increasing pressure on investment activity and on the markets in developing countries. For this reason we at DEG did a great deal in 2008 to help stabilise our private business partners, with the greatest amount of new business since the foundation of DEG – EUR 1.2 billion – and with projects of the same high quality as before.

Water – a valuable resource

Population growth, food production and industrialisation are further increasing the demand for water. At the same time, supplies are shrinking due to pollution, wastage and the effects of climate change. In 2008, therefore, on behalf of the Federal Government, we continued to help our partner countries to protect the vital resource that is water. In this we were the third-largest bilateral donor.

Greater local presence – worldwide

In order to work even more closely with our partners, we are strengthening our local presence. In 2008 we therefore raised the number of our local KfW Entwicklungsbank and DEG offices to 64 in total.

The financial and economic crisis is shaking the world. It is rocking a system which, despite being distorted in some regions, had for decades been thought to be generally stable and secure, and which had enabled many poor countries to make great strides in their development. It is too early to assess the negative consequences of the crisis with any certainty. It is certain, however, that we face far-reaching changes. It is also in our long-term interest not to lose sight of the developing world and not to sacrifice development cooperation in favour of issues that appear to be more immediate. At this time especially, people in developing and transition countries depend on our support. They need capital to finance adjustment processes and investment for development, and in this area there is an acute bottleneck, which our activities help to relieve.

On behalf of the Federal Government, we are working to reduce poverty, protect the climate, secure peace and create a form of globalisation that will benefit people in poorer regions in particular, even in difficult times. The community of nations wants to move a great deal closer to these goals by 2015. In concrete terms this means food security and primary education for all, sustainable economic growth that is not achieved at the expense of the environment, and a reliable energy supply. But it also means providing drinking water and sanitary facilities to many more people than currently have access to them.

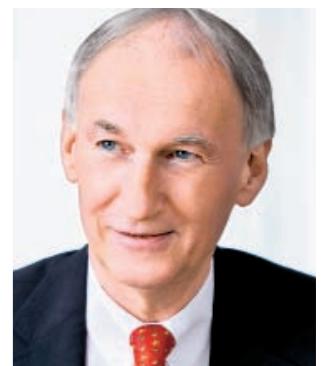
The provision of such facilities in many parts of the world is nowhere near as efficient as it is in the developed countries: overall, 1.1 billion people have no access to clean water and more than twice as many lack sufficient sanitary facilities. And water, which is in any case a limited resource, is becoming even scarcer due to population growth and climate change. In order not to literally leave ourselves high and dry anytime soon, we must cope with the competing demands of diverse users with an eye to the future. One of the most crucially important tasks for the future is to use water reserves more sensibly and simultaneously protect them.

In this spirit KfW Entwicklungsbank and DEG have been supporting developing countries for years in the water sector in very diverse areas, ranging from the provision of drinking water through rural irrigation to the use of water as a renewable source of energy. Due to the consequences of climate change our activities gain added importance. As part of KfW Bankengruppe we have many years' practical experience and a sound knowledge of this essential building block of life. Together with our partners we have already achieved a great deal.

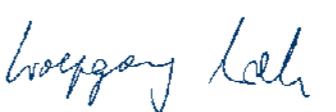
In order to win the fight against poverty and make sustainable improvements to human health, people must have access to clean water. If we want to conserve nature and the environment we must be less wasteful of water resources. And if we want to avert conflicts over "blue gold" we must develop long-term, environmentally friendly ideas, which can be applied across borders and which respect everyone's rights in equal measure. This is what we are working towards together with our partners in the developing countries because only in this way can we overcome water-related problems and thus also tackle need and misery decisively and energetically – even in times such as these.



Wolfgang Kroh



Dr Winfried Polte



Wolfgang Kroh
(Member of the Managing Board of KfW Bankengruppe)



Dr Winfried Polte
(Chairman of the Board of Management of DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH)

VALUABLE, SCARCE AND COMPLEX

SOLVING THE WORLDWIDE WATER PROBLEM REQUIRES INTEGRATED MANAGEMENT



Water is a fundamental element of life. If there is too little of it or – in the case of floods – far too much, if the supply is erratic or if it is contaminated with toxic substances, it affects all areas of life. It has an impact on the natural environment, on health, on the quantity and quality of food resources, and even on education and on economic and social development. It is already apparent that this valuable resource will become even scarcer in the future. Today, more than 50 nations suffer from water stress. Without decisive action this number will rise still further. In the worst case, 30 years from now nearly half the world's population will be living in countries suffering from a chronic lack of water. This is because more people, more agriculture and more industry use ever more water. At the same time nature demands its share, but it frequently has to make do with whatever is left over by humans. This is a dangerous development as it is the ecosystems that filter and store water. One of the most important tasks for the future is to deal with these competing demands while looking at the long term, to use limited water supplies more efficiently and at the same time to protect them.

Three quarters of the globe is covered in water but only 3% of the huge total of 1.33 billion cubic kilometres consists of drinkable fresh water. The bulk of this is trapped in ice and snow at the poles and in the mountains. Thus, people can only use around 1% of all the water available on Earth. What is more, this water is not equally distributed and in many regions it is overexploited. Non-renewable, fossil groundwater supplies are being used up. The situation is already precarious in the water-poor Middle East and in parts of Africa, and it is also growing increasingly serious in southern Europe, India, Central Asia and north-eastern Brazil. In Northern China, too, more than 200 million people suffer from water scarcity.

From riverside neighbours to rivals

Water is not evenly distributed in the same way as air. Whereas climate protection presents a global challenge, water management is always a regional or even a local matter, which depends on the naturally occurring conditions in each individual water catchment area or river basin. Water for agriculture, drinking water for people, water for industry and energy production, or water for ecosystems – human beings and nature usually have to make do with the water available in their area. Abstracting water from other river basins or desalinating seawater – possible options for richer countries – are technologically complex, possible only in a few places and pose ecological and social risks.

Reconciling different demands for water use is a manageable task in small catchment areas of a few square kilometres. In contrast, in large river basins with many competing user groups the task quickly becomes extremely complex. "Rivalis", riverside neighbours in the Latin sense of the word, quickly become rivals as soon as either the quantity or quality is insufficient. Water extracted by people upstream is no longer available for those further downstream. If river basins also cross national boundaries the situation becomes politically delicate – and there are 145 states that share rivers and other watercourses with their neighbours.

Integrated water resources management as a solution

Thus, there is a need for integrated water resources management (IWRM), which takes into account regional and often transboundary user interests, along with their interdependency and reciprocal effects. IWRM is the foundation on which to develop and implement concrete measures for efficient use of water resources that is sustainable and at the same time socially just.

To achieve this, it is necessary to escape narrow sectoral limits. All activities that have an effect on the water balance must be taken into account. In the case of a project to provide drinking water this can mean, for example, taking into consideration hydropower facilities, forest conservation and erosion prevention in the upper course of a river, the contamination of water and soil by waste, or overall land use planning.

To this end, many players must work closely together: legislators, regulatory authorities, water supply companies, industry and agriculture, and not to forget the users themselves. It is frequently necessary to break down old structures and build new ones. This can often be done only in small steps and with a great deal of patience and endurance. Initially therefore, in any one programme cycle only some elements of an IWRM plan can be implemented. However, the involvement of KfW Entwicklungsbank, always designed for the long term, provides for structural support and ensures sustainability.



"Securing the future of people and the environment will only work with enlightened and integrated water resources management".

James Leape
Director General
World Wildlife Fund (WWF)

Climate proofing as part of an inclusive approach

Dealing with the approaching water shortage demands profound rethinking and foresight – for example, for long-term planning that accommodates the necessary responses to climate change and how to finance them over the next 20 to 30 years. This is because the situation is made acute in many regions of the world by several factors. These include the anticipated temperature rises, more rapid evaporation, and much more infrequent, more irregular, and also more extreme rains that may cause floods, as well as the threats to coasts by rising sea levels. Given these factors, climate model-based projections indicate that it will not be possible to supply sufficient water to about 3 billion of the 8 billion people expected to live on the Earth in 2025.

KfW Entwicklungsbank is responding to these dangers with new approaches. Within the framework of IWRM, climate proofing enables, for instance, countervailing the project against climate change risks even at the planning stage. Amongst other things, that may imply adapting the location, design and operation of the project to the changing conditions.

Third-largest bilateral donor

Commissioned by the Federal Government, KfW Entwicklungsbank supports developing and transition countries to overcome the considerable challenges of planning and financing in the water sector. For this purpose, it makes available, in more than 60 partner countries of German Development Cooperation (DC), ideas, concepts, financing and advice – together with other DC organisations. This is based on the Water Sector Strategy of the Federal Ministry

for Economic Cooperation and Development (BMZ). In this area, Germany is the third-largest bilateral donor worldwide.

The principal objective of this strategy is to provide people with drinking water and water for other purposes. Where water is already in short supply or contaminated, KfW Entwicklungsbank concentrates, in accordance with IWRM principles, on raising the efficiency of use, reducing water loss, and improving wastewater and solid waste management, thereby protecting natural resources. We are particularly concerned with the accompanying political, economic and social conflicts. We therefore promote good governance in the partner countries in order to overcome differences and to stimulate joint development.



Energy from water – water from energy

Water and energy – an undervalued interrelation

Water is needed for the largest part of electrical energy production. Still far too little attention is paid these days to just how much energy production is dependent on water and which interrelationships exist in this context.

Hydropower is currently the world's most important source of renewable energy. However, hydropower competes with agriculture and other water users for the water from rivers and reservoirs. Biomass energy production is also dependent on water for cultivating "energy plants" such as maize. Even solar power stations require water to clean the mirrors and as processing and cooling water for the steam turbines.

Water also plays an important role in conventional energy production. Power stations require huge amounts of water for cooling. Less power is produced when rain fails and rivers warm up too much as, for example, in the 2003 heat-wave summer in Germany.

In its turn, energy is needed to ensure a comprehensive water supply or, in agriculture, to pump water to the fields. Half the operation costs of municipal water companies may consist of energy costs.

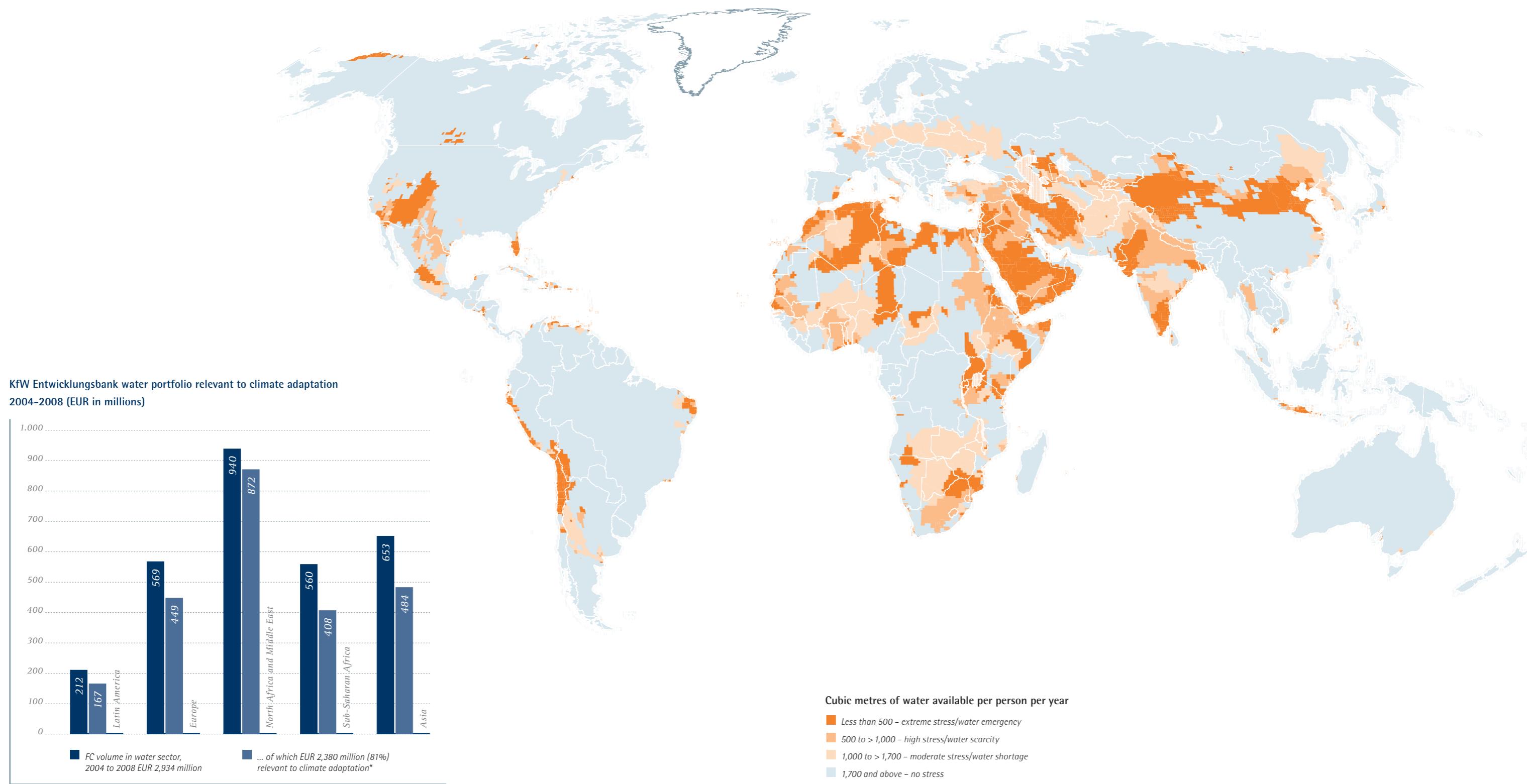
Climate change will alter the global water balance and increase competition for water as it grows scarcer, for hydropower stations as well.

In addition, energy production facilities will have to be protected from flooding and other climatic extremes.

This shows that integrated water resources management is essential in all sectors – management that considers equally the environment and all user groups.

GLOBAL WATER STRESS 2020

OWING TO CLIMATE CHANGE WATER SCARCITY WILL INCREASE IN MANY PARTS OF THE EARTH



* Projects in developing countries and emerging economies experiencing water scarcity, which contribute to the protection and more efficient use of water resources, were evaluated as being relevant to climate adaptation. These are in particular projects for optimising wastewater management (e.g. reduction of water loss, recycling of treated wastewater, etc.), irrigation efficiency, resource-preserving hydropower, as well as protection of the environment and ecosystems.

A NOVELTY IN THE REGION

ANGOLA AND NAMIBIA JOINTLY INVESTING IN THEIR WATER SUPPLY

How we make a difference
The projects initiated by KfW in 2008 will improve the life situation of more than 6 million people through measures for water supply, wastewater treatment and disposal.

The Cunene carries water year-round. It originates in Angola and, for long distances, forms the border with Namibia. Nevertheless, water scarcity exists in many localities in the Angolan province of the same name, because the available water is not used optimally. None of the municipalities has a centralised water supply system. Water for the total of 100,000 inhabitants is brought by tank trucks from Namibia. Namibia itself began to build its own drinking water system as early as the 1970s and has continually expanded it.

Even the water pipeline built in 2005 by the Angolan Government has not been able to alleviate the population's lack of water. This is because of insufficient pump capacity. No more than one to two litres per day is available for each person.

Namibia and Angola are now cooperating on water supply and are receiving financial and technical help from Germany. This is a novelty in the region: both countries are investing jointly in infrastructure and are building water storage, water works and pumping stations, which feed drinking water through trans-regional pipelines and into the water distribution networks of the municipalities.

Carrying water over long distances – in the future hopefully a thing of the past



The water from the Cunene must be redistributed if the Namibian and the Angolan villages are to be provided for equitably. It is therefore not only necessary for the technical systems to be aligned, extended and integrated with each other, there also has to be functional political and institutional cooperation. This cooperation has to be ensured between the governments of Angola and Namibia, the yet to be founded River Basin Commission, the Secretariat of the Southern African Development Community (SADC), as well as various user groups. This is a rather simple technical solution but an enormous advancement in terms of IWRM, one that overcomes old boundaries.

KfW Entwicklungsbank is making available from the BMZ budget two-thirds of the project's total costs of nearly EUR 18 million. The aim of the project is to provide 20 litres of water per person per day. For this, 2,000 cubic metres of treated water will flow to Angola – day after day. In addition, in a second stage, a circular supply system will be built that will provide clean water throughout the year not only to northern Namibia but also to all of southern Angola.

A CLEAR POLITICAL WILL

TUNISIA'S COMPREHENSIVE APPROACH PROTECTS PRECIOUS RESOURCES



The quality must be right before wastewater can be reused.

Water is a very scarce commodity in dry Tunisia. With over 26 reservoirs and several thousand wells, the country currently uses almost all of its renewable water resources. Yet in some regions the groundwater level is continuously falling, and the "blue gold" is being additionally endangered by wastewater and water percolating from solid waste dump. Agriculture swallows up more than 80% of the water. The Tunisian Government, with the support of its partners, is therefore doing everything possible within a comprehensive IWRM to use the available resources more efficiently and to protect them from pollution.

Tunisia's biggest river, the Medjerda, is vitally important because it carries water year-round. In the river's catchment area, KfW Entwicklungsbank, on behalf of the Federal Government, is supporting a strategy for comprehensive water use by financing plans for efficient drinking water and irrigation management, a modern wastewater system and controlled landfills. Rain and wastewater will be collected from private households with 400,000 people in 11 towns of the region. It will then be bio-mechanically treated and part of it reused in agriculture. Wastewater treatment is needed in order to protect the Sidi Salem reservoir, Tunisia's most

important store of drinking water, from contaminants and excessive algal growth.

Our support of optimal water resource use today includes the desalination of groundwater and brackish water. Furthermore, the treatment plants use organic sludge for producing biogas. When dried, this material becomes available as fertiliser for agriculture and to the cement industry for co-incineration. KfW Entwicklungsbank's involvement is rounded off by its support for investment in environmental protection by industrial enterprises.

coverage for the disposal of all kinds of waste. There are already seven landfills financed by KfW Entwicklungsbank as well as a national disposal centre for hazardous waste, particularly from industry. Three more landfill sites will be added shortly, two in the Medjerda valley and a second large one for Tunis. The modern landfills limit the production of landfill gases that damage the climate. The costs are partially met by the revenue from emissions certificates. This is good for the climate and a major step forward in protecting valuable water resources.

KfW Entwicklungsbank's long-term involvement is showing results. Thanks to the comprehensive IWRM approach, which includes drinking water, irrigation, wastewater and solid waste, the quality of the ground and river water has greatly improved and its use has clearly become more efficient; and all of that while protecting the climate and the environment.

MAXIMUM RETURN PER LITRE

SUFFICIENT WATER FOR FOOD SECURITY



Nowhere is so much water needed and used as in food production. Of all the fresh water humans currently use worldwide, 70% flows into agriculture – to fields, meadows, plantations, and greenhouses. In many dry regions it can even be as high as 90%. Industry, crafts and energy production consume around 20%, private households, in contrast, only about 10%.

Accordingly, competition for the limited fresh water resources is stiff. By 2050 the world population will grow to over 9 billion people. To feed them, agricultural production will have to rise markedly over the next 40 years.

In many regions, however, this is something that agriculture cannot achieve. Even in areas where regular and sufficient precipitation falls, rain-fed agriculture is still far below its potential. In addition, more than half of the food never reaches the table. It rots after harvest or is destroyed by pests. In countries where irrigation is necessary, much of the water is lost on its way to the fields. The systems are antiquated and defective, and good organisation is lacking.

Increasing production, reducing water demand

If water is not managed more efficiently, forecasts indicate that agricultural demand for water will nearly double by 2050. New water resources could be tapped, of course, but only to a limited extent. Any intervention in the water cycle has, in any case, severe consequences. Because available water is becoming increasingly scarce in all other areas: for drinking water supply, conservation of biodiversity and natural habitats that are

worth protecting, as well as for economic and social development. Therefore, any increase in agricultural production necessitates simultaneously increasing the efficiency of water use and limiting its consumption.

One of the most important tasks of KfW Entwicklungsbank is to support partner countries in raising yields with the same or reduced amount of water and so to lessen the pressure on the water balance. The "BMZ reference framework for rural development" stipulates that all technical possibilities should be fully exploited so that surface and groundwater are used as economically as possible and the water quality is not endangered. The principle of "more crop per drop" aims to promote food security while protecting resources. Research assumes that these divergent objectives can be reached with appropriate innovations – but that it will require enormous investment.

Even if the main goal is to produce more food, other water users must not be thereby disadvantaged, or conflicts over water resources caused or exacerbated. This is particularly the case for the extension of irrigated agriculture. Here also, water may only be used after careful consideration of the interests of all stakeholders. At the same time it is becoming increasingly important to introduce more efficient methods of irrigation and improve existing systems.



"Only if we use water – the basis for our food production – really efficiently, food supply for our ever growing world population can be secured".

Joachim von Braun
Director General
International Food Policy Research Institute (IFPRI)

SMALL DAMS WITH BIG IMPACTS

A LITTLE MORE WATER MAKES A NOTICEABLE DIFFERENCE TO LIFE IN MALI

Adapted to the water catchment area

Projects for food security must be adapted to the specific characteristics of each water catchment area. Areas seen as unproblematic show an even or positive water balance, i. e. they have enough water for all. In such non-critical catchments, primarily in Sub-Saharan Africa and in Latin America, irrigated agriculture could still be extended.

In these areas, KfW Entwicklungsbank supports the construction of new irrigation systems, advises on the introduction of sustainable cultivation techniques and promotes the organisation of water distribution by small farmer associations. In Peru's Alto Mayo region, for example, this has led to the farmers being able to bring in two harvests a year. The additional income has noticeably improved their living conditions.

In threatened or critical catchments the water balance is variable or negative. The scarce water has to be distributed equitably among all the user groups and thus used as efficiently as possible.

In these arid regions, KfW Entwicklungsbank is financing measures that improve rain-fed agriculture to make optimal use of precipitation. Slope terracing, reforestation, and contour bunds reduce rapid rainwater runoff and thus increase water retention in the soil. In Mali, Ghana and Burkina Faso KfW Entwicklungsbank supports the construction of small retention dams in valleys. The water retained here limits the risk of crop loss if the rains fail or are late.

Saving, storing, and reusing water

To use water as economically and sensibly as possible, KfW Entwicklungsbank is developing adapted solutions together with the partner countries. In Bolivia, for example, irrigation channels, small water tanks and retention basins are being built to bridge periodic dry spells. In Tunisia, wastewater that used to flow untreated into the sea and was therefore lost to agriculture, will in the future be treated and fed back into the groundwater. Returning it to the water cycle provides an additional source of water for the irrigation of over 12,000 hectares of fruit plantations.

In Jordan, one of the driest countries on Earth, KfW Entwicklungsbank supports irrigation projects in which treated water from towns in the north is used for irrigation in the Jordan valley. This will, in the future, save drinking water that was previously consumed by agriculture. About 15 million cubic metres, or approximately 20 litres per inhabitant per day, of additional water will become available for Jordan's capital Amman.

In all projects the main aim of the Federal Government and KfW Entwicklungsbank is to support partner countries in strengthening their agriculture and preparing for future food requirements. This is to be achieved by increasing agricultural production while conserving resources, by more efficient irrigation systems and through innovative, water-saving solutions such as the systematic recycling of wastewater for irrigation.



Small dams secure food supplies and lift people out of poverty.

60 tonnes of onions and two tonnes of millet per year – every small dam that is newly built or repaired in Dogonland in eastern Mali is a success story in itself. With irrigated agriculture, each small dam means that on average around 100 men and women can grow vegetables on 540 square metres each. After all costs have been deducted an additional income remains for the families, which significantly improves their living standards.

This comes to EUR 73 per person on average, which is approximately 40% of a typical annual income. Three meals a day, decent clothes and regular schooling for the children are no longer impossible dreams – and this in a region where more than three quarters of the people

live below the poverty line. More than half have no access to drinking water and child mortality is 30% higher than the national average. Everywhere there is a lack of infrastructure, such as connecting roads overland or leading to individual villages.

By building small dams and simple tracks, which are often the first form of access to villages and which are important for being able to transport goods to market, KfW Entwicklungsbank, in close collaboration with the German Development Service (Deutscher Entwicklungsdienst/DED), promotes agricultural and economic development in the region. "By managing water efficiently and carefully, people can produce two to three harvests per year from larger areas of

cultivated land", says Martin Bostrom, agricultural expert at KfW Entwicklungsbank. "That secures their food supplies and lifts them out of poverty". Thanks to the small dams the groundwater level rises. This means that people also have more drinking water.

Using BMZ funds, KfW Entwicklungsbank has financed 63 small dams since 1989. At least half of the construction costs benefited the population in the region in the form of direct income. This money is integrated into the planning and implementation of all construction projects. At the same time people are trained in how to use and maintain the new facilities themselves. An additional 40 new or restored small dams will be added to this figure. A further track will also be built, which will give 44,000 people easier access to 19 schools, 3 health care centres and 9 markets. Because of these success stories the Government of Mali wants to turn this type of small-scale irrigation scheme into a national programme.

MORE MAIZE AND MANIOC

SMALL FARMERS IN PARAGUAY BOOST THEIR AGRICULTURAL YIELDS



The right farming methods improve the soil water balance – and therefore the harvest.

Land distribution in Paraguay is extremely uneven. A small number of very rich individuals own more than three quarters of all farming land. The majority of the rural population must make a living from the meagre amount of land remaining. There is a lack of money and opportunities to farm this land sustainably and to invest in improved farming methods that use less water. Advice is also lacking.

This situation has now changed for some 13,000 families. Since 1998 KfW Entwicklungsbank – in a joint project with the national Ministry of Agriculture and the German Agency for Technical Cooperation (Gesellschaft für Technische Zusammenarbeit/GTZ) – has been supporting the rural population in central and eastern Paraguay

with ideas and money. The second phase will include a further 4,000 families, because the project has demonstrated that, with the right support, small farmers can significantly increase their yields, without at the same time destroying the environment and their source of livelihood. This result can also be achieved without the need for additional irrigation.

To this end farmers rely above all on zero-tillage, meaning they sow directly into the unploughed soil. Roots and other parts of the plant cover grown previously as green manure are kept in the soil. These allow rapid percolation of rainwater and thus lead to a better water balance. As a result, plants can more easily withstand short periods of drought.

An improved water balance, green manuring, crop rotation, a moderate application of additional fertiliser and no ploughing or burning off the fields all increase the fertility of the soil and lead to significantly higher yields.

BMZ grants help farmers to afford investment in zero-tillage farming. Small farming families can buy hand sowing equipment, seeds for crops and fertiliser. Large, expensive machines, such as a roller to prepare the fields or an ox-drawn zero-tillage machine, are purchased jointly by the community.

The project, which runs until 2010, is considered to be exemplary in Paraguay and it has already inspired many imitators. There is good reason

for this as yields of maize, sesame and manioc have risen considerably in just a short time. The soil is more fertile and periodic water stress is reduced. It has been possible to conserve arable land and wooded areas, and to save water resources. This is a major gain for nature and especially for the rural population, whose living conditions have improved in a sustainable way.

How we make a difference
The energy projects appraised by KfW in 2008 – quite apart from their demonstrative character – saved at least 2.8 million tonnes of carbon dioxide per year, making a direct contribution to climate protection. This is equal to the CO₂ emissions of a medium-sized German city. A total of 13.3 million people are benefiting from an improved energy supply.

The health projects appraised by KfW in 2008 will be helping approximately 153 million people. Of those, around 33% live below the relevant national poverty line. Our HIV/AIDS prevention programmes target around 92 million people and we reach 40 million people with programmes to combat infectious diseases such as polio and tuberculosis.

CLEAN WATER AND SANITARY FACILITIES FOR ALL

BREAKING THE VICIOUS CIRCLE OF POVERTY



One out of six people on Earth – currently 1.1 billion – must go to a great effort every day to fetch water, often from far away. This task is mainly left to women and girls. The water is often dirty, contaminated with germs, and makes people ill. These people do not have their own water connection, standpipe or water kiosk that reliably delivers clean water. In 2008, according to the World Health Organisation (WHO) and the United Nations' Children's Fund (UNICEF), a total of 2.5 billion people had to do without the most basic sanitary facilities – without clean places to wash and without toilets or at least latrines nearby. A connection to a public wastewater disposal system, which is taken for granted in developed countries, is completely unattainable for two thirds of the world's population.

Europe has mostly forgotten the catastrophic hygiene conditions that existed in its fast-growing cities of the 19th century, as well as the great cholera epidemics. The introduction of a secure drinking water supply and regular wastewater management, which brought noticeable and long-term improvements to living conditions, is one of the greatest health achievements in European history.

Conditions today for people living in many slums and on the outskirts of cities in developing countries are similar to those of people in the poor quarters of London or Hamburg 120 years ago. In many rural areas of Africa and southern Asia the precarious hygiene situation has considerable negative effects. According to research by the World Health Organisation, four out of five cases of illness in developing countries are due to unsafe drinking water and a lack of hygiene. Around the world approximately 5,000 people, mainly children under five, die every day as a result of drinking, or coming into contact with, contaminated water. An insufficient drinking water supply and a lack of hygiene in the home and its immediate surroundings increase the mortality rate, damage productivity and income, and reduce educational opportunities. These factors are not only a sign of poverty, they are also one of its most important causes.

Water supply and sanitation – a priority development area

It is thus for good reason that constructing and modernising water supply and sanitation plans, i. e. a drinking water supply, basic sanitation and wastewater management, are priority development areas for the Federal Government and KfW Entwicklungsbank. Currently 270 projects for a total of EUR 6.7 billion are being financed. The partner countries' own share is EUR 2.2 billion. These projects reach approximately 70 million people and bring clear improvements to their living conditions. Our involvement in this area makes a significant contribution to reducing poverty and conserving valuable water resources.

Better living conditions in cities

Urban areas are increasingly becoming the focus of attention because worldwide there are now more people living in cities than in rural areas. Of these 3.3 billion city dwellers around one billion live in slums and informal settlements in urban peripheral areas. The city water systems cannot manage to provide them all with drinking water; they lack both the financial means and the operating plans and capacity. Moreover, in arid countries they frequently lack sufficient supplies of water. Particularly in the slums people often have to buy drinking water at inflated prices from private water vendors or obtain water from wells and springs, where it is frequently of dubious quality and only sporadically available.

An important element of our work is therefore to guarantee a long-term drinking water supply that meets people's needs and basic sanitary facilities in those areas which have thus far lacked such provision – especially in Africa. Strategies which have been agreed with users and operators, and which are adapted to the individual situation, ensure that as many people as possible receive clean water and can live in hygienic surroundings. On the edges and in the slums of African cities, for example, the model of water kiosks has proved its worth.



"Investing in sanitation is about giving people health, dignity and development. It leads to fewer deaths and consequences from waterborne diseases in lowering child mortality and enhancing maternal health; fewer girls dropping out of school and more women playing an active role in their communities".

*Prince Willem of the Netherlands,
Chairman of the "United Nations
Secretary-General's Advisory Board
on Water and Sanitation"*

In many countries which suffer from water shortages there are urban water distribution networks and disposal systems but only insufficient or contaminated water. In extreme cases, as in many cities in the Middle East, the inhabitants have water only once a week for a few hours. Here our involvement is mainly aimed at distributing water more efficiently and reliably, improving water quality and reducing losses.

However, KfW Entwicklungsbank's work is not just limited to tackling the symptoms. Our commitment to improving institutional structures in the water sector and enhancing the management, administration and operation in partner countries is just as important. Ultimately it is good sectoral policy, regulation, transparency, accountability and participation that ensure sustainable drinking water supply and basic sanitation in the cities of developing countries.

Taking into account water cycles

It is already a major challenge to improve the living conditions of people in cities and villages by providing a secure drinking water supply and sanitary facilities. However, oftentimes this is by no means enough in the context of the overall IWRM concept. Water cannot be propagated. In a series of great cycles water used by humans returns to nature and then once again returns to humans. At a time of growing contamination and water scarcity these cycles are increasingly the centre of attention. One frightening figure shows how important this is: 90% of wastewater worldwide, especially in the great conurbations, is not treated.

In order to sustain the basic conditions of life for humankind, the economy and for nature, we are providing increasing support, now and in the future, for measures to collect wastewater, treat it and, where possible, allow it to be reused. Recycling the organic substances and nutrients contained in wastewater plays an increasingly important role in this regard. KfW Entwicklungsbank is making approximately EUR 1.6 billion available for such wastewater management projects.



Modern waste management returns recyclable materials to the economy.

Valuable transformation

As the cities grow in developing and emerging countries, so do the mountains of waste. If they are not properly disposed of and treated, they threaten people's health. Refuse is a breeding ground for mosquitoes and a source of food for rats and other pests. If solid waste also hinders the flow of wastewater in the sewers it creates ideal conditions for pathogens to multiply. Unsecured waste disposal sites also contaminate rivers, lakes, coasts and seas. These dangers must be taken into account in integrated water resources management.

For this reason professional waste collection, treatment and storage on the one hand and

municipal water supply and wastewater disposal on the other complement each other. Furthermore, as part of a resource management plan, modern waste management can recover recyclable materials and return them to the economic cycle as raw materials, using them as a source of energy. Only the remaining unusable waste is disposed of in an environmentally acceptable way. Waste treatment and landfill gas recovery also allow significant reductions in greenhouse gas emissions.

However, there is hardly a developing country or even an emerging economy with the financial means and sufficient expertise for such

measures. Therefore, to complement its activities in the field of water supply and sanitation, KfW Entwicklungsbank has committed EUR 177 million from budget funds and from its own funds in eight partner countries for major waste management programmes. Together with setting up the institutional framework, these programmes create the fundamental structures for disposing of waste in a reliable and sustainable way. Further projects in 13 countries are currently being prepared, particularly in the more advanced countries of South-Eastern Europe, the Middle East, North Africa, East Asia and South Africa.

SUCCESSFUL MODEL

WATER KIOSKS MAKE DAILY LIFE EASIER IN ZAMBIA'S POOR NEIGHBOURHOODS



Water and more: kiosks are also meeting points for the community.

All the new water kiosks in Zambia's poor neighbourhoods are hives of activity. Girls and women bring their canisters to fetch water for washing clothes or for cooking. Anyone who also quickly needs to buy some flour or sugar can find it here, too, as the water kiosks double as small shops selling items of daily use. Women no longer need to walk for hours to fetch water and the clean water available in the vicinity costs less than the dirty water from the tankers of illegal water vendors used to cost.

So far more than 200,000 people in Zambia have benefited from these kiosks. There are already 170 of them and another 100 will be added in 2009. Local committees of future users decide

where exactly the kiosks will stand. They are mostly run by women who are subcontractors of the city water companies. They receive a commission for every litre sold but may not exceed a fixed price.

The kiosk concept is the key element of a project that has been running since 2006 and that has caused a sensation throughout the country. Thanks to simple, low-cost technology the kiosks supply water precisely to those people who were previously considered to be too unattractive as customers because they could not as a rule afford an expensive connection to the water supply system.

Construction of the kiosks is financed by the Zambian "Devolution Trust Fund" (DTF), a water fund for whose financial and advisory services the municipal water companies can apply.

KfW Entwicklungsbank made a crucial contribution to developing the concept and provides the largest financial contribution of EUR 9 million on behalf of the Federal Government. In parallel the GTZ (the German Agency for Technical Cooperation) advises the fund's management.

DTF's concept has become very popular. A water fund for the poor in Kenya is currently being set up, following DTF's example, and Zambia is considering applying this successful model for urban water supply across the whole country.

FOR PEOPLE AND FOR THE SEA

THE HARBOUR TOWN OF BATUMI RENEWS ITS WATER SUPPLY AND SANITATION SYSTEM



The sewerage system is no longer functioning.

When the sun shines, the Georgian harbour town of Batumi still shows traces of its former glory. In Soviet times the Black Sea town was a popular seaside resort. When it rains, however, the townspeople wade ankle-deep in wastewater. After heavy rains the town's run-down sewerage system cannot cope with the volume of water. Nearly a third of the town is then flooded with sewage-filled water that is a danger to health and the environment and that flows untreated into the Black Sea.

The nearby river Chakvi, from which Batumi obtains its drinking water, amongst other things, also becomes so dirty after heavy rain that the town is forced to turn off the taps. Up to now there has been no way of treating the water sufficiently.

For this reason KfW Entwicklungsbank is supporting the town administration with approximately EUR 65.5 million to carry out thorough repairs of the water supply and sanitation system. "To supply the population with drinking water and dispose of the sewage in an environmentally friendly way", says Isabelle Steimer, water expert at KfW Entwicklungsbank, "is our common goal". The water treatment facilities are being

repaired and the leaky pipeline network is being replaced in order to put an end to heavy water losses. In addition, wastewater is to be collected, treated and disposed of in such a way that there will be no more flooding and the waters of the Black Sea will be cleaner. To this end a new biomechanical treatment plant is being built.

In order to make sure that the modernised facilities are also subsequently operated professionally, each new phase of rehabilitation begins only once the town administration and utilities companies have done their "homework" and have fulfilled certain technical, financial and administrative requirements. KfW Entwicklungsbank provides financial support for advice, education and training. In an intensive public information campaign the town's authorities are informing people that saving water is not only ecologically necessary but also economically reasonable for every household in view of future water tariffs, which will be charged according to use and will cover costs.

MORE SPACE FOR NATURE MEANS MORE WATER

RICH REWARDS FOR THOSE WHO PROTECT ECOSYSTEMS



In the past the forests bound the soil, gave the rainwater time to seep into the ground and released this stored water back into the environment during dry periods. Today such forests have almost disappeared in Kenya. In just 40 years the Kenyan population has grown from 6 million to 33 million people. This puts enormous pressure on the environment as ever more fields are needed for growing crops and ever more pasture for grazing livestock. Steppe expansion, soil erosion and overgrazing are the results. There is no longer anything to hold back the very heavy, almost tropical, rainfall, leading to a constant cycle of flooding and drought.

The worldwide loss of biodiversity, i.e. the decline in habitats, animal and plant species and in genetic diversity, presents, together with climate change, the greatest environmental problem of our time. This biological diversity is irreplaceable; it stabilises the climate and the water balance, and offers a supply of genetic resources that have as yet barely been studied. Essential for conserving biodiversity are intact natural ecosystems, not least floodplains and wetlands, especially in tropical and subtropical regions.

Ecosystem protection worth billions

However, it is precisely in these regions that particularly great pressure is being exerted on natural habitats. Many developing countries face urgent social and economic problems, and nature conservation is not first on their list of priorities. As a short-term solution, overexploitation of natural resources is more lucrative than the long-term conservation of forests or wetlands. The economic, ecological and health consequences are huge and remain underestimated to this day.

It is a major goal of the Federal Government to support the sustainable management of natural resources in these countries for the benefit of people and nature. Since 1992 KfW Entwicklungsbank has been supporting more than 100 projects to protect intact ecosystems in more than 40 countries. More than half of these funds, approximately EUR 1 billion, have been allocated to Latin America, while around 30% went to Africa and 16% to Asia.

Planning in harmony with nature

If we are to provide ourselves with a constant and adequate supply of water, we need to maintain sufficient water in the ecosystem. However, with humans clearing forests, polluting lakes and rivers, expanding cultivated and industrial areas, and thoughtlessly overexploiting water resources, ecosystems are damaged, leaving everyone literally high and dry. These activities damage natural water storage processes and capacities, impair water quality and eventually even alter precipitation patterns.



"Human development is, in every respect, closely linked to the productivity of ecosystems. Healthy ecosystems make the world habitable; they purify air and water, maintain biodiversity integrity and provide many other critical functions. That is why development financing must also consider the 'Green Economy' as a priority for a sustainable future".

Achim Steiner
UN Under-Secretary-General and
Executive Director of United Nations
Environment Program (UNEP)

NOT WITHOUT THE NEIGHBOURS

CROSS-BORDER ECOSYSTEM PROTECTION IN SOUTH-EASTERN EUROPE BENEFITS EVERYONE

In order to prevent such damage from the outset, all development measures promoted by us, whether in agriculture, industry or urban development, incorporate the complex interconnections of the water cycle in their plans. The quality of each individual water catchment area determines subsequent action. Thus simple and targeted conservation measures to maintain a healthy water cycle can stabilise the ecosystems and bring great benefits to people.

In three communities in Peru, for example, KfW Entwicklungsbank supports environmentally friendly measures to increase coffee production. The small fermentation facilities for 13,000 families, paid for with FC funds, reduce by 90% the amount of water contaminated by production residues. Since these facilities started up, pollution levels in rivers and lakes have dropped significantly.

Erosion control is particularly important

In KfW Entwicklungsbank's ecosystem protection programmes, erosion control plays a prominent role. Thus the Federal Government, through the work of KfW Entwicklungsbank, supports the stabilisation of crucial water catchment areas in Ethiopia, the Sahel region, Costa Rica, the Dominican Republic, India and China by means of reforestation and soil conservation. This improves the local water balance and raises the water storage capacity of the soil, which is not only good for the farmers' fields but also for the region's drinking water supplies.

In the Guidimakha region of Mauritania the first effects of erosion control measures can be seen after three years. Rainwater no longer flows away so quickly and is stored better in the soil. As a result, millet yields have risen in all fields under cultivation and the decline in valuable tree, shrub and grass species has been halted. The increase in water seeping into the soil has made the groundwater level rise again and the drinking troughs contain more water for livestock.

Only with the people

Around the world more than 200 million mostly poor people live from natural ecosystems such as forests and river basins. Nature provides them with the essential basis of their livelihoods – food, clean water, fertile soil and fuel. Therefore measures to protect ecosystems, particularly in poor developing countries, will be successful only with, and not against, the local population. This means that projects must take account of the interests of these people and help to improve their living standards. Ecosystem protection must in no way simply demarcate protected areas; it must include the sustainable use of ecologically valuable areas as well as agriculture, whose water management influences the total water balance of the region. Sustainable ecosystem protection thus requires an interdisciplinary approach in which all competing user groups and sectors are considered at the same time.

A lot of patience is needed for complex ecosystem protection programmes. In Brazil, for example, we have for many years been promoting the protection and careful management of the natural resources of floodplains. The creation

of a sustainable fishing business guarantees biodiversity in the waterbodies. Agreements between local fishermen and regional fishing companies prevent conflicts between users, and as the fishermen have a secure income, they no longer need to cut down tropical wood in order to survive. This is an important contribution to protecting the Brazilian rainforests.



An efficient wastewater system protects the World Heritage Site of Lake Ohrid.

The Prespa region in the area where Albania, Macedonia and Greece meet contains real treasures. Lynx and brown bear live in the woods, rare species of pelican and cormorant nest in the wetlands, and in the lakes there are fish that hark back to the ice age and other species that only occur there. This extraordinary diversity makes the entire Prespa region an ecosystem of global significance. Lake Ohrid has been declared a World Heritage Site by UNESCO.

However, this priceless natural habitat faces a double threat. The region is poor, particularly in the Albanian part. People here have barely EUR 2 per day on which to live. Consequences of this poverty are inappropriate agriculture, illegal felling, overgrazing and overfishing, which destroy the ecological balance and with it the livelihoods of the local people. By Lake Ohrid there is also no functioning wastewater disposal and treatment system, either on the Albanian

or the Macedonian side. Wastewater from private households, commercial enterprises and industry flows untreated into the lake, thereby contaminating it.

In order to halt this extremely damaging process, Albania, Macedonia and Greece have committed themselves to cross-border cooperation. They are being supported in this by the German Government, which is simultaneously promoting two cross-border projects in the region. The first is to protect biodiversity in the national parks, which are particularly under threat, and the second is to establish an efficient wastewater system in the area of Lake Ohrid.

Thus, the park managements in Albania and Macedonia are being helped to restructure their hitherto inadequate management plans in order to concentrate strongly on protecting biodiversity and to draw up a land use plan for the people living on the edges of the park, a plan which is environmentally compatible and sustainable.

At Lake Ohrid KfW Entwicklungsbank is committed to a new comprehensive concept, including a better drinking water supply, efficient wastewater disposal, modern sewage treatment plants and viable municipal water services providers. On the Macedonian side the water and wastewater projects have been successfully completed. On the Albanian side, in the town of Pogradec and surrounding villages, KfW Entwicklungsbank is currently still supporting the gradual renewal of the pipeline network and the construction of a new treatment plant.

The first signs of success are already visible. Pogradec is now the second town in Albania with running water around the clock. People in Pogradec were also willing to pay more – an important precondition for sustainable operation of the sewerage system.

FROM BARREN LAND TO GREEN GARDENS

INDIA: EROSION CONTROL IN WATER CATCHMENT AREAS BEARS FRUIT



Women now have two or three harvests a year and sell the surplus at the market.

The results are impressive. Where depressing yellowish brown tones once dominated there is now vibrant green; barren slopes have given way to a fertile garden landscape where tomatoes, chilli peppers and millet grow. For hundreds of thousands of people in central India life has improved considerably. The groundwater level has risen significantly and there is water even in the dry season. Instead of just one harvest after the rainy season, families can now have two or three harvests and sell the surplus at the market. They no longer have to move to other regions during the dry months in order to earn money there. Many more children now go to school.

This was made possible by the Indian-German development programme for water catchment areas. Action begun in 1992 in individual villages in Maharashtra State now covers approximately 300 communities with more than 120,000 hectares of land. The programme has since been adopted in the states of Andhra Pradesh, Gujarat and Rajasthan. The project executing agency is the National Bank for Agriculture and Rural Development. Altogether more than EUR 70 million flows into this programme. KfW Entwicklungsbank also provides nearly EUR 20 million of support to its partner bank within the framework of a new umbrella programme to introduce innovative approaches to natural resource management in India.

The figures show how urgently this is needed. Data from the Food and Agriculture Organisation (FAO) indicate that 60% of agricultural land in India is already damaged by soil erosion and persistent desiccation. Climate change, which is particularly noticeable in India, reinforces this trend.

It is thus the top priority in the four Indian states to develop and implement appropriate erosion control measures, together with the inhabitants, in order to conserve soil and water. On the slopes people work, and contribute financially, to construct contour bunds and diversion trenches, and to plant trees to protect the soil. "This halts the rainwater that falls into the valley and the valuable soil that is washed down by the rain", explains Marcus Stewen, ecosystem expert at KfW Entwicklungsbank. "The water can percolate back into the soil, stabilising the water balance".

In Gujarat and Maharashtra KfW Entwicklungsbank is also giving EUR 36 million to support a programme aimed specifically at the indigenous population. The programme is centred around small fruit plantations, where 40 cashew trees and 20 mango trees per family guarantee a long-term income. There are currently 28,000 families benefiting from this programme.

How we make a difference
Of the projects committed to by KfW in 2008, 40% make a considerable contribution to protecting the environment and natural resources. Through these projects nearly five million people benefit from carefully chosen environmental protection measures in their immediate surroundings. We are thereby contributing to conserving valuable natural habitats such as tropical rainforests and tree savannahs. The area covered – over 45 million hectares – is nearly as large as Spain.

With nearly EUR 300 million in new commitments in 2008, KfW is supporting the granting of loans for investment in energy efficiency and renewable energy sources in developing countries, which will cut energy use by an average of 20%.

PROTECTING WATER AND USING IT FAIRLY

A BALANCING ACT THAT CAN SUCCEED ONLY WITH GOOD GOVERNANCE



Sufficient clean water for all – a simple enough challenge but extremely difficult to achieve, as the available supplies must be used in a way that is not only ecologically sustainable but also socially equitable and economically efficient. With rising demand on all sides, these goals cannot always be reached simultaneously and in their entirety. It is often necessary to make difficult political decisions, which turn integrated water resources management (IWRM) into a balancing act. Success depends on comprehensive plans, efficient structures for legislation and administration, adequate involvement of all those affected and, last but not least, effective organisations or companies to get supplies to the people. In short, good public and corporate governance are fundamental to the water sector.

However, in many developing countries the legal foundations for a good water policy are absent. Where they exist, they are not properly applied by weak and divided administrations. The human right to water is being voiced increasingly clearly, yet many countries are not in a position to meet this demand, so many people remain without. Users or their representatives are often not sufficiently involved in their countries' decisions on water policy. How water is distributed among industry, energy production, agriculture and private households is often decided more according to short-term political interests than carefully considered IWRM plans. Water services providers are also frequently subject to strong political influences.

In such an environment it is hardly possible for good corporate governance to develop. As a result the performance of water services providers and the efficiency of irrigation systems are usually poor. Dubious water quality, areas and population groups with inadequate water supplies, dilapidated infrastructure or a lack of customer focus are the order of the day. Many companies in the water sector suffer, as water prices are too low while costs are high. At the same time, however, there are no opportunities and no incentive for them to change anything. In consequence most of these companies do not cover their costs and depend on state subsidies.

Good governance: Reforms necessary for sustainable investment

Huge investments are needed in order to supply everyone with sufficient water. However, such investments can only be effective over the long term if underlying conditions are improved. Therefore KfW Entwicklungsbank, together with the BMZ, is pursuing a two-pronged strategy. It helps partner countries to finance urgently needed infrastructure and at the same time it demands and promotes reforms.

However, patience and endurance are needed to set in motion the reform process that will allow good public and corporate governance to become rooted in a partner country, and this can only be achieved step by step. In order to achieve more, individual measures are embedded in a long-term promotional strategy. Such a strategy often consists of what are called graduated plans with important benchmarks in each stage, which must be reached before further financing is forthcoming. For a partner this can mean, for example, improving water legislation, prepare water resource management plans, adjusting water prices or redetermining and formalising the tasks and structures of the institutions concerned with water, from the ministry to local user groups.

How we make a difference
With the projects to which KfW committed in 2008 we are giving and ensuring access to microfinance services for more than 11 million people. Over the next five years we will be enabling some 3.2 million additional loans to be granted, thus securing more than one million jobs.

The decentralisation projects appraised in 2008 are enabling KfW to support 131 communities. More than 10.7 million people are thus benefiting from improvements in municipal administration and services.



"Good water governance and modern corporate governance ensure water for all. We are committed to these principles, and our Development Partners' support in this regard is crucial."

H. E. Eng. Raed Abu Soud
Minister for Water and Irrigation,
Kingdom of Jordan

Such tasks are particularly sensitive politically. In the longer term the water sector should finance itself by means of a well-balanced tariff system and provide the right incentives for people to use water sparingly. At the same time water should remain affordable, particularly for the poor in developing countries. Water tariffs must be acceptable to all users. In order for the partner countries to meet this challenge more easily, KfW Entwicklungsbank helps them to set up commercially and socially viable pricing systems with appropriate monitoring and regulation.

Corporate governance: Transparency, accountability and autonomy

It is not enough just to demand that water prices be adjusted, which in many countries means a price increase. At the same time, costs must be reduced, corruption and abuse tackled effectively and the quality of service improved. Central to our support are thus always efforts to strengthen operating organisations, supply companies and user groups.

Without the principles of good corporate governance – transparent and efficient corporate policy, including accountability – no lasting improvements can be made in supply services and customer care in the water sector. However, such corporate governance presupposes that public and private supply companies have enough autonomy to organise their business activities profitably. They must be independent in developing and implementing their own business strategies, in making investment decisions and in their staffing policy, including remuneration in line with performance and market rates. Supervisory boards, on which customers should also be represented, provide the necessary checks. State-run supervisory authorities must monitor adherence to legal standards particularly closely in the socially and politically crucial water sector.

Different countries, different solutions

Whether this can be done better by centralised or decentralised structures, by the public sector or private companies, is the subject of lively discussion all over the world. There is no single ideal solution, but rather solutions agreed with partners and adapted to individual countries. In Tunisia, Morocco and Uganda, for example, the principles of corporate governance are embedded in central water supply and sanitation companies. In Yemen, Syria, Egypt, Albania and Zambia, in contrast, former centralised water companies are decentralised and subsequently given the necessary expertise. In Turkey, Macedonia and Kenya, municipal companies are reformed into an autonomous structure and then further developed.

The challenges are often very complex and cannot be resolved through isolated projects. For this reason KfW Entwicklungsbank promotes what are known as sector-wide approaches in many partner countries, such as Tanzania, Kenya, Uganda or Peru, in order to support the planning and implementation of important sector reforms together with other donors.



Meeting the basic human need for water is especially important for children.

At least 20 litres a day

A "human right to water" is not explicitly mentioned in the Universal Declaration of Human Rights and subsequent human rights pacts. However, it can be deduced from human rights listed there, such as the "Right to an adequate standard of living" and the "Right to health". Articles 11 and 12 of the "Social Pact" agreed by the international community in 1966 include the right to adequate drinking water and sanitary provision – at least 20 litres per person per day, for everyone in the world and for future generations.

At present this right is being violated in many places in the world, because water is not suf-

ficiently available or is even harmful to health; because it is more than 20 minutes' walk away or cannot be reached by disabled people; or because it is financially out of reach for many people as they have to buy it at inflated prices from water vendors.

Nations have an obligation to ensure that all people have access to clean water and to basic sanitary facilities. Many countries are currently unable to meet this requirement properly. They must, however, explain what concrete steps they are taking towards making this right to water a reality for all in equal measure.

REMEDY FOR INSTITUTIONAL DEFICIENCIES

GOOD GOVERNANCE HELPS PERU TO REFORM ITS WATER SECTOR

Peru is faced with serious water problems. Almost a quarter of the population has no reliable access to drinking water; almost half lives without sufficient sanitation. Untreated wastewater severely contaminates both people and the environment. The country, however, is determined to reform its water sector. "The Government has recognised", says Joschka Greve, a KfW Entwicklungsbank water expert, "that there is not only a great need for investment but above all a great need for reform".

In the past, state investment in the water sector fell far short of reaching the entire population. The quality of water provision and the length of time it is available must also urgently be improved. To remedy the greatest deficiencies Peru decided on considerable investment – under the slogan "Agua Para Todos" (water for all) – and on far-reaching reform of the entire sector.

For this reason the country is ready to be judged according to the principles of good governance in the water sector. Indeed, the budget support for the Finance Ministry, which has been agreed by the country and the Inter-American Development Bank (IDB) together with KfW Entwicklungsbank, will only be provided if Peru can demonstrate that it is carrying out jointly agreed reforms. IDB is contributing up to USD 300 million over the three-year term of the programme, EUR 54 million is coming from the Federal Government (one third BMZ budget funds, two thirds KfW's own funds), and a further EUR 15 million is planned.



"Water for all" is the aim of Peru's water sector reforms.

The reforms affect all levels, from the legal structure through planning to price-setting. One milestone, for example, is that in the second year of the reform programme tariffs in at least 15 towns must be set such that they cover the actual costs.

In order for good governance to be achieved within the water services companies, they will also be strengthened from the inside. This includes not only staff training but also greater participation by the general public, which will in the future be better represented on the supervisory boards. Contracts with the Government lay down the targets, incentives and penalties as well as a code of conduct for the companies. This will be the case throughout the country.

THIS IS WHAT WE WANT TO CHANGE

UZBEKISTAN'S FIRST PRIVATISATION OF THE DRINKING WATER SUPPLY SHOWS THE WAY



Problems of the past: leaking taps and no service

The Khorezm region now has little in common with its name – which means "good earth" – as it has been scarred by an incomparable environmental catastrophe. The Aral Sea, half of which belongs to Kazakhstan and half to Uzbekistan, was once one of the largest inland seas in the world. Today, as a delayed result of Soviet agricultural irrigation policies, it is at risk of disappearing entirely. As a consequence, the supply of drinking water in the region surrounding the sea is also precarious, because the water is extracted from the Amu Darya river that feeds into the Aral Sea.

It is not only the water balance that is in a critical state here; there is also a lack of water supply infrastructure. In many places people have to use boreholes to obtain groundwater. However, this water is usually polluted with pesticides, fertilisers and faeces. Where there is a public

water supply, it is in a desperate condition as it is neither regularly maintained nor repaired. The state-owned operators do not have the money to do so.

In order to redress the situation, KfW Entwicklungsbank has supported the country with nearly EUR 14 million to set up a private operating structure. Through "Khorezm Obi Hayet" the water supply for seven kolkhozes (collective farms) – or around 40,000 people – is in private hands for the first time. So far some 7,000 houses have been connected to the water supply system. In addition, the 62 public institutions in Khorezm have been connected to the now repaired water supply network. These include kindergartens, schools and medical centres. Now water flows out of the tap 24 hours a day, seven days a week.

KfW water expert Christian Lauerhass thinks the reason for this success lies above all in the intensive support given to staff: "Again and again trainers taught staff on the ground how to lay pipes and install water meters, and how pumps and switchboards should be maintained. Employees now also know what a business plan and a balance sheet are, and they are practised in dealing with customers".

In order for the system to be operated properly, the price of drinking water has quadrupled – and still there is no threat of an uprising in the kolkhozes of Khorezm. The people notice that with the "private water" their health is noticeably better compared with their neighbours a few kilometres away. Consequently, the operator has already received 8,000 requests from neighbouring villages for houses to be connected to the system in Khorezm.

DEG: HARNESSING ENTREPRENEURIAL SPIRIT TO IMPROVE STRUCTURES

DEG PROMOTES INVESTMENT BY PRIVATE COMPANIES IN THE WATER SECTOR



In many developing and transition countries state authorities and operators are frequently unable to provide the population with a reliable supply of drinking water. Finance, trained personnel and effective organisation are all lacking. The same is true for the wastewater sector and energy production from hydropower. Committed private companies often fill a gap here. Moreover, they react to water scarcity in their countries by applying innovative water-saving techniques and by reusing wastewater. However, this is not possible without start-up financing.

This is where DEG – like KfW a part of KfW Bankengruppe – comes in. In developing, transition and emerging countries, it stimulates the expansion and restructuring of the water sector by supporting selected entrepreneurial initiatives in the private sector, which help to ensure that water is used in a sustainable, efficient and non-wasteful way.

In addition to providing finance, DEG also advises its partners on setting up a comprehensive environmental and social management plan, thus helping to ensure the sustainability of the joint projects and at the same time to promote higher standards in the partner countries. Particular attention is paid to monitoring water consumption and the adherence to sewage limits in the case of dams and in agriculture, but also in many industries, such as paper manufacturing.

With a volume of around EUR 45 million, DEG finances private sector operators who invest in the purification and distribution of drinking water in urban centres. Another important area of investment is that of alternative purification methods, such as seawater desalination in economically advanced countries, or wastewater disposal solutions that save natural resources, such as recycling treated wastewater for agriculture. In industry DEG is concerned with innovative processing methods. In the production of electricity from hydropower, too, there are vastly more efficient solutions today for plant construction than there were just a few years ago.

As part of the Federal Government's development policy, DEG makes available, for private sector investment, long-term loans as well as venture capital that can otherwise rarely be raised in the financial market, or that is not available in sufficient amounts. This is usually achieved through equity investment and other quasi-equity finance, and it allows the companies to carry out promising development projects, which they would otherwise hardly be in a position to finance.

How we make a difference
Approximately two thirds of companies co-financed by DEG in 2008 pay above-average wages and many also show social commitment, for example by funding kindergartens and schools, building medical centres and implementing health programmes, including HIV/AIDS prevention, and supplementary insurance and care services.

INNOVATIVE WATER SUPPLY AND SANITATION PROJECTS

Private involvement in water supply is particularly needed when state budgets are overstretched, for example when it comes to extending and modernising dilapidated pipelines. Specialist knowledge, which is something that companies are able to offer, is also needed for treating wastewater and developing recycling systems. DEG finances a multitude of innovative water supply projects, both using its own funds and with the help of the BMZ's Public Private Partnership financing programme.

More water from seawater and intact pipelines

"Water for the Poor" with the help of innovative pilot plants and private investment

Providing a regular water supply is often particularly difficult in large conurbations with many millions of inhabitants. Either many people are not connected to the water supply network at all or there is not enough fresh water available, such as in the Indian city of Chennai. Yet another problem can be that the water pipes are in such a poor condition that the water does not even reach the people and has to be bought at considerable cost from mobile vendors, as in Manila, for instance. In both of these cities DEG is funding projects that will bring major improvements to the provision of water to the population. North of Chennai on the Gulf of Bengal, India's first large private seawater desalination plant is being built. In Manila private companies are investing in the modernisation of the supply network.

With its desalination plant with a capacity of 100 million litres per day, Chennai Water Desalination Ltd. (CSDL) will supply one tenth of the total water requirement of this city of seven million inhabitants. It also sets high environmental standards with its especially efficient

technology. It uses nearly a third less energy than other desalination plants. In order to compensate for the comparatively limited but still unavoidable loss of marine flora and fauna due to the construction of the plant, as a result of brine being returned to the water, an artificial reef will be established, amongst other things, which can be colonised by marine animals and plants, providing favourable conditions for fishing. DEG is financing the project as the sole international donor with a long-term loan of EUR 14 million, which filled a financing gap in the total cost of EUR 86 million.

In the eastern part of Manila the water supply has improved considerably for more than five million people. A constant supply of clean water is now available to 99% of the population at prices that everyone can afford. This was not always the case. In the past, nearly two thirds of drinking water was lost due to damaged pipes. In addition, there was illegal tapping of the water pipes, which brought with it dangers of contamination.

Today, a good decade later, water loss is down to 24%. This improvement is the work of the private water supplier Manila Water Company Inc. (MWC). After 1997, when the company obtained the concession for water supply and wastewater disposal services in the eastern part of Metro Manila – an area of approximately 1,400 square kilometres with 23 cities and municipalities and a total of 5.6 million inhabitants – water connections tripled in just a few years.

As the first international financial donor, DEG had made available long-term funding in the sum of USD 20 million. This was used to renew damaged pipelines and to extend the supply network. MWC was able to reduce water theft – responsible for major losses – principally by means of the "Water for the Poor" project. Thus far, 1.2 million people have benefited from this project, particularly those living in the slums. Communal connections provide clean drinking water to several households at once.



A sewage treatment plant being built in Mexico

Intelligent treatment and recycling of wastewater

The Planta Oeste pilot plant in Durango serves as a demonstration project

Polluted, contaminated with toxic substances and heavily overused – the state of ground and surface water in Mexico has worsened dramatically. One major reason for this is that only one in every three sewage treatment plants in the country functions properly. Many plants, especially municipal ones, are either poorly designed or are operated and maintained with insufficient specialist knowledge.

One typical example is the central Planta Oeste sewage treatment plant in Durango. In order to sterilise the wastewater as prescribed, huge quantities of chlorine are added after treatment. This is not only expensive, it also represents a considerable hazard for staff and for the surrounding population. The effluent treated in this way is also almost completely unsuitable for use in agricultural irrigation as the high chlorine concentration in the water causes soil salination.

In a pilot project, two German companies from Saxony want to demonstrate low-cost

alternatives to this method, which also do not exceed the budget of the chronically under-financed wastewater companies in Mexico. Experienced managers from Leipzig are therefore analysing the operating parameters of the sewage treatment plant, together with technical staff from Durango, and optimising operations. Initial results can already be seen. Treatment performance has improved and energy consumption has dropped. In the second phase a small model sewage treatment plant is to show how chlorine treatment of effluent can be avoided in the future. "If the demonstration is successful this procedure can also be employed in other municipal sewage treatment plants in Mexico", says DEG project manager Bernt Hagenlocher. "It could make a significant contribution to the recycling of wastewater and to relieving the pressure on valuable drinking water resources".

DEG is contributing EUR 200,000 of the total EUR 0.5 million cost of the project, within the framework of the BMZ's Public-Private Partnership Programme. The remaining costs are being shared among the two German partners and Durango's municipal water supplier.

How we make a difference
The 112 projects co-financed by DEG in 2008 create approximately 35,000 new jobs. DEG partner companies and their suppliers employ a total of approximately 543,000 people and thereby provide them with an income and security.

THE ECOLOGICAL CHALLENGE OF EFFICIENT WATER USE

Water is becoming scarcer around the globe, so agriculture and industry must develop methods for saving water and devise strategies to protect this resource from pollutants. When it commits funds, DEG therefore also always negotiates binding ecological and social standards, and insists on reliable monitoring systems.

Socially and environmentally aware

How an Indian paper manufacturer saves natural resources

With consumption of approximately 90 cubic metres of water per tonne of paper, the Indian cellulose and paper manufacturer Andhra Pradesh Paper Mills Ltd. performs well internationally, even excellently by local standards. In India average water use is approximately 300 cubic metres per tonne of paper. Thanks to efficient technology and strong environmental awareness, this private company combines economic growth with saving water. The company has continuously reduced its consumption in recent years.

DEG has been supporting the company since 2005, with EUR 12.5 million in total, in carrying out environmentally compatible modernisation and expansion at its two production centres in Rajahmundry and Kadiam. Processing of the raw materials and the end products was improved, chlorine bleaching of the paper was replaced by a chlorine-free process and energy and water efficiency were increased. The company has drawn up an environmental action plan and has committed itself to meeting World Bank/IFC standards.



Farm forestry programme for environmentally friendly papermaking

However, for the cellulose and paper manufacturer sustainable business also means social involvement. As early as the 1980s it was the first company to set up what is known as a farm forestry programme in order to meet its needs for raw materials. The company makes seedlings available to approximately 34,000 small farmers at subsidised prices and trains them to manage

the resulting forestry plantations sustainably. The families care for the seedlings, harvest the wood and sell it to the company at a good price. "It is a particularly successful project", says project manager Antje Fuchs, "which not only sets high environmental standards but also benefits the poorest people of India, the small farmers".

CLEAN ENERGY THROUGH HYDROPOWER

Hydropower plants have a permanent place in DEG's portfolio. They make it possible to avoid CO₂ emissions and help protect the climate. DEG prefers to support small-scale run-of-river power plants. As a rule these are more environmentally and socially acceptable as their construction does not usually involve major disruption to the environment or displacement of people. DEG is currently making approximately EUR 80 million available for a total of eight projects worldwide.

The socket as a status symbol

New prospects created in Peru through hydropower

Access to electricity is not simply a question of quality of life, it also opens up new perspectives. A reliable electricity supply offers additional opportunities to earn money through manual work, small commercial enterprises or services. This is no longer simply a dream for some 28,000 families living around the Poechos reservoir in northern Peru. The first 5,300 families have already been connected to the grid and the socket has since become a beloved status symbol. For some years DEG has been supplying long-term financing totalling USD 14 million for a small hydropower plant.

Harnessing the power of water



The power plant, operated by private energy supplier Sinersa, is integrated into an agricultural irrigation complex. The Poechos reservoir regulates the Chira river, making it possible, by means of irrigation canals, to continuously use approximately 110,000 hectares of land for agriculture. Initially, hydropower plants require higher investment per megawatt of power than gas-fired power stations, for example. Building such infrastructure not only takes time but also requires a long-term financial view. For this reason DEG supports the private operator Sinersa with long-term loans. "And in this way we support an employer", says project manager Jessica de Wolff, "who demonstrates great social responsibility. All 60 employees have permanent contracts and health insurance, there are payments for professional development and university scholarships for students without financial means". Construction of hydropower plants is worthwhile in spite of the higher initial costs. They contribute much longer to the grid, they are cheaper and environmentally friendly to operate, and they contribute to climate protection. The Poechos I plant has been certified according to the Kyoto Protocol since 2006. Compared with a coal-fired power station of the same capacity, it saves approximately 30,000 tonnes of CO₂ per annum.

OUTLOOK

CONSERVING WATER AND USING IT WISELY



In many regions of the world water is still being used as if it were an inexhaustible resource that is immune to pollution. Households, industry and agriculture consume vast amounts of water, and we contaminate our waters with large quantities of toxic substances. Particularly in our partner countries high population growth, rising demand for food, advancing industrialisation and the accompanying hunger for energy lead to a rapid dwindling of water resources and an accelerating decline in water quality. In addition, climate change is aggravating water stress still further in many parts of the world.

It is clear that this "blue gold" must be protected more than ever before. It must be used more prudently, economically and efficiently. At the same time many more people need to be provided with a secure drinking water supply and sanitary facilities in order to prevent disease and create decent living conditions. We must protect the environment much more strongly than before through regulated wastewater and solid waste management. Fragile ecosystems, which are dependent on the water balance and are at the same time our most important stores of water, must be better safeguarded. Finally, water for food production must be used much more prudently than before. Helping our partner countries to achieve this is our most important goal, now and in the future.

We offer workable concepts

Integrated water resources management (IWRM) has become an internationally recognised water policy concept, which also determines Federal Government policy. We help our partner countries to put this complex concept into practice step by step. With this action we want to protect water resources and ensure that they are used sparingly, so that a sustainable and appropriate supply can be guaranteed for all. This averts conflicts, prevents waste and misuse, and conserves water for the future. For the water sector, too, adapting to climate change will present huge financial challenges. Therefore we offer our partners, in both the public and the private sectors, workable concepts to lessen the consequences for the water sector resulting from climate change.

Our goal here is to jointly finance and implement national, regional and cross-sector solutions to help avoid water stress but also to afford protection against extreme climatic events such as disastrous floods and storms. The world population is continuously growing and food security is needed. We want to increase our help to partner countries to find ways of practising more intensive agriculture while protecting the environment. Such methods, together with innovative ideas such as the systematic recycling of treated effluent, will allow them to increase food production significantly.

We invest – for humankind and for nature

Urbanisation usually advances even faster than a population grows. In the world's cities, their slums and the shanty towns on the outskirts, adequate water services are often lacking. For this reason urban water supply and sanitation remains our highest priority for our promotional activities in the water sector. With our support in setting up, extending and modernising drinking water supply services, basic sanitation and wastewater management we make an important contribution to fighting poverty and preserving valuable water resources.

We live in and with the nature and gain our livelihood from it. Ecosystems are an integral part of nature. They stabilise the climate, regulate the water balance and ensure biodiversity. This is important for all of us, even though economic and social pressure on these natural habitats is particularly strong. Sustainable management of natural resources is therefore essential, for humankind and for nature.

We promote transparency and initiative

A fair water policy, implemented with the participation of all concerned, and efficient supply systems – these cannot be achieved without good governance and corporate governance, features that are, however, still absent in many of our partner countries. It is therefore very important to us in all our activities to work together with our partner countries to reinforce transparency, accountability, participation and user and customer orientation, and to make these a permanent part of the countries' structures.

Governments are increasingly allowing room for private sector involvement in the water sector. Our aim is to support precisely those business initiatives in developing, transition and emerging countries, which contribute to sustainable and efficient water use. This allows us constantly to broaden the range of future-minded projects from drinking water supply through seawater desalination and reuse of treated wastewater to recycling initiatives that save resources, and to complement them with appropriate advisory services.

Financing long-term solutions in the water sector frequently exceeds the capacities of partner countries' budgets. This is exactly where we come in with innovative ideas and tailor-made solutions. We do not work in isolation, but rather embedded in sectoral strategies, in concert with other donors. This is the only way that the huge challenges of the future can be met.

We are there for our partners – even in times such as these.

ACTIVITIES IN FIGURES

KFW ENTWICKLUNGSBANK AND DEG



KfW Entwicklungsbank

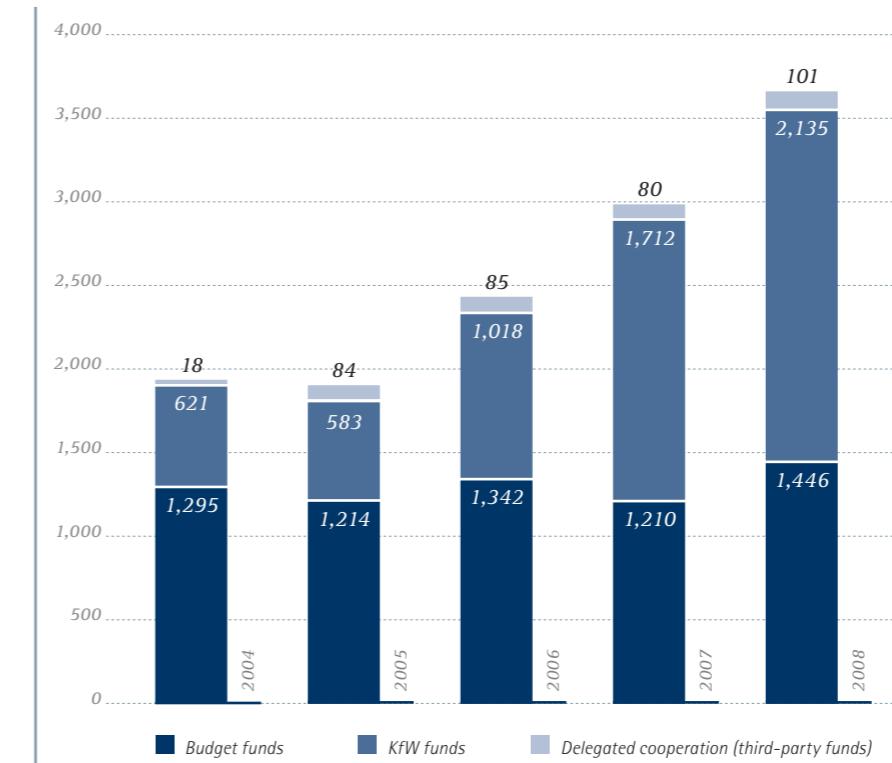
At about EUR 3.7 billion in 2008, financing commitments by KfW Entwicklungsbank again well surpassed the previous year's record (2007: EUR 3.0 billion), the highest overall volume of commitments since the beginning of German Financial Cooperation (FC) in 1958.

We were able to meet the keen demand by developing countries, as for some years now we have supplemented the federal budget funds for development cooperation with our own funds raised on the capital market, which came to EUR 2.1 billion in 2008, some 58% of total commitments. This way, we effectively support the Federal Government in meeting its obligations to increase funding for official development assistance (ODA).

How we make a difference
Thanks to the projects started by KfW in 2008, about 18 million people will benefit from improved transport infrastructure.

Around 54% of KfW projects contribute to advancing gender equality.

Origin of funds committed in 2004–2008 (EUR in millions)

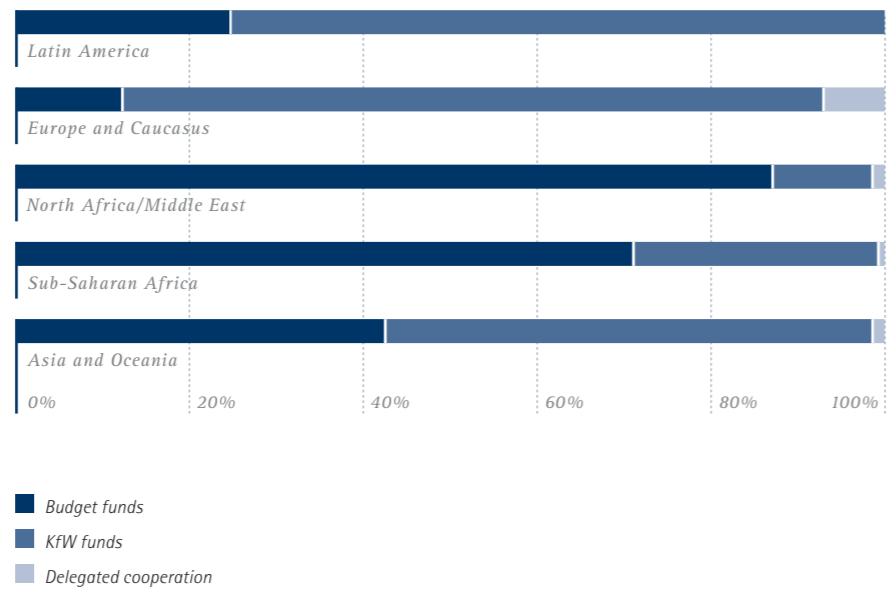


Commitments by region

By adding our own funds (low-interest development loans) or through financing from KfW funds only (FC promotional loans), in 2008 we again financed many useful projects and programmes in partner countries that no longer have to rely solely on non-repayable grants thanks to their current development progress. The prime beneficiaries of KfW's own funds are the regions of Eastern Europe, Latin America and Asia. This way, we help the Federal Government to use scarce grant funds from the national budget more sparingly and employ these more for the poorest regions of the world, such as in Africa.

After Asia/Oceania (33%), the largest portion of budget funds was again allocated to Sub-Saharan Africa (27%), ahead of North Africa/Middle East (22%), Europe/Caucasus (10%) and Latin America (8%). Measured against total commitments including KfW's own funds, at 33% and a volume of EUR 1.2 billion (2007: EUR 0.7 billion), Europe/Caucasus made up the largest target region for the first time, while accounting for only 10% of budget funds. Sub-Saharan Africa, North Africa/Middle East and Latin America all also received more funding in 2008 than in the previous year. The commitment volume for Sub-Saharan Africa rose to EUR 0.54 billion (2007: EUR 0.48 billion) and for Latin America, to EUR 0.44 billion (2007: EUR 0.27 billion). At EUR 0.37 billion, commitments for North Africa/Middle East well exceeded last year's figure (2007: EUR 0.2 billion). At EUR 1.1 billion the Asia/Oceania region received altogether fewer commitments (2007: EUR 1.4 billion), yet it still made up 30% of the total volume.

Breakdown of total commitments in 2008 by region and origin of funds



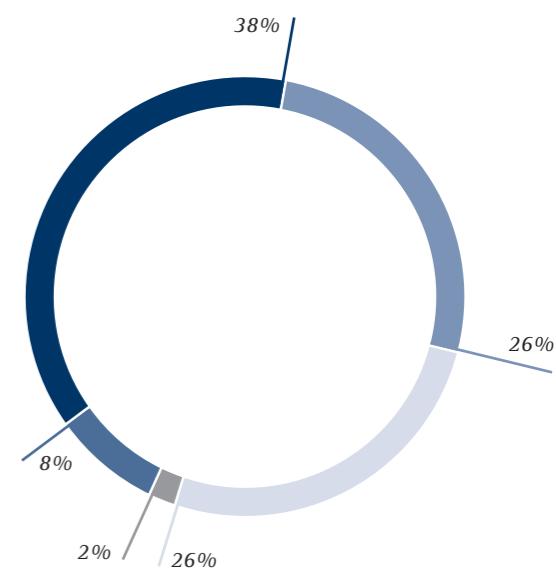
Commitments by priority development sector

In line with BMZ priorities, KfW Entwicklungsbank placed special emphasis in 2008 on the water sector, environmental and climate protection and the financial sector. We thus supported the partner countries in areas of major future importance.

Above all, KfW Entwicklungsbank expanded its engagement in the financial sector. With a volume of commitments of EUR 1.4 billion (2007: EUR 0.78 billion), about 38% of the total, KfW helped set up efficient financial systems, provide long-term refinancing loans for partner banks and microbanks and advise and train them.

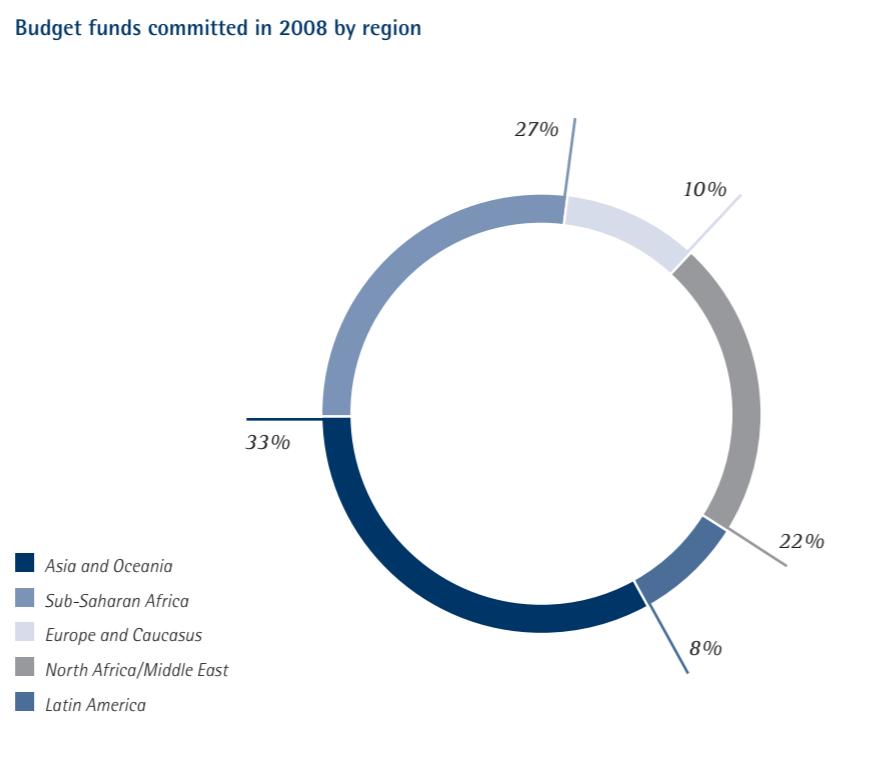
26% of commitments each went to social and economic infrastructure. Investment measures in economic infrastructure concentrated primarily on the energy and transport sector, and are therefore of high relevance to climate protection. With EUR 0.7 billion, we helped promote energy efficiency and renewable energies as well as rural electrification. With an additional EUR 0.2 billion we financed climate protection investments in public transport.

Total commitments of KfW Entwicklungsbank in 2008 by priority development sector



Half of the commitments in social infrastructure were allocated to water supply and sanitation projects. Moreover, we supported projects and programmes in health and family planning (EUR 0.2 billion), state building and civil society development (EUR 0.1 billion) and education (EUR 0.08 billion).

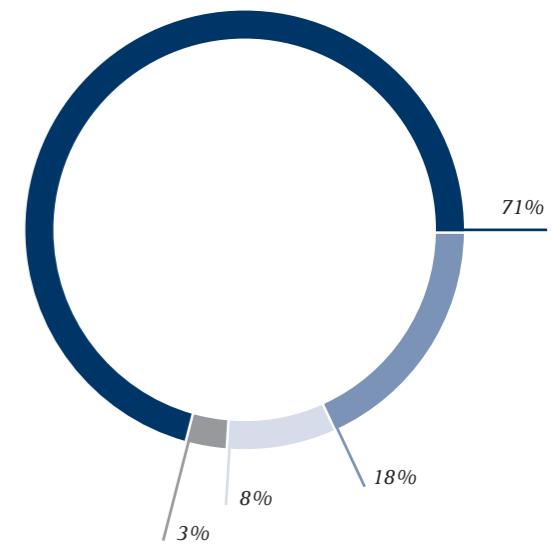
Budget funds committed in 2008 by region



Water portfolio

With commitments totalling EUR 2.9 billion over the last five years, the water sector makes up one of KfW Entwicklungsbank's most important development sectors. Water supply and sanitation is our priority in this sector, accounting for 71% of commitments and a total volume of EUR 2.1 billion. With projects and programmes to promote water supply and basic sanitation as well as wastewater and solid waste management, we aim to ensure humane living conditions for people in developing and emerging countries. The use of water as a resource for generating renewable energy is also gaining importance in our sector portfolio, however, already making up a fifth of the commitment volume with some EUR 0.5 billion at the end of 2008. To prevent conflicts over water use, we support our partner countries in implementing all projects and programmes as part of integrated water resources management (IWRM).

Total commitments of KfW Entwicklungsbank in the water sector in 2004–2008



Our contribution to the MDGs

With the Millennium Development Goals, the international community pledged for the first time to attain verifiable targets by the year 2015. This infused development policy with fresh momentum. The eight MDGs have since become an important compass guiding development assistance worldwide. The BMZ has accorded them binding authority for German Development Cooperation and applies them as yardsticks to measure its performance.

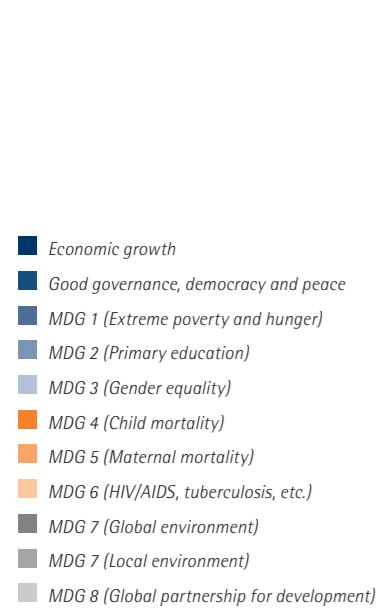
KfW Entwicklungsbank's new instrument, MDG Reporting, is a way of measuring the direct and indirect impacts of FC projects and programmes on the MDGs more accurately. For this, we defined 41 project/programme types and ascertained their anticipated contribution to attaining the MDGs and to the goals of economic growth and good governance.

We carried out these assessments with assistance from analysts at the University of Göttingen. Using MDG Reporting, any FC portfolio of KfW can be assessed for its anticipated MDG impacts. All project/programme types are expected to make a contribution to at least one MDG.

The distribution of the anticipated effects of the commitments for 2008 shows that more than two thirds (70.8%) of FC funds can be expected to impact individual MDGs. About one third of funding has a primary effect on economic growth (22.4%) and good governance (6.8%), thus making an indirect contribution to MDG achievement.

FC funds in 2008 mainly have an effect on the following MDGs:

- **MDG 1:** 13% on the eradication of extreme poverty and hunger
- **MDG 2:** 4.6% on achieving universal primary education
- **MDG 3:** 8.6% on gender equality
- **MDG 4, 5, 6:** 12.4% on reducing child and maternal mortality and combating fatal diseases
- **MDG 7:** 8% on the global environment (preventing emissions harmful to the climate, conserving biodiversity) and 15.9% on the local environment (drinking water supply and sanitation)
- **MDG 8:** 8.2% on global partnerships for development, particularly the promotion of technology transfer, a regulated and non-discriminatory trade and financial system, youth employment and communications technology



Differences in the totals are due to rounding.

DEG

Business in 2008 saw a lively demand for long-term finance and venture capital in DEG partner countries, both in the financial sector and in the real economy. With growing global economic uncertainties and problems, also affecting the emerging nations, DEG was in greater demand as an experienced crisis manager and partner. At EUR 1,225 million (2007: EUR 1,206 million), it was able to slightly extend its extensive finance business by almost 2% on the previous year, recording its highest new commitment volume in over 46 years. The share of lending sub-participations amounted to EUR 134 million (2007: EUR 75 million). No new finance commitments were made under trust business.

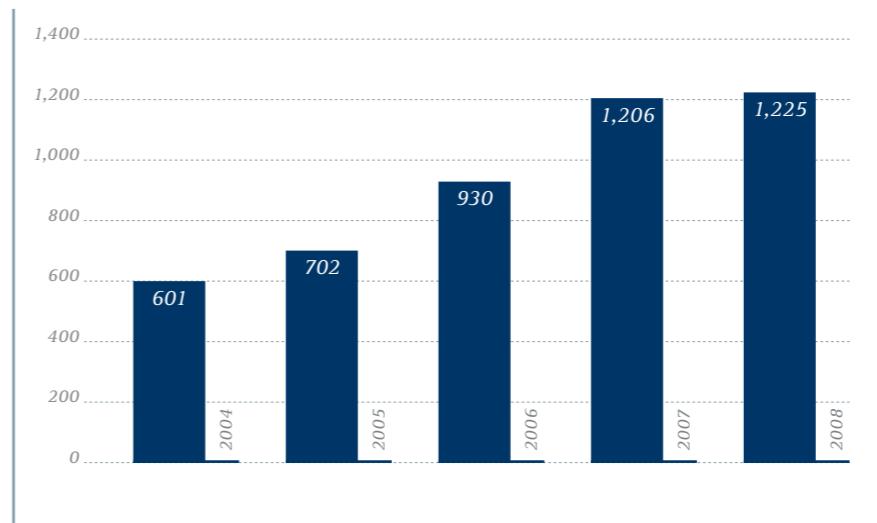
The entire portfolio increased by 24% to EUR 4.4 billion, spread over 512 enterprises in 84 partner countries. DEG thus continues to be one of the largest European development finance institutes specialising in private-sector development in developing and emerging countries.

In the reporting year, DEG committed EUR 163 million to acquiring participating interests. The share of lendings amounted to EUR 1,029 million, with EUR 253 million arranged as mezzanine finance. This brought total venture capital allocated under corporate and development policy as equity and mezzanine finance to EUR 416 million, making up 34% of new business (2007: 37%). EUR 33 million was allocated for guarantees.

How we make a difference

Countries with high risk and/or low per capita income accounted for about 42% of DEG's new projects.

Growth in DEG commitments in 2004–2008 (EUR in millions)

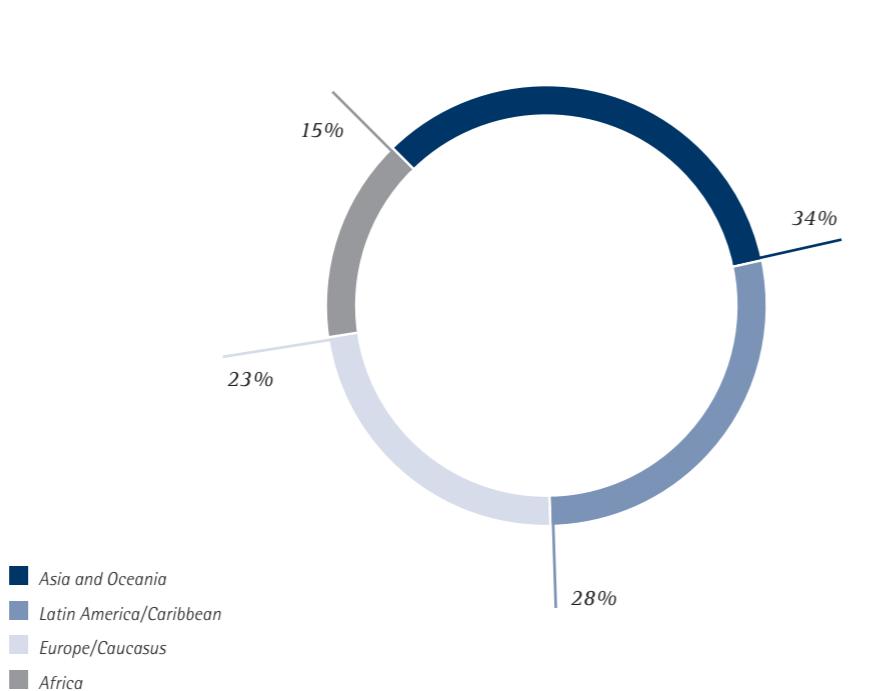


Regional commitments

Financial commitments in 2008 were spread over investment projects in 42 countries (2007: 44 countries). After a prolonged discontinuation, business activity was resumed in Ethiopia and Paraguay. The least developed countries (LDCs) where DEG co-financed projects in 2008 included Ethiopia, Madagascar, Mozambique, Rwanda, Tanzania and Uganda in Africa as well as Bangladesh and Cambodia in Asia.

Owing to ongoing economic growth, the geographical focus of new business was again Asia, with financial commitments amounting to EUR 414 million (34%), followed by Latin America with EUR 342 million (28%) and the Europe/Caucasus region with EUR 287 million (23%). Altogether, EUR 179 million (15%) went to companies in Africa, with Sub-Saharan Africa accounting for EUR 163 million and North Africa for EUR 16 million. No new business was started in the Middle East in 2008.

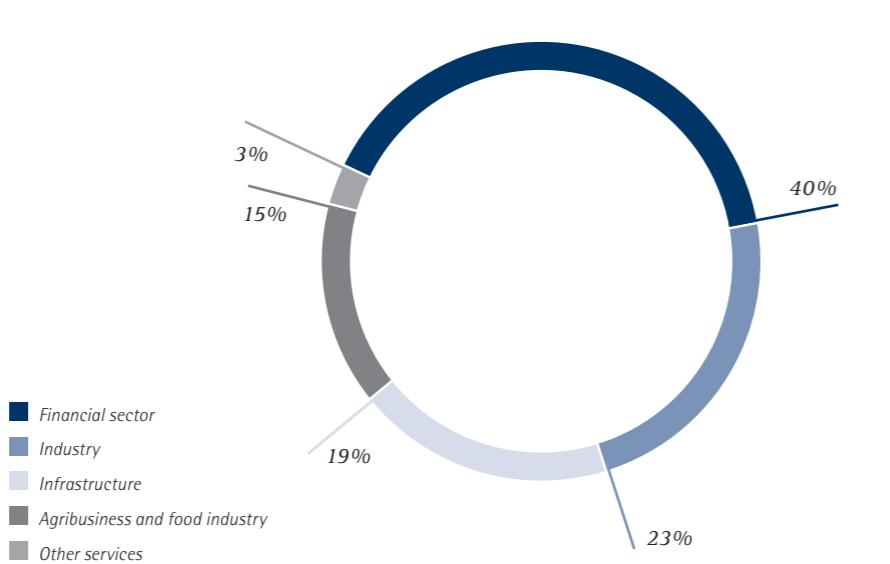
DEG commitments in 2008 by region



Commitments by sector

In the reporting year, DEG continued to devote special attention to strengthening the financial sector in partner countries, the funds allocated for this amounting to EUR 487 million, about 40% of new business. One focus was assisting local and regional commercial banks. Within the limited scope of its functions, DEG helps to consolidate the financial markets, which have been severely impaired by the global crisis. Via the partner bank network, especially small- and medium-sized enterprises in developing countries can obtain long-term investment capital even when they are not based in a central location. By providing scarce venture capital, equity and mezzanine funds perform a particularly important developmental function. Major secondary objectives of financial sector development were enhanced institution building and good corporate governance. DEG provided EUR 282 million (23% of its financial commitments) for enterprises in the manufacturing sector, with the main investments here made in the electro, paper, chemicals, automotive and

DEG commitments in 2008 by sector



mechanical engineering industries. Infrastructure projects recorded another clear increase to mark a new record of EUR 234 million; power and water supply, telecommunications, transport, health and education accounted for 19% of new commitments. The share of agribusiness

Technical assistance

To enhance the developmental impact of DEG financing, EUR 1.4 million of BMZ budget funds was allocated for technical assistance in 2008. DEG contributed an additional EUR 1.3 million from its own funds. Altogether, 56 accompanying measures were financed in 2008 to support the economic, social and ecological sustainability of projects.

Development partnerships with the private sector

As part of the BMZ's Public-Private Partnership (PPP) Programme, DEG financed 31 projects in the reporting year, committing EUR 4.9 million from government funds for this purpose. The partner companies and third parties invested EUR 9.2 million. This enabled a project volume of EUR 14.1 million to be realised in 2008. Under the PPP Study Facility, in 2008 ten preproject measures were financed in infrastructure and financial sector development. In 2008, too, another strategic alliance was begun in East Africa with twelve European and local partners for the cultivation of jatropha under a pilot project.

New development programme for smallholder farmers in Africa

An agreement was signed with the Bill & Melinda Gates Foundation for promoting cotton-growing smallholder farmers in six African countries. The development programme includes training and organisational support for the certification and sale of the cotton. The overall programme is worth USD 48.9 million, with USD 24.4 million provided by the Gates Foundation. Additional funds are provided by the BMZ (USD 6.0 million) and local cotton companies (USD 18.5 million). The project is being implemented jointly with the GTZ.

How we make a difference

Thanks to DEG investments in 2008, the co-financed enterprises will pay about EUR 360 million a year in tax, enabling their host nations to do more to reduce poverty and improve education, health care and infrastructure. They will also contribute EUR 2.1 billion a year in foreign currency earnings for these countries and help stabilise local currencies.

DISBURSEMENTS

BY KFW ENTWICKLUNGSBANK AND DEG



Expanding water supply in Metro Manila

Business start-ups

To provide small- and medium-sized businesses in Afghanistan with easier access to adequate finance, DEG set up a credit guarantee fund in 2005, for which funds have been provided by the BMZ and the US development aid agency USAID. For loans issued by two local partner banks, the fund underwrites 72% of credit exposure. In the reporting year, 453 guarantees were issued for a lending volume amounting to USD 13.3 million. Total aggregate commitments since December 2005 for 724 loan commitments come to USD 19.6 million. This has created or secured some 15,800 jobs.

Environmental and social standards

Besides national provisions, DEG abides above all by international standards as benchmarks for its finance business. The World Bank Group environmental standards for the private sector were contractually agreed on again in all finance projects in 2008. The core labour standards of the International Labour Organization (ILO) were also accepted as binding by all co-financed enterprises. In 36% of new projects, at least one beneficial environmental impact can be expected, particularly the application of renewable raw materials or energy, more efficient resource use, cleaner production technologies and the production of environmental goods. Ten new projects are expected to help protect the climate. The funds provided for this amounted to EUR 96 million.

In 2008, KfW Entwicklungsbank disbursed EUR 2.8 billion for projects in developing and transition countries, marking an increase of 38% on the previous year (2007: EUR 2.0 billion) with EUR 1.4 billion of this stemming from federal funds.

Due to the expansion in finance business, DEG's disbursements reached a new record total of EUR 1,131 million in 2008 (2007: EUR 858 million). Of this, EUR 106 million (2007: EUR 69 million) was allocated to project companies as part of third-party risk sub-participations. Disbursements made in trust business amounted to EUR 0.4 million (2007: EUR 0.2 million).

Debt rescheduling and cancellation

Under certain conditions, the Federal Government grants highly indebted partner countries relief in development loan repayment. As a rule, this is done by rescheduling or cancelling debt, based on agreements reached with the international donor community in the Paris Club, under the so-called Heavily Indebted Poor Countries Initiative (HIPC initiative), for example. KfW takes part in the negotiations on the German side.

Developing countries can receive debt relief if they agree to use the funds for poverty reduction, environmental protection, education or HIV/AIDS prevention and actually implement appropriate measures.

On behalf of the Federal Government, in 2008 KfW cancelled a total of EUR 0.54 billion in debt owed by Cameroon and Liberia. In the same year, KfW Entwicklungsbank agreed with Ecuador, Egypt, Kenya, Montenegro and Pakistan on debt conversions amounting to EUR 0.11 billion. After these countries had carried out relevant programmes, Germany was able to waive about EUR 0.07 billion, also accounting for various agreements from previous years.

How we make a difference
With education projects appraised in 2008 for constructing schools and improving the quality of teaching, KfW has benefited 2.1 million children and vocational students, about 43% of them girls. Roughly 37% of these students live below the poverty line.

The 112 projects co-financed by DEG in 2008 mobilised investments worth EUR 4.8 billion.

STATISTICAL ANNEX



Total commitments by KfW Entwicklungsbank and DEG in 2004–2008 (EUR in millions)

KfW Entwicklungsbank	2004	2005	2006	2007	2008
<i>FC grants*</i>	703	751	864	803	882
<i>FC standard loans</i>	271	307	280	277	351
<i>FC development loans</i>	782	492	704	579	1,033
- budget funds	321	157	198	130	213
- KfW funds	461	336	507	448	821
<i>FC promotional loans</i>	160	247	512	1,263	1,314
<i>Delegated funds</i>	19	84	85	80	101
<i>Sum</i>	1,934	1,881	2,445	3,002	3,681
<i>DEG**</i>	601	702	930	1,206	1,225
Total (KfW + DEG)	2,535	2,583	3,375	4,208	4,906
<i>Note: Interest grants</i>	10	19	38	37	90

* Differences compared with previous years due to interest grant adjustments

** All figures including risk sub-participations

Differences in the totals are due to rounding.

Origin of total commitments by KfW Entwicklungsbank in 2004–2008 (EUR in millions)

	2004	2005	2006	2007	2008
<i>Budget funds</i>	1,295	1,214	1,342	1,210	1,446
<i>KfW funds</i>	621	583	1,018	1,712	2,135
<i>Delegated funds</i>	18	84	85	80	101
Total	1,934	1,881	2,445	3,002	3,681

Differences in the totals are due to rounding.

Breakdown of total commitments in 2008 by region (EUR in millions)

	KfW Entwicklungsbank			DEG		Combined total		
	Budget funds	Total	Total	Total	commitments			
<i>Asia and Oceania</i>	479	33%	1,122	30%	414	34%	1,536	31%
<i>Sub-Saharan Africa</i>	385	27%	540	15%	164	13%	703	14%
<i>North Africa/Middle East</i>	324	22%	371	10%	16	1%	386	8%
<i>Europe and Caucasus</i>	148	10%	1,207	33%	287	23%	1,494	30%
<i>Latin America</i>	109	8%	441	12%	342	28%	783	16%
<i>Transregional</i>	0	0%	0	0%	3	0%	3	0%
Total	1,446	100%	3,681	100%	1,225	100%	4,906	100%

Differences in the totals are due to rounding.

Total commitments in 2008 by country (EUR in millions)
Ranked by BMZ budget funds

Rank	Country	BMZ budget funds	KfW funds	Funds from other minis- tries/donors	DEG
1	Afghanistan	99.40		11.50 ²	
2	Palestinian Territories	92.87			
3	Pakistan	88.37			7.11
4	China, PR	81.39	328.98		105.27
5	Kenya	74.96	15.86		43.27
6	India	74.26	201.00		83.42
7	Yemen	66.32		3.64 ²	
8	Congo, DR	59.35	0.35	1.10 ¹	
9	Syria	58.91			
10	Egypt	45.76	7.13		2.92
11	Tajikistan	42.00			
12	Georgia	41.35	51.70	8.00 ²	16.30
13	Mozambique	34.60			8.37
14	Bangladesh	31.40			6.59
15	Uganda	28.81		2.73 ²	1.53
16	Ghana	26.00			0.14
17	Bolivia	25.91	14.62		
18	Guinea	25.31			
19	Peru	25.11	53.69	1.93 ¹	26.02
20	Morocco	24.55	34.90		
21	Tanzania	23.45			24.93
22	Brazil	23.29		5.70 ¹	45.35
23	Jordan	19.50			
24	Vietnam	16.00	30.31	0.75 ²	
25	Turkey	15.03	221.49	7.00 ²	0.29
26	Lebanon	14.00			
27	Liberia	14.00			
28	Senegal	13.50			
29	Cambodia	11.71			7.29
30	Mongolia	11.39			
31	Namibia	11.35	35.00		
32	Serbia	11.00	161.00		22.00
33	Kosovo, Republic	10.00	20.00		
34	Ethiopia	10.00			8.00
35	Nepal	10.00			
36	Benin	9.00			
37	Niger	9.00			
38	Chile	8.40	135.72		
39	Albania	7.50	9.00	7.90 ²	4.40
40	Bosnia and Herzegovina	7.00	25.00		35.00

Total commitments in 2008 by country (EUR in millions)
Ranked by BMZ budget funds

Rank	Country	BMZ budget funds	KfW funds	Funds from other minis- tries/donors	DEG
41	Madagascar	7.00			0.15
42	Sierra Leone	7.00			
43	Azerbaijan	6.84			21.16
44	Burkina Faso	6.00			
45	Paraguay	5.52			3.85
46	Armenia	4.00			
47	Laos	4.00			
48	Croatia	3.00			20.00
49	Zambia	3.00			0.24
50	Kazakhstan	2.56			94.03
51	South Africa	2.00			10.93
52	Uzbekistan	2.00			
53	Cameroon	1.17			
54	Moldova	0.80			
55	Ukraine	0.15			46.17
56	Tunisia	0.02			12.83
57	Montenegro				40.00
58	Mexico				38.24
59	Philippines				37.18
60	El Salvador				19.50
61	Ecuador				14.62
62	Nicaragua				7.31
63	Costa Rica				6.46
64	Panama				2.53
65	Papua New Guinea				4.80 ¹
66	Belarus				2.51 ¹
67	Argentina				109.63
68	Romania				55.00
69	Malaysia				40.00
70	Nigeria				33.75
71	Guatemala				31.17
72	Honduras				27.78
73	Thailand				22.17
74	Uruguay				6.33
75	Rwanda				0.05
76	Chad				0.001
	Supranational	45.53			60.22
	Other	18.41			66.36
	Total	1,420.75*	2,134.88	125.59	1,224.66

Note: Interest grants total EUR 90 million (of which BMU: EUR 46 million, BMZ: EUR 44 million)

* Deviations from total budget funds, as only BMZ funds

¹ BMU funds; ² Delegated funds (also funds from other ministries)

Breakdown of total commitments in 2008 by DAC development sector (EUR in millions)

	<i>KfW</i>		<i>DEG</i>		<i>Total</i>
<i>Financial sector</i>	1,392	38%	487	40%	1,879
<i>Social infrastructure</i>	973	26%	71	6%	1,044
<i>Economic infrastructure</i>	966	26%	163	13%	1,129
<i>Production sector</i>	62	2%	469	38%	531
<i>Other</i>	289	8%	34	3%	323
Total	3,681	100%	1,225	100%	4,906
					100%

Differences in the totals are due to rounding.

Total DEG commitments by sector (EUR in millions)

Differences in the totals are due to rounding.

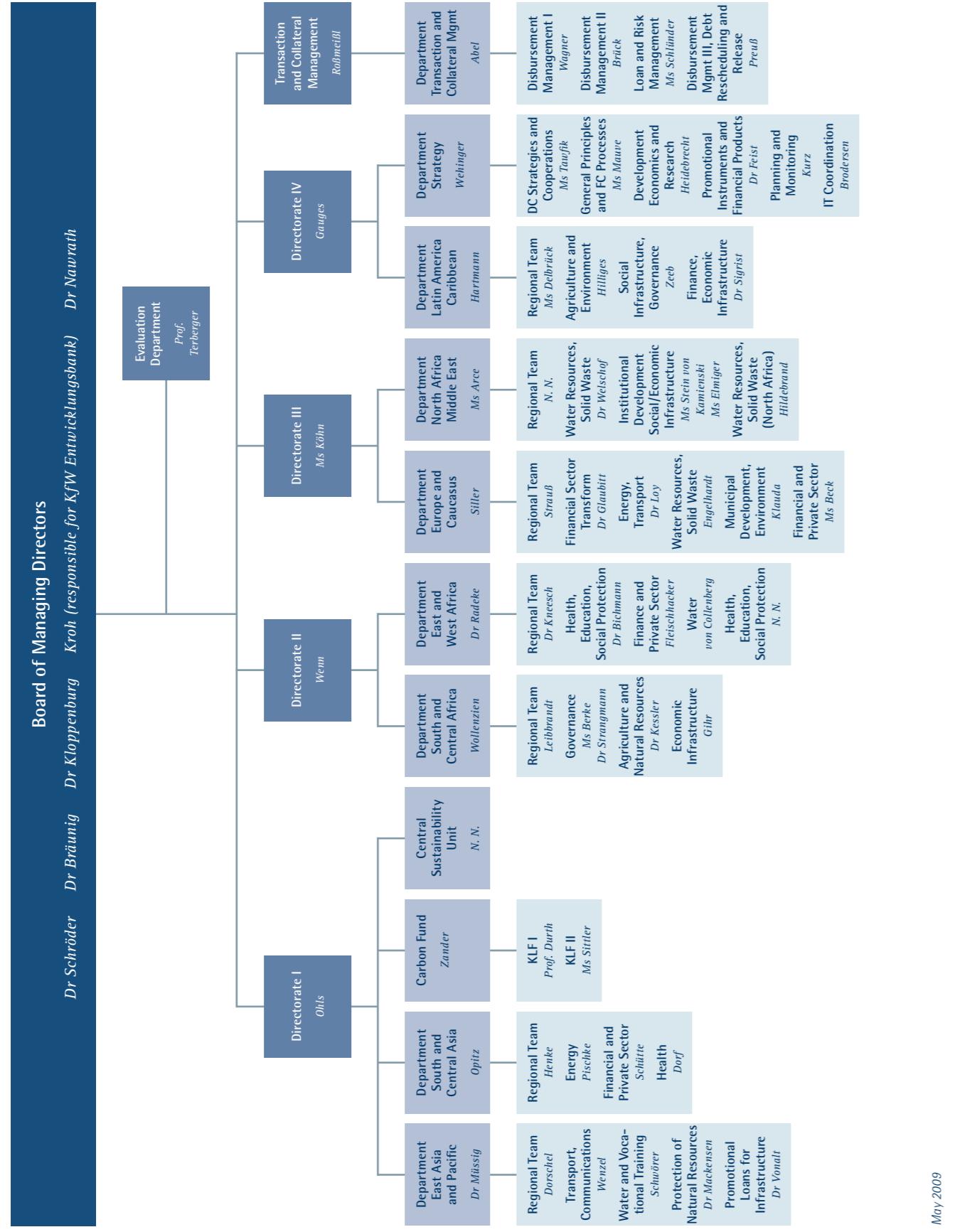
Total KfW Entwicklungsbank commitments by BMZ priority area (EUR in millions)

<i>BMZ priority area</i>		<i>2007</i>		<i>2008</i>
<i>Economic reform, development of a market economy</i>	903	30%	1,421	39%
<i>Energy (including energy efficiency, renewable energies)</i>	514	17%	672	18%
<i>Drinking water, water management, wastewater/solid waste disposal</i>	373	12%	527	14%
<i>Transport and communications</i>	493	16%	212	6%
<i>Health, family planning, HIV/AIDS</i>	172	6%	211	6%
<i>Other, non-attributable</i>	114	4%	188	5%
<i>Environmental policy, conservation and sustainable use of natural resources</i>	114	4%	175	5%
<i>Democracy, civil society and public administration</i>	172	6%	116	3%
<i>Education</i>	94	3%	84	2%
<i>Peacebuilding and crisis prevention</i>	4	0%	46	1%
<i>Food security, agriculture/fishery</i>	47	2%	28	1%
Total	3,000	100%	3,681	100%

Differences in the totals are due to rounding.

ORGANISATIONAL CHART

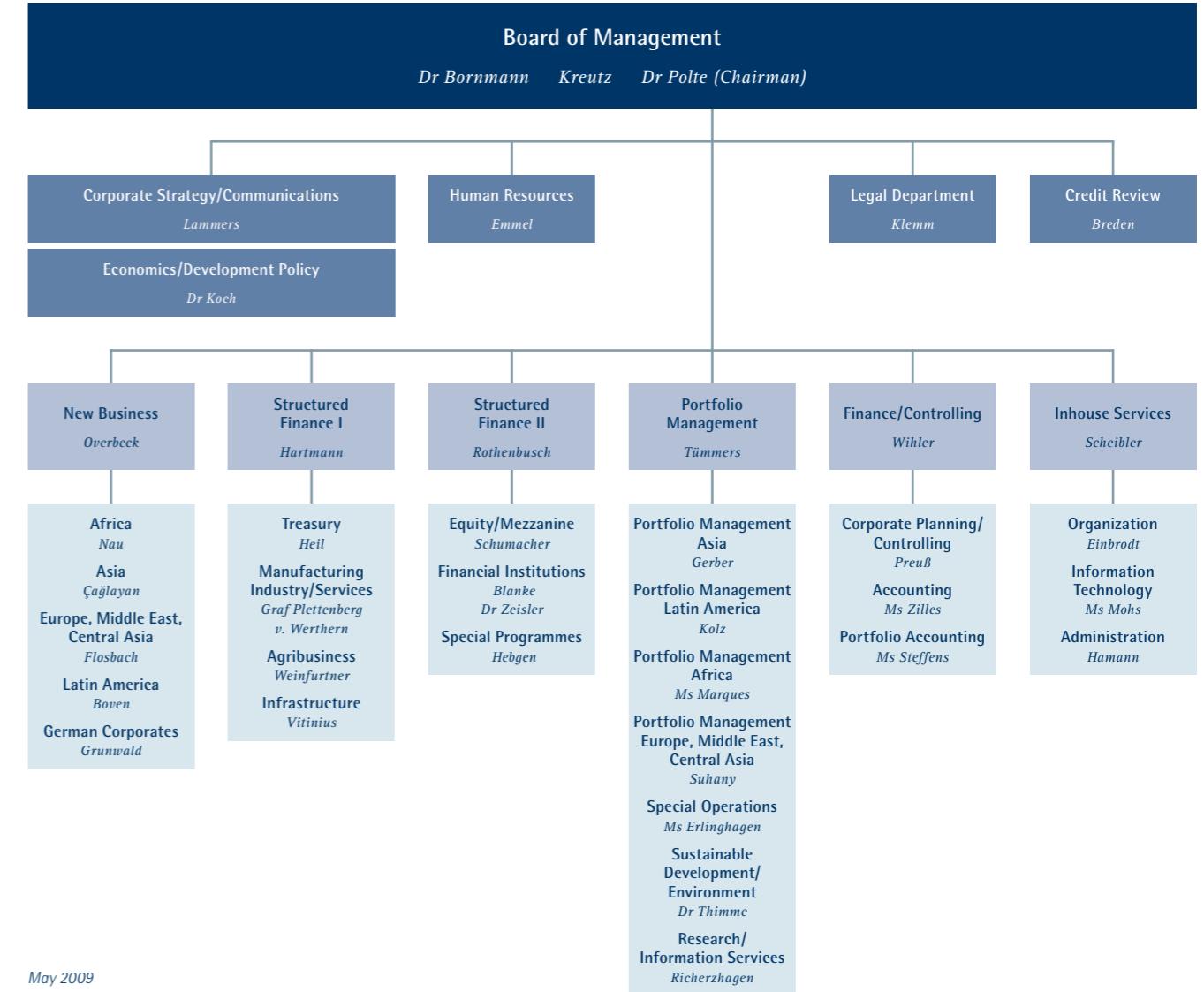
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May 2009

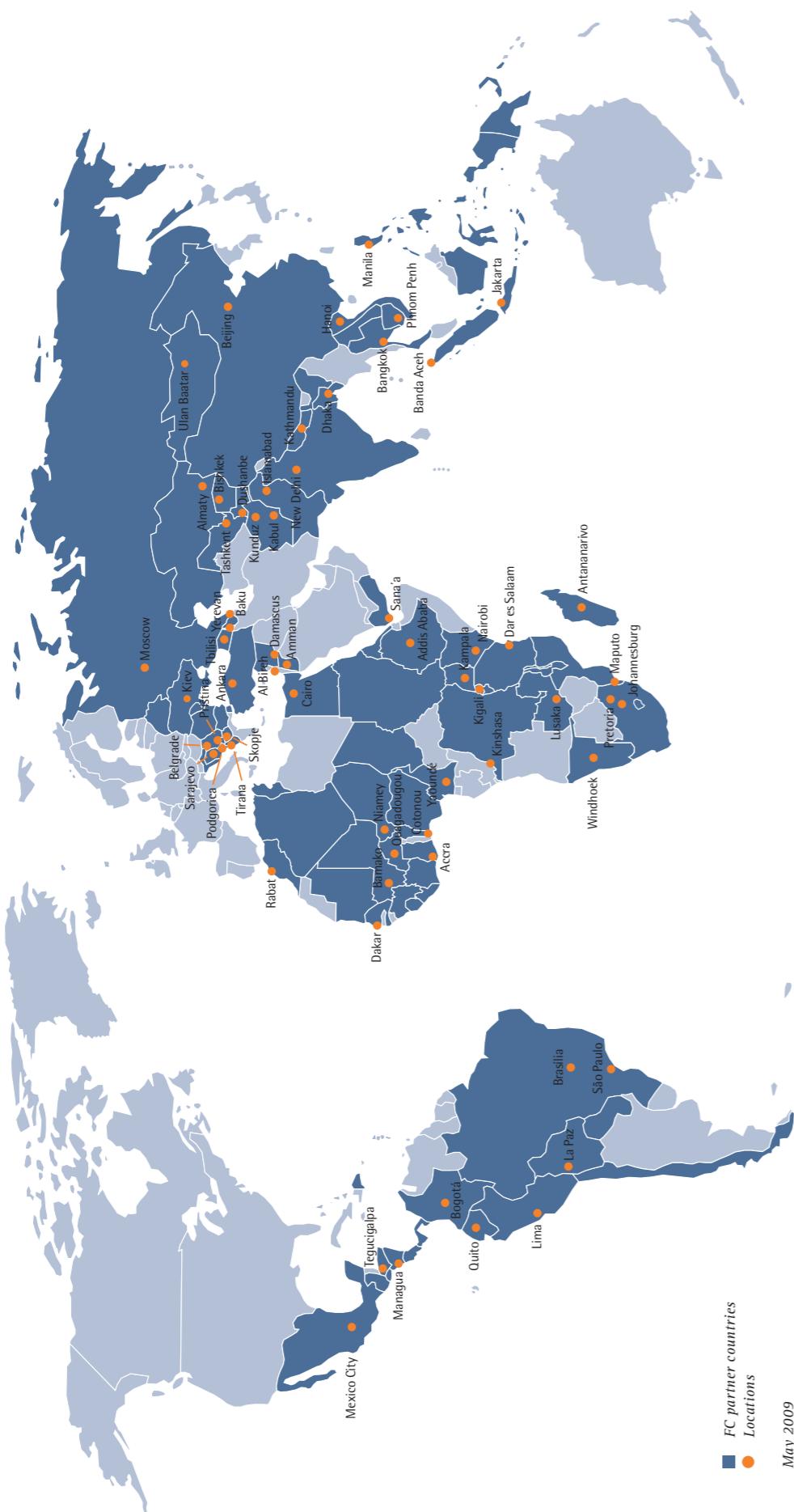
ORGANISATIONAL CHART

OF DEG



WORLDWIDE COMMITMENT

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