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Kicking away the financial ladder? German development banking under economic globalisation

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Abstract

While extensive literature exists on how economic globalisation has limited developing countries' policy space for industrial policy, the literature on how it has affected advanced economies remains scant. We utilise original archival material to analyse the activities of the German public development bank, the Kreditantstalt für Wiederaufbau (KfW), in order to shed light on an important, but neglected aspect of German industrial policy. We analyse how the KfW responded to multiple challenges after the rise of economic globalisation, including a funding crisis, international agreements to limit export subsidies and Europeanisation. We argue that KfW successfully managed to navigate these challenges in order to retain, and even increase, its ability to conduct selective industrial policy in the post-1980s era. This was possible because of Germany's hard currency and low sovereign credit risk, large market size, which was

augmented by membership in the European Union, and Germany's position as regional hegemon within Europe. More broadly, this shows how, conditional on domestic politics, advanced economies are able to shape and exploit the rules of the international economic system to implement industrial policies to their advantage, even as developing countries are given the opposite policy recommendations.

Keywords:

Development banks | industrial policy | globalisation | policy space | finance | Germany

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Disclosure statement

We have no potential conflict of interest to report.

Notes

1. Industrial policy is defined as ‘any policy that attempts to affect the evolution of specific industries through state intervention in order to effect national efficiency and growth’ (Chang, 1994).

2. The bank underwent a name change to ‘KfW’ in 2012. Throughout the paper, we will use the abbreviation ‘KfW’.

3. For example, as of December 2015, KfW's lending volume makes up 14% of the total loans to the non-financial corporate sector by banks in Germany (KfW, 2015; Bundesbank database: Loans to the non-financial corporations, 2015). However, the figure dramatically understates its importance, since KfW finance is targeted only towards specific sectors, and is meant to be catalysing in nature.

4. The total value of exports that KfW helped to finance in 1974 was about 10% of the export volume of durable capital goods to developing countries; the share of the latter in total German exports in turn amounts to roughly 5% (KfW, 1974, p. 72).

5. For example, KfW financed sales to Eastern Airlines in 1978, one of the weakest American airlines, which later became insolvent (Harries, 1998, p. 136).

6. These programmes have been important in financing SME investment since the 1980s; in 1985, the KfW financed 45% of the total investment of manufacturing small enterprises (revenues less than 5 mn. DM), and 20%–25% of medium firms (revenues between 5–10 mn. DM) (Götte, 1988).

7. Self-financed loans made by KfW do not count towards core Federal budgets, and only the direct allocation from Federal or ERP budgets have to be recorded in the State Subsidies Reports (Subventionsberichte der Bundesregierung) as an officially declared subsidy (Bundesbank, 2000, p. 18).

8. The ERP fund was set up under the Marshall Plan, but when the Marshall plan ended in 1953, it was turned into a revolving fund for long-term investment loans, which grew over the decades due to the interest being accrued (KfW annual reports, various years).

9. While bringing benefits, KfW's reliance on international capital markets might also create new risks, if the German government is downgraded or if the Euro ceases to be seen as a strong currency.

10. The EU is referred to as the European Communities at the WTO.

11. An ECA is a public entity that provides government-backed loans, guarantees and insurance to corporations that do business abroad, from their home country.

12. The government guarantee for KfW's market window was explicit until 2008 when market and official window operations were conducted within the same legal entity. After 2008, KfW's market window operations became legally independent as KfW-IPEX,

but were still owned by the parent company, making the government guarantee implicit. This will be discussed further in the next section.

13. Firms have reported that KfW offers market window financing a full basis point lower than commercial banks (Mendelowitz, 2001, p. 175).

14. By 1989, the majority of KfW's financing for Airbus was provided on a market window basis (KfW, 1989, p. 41).

15. Deutsche Airbus was on the ‘verge of bankruptcy’ in 1989, necessitating a rescue plan by the German government, which included KfW providing a DM 505 mn. capital infusion by taking a 20% equity stake in the company (WTO, 2016, p. 267).

16. Musacchio and Lazzarini (2014) argue that the development bank lending to firms that are already competitive, and therefore able to raise finance privately, constitutes ‘rent seeking’ rather than industrial policy, because this merely subsidises the cost of capital, but does not increase productivity. We believe this argument does not apply to industries where there are sufficient scale economies. KfW financing remained vital to improving Airbus’ productivity, even after it became internationally competitive, through enabling it to capture the market share, thus increasing the economics of scale and long-run productivity. Separately, KfW financed risky technological innovations, which would not have been financed in private markets.

17. Email correspondence on 17 October 2017.

18. Other important potential challenges included the Maastricht Treaty, the effect of which has already been discussed, the EU Banking Regulations and the post-crisis ECB Single Supervisory Mechanism. Since KfW was not classified as a bank under German law, the latter two simply did not apply to it.

19. These were the Mittelstand (SME) bank, the Privatkundenbank and Kommunalbank, which lend to domestic SMEs, large corporations and municipal governments, KfW Entwicklungs (development) Bank that finances projects in developing countries and the KfW Deutsche Entwicklungs- und Investitionsgesellschaft (German Development and Investment Association, DEG) that provides advice and technical expertise.

20. For example, the KfW Innovation Programme for SMEs wasintended to round off the Federal Government promotion of research and development, R& D), which is strongly oriented to basic research… [KfW's] loan finance for application-oriented R&D will lead

to a helpful solution for the company, if the company cannot fund all the work itself as is the usual practice. (KfW, 1994, p. 28)

21. These provide renewable energy producers a guaranteed price at which they can sell to the energy supplier, providing the producers with long-term security to encourage investment. The ultimate cost is passed on to the consumer.

22. Which in many cases would not have been possible without KfW financing, as KfW plays the role of lead bank in consortium lending.

23. The US Coalition of Solar Manufacturers that initiated investigations against China was led by the US arm of the German SolarWorld (Lewis, 2014).

24. A coalition of European solar producers called ProSun was later formed to lead the filing of complaints at the WTO.

Additional information

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