CGAP

HIGH-LEVEL BRIEFING

What inclusive finance can offer the climate agenda

The global climate agenda is currently dominated by intense discussion around climate finance—how much is needed and who should pay what—but the question of **who has access to this finance** is less in focus.

This document outlines CGAP's view that to respond to the climate emergency, more climate finance needs to be channeled directly into the hands of affected people, to empower them to take the climate actions they see fit; and that inclusive financial services are a unique and underutilized tool for making this happen.

The Role of Inclusive Finance

'Inclusive finance' is the effort to ensure that all people and small businesses have access to, and are empowered to use, affordable, responsible financial services.

Such financial services are a critical enabler for any climate action that people want to take for themselves in order to adapt to new climate realities, bolster their resilience, and seize new green opportunities:

- Savings and credit products enable people to invest in cleaner technologies, adopt more sustainable practices, and build more resilient livelihoods.
- Remittances and government payments are crucial in helping households live through climate shocks and avoid negative coping mechanisms.
- Insurance solutions strengthen risk management, unlock investment in livelihoods, and help affected people rebuild their lives after a crisis.

The Opportunity

Inclusive finance could make a significant contribution to the global climate agenda and to locally led adaptation if financial services providers were better utilized as vehicles for delivering climate finance to their billions of low-income clients and better equipped to offer solutions tailored to driving climate action.

Closer ties and partnerships between inclusive finance and climate finance could unlock greater climate investment at the grassroots level, empower low-income populations to invest in their own adaptation and resilience, and help climate funders overcome some of the hurdles in getting finance directly into the hands of the vulnerable. The common goal should be to render climate finance itself more inclusive.

The potential benefits for the global climate agenda include:

UNLOCKING INVESTMENT IN GREEN TECHNOLOGIES

It is a common complaint in climate finance circles that there are not enough investable projects in the pipeline. This perspective overlooks the people on the ground: climate-exposed people have ample actions they want and need to take; what they don't have is financing.

Many green technologies are now both better and cheaper solutions for low-income households over the long run[1], but they require upfront investments that are larger than many households can afford or are able to save for. Inclusive finance can unlock these investments and help spawn entire green sectors, as shown by the pay-as-you-go solar industry, which has scaled in a few years to bring clean energy to 480 million low- and middle-income households thanks to an innovative model of embedded credit.[2]

EMPOWERING LOCALLY LED CLIMATE ACTION

The movement toward Locally Led Adaptation has rightly grown in recent years, emphasizing the need to involve communities in adaptation investments and devolve authority over decisions, and control over resources, to the lowest level possible.

There is perhaps no greater way to accomplish this than putting resources directly into the hands of climate vulnerable individuals and households, whether in the form of grants and cash transfers from governments and development organizations or loans from commercial financial institutions—all of which typically involves banks or other formal financial services providers.

DRIVING SCALE AT THE GRASSROOTS

The magnitude of the climate crisis demands a truly global response which engages all 8 billion people on the planet. Inclusive finance is a proven way to drive scale across all segments of society, as shown by the mobile money revolution whereby the number of phone-based formal financial accounts worldwide increased from 30 million in 2012[3] to 1.8 billion in 2023.[4]

HELPING TO ALLEVIATE THE GLOBAL CLIMATE FINANCE GAP

Climate finance remains far below what low- and middle-income countries need, especially for adaptation, and there is universal agreement around the need to mobilize far more money from private sources. Inclusive finance has proven successful at mobilizing private capital for development, transforming from an NGO-based and grant-orientated sector to a major commercial industry, with inclusive financial services providers now lending more than $180 billion/year globally[5] to low-income clients. These are resources and capabilities that can be leveraged to support climate action.

SPEEDING UP THE DEPLOYMENT OF CLIMATE FUNDING

Adaptation finance from bilateral development funders to developing countries has a mere 66% disbursement rate compared to 98% for all bilateral development finance.[6] Climate funders are routinely criticized for lengthy processes of accreditation, application, due diligence, and risk management that result in funding taking years to access. Because the inclusive finance ecosystem is already channeling large volumes of finance to low-income populations in EMDEs through heavily regulated financial institutions, it is well placed to convert large tickets of climate finance into small-ticket funding that reaches low-income households directly, with relatively light additional risk assessments and rapid turnaround time.

Why hasn't this happened yet?

CGAP currently sees three gaps that are hindering locally led climate action:

1. **There are very few linkages between climate finance and inclusive finance today.** Not enough climate funding or knowledge is flowing through the inclusive finance ecosystem and therefore very little is reaching those who most need it. Climate investments in emerging markets and developing economies (EMDEs) focus heavily on large-scale projects by governments and international organizations, with less than 10% estimated to reach the grassroots.[7]
2. **The financial services that vulnerable people around the world have access to are not designed with climate change in mind.** This makes them less effective at supporting climate action and helping vulnerable populations build resilience. This is a missed opportunity.
3. **Financial services providers (FSPs) themselves don't have access to the solutions they need to keep serving increasingly climate vulnerable clients in low- and middle-income segments.** As climate exposure steadily grows in their portfolios, many FSPs are facing the difficult choice of pulling back from vulnerable clients, potentially abandoning their core mission, or taking on unsustainable levels of risk that could jeopardize the survival of their institutions.

The Road Ahead: Priorities

In all the ways outlined above, inclusive finance can be a unique and effective tool for unlocking grassroots climate action and empowering vulnerable populations to pursue the adaptation, resilience, and transition strategies they themselves believe are right for them.

For this to be fully effective, however, there is an urgent need for deeper partnerships between climate and financial inclusion stakeholders to support climate action in three key ways:

1. **Making better use of the existing inclusive finance ecosystem for channeling climate finance to the grassroots and for mobilizing private capital towards climate action** - successfully leveraging on the billions of customer relationships that these providers already have in low-income, climate vulnerable segments.
2. **Developing financial solutions better tailored to the needs of low-income segments for climate adaptation, mitigation, and the green transition** - there is an urgent need for a bigger range of climate-orientated financial services products, and more knowledge, funding and resources to support further innovation.
3. **Helping inclusive financial services providers keep serving climate vulnerable clients** - there is a rapidly growing need to develop better and more affordable risk transfer solutions for FSPs themselves, including portfolio climate risk insurance at the country and regional levels. At the same time, public funders and impact investors who want to avoid a withdrawal of financial institutions from climate exposed regions and value chains must also shoulder some of the risk, in the form of credit guarantees, first-loss capital, and so forth.

We cannot afford for climate finance to be anything but inclusive. As the world debates the enormous amounts of financing that will be required to address the climate emergency, inclusive finance can be a powerful ally and source of solutions.

References

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Notes

In this document, the 'inclusive financial ecosystem' refers principally to four key, inter-related groups:

(1) financial services providers (FSPs) serving low-income clients, including banks, microfinance institutions, mobile money providers, digital finance companies, fintechs, insurers and remittance providers, and their branches, agents, and other physical touch points.

(2) organizations (such as private investors, impact investors and development finance institutions) that have equity stakes in and/or offer debt capital to these FSPs, including the intermediary funds through which some of them operate.

(3) development agencies and philanthropic funders that provide grant financing, technical assistance, credit guarantees and first-loss capital to the FSPs (and sometimes their investors).

(4) the global standard setting bodies as well as the national government policy makers, regulators, and supervisors that define the enabling environment for financial services, enforce the rules, and take actions to pursue national policy goals in this arena.

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