Briefing

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Policy pointers

The right mix of intermediaries can empower low income groups to manage development and climate finance themselves

Accountable local governments can direct finance to local priorities

National development banks can use instruments such as concessional loans and guarantees to unlock finance for risky markets

With the right regulatory structures and incentives, commercial banks can be encouraged to prioritise the needs of the poor

Delivering climate and development finance to the poorest: intermediaries that 'leave no-one behind'

Efforts to achieve the UN Sustainable Development Goals (SDGs) and implement the Paris climate change agreement will fail if finance does not reach the poor women and men who need it most. Intermediaries that channel climate or development finance to these groups will therefore be crucial. These intermediaries include local funds, national and local governments, development banks and microfinance providers. Experiences from Asia and Africa show how intermediaries can be inclusive and empower the poor. Different intermediaries have comparative advantages in different contexts. To prioritise the needs of the poorest, it is best to use a range of intermediaries, taking into account people's financial needs, the stage of market development and what each intermediary offers. Financial, regulatory and reputational incentives can encourage intermediaries to prioritise poor people's needs and enable them to take action for themselves.

The SDGs strive to 'leave no-one behind'; UN climate change negotiations aim to 'avoid dangerous climate change'. But the agreements behind these grand aims will only succeed if the world's poorest people can react to the challenges they face. Poor people are already using their own scarce funds to adapt to climate change, pay for services, recover from extreme events, develop sustainable businesses and secure low-carbon energy supplies. The aim of national and international public development finance and climate finance should be to complement these household expenditures.

In July 2015, the international community agreed to tackle this challenge through the Addis Ababa Action Agenda on Financing for Development. UN Secretary-General Ban Ki-moon recommended that the action agenda should guide "smart investments in people and the planet where they are needed, when they are needed and at the scale they are needed". While policy debates have focused on where this money will come from, the real question will be how to get finance to the poor and vulnerable people who need it most. This calls for attention to turn to appropriate financial intermediaries — the structures and institutions that channel finance from its sources to its spenders.

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The advantages and disadvantages of each intermediary vary from context to context

Wanted: inclusive intermediaries

A long-standing problem with development finance is that very little of it trickles down to the villages and informal urban settlements it is meant to reach.[1] Furthermore, the people most at risk rarely have a say in how to spend the money. However, self-organising low-income groups have shown they are more than capable of identifying and articulating their needs, and managing finance to address them.

A big part of the problem is that existing channels have a poor track record at making finance available at the levels and timescales low-income groups need. National centralised ministries, mainstream financial institutions and large-scale investors do not usually serve the poor.[2] Reasons for this include:

- Difficulties in reaching out to communities
- Priorities for growth over social development
- Low returns on investments
- High transaction costs
- Risks that borrowers will default on loans

Experience shows that this need not be the case. Our research points to several ways in which financial intermediaries can prioritise the needs of the poor.

1. Local funds and organisations

Local funds can quickly provide cash to address collective needs of low income groups in a cost-effective way. Several such funds have emerged from local savings groups and have been bolstered by international donors, giving the poor direct access to development finance that would ordinarily fail to reach them.

Box 1. Urban poor partner with city governments to transform slums[4–5]

The Asian Coalition for Community Action (ACCA) programme of the Asian Coalition for Housing Rights enables urban poor groups to improve living conditions in partnership with city governments. As of 2014, ACCA had improved informal settlements in 165 cities in 19 Asian countries.

Under the ACCA programme, the first step is a city-wide, community-led survey that identifies priorities for small upgrading projects, such as improving drains, toilets and electricity supplies, or building roads, community centres, bridges and playgrounds. ACCA also develops larger housing projects, financed through a mix of community, local government and international donor funds.

Between 2008 and 2011, ACCA's investment of US$2.3 million unlocked US$35.6 million worth of government land for poor people's housing.

Local funds are often distributed as revolving loans rather than grants, and can therefore be re-used for future investments. Such funds can nurture partnerships between communities and local governments. This results in a more democratic planning process and helps to release further funds from the state to deepen local development initiatives. Local funds are often facilitated by community based organisations and civil society organisations that are representative of poor people themselves (see Box 1).

Most experiences of effective, efficient and empowering local funds come from urban contexts. They enable development finance to reach the most marginalised communities while scaling-up community processes from the local to city, provincial and even national levels.[3]

Local funds are distinct from microfinance, which tends to target individuals or households and is not available to the poorest of the poor. Unlike microfinance, local funds focus on collective, community-led development, providing more scope for political empowerment.

2. Local governments

Local authorities are often better able than central governments to improve infrastructure, provide services, manage natural resources and resolve conflicts in ways that involve local citizens and respond to their needs (see Box 2). Local governments also can provide seed funds for local level renewable energy supplies such as off-grid hydro and solar technology.

Channelling climate and development finance through local governments can therefore be an effective way to help poor households adapt to climate change, meet energy needs and improve livelihoods. For this to happen, local governments need capacity and autonomy, and local people need to be able to hold the authorities to account.

Box 2 describes a successful example of a local government fund that supports adaptation to climate change in Kenya. Such funds are filled by national treasuries or donors and are designed to disburse their principal capital each year. They are crucial for poor rural communities that cannot use their own savings to raise funds for public goods in the way urban local funds can. The long-term value of these funds will depend, however, on governments and development partners replenishing them.

3. Development ministries

In many countries, international and domestic development finance tends to flow to centralised government ministries such as those responsible for infrastructure and energy. Such ministries often

take a 'one-size-fits-all' approach across the entire country. Marginalised communities can therefore rarely have a say in how the money is spent.[8]

Social development, education and health ministries also have roles to play in fostering resilience to climatic shocks among the poorest, and they often have strong relations with communities and civil society groups. Health ministries and institutions, for example, must monitor, prepare for and react to climate-related health threats.

However, these institutions often lack knowledge of and access to large-scale international climate finance. By addressing these gaps, and channelling finance through these ministries and local departments, governments and donors can help ensure the poorest communities benefit.

4. National development banks

Domestically-funded national development banks have a mandate to provide long-term financing to risky sectors commercial banks do not serve. In the past, however, these banks have been criticised for failing to reach the poorest people. This has often been because institutional mandates require such banks to use credit-based instruments to ensure commercial viability, which pro-poor investments may not always offer. However, some national banks have begun to target the poor and incentivise commercial banks to lend to borrowers they usually consider too risky.

The Central Bank of Bangladesh was the world's first federal bank to provide dedicated resources toward a sustainable development agenda. It shows how a strong regulatory command-and-control approach and national authority can channel finance to marginalised communities and encourage commercial banks and the private sector to get involved.[9]

Since 2005, the bank has run a refinancing scheme that offers low-interest credit to commercial banks that finance household biogas and solar systems in off-grid rural areas. The central bank encourages commercial banks to lend to poor borrowers through microfinance providers as these are better able to reach rural communities. To further reduce costs to borrowers, the central bank also supports commercial banks that are setting up new branches to channel funds for solar irrigation direct to farmers' co-operatives. The co-operatives can access finance at favourable rates as they can combine their members' collateral.

Other national development banks have a history of channelling development finance to sectors and actors that remain marginalised from mainstream financing, including the SMEs in renewables sector. For example, the Development Bank of Ethiopia uses instruments such as long-term loans and guarantees to encourage investments. The bank provides 70 per cent working capital loans at an interest rate of 8.5 per cent to developers with a five-year repayment period. The bank also provides concessional loans to microfinance providers at an interest rate of six per cent with a ten-year repayment period.

However, not all development banks have been instrumental in reaching to the poorest. Often, the institutional mandates of national development banks require them to use credit based instruments, ultimately seeking to ensure commercial viability of investments which pro-poor investments may not always offer.

5. Dedicated agencies

Some governments have created dedicated agencies to accelerate the flow of funds that meet the needs of the poor.

Bangladesh. A state-owned financial intermediary called the Infrastructure Development Company Limited (IDCOL) enables low-income households to buy renewable energy technologies at reduced prices. To do this, IDCOL offers low-interest loans lends to microfinance providers which not only lend the money onward to households, but also provide and install the technology. Between 2003 and 2014, more than three million solar home systems were installed. IDCOL has taken account of the needs of the poorest people. It has gradually phased out subsidies for all but the lowest-income households and has made smaller, more affordable solar systems available for such households.[9]

Nepal. The Alternative Energy Promotion Centre (AEPC) uses finance from the central government and international donors to support energy access for the poor. AEPC provides public subsidies to renewable energy financiers and developers in the early stages and creates an enabling environment for credit financing in the long term. The centre set up a Central Renewable Energy Fund (CREF) to facilitate a shift from subsidies to credit Hosted within a commercial bank, CREF provides subsidies to renewable energy installers and extends credit funding from partnering banks to

Box 2. Local government financing adaptation in rural Kenya[6-7]

Investments in public goods are a cost effective and socially cohesive way of building long-term resilience. Such investments combine well other support such as grants, loans, cash transfers and food aid.

In Kenya's Isiolo County a Climate Adaptation Fund was set up with donor finance to allow local people to identify public-good type investments that build resilience to climate change. Communities identified projects for funding through ward-level committees. A county-level committee of community and government representatives then assessed the proposals and helped strengthen them to meet the funding criteria.

The funded projects include rehabilitation of a livestock disease laboratory, sand dams to store water, and the establishment of local agreements to strengthen the traditional dedha system of rotating grazing lands and managing access to dry season water. Successes like these have prompted the approach's expansion in four more counties, to cover a combined 29 per cent of Kenya.

developers, households and communities that wish to invest in renewable energy.[11]

6. Microfinance providers

In some instances, microfinance providers can be well-placed to ensure money reaches the poor, as they have strong relations with local communities and agencies, and good knowledge of local markets, barriers and risks. Governments and commercial banks may prefer to channel finance through such microfinance providers, because of their experience in both disbursing and collecting credit from rural off-grid borrowers.

Indeed, microfinance providers play various roles in low-income markets for renewable energy in Bangladesh, Ethiopia and Nepal, from lending money to installing and servicing the technology. In Mozambique, a public-private microfinance provider called GAPI focuses its support toward community groups and small and medium enterprises, by promoting local savings, business development, capacity building and access to credit.[12]

But while effective in improving access to finance, microfinance providers do not always work to empower marginalised communities or to tackle poverty. Some studies suggest there is actually little evidence to support the idea that microfinance has a positive effect on the well-being of the poor.[13] This is particularly true within the context of shelter microfinance, where loans are rarely available and of little use to the poorest people living in informal or rented housing.[14] They tend to have high transaction costs, which can increase interest rates for poor end users. To mitigate this, national banks could regulate the interest microfinance providers charge. Another option is for national banks to use microfinance providers while markets develop, then phase them out once other financial institutions are established. As markets mature and commercial banks set up more branches, these banks may be better placed than microfinance providers to channel low-interest loans directly to end users.

Conclusions

The advantages and disadvantages of each intermediary vary from context to context. Local revolving funds work best in urban areas. Rural areas benefit more from grant-based funds that invest in public goods rather than revenue-generating activities. National development banks are better suited to unlocking finance for risky markets. And while microfinance providers can deliver finance to poor borrowers in early-stage markets, as these markets mature banks can provide cheaper credit.

Experience shows that, with the right incentives, a combination of financial intermediaries can deliver climate and development finance to the poorest parts of society. To achieve this, these intermediaries must:

- Be able to draw down finance targeted for the poor
- Make investments in climate-smart, socially-beneficial activities
- Have the capacity to involve the poor as participants in the design of projects and programmes
- Have strong systems for delivering and implementing for the poor, including through use of appropriate financial instruments.

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Knowledge Products

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Notes

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