Environmental Microfinance

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Environmental microfinance:

- The provision of financial services to low income families in direct support of activities that contribute to the long term health of the planet:
  - Use of microfinance in projects that integrate improved livelihoods and natural resources management measures such as organic farming or sustainable forestry and fishery management,
  - Use of microfinance to support enhanced livelihoods for populations that live in or around protected areas – normally associated with measures to protect biodiversity,
  - Use of microfinance to support the development of new small and microenterprises that engage in the sustainable exploitation of biodiversity resources, eco-tourism, or eco friendly activities,
Environmental Microfinance:

- The provision of financial services to low income families in direct support of activities that contribute to the long term health of the planet:

  - Use of microfinance to support the adoption of alternative technologies that reduce the consumption of fuel woods, fossil fuel, or other scarce natural resources. (solar lighting systems and efficient cookstoves),

  - Use of microfinance to support transition of small and microenterprises away from activities that have a strongly negative impact on the environment, or, conversely contribute to the mitigation of their impact,

  - Use of microfinance to optimize the use of payments for environmental services rendered by small and micro farmers in and around protected areas, and managed watershed and forests.
Why is E.Mf Important?

• MDG has focused efforts of multilateral organizations and national governments on reducing extreme poverty (proportion of inhabitants living on less than US$1 per day)

• 75% of extremely poor (900 million) live in rural areas, particular importance of gender inequality

• Rural poor are extremely dependent on natural resource systems – small scale farming, livestock production, fishing, hunting, artisanal mining, and logging (54% workforce).
Why is E.Mf Important?

- Environmental Income (income from the direct use of nature – farming, fishing, hunting, collection of firewood) is substantial, represents a ‘safety net’ during difficult times for subsistence level families.

- Environmental factors add to health burden of poor – air and water pollution, insect borne diseases, pesticides, a burden that is not addressed by health care systems.

- Degradation of natural resources, either through over exploitation, or by contamination, increases the vulnerability of the poor who depend on these.
Why is E.Mf Important?

Microfinance has proven to be an extremely effective tool for:

- reducing the vulnerability of the poor to life’s shocks,
- administering the financial flows associated with life cycle events, and,
- growing income generating activities.
Addressing the situation of rural poor, who live or depend on degraded or sensitive natural resources requires an integrated approach:

- Measures to protect and enhance the ability of the natural resource to provide ‘environmental income’ through better management,

- Measures to enhance both the natural resource driven and the non-natural resource driven income generating options of families,

- Permanent access to financial services that reduce vulnerability, smooth financial flows, build accessible capital, support income growth,

- Measures to increase the participation of the rural poor in the governance of their own natural resources.
Importance of E.Mf to IFAD

• Seventy percent of IFAD rural poverty alleviation projects are located in ecologically fragile, marginal environments.

• IFAD feels that “unless this circular, cause and effect relationship between rural poverty and environmental degradation can be addressed directly, the sustainability of rural development projects will be undermined and attempts to alleviate rural poverty will be jeopardized.”

• MF can support enhanced livelihoods activities, provide financial protection against income shocks, and help families build capital assets – all impacts that directly affect the ability of the poor to lift themselves out of poverty or avoid falling back into poverty.
3 Strategic Objectives - IFAD

Enabling the rural poor to overcome their poverty

• Human and social assets
• Productive assets and technology
• Financial assets and markets
Key Elements of Successful MF

Borrower Selection
• Use of peer based information on character and capacity to repay
• Incremental lending – testing will to repay through gradual increase in payment amounts

Appropriate Loan Terms
• Small loans in relation to repayment capacity
• Cash flow based lending, not project finance
• Short terms, renewable, frequent payments that match income into household
• Low Transactions cost offsets ‘high’ financial cost

Disciplined Portfolio Management
• Primary pressure to repay comes from potential cut off from future loans
• Insistence on collections, social pressure to repay
• Proximity and immediacy in collections efforts
Chief accomplishment of microfinance is that it has created a

“General obligation to repay”

on the basis of family cash flow, that is independent of the specific results of activity undertaken with loaned funds.
In any agency, project, community that is trying to grow an economy, while taking into consideration the sustainable use of natural resources there is a tension between competing objectives:

- For most activities, we have not developed commercially attractive alternatives to approaches that degrade natural resources (little or no immediate value placed on sustaining resources, problem of the commons)

- Environmentalists and developmentalists are usually from two different communities. These two groups don’t talk much together – perhaps they are led by their extremes (deep ecologists and econ. growth maximizers)
Two Tasks for IFAD:

- Identify NRM projects where good microfinance practice can be found to draw lessons for future project design and execution.

- Review the “Administrative Procedures for Environmental Assessment in the Project Cycle,” and write operational statements on rural finance and small and micro enterprise.
We need to find a balance between Environmental, Social, and MF impacts.

• When looking at triple bottom line (TBL), and ways to implement it in segment of society that are under the line of poverty, we can assume that there will be conflicts. A trade off will have to arise when working with poverty alleviation.

• Microfinance could be in support of environmental objectives – looking at win-win situations, and investment opportunities. There are good samples of win-win, proactive and has moved beyond the “do no harm” perspective
We are seeking to highlight IFAD projects that work on a triple bottom line:

- Measures for natural resources management that enhance the natural / environmental income derived by poor families,
- Measures that increase the incomes of the poor,
- Microcredit or other microfinance services that are sustainable, have high repayment rates,

From which to draw lessons learned for future projects.

Interest in putting together some pilots, perhaps w/ GEF.
How do we do targeted credit – better?

• The key to success is the notion that microcredit is tied into a specific activity. Thirty and forty years ago, microcredit was part of rural “integrated development programs” and failed. Since then, we have moved away because those elements did not work well.

• How do we do it without making mistakes of the past? We engage with a cleaner, sharper eye to create services. The significant challenge will be to train people to recognize and calculate “value.”
• We have undertaken a review of guidelines of most major multi and bi-lateral agencies – most of their filters are based on client size, exclusion lists of non-fundable activities.
  – Looked at 200 environmental assessment documents,
  – Talked to environmental focal points from a number of multi and bi lateral agencies about their experiences with guidelines,
  – Only 50% mention small and microenterprises, 31% highlight impact of SMMEs, 1 (IDB) suggests a regime for that was designed specifically for SMMEs from its origin.
  – ADB, World Bank, IFC, IDB, CIDA, GTZ, GEF, USAID were looked at in more detail,
  – ADB, IDB and IFC create a category for FI, in addition to A, B, C.
IFC, IADB, and ADB have all tried to pass the responsibility onto the financial institution for environmental management of their loan portfolio – following a general trend in international finance.

Institutions should have ability to analyze environmental impacts at the level of final client, propose mitigation measures, and refrain from lending if not complied with.

Below specified levels, no measures applied: $5,000 for individual loans, $500,000 for FIs.
Issues with current approach

• Ok for larger organizations, larger clients. Though it does pass a ‘public’ responsibility on to the banking sector.

• Smaller clients, bigger problems, more expensive to resolve, smaller institutions – end result is probably just the exclusion of particular client groups or communities. Asking the financial institution to sort out competing public goals – income generation vs environmental

• Cumulative effect of very large number of very small interventions can be important – should not be excluded
We believe that IFAD is in a class of its’ own – singular focus on very poor clients, in very rural areas, who are dependent on ‘environmental income,’ and who live on or use heavily degraded resources.

Suggests an EA approach that separates clients not on the basis of the size of their activities, but rather, on the degree of their dependence on ‘environmental income,’ and the necessity that those projects contain measures to enhance the productivity of the resource, in part, as a means to increase incomes, and ensure repayment of loans made through the financial component.

RF projects to non-dependent families would not need EA screening.