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CENTRAL BANK OF THE FUTURE

Central Banks, Climate Change, and Financial Inclusion (Summary of Private Roundtable Discussion)

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Abstract

On March 31, 2021, the University of Michigan Center on Finance, Law & Policy convened a roundtable of central bankers, policy experts, and researchers to examine the intersection of climate change and financial inclusion. Participants included a small group of central bankers, policymakers, and researchers from seven countries who have expertise in these issues. The Roundtable attendees participated in the conversation under Chatham House Rule. Therefore, the ideas presented in this paper are not attributed or attributable to any one participant. These ideas are also not necessarily reflective of the opinion of the participants or authors and are certainly not an exhaustive exploration of the topics at hand. The authors have synthesized and reordered the discussion to effectively convey the thoughts and ideas presented at the Roundtable.

The Disparate Impacts of Climate Change

As a central banker from an island country observed, this was not a theoretical discussion; their country is already dealing with the impacts of climate change, and every governmental institution must contribute to solutions.

The roundtable aimed to answer four questions about central banks' ability to meet the needs of their countries' low and middle income populations:

1. How well do current approaches and reforms to payment systems improve the circumstances of the un- and under-banked during an acute climate crisis?
2. How can central banks make resiliency to the chronic effects of climate change possible through efforts to broaden credit access and thereby enhance financial inclusion?
3. What have central banks learned from financial inclusion issues in the wake of the COVID crisis that can be applied to the climate crisis?
4. Should central banks look to expand their mandate to deal with the effects of climate change to better serve the poor? If so, how? If not, why not?

Participants defined household-level climate resilience as the ability to anticipate, prepare for, and respond to hazardous events.

Key Takeaways

Payment Systems in Climate Crisis

- During a shock, savings and remittances play a large role in the stability of low-income consumers, so a resilient payments system is critical.
- Mobile money has previously run into access problems during crises and may not provide resilient access during a climate emergency. Therefore redundant physical and digital payments systems are often required to withstand a climate crisis.
- The informal sector remains a significant part of the economy in many countries, and by definition, the central bank may have less ability to measure the impacts of climate change, much less provide solutions for those sectors.
- Creativity and public-private partnerships may be required to respond in a crisis, such as when a mobile money provider helped distribute disaster-relief funds earmarked for a

rebuilding program and restricted the funds to usage in hardware stores at the direction of the government.
- A non-governmental CBDC system may be too opaque to evaluate whether it is climate-resilient.

Resiliency through Credit Access

- Agricultural smallholders will be disrupted by climate change, but green financial products which could address such disruption face challenges. On the demand side, smallholders experience income volatility that makes planning for credit repayment difficult. On the supply side, information asymmetries, such as the aforementioned income volatility, uncertainty regarding the impact of climate change, and limited consumer data, make it difficult for lenders to profitably provide financial products.
- Access to capital itself may not be the main constraint to resiliency. Consumers with access to capital still struggle with decision-making, which will only worsen under uncertainty about the effects of climate change. Without personal or community experience, consumers do not know how to assess the effectiveness, necessity, or opportunity cost of financial products.
- Migration will dislocate people from established community relationships, which means that digital infrastructure (e.g. identification, creditworthiness) will be necessary to ensure credit access in a new location.

Lessons from COVID-19

- There are limits to how much shock a household can prepare for, so governments will have to be prepared to provide a shock response. The financial system must be resilient enough to support this, so central banks should identify transmission mechanisms beforehand and invest in necessary infrastructure, innovation, and adoption efforts.
- Low penetration of infrastructure, such as digital ID, exacerbates problems during crises.
- The COVID-19 response has encouraged central banks to change their mental models of the population (e.g. Jay Powell's disaggregation of unemployment by race).
- We have seen widespread attempts to scam citizens out of COVID-19 stimulus money, so any climate change response needs to consider appropriate consumer protections.

Necessity of Mandate Expansion

- Without expanding their mandate, central banks are in fact able to directly address inequities in savings and payments infrastructure.
- Even if an issue is decided to be outside of a central bank's mandate, central banks have significant convening power and, frequently, the largest budget and technical capacity to do the necessary work.
- A mandate to address climate change may run afoul of existing mandates. For example, reducing access to finance for dirty industries may run counter to mandates to expand credit access. Central banks need to be aware of such tensions and work proactively to try to address them.

- Central banks play different roles in emerging and developed markets, so there may not be a one-size-fits-all approach.
- Under the threat of climate change, inaction by the central bank is not a neutral choice.

New Questions Raised

- Climate risk is relatively new, and even households with access to capital may not know how to best allocate their scarce resources to become climate change resilient. What role can new financial or digital tools play in overcoming this information asymmetry?
- Central banks are grappling with the digitization of finance, from fintech platforms to rapid settlement systems to digital currency. Viewed through the lens of climate resiliency, which digital technologies are most important for central banks to improve in the next decade? What do the requirements for a climate-resilient digital transformation look like? What kind of digital payments system is best prepared to provide payment services?
- How should international payment systems evolve to support efficient, inexpensive transmission of remittances?
- What should central bank catastrophe planning look like, and who are a central bank's partners in this effort?
- What data should central banks collect to ensure a strong feedback loop regarding progress on climate change and financial inclusion?
- Whose profiles/personas should central banks use in their mental models to analyze the effect of climate change policies?
- What will the effect of likely government programs be on the financial system? (e.g. What are the financial stability implications of debt moratoriums for agriculture?)

Conclusion

While each country is different, participants agreed that there is much that central banks around the world can do to address both the acute and long-term impacts of climate change and the disparate impact on the poor.