Financing Adaptation to Climate Change

Key Findings

- **Without a deal on adaptation, including finance, it is unlikely that a post-2012 framework can be agreed in Copenhagen.**
- **Successful adaptation in developing countries depends on broader development progress. Policies addressing sustainable livelihoods and alleviating poverty can also reduce risks and enhance the adaptive capacity of vulnerable sectors and groups.**
- **Bringing adaptation activities and policies into the development mainstream results in effective and sustainable investments. In many developing countries, Official Development Assistance (ODA) can also support adaptation.**
- **The direct representation of developing countries on the Adaptation Fund Board and the fact that applicant countries can choose their own implementing entities are strong improvements on the existing funds managed by the Global Environment Facility (GEF).**
- **Private or public/private initiatives on adaptation, particularly with the insurance sector, are worth exploring. Further dialogues with the private sector, in particular the finance sector, are needed to pursue these options.**

Introduction

In December 2007, the Bali Action Plan launched a comprehensive process to enable the full, effective and sustained implementation of the United Nations Framework Convention on Climate Change (UNFCCC). The aim is to agree on long-term cooperative action to reach an agreed outcome at COP 15 in Copenhagen in December 2009. The Bali Action Plan attaches equal weight to mitigation and adaptation, and identifies technology and finance as the key mechanisms to enable developing countries to respond to climate change.

The past decade has seen a surge in research and policy analysis on how technology and finance can support mitigation. Similar studies for adaptation are much more recent, and their results less mature. This is a potential problem in the negotiations towards an agreement in Copenhagen.

What are financial needs for adaptation?

Adaptation to climate change will mean additional costs for the public and private sectors. However, assessing the costs and, especially, the benefits of adaptation is more complicated than for mitigation. The performance of adaptation options cannot be measured in a single indicator (e.g. CO_2 or US dollars), making it difficult for decision-makers to compare alternative adaptation options and to consider trade-offs.

Various organisations have published aggregate estimates of the financial needs for adaptation. Although these estimates vary widely (see Table 1), and there is disagreement on the assumptions and methods employed, they all reveal a serious funding shortfall for adaptation in developing countries.

Current sources of adaptation finance

Article 4.4 of the UNFCCC commits developed countries to assist developing country Parties particularly vulnerable to the effects of climate change to meet the costs of adaptation. This assistance is understood to come in the form of new and additional funding (i.e. beyond what developed countries provide as ODA).

Three funds were established by the COP to support adaptation activities in developing countries: the Least Developed Countries Fund and the Special Climate Change Fund under the UNFCCC, and the Adaptation Fund under the Kyoto Protocol. The two funds under the UNFCCC are operational and managed by the Global Environment Facility (GEF). The Adaptation Fund is not yet operational, though draft operational guidelines and policies are in preparation. The Adaptation Fund is the first financial instrument under the UNFCCC and its Kyoto Protocol that is not based solely on voluntary contributions from donor countries.

Table 1: Estimates of financial needs for adaptation in developing countries

UNFCCC Secretariat	World Bank	Oxfam International	UNDP
USD28–67 billion per year by 2030	USD9–41 billion per year	More than USD50 billion per year	USD 86-109 billion per year by 2015

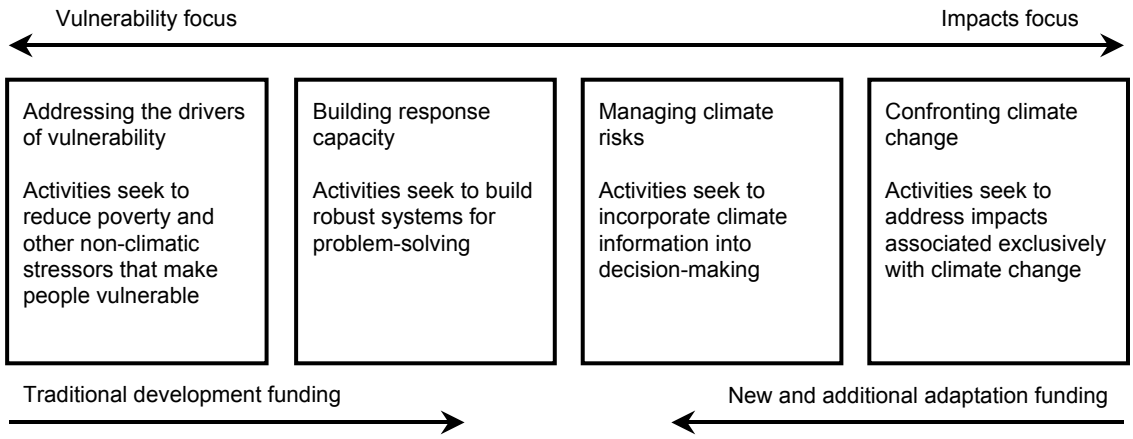

Figure 1: Adaptation as a continuum from addressing the drivers of vulnerability to confronting the impacts of climate change

Source: Adapted from McGray *et al.* (2007)

In many developing countries ODA can also support adaptation. It is possible to create synergies between ODA and adaptation investments, for example, by integrating climate risk into development planning, a process called "mainstreaming".

Adaptation, development, or both?

Empirical studies of climate adaptation have shown that the success of adaptation in developing countries depends on broader development progress. Vulnerability to climate change does not emerge in isolation. Consequently, adaptation that is limited specifically to climate change (i.e. stand-alone adaptation) is often inadequate. A recent study (McGray *et al.*, 2007) on initiatives in developing countries labelled as "adaptation" found that in practice there is little difference between adaptation initiatives and initiatives that can be considered good development. The study presents adaptation as a continuum, ranging from more narrowly defined activities aimed specifically at addressing impacts of climate change, to building response capacity and addressing the drivers of vulnerability (Figure 1).

Mainstreaming – opportunities and issues

"Mainstreaming" refers to the integration of climate risks into development planning, and is something that many developing countries already do. Mainstreaming reduces the sensitivity of development activities to both today's and tomorrow's climate, thus ensuring the effectiveness and sustainability of investments. For instance, policies that support sustainable livelihoods and alleviate poverty can also reduce risks and enhance the adaptive capacity of vulnerable sectors and groups. From an operational perspective, mainstreaming makes common sense. However, from a policy perspective mainstreaming is difficult in practice. Developing countries are concerned that efforts to promote mainstreaming are a ploy of the developed countries to avoid providing new and additional adaptation funding by absorbing it into ODA budgets of a fixed or decreasing size. Developing countries have expressed their preference for stand-alone adaptation measures, as opposed to mainstreaming, as these allow for the measurable, reportable and verifiable use of new and additional funding. Table 2 summarizes the advantages and disadvantages of mainstreamed adaptation and stand-alone adaptation in a funding context.

Key questions

Given that a solid infrastructure for adaptation funding is a pre-requisite for a post-2012 climate agreement, developed and developing countries must come to a mutual understanding of the following questions:

- Should adaptation be designed as stand-alone activities or should it be mainstreamed into development projects and programmes?
- Should the provision of support for adaptation follow the polluter-pays principle or is it an additional focus of ODA?

Ideally, these should not be either/or questions – answers should depend on the type of adaptation being considered and on what it is trying to achieve (see Figure 1). However, because there is no agreement on the second question, the first is politically charged, which leaves little room for such nuance in the current UNFCCC negotiations on adaptation funding.

Table 2: Pros and cons of stand-alone adaptation and mainstreamed adaptation in the context of adaptation funding, as perceived and expressed during UNFCCC negotiations

	Stand-alone adaptation	Mainstreamed adaptation
Pro	Easy to calculate new and additional funding needs Greater country ownership	More efficient in implementation More effective, more sustainable impacts
Con	High administrative costs when scaled up Synergies with development may be missed	Difficult funding situation, possibly diverting ODA Seen as imposing conditionalities

Source: Klein (2008)

Photo: David Gil

Future adaptation financing: modalities and concerns

Whether used to support stand-alone or mainstreamed activities, existing and expected resources fall short of the estimated costs of adaptation by roughly two orders of magnitude. A number of developed countries and development banks are in the process of setting up separate ODA-based funds to support adaptation activities in developing countries. The new funds, all of which target both mitigation and adaptation, include the Environmental Transformation Fund of the United Kingdom, Japan's Cool Earth Partnership, the International Climate Protection Initiative of Germany, and the Climate Investment Funds created under the World Bank.

Despite promises of additional funding for adaptation, there is concern that these funds are donor-driven, that money may be made available as loans instead of grants, and that possible competition between these funds and those under the UNFCCC and the Kyoto Protocol may lead to a decoupling of adaptation and mitigation in the climate negotiations. Taking adaptation financing largely off the agenda of the negotiations could undermine the developing countries' position that support for adaptation is a moral imperative for the developed countries, which has to go hand in hand with emission reductions. Developing countries' might then be less willing to accept mitigation actions, which as a result could weaken the carbon market. The carbon market, created by the Kyoto Protocol, has the potential to move huge financial flows to developing countries for mitigation and adaptation. In theory the carbon market could make a future climate agreement self-financing: if emission targets were ambitious, the price of carbon would rise significantly, increasing financial flows to developing countries.

The Adaptation Fund is the first example of the use of market-based options to generate substantial financial resources to address climate change (as opposed to using ODA). However, instead of taxing carbon emissions (in line with the polluter-pays principle), it taxes carbon exchanges, which provides a disincentive for investment in developing countries. Nonetheless, many see the institutional set-up of the Adaptation Fund as superior to those of the separate funds. In particular, the direct representation of developing countries on the Adaptation Fund Board and the fact that applicant countries can choose their own implementing entities are seen as strong improvements on the existing GEF-managed funds.

Official national and multilateral strategies for adaptation in developing countries focus on public policies and investments, but there is also emerging interest in private or public/private partnership initiatives on adaptation. In particular, potential insurance-related options have been identified, including multi-state risk-pooling mechanisms, regional reinsurance facilities, catastrophe funds linked to international financial markets, national/regional disaster funds supported financially by the international community, micro-insurance, generation of carbon credits in exchange for support for insurance, and weather derivatives that provide payouts in response to weather triggers rather than in response to demonstrated losses. These options involve different kinds of burden-sharing between public bodies and private individuals, as well as between developing countries and developed countries. Further dialogues with the private sector, in particular the finance sector, would be needed to pursue these options.

This policy brief is a synthesis of three papers:

- the briefing note for the European Climate Platform *Financing Adaptation to Climate Change: Issues and Priorities,* by Richard J. T. Klein and Åsa Persson (2008);
- the annex on adaptation prepared for Tony Blair's report *Breaking the Climate Deadlock,* by Richard J.T. Klein (2008);
- the briefing note for the European Parliament *Mainstreaming climate adaptation into development policies and programmes: a European Perspective*, by Richard J. T. Klein (2008).

Recommendations

More than scale up
By all estimates, current levels of adaptation funding must be scaled up and allow for private sector integration. Yet increased funding for adaptation will be meaningless if other issues including sources of funding, delivery mechanisms, and the moral and legal framing of adaptation financing are not also addressed.

Equity and fairness in North-South cooperation
The trust deficit between Annex I and non-Annex I countries is perpetuated by Annex I countries' failure to meet both their Kyoto commitments and to fulfil the new and additional funding commitment. Trust building must be achieved through transparency and neutrality of processes and implementing institutions for adaptation finance.

To mainstream or not to mainstream
There is no "right" answer to the question of whether adaptation should be funded as a stand-alone activity, or whether it should be mainstreamed into development policy. Rather, the choice should be specific to circumstances and an outcome of a country-driven national planning process. National adaptation planning in developing countries needs to be supported under the UNFCCC, and developed countries must provide follow-up support to implement adaptation activities identified in these national plans.

Polluter pays versus ODA
Whether adaptation support should be provided as new and additional funding or whether it should be a new aspect of ODA is contingent on the nature of the activities concerned. ODA should be used to support activities that address the drivers of vulnerability and to build response capacity, while new and additional funding should support activities that manage climate risks and confront climate change.

Funding coordination to ensure fund complementarity
The relationship between the various emerging multilateral and bilateral funds for adaptation, in addition to the GEF Funds and the Adaptation Fund, must be thought through. New and additional resources could be channelled to the Adaptation Fund, while the donor-initiated funds could be fed by contributions that count as ODA. The COP should provide clarity on how traditional ODA, the Adaptation Fund and various other bilateral and multilateral funds for adaptation can complement one another.

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