HEINRICH BÖLL STIFTUNG
NORTH AMERICA
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Climate Finance Fundamentals

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Brief 3

Written by **Smita Nakhooda**, **Alice Caravani** and **Neil Bird**, Overseas Development Institute and **Liane Schalatek** Heinrich Böell Stiftung

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Adaptation Finance

Meeting the costs of adaptation to climate change in developing countries is a major challenge for the international community; the UNFCCC projects costs in the range of $28 – 67 billion per year for such countries by 2030. There has been a considerable increase in adaptation finance from dedicated climate financing instruments in 2011, up from 8% of total climate finance ($587 million) to 21% ($957 million). The Least Developed Countries Fund and the Special Climate Change Fund have disbursed the most finance for adaptation, but the Adaptation Fund, the Pilot Program on Climate Resilience of the Climate Investment Funds, and the EU Global Climate Change Alliance have substantially added to the volume of finance available. Only $2.9 billion of Fast Start Finance commitments under the Copenhagen Accord so far have been directed to adaptation, however. Furthermore, the distribution of adaptation finance to highly vulnerable countries and to the most vulnerable people and populations groups within recipient countries remains uneven. The scale of finance is not commensurate with estimated needs, and its effective use is further impeded by severe fragmentation across various initiatives.

Overview

We are already feeling the effects of climate change, with some regions of the world, notably Sub-Saharan Africa, worse affected than others (IPCC). Adaptation finance is necessary to fund new activities that are required in response to these impacts of climate change, such as flooding, coastal erosion, increased variability of precipitation and water availability. This funding is required on top of traditional development needs. Such finance may be sourced from the public or private sector and in different forms. Funding is needed to implement activities that vary in scale, location and technological adoption. Therefore, there is considerable complexity to adaptation finance, and careful analysis is needed to identify the appropriate financial instruments that meet the needs of recipient countries.

It is a significant challenge to direct finance to poor and vulnerable countries, which often have limited institutional capacity to frame responses to climate change. Furthermore, ensuring that adaptation finance benefits the poorest and most vulnerable people within countries that are to be severely affected by climate change is a serious challenge. Finding creative and efficient ways to engage poor and rural communities in the design of programs to respond to climate change will be essential.

The 2009 Copenhagen Accord stated that funding for adaptation would be prioritized for the most vulnerable developing countries, such as the least developed countries, small island developing states and Africa. At the 2010 UNFCC COP, Parties adopted the Cancun Adaptation Framework, which committed support to developing countries for adaptation action that builds on National Adaptation Programs of Action (NAPAs) by proposing that all developing countries, not only the least developed ones, establish medium-term National Adaptation Plans, consistent with the principles of the UNFCCC and with a focus on building institutional capacity to adapt to climate change and engage all relevant stakeholders.

Despite the need for urgent action, some recent studies suggest that only $2.9 billion of Fast Start Finance (FSF) pledges so far have been directed to adaptation activities, suggesting an urgent need to scale-up adaptation funding in 2012 (IIED 2010). However, the lack of data on how countries are spending pledged finance creates uncertainty about the accuracy of these estimates.

The Costs of Adaptation

Estimates of financial needs for adaptation vary substantially and unsurprisingly given the uncertainties involved. In 2010, the World Bank estimated that it would cost $70 - $100 billion each year (at 2005 prices) to adapt to climate change between now and 2050; these numbers were recently confirmed in a 2011 update to the study. The UNFCCC secretariat has estimated that additional investments and financial flows of $60-182 billion per year for adaptation are needed globally by 2030; of these, $28-67 billion per year is needed in developing countries. Some analysts suggest these estimates may in fact be too low because the scope of assessment of the impact of adaptation has been too narrow.

Different groups certainly have diverging interests in proposing cost estimates, and see different roles for public and private finance respectively. Many observers perceive World Bank analysis to represent the perspectives of donor shareholders which results in lower estimates overall, and a larger proposed role for the private sector. Developing country negotiators and some NGOs take a different view and present higher estimates, and advocate for a larger share to be funded publicly.

Development and Adaptation

There is a close relationship between adaptation and development. The impacts of climate change threaten the sustainability of many development programmes, such as health problems exacerbated by climate risks including the lack of drinking water or the spread of disease vectors.

In turn, sustainable development can reduce vulnerability to climate change, because vulnerability depends on factors linked to development. Adaptation activities are therefore closely linked to development activities and key to good development practice in a climate-challenged world, for example through the practise of "climate-proofing" investments. Adaptation can be regarded as a progression on a continuous scale closely linked to development activities. Likewise, many publicly funded development organizations classify significant portions of their existing development contributions as 'climate-relevant' aid.

Some countries have suggested that adaptation finance should be spent in accordance with the 2005 Aid Effectiveness Principles, particularly the principle of "national ownership". However, the use of an Aid Effectiveness framework is controversial for other stakeholders because they see adaptation financing not as "aid", but as a financing obligation under the polluter pays principle.

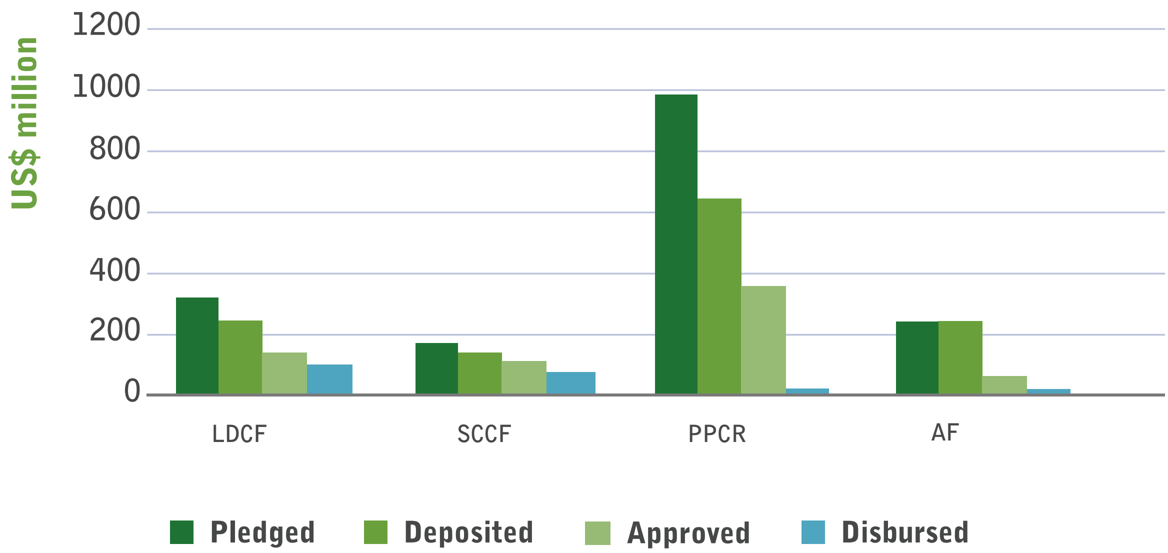
The complementarity of development and adaptation finance is a highly contentious issue at the international level because not all adaptation is development, and not all development reduces vulnerability to climate change. Climate change is the result of unsustainable development pathways. Those countries that are least developed (and most vulnerable) to climate change are also the least responsible, whilst the industrialised nations are responsible for the increasing vulnerability of the South. The responsibility of assisting the most vulnerable countries in coping with the impacts of climate change can therefore be seen as being additional to existing aid commitments. While contributor countries use different definitions of additionality, the most commonly used classifies it as climate finance over and above the '0.7%' ODA target.

Almost all dedicated international climate funding instruments are classified as ODA transfers at present. The two exceptions are the Kyoto Protocol Adaptation Fund, which is financed through a 2% levy on CDM proceeds, and part of the German International Climate Initiative, which is financed through the national auction of emissions allowance units.

Adaptation finance is increasing

Climate Funds Update data suggests that the amount of finance approved for adaptation through dedicated funds has doubled over the past year. In 2010, adaptation finance represented only 8% ($587 million) of total climate finance approved. In 2011, it represents 21% ($957 million). $95 million was disbursed for 31 projects in 2011 compared to $38 million for 17 projects in 2010. The sharp increase in climate finance relative to general trends over the past 8 years (as shown in Figure 1) suggests that the commitments made at Cancun may have had some impact. Nevertheless, the majority of climate finance is still directed towards mitigation. Furthermore, the distribution of climate finance remains highly uneven, and the poorest countries of Africa –who are highly vulnerable to climate change—appear to have received very little finance.

Chart: Adaptation funding going through dedicated multilateral climate funds



Adaptation Finance Instruments

There are five dedicated multilateral climate funds that support adaptation in developing countries. There has, however, been a lack of consolidation and coordination of funding streams at the international level, which in turn has established a lack of consolidation and an extra administrative burden at the national level in recipient countries. This can prevent countries from creating synergies between adaptation goals and other development priorities, as well as unnecessarily complicating access to funding, lengthening project cycles, and hindering the assessment of developed countries' compliance with their financial commitments.

The Least Developed Countries Fund (LDCF) primarily supports the preparation and the implementation of NAPAs. As of November 2011, it had disbursed $107 million. The Global Environment Facility (GEF), an operating entity of the UNFCCC's financial mechanism, administers the LDCF. All Least Developed Countries are eligible for support.

The National Adaptation Programmes of Action (NAPAs) focus on immediate and urgent needs of the Least Developed Countries to adapt to climate change. They are action-oriented and based on a number of short term projects between $10 and $40 million each and are intended to promote country ownership. To date, only about 20% of NAPA needs are being met from dedicated climate funds (Bird 2011). 46 countries have developed NAPAs, which have generally focused on agriculture, food security and water projects.

The Special Climate Change Fund (SCCF) was established in 2002 to support long-term adaptation measures that increase the resilience of national development sectors to the impacts of climate change. It is administered by the GEF on behalf of the UNFCCC COP. To date, the SCCF has disbursed $80 million for adaptation projects, many of which have focused on water and coastal zone management, and strengthening capacity to cope with drought.

The Strategic Priority on Adaptation (SPA), now completed, was a three-year pilot programme of the GEF that supported pilot and demonstration projects to show how adaptation planning and assessment can be practically translated into full-scale projects. $50 million was disbursed between 2004 and 2010.

The Adaptation Fund (AF) was established under the Kyoto Protocol and made operational in 2009. It is the only multilateral adaptation finance mechanism funded by an automated funding source and has introduced direct access to its resources. This means that recipient countries can directly access financial resources from the fund via a country-designated National Implementing Entity (NIE), which meets fiduciary standards of transparency and effectiveness. Benin, Senegal, and South Africa are among the first few countries to register NIEs. As of November 2011, the AF has disbursed $22 million for projects in 12 different countries, although almost half of this amount has supported fund administration costs. A further $48 million has been approved for projects in 3 other countries.

The Pilot Program for Climate Resilience (PPCR) is a programme under the World Bank administered Climate Investment Funds (CIFs). It was set up in 2008 to provide incentives for integrating climate resilience into national development planning, and MDB programming. $366 million has been approved for 12 pilot countries and regions, although no funding for program implementation had been disbursed as of

November 2011. It has sought to take a programmatic approach rather than financing individual projects. The fact that the PPCR offers loans to least developed countries for adaptation finance is also an issue of some controversy. While the PPCR is intended to be a pilot program whose operations conclude in 2012, its life is likely to be extended pending the operationalisation of the Green Climate Fund under the UNFCCC.

The Global Climate Change Alliance (GCCA) is a bilateral initiative of the EU that has disbursed a significant volume of finance for adaptation, including the largest adaptation project to date: a $13.5 million programme to mainstream climate change into Mozambique's policies and strategies. In 2011 alone, the GCCA disbursed $76 million for climate change projects with a strong adaptation focus, mainly in support of sector-level activities such as flood prevention, disaster risk reduction, water and agriculture. Much of its funding has been directed to East Asia and the Pacific.

New Funding Instruments

The question of which instruments are best suited to financing adaptation within developing countries is also a source of debate. The role of insurance has received significant attention, although the suitability of such an instrument for poor communities is a point of contention. Nevertheless, collective insurance mechanisms may be one route to help some rural communities respond to climate change. Microfinance could also be targeted to help poor people and communities adapt to climate change. The idea of a vulnerability index has been proposed by some analysts to help prioritise recipients of adaptation finance, while potentially serving as a tool for targeting climate change related insurance mechanisms.

Financing adaptation through loans has been a source of significant controversy for some developing country governments and civil society organizations. They stress that adaptation finance should not add to the debt burdens of poor countries – many of whom are already highly indebted countries – and have questioned the morality of extending loans for adaptation even on highly concessional terms. In times of fiscal austerity, however, some argue it may be easier to mobilize financing through such instruments and the case for loan finance in some sectors appears credible.

Getting to scale

Raising new sources of revenue may help increase the volume of finance available for adaptation. A number of new sources have been examined through the work of the high-level advisory group on climate finance (AGF) as well as work commissioned by the G20, although so far no decisions have been taken to implement any of the proposed measures which include the use of taxes or levies on financial transactions or bunker fuels and carbon market revenue.

Public funding for adaptation will in all likelihood continue to provide the core of investments in adaptation projects, particularly for those efforts benefitting the poorest and most disadvantaged populations groups, women and Indigenous Peoples, which rarely provide a financial return on investment. Nevertheless, there is an important role for private finance to help scale up the quantum of finance and so address the present shortfall in adaptation funding. So far, there is very limited private sector investment in many developing countries, particularly least developed countries.

Negotiations over the design of a global Green Climate Fund (GCF) under the UNFCCC have grappled with the question of how to mobilise finance at the necessary scale, as well as how to spend funds in the most equitable and effective ways both among and within recipient countries, while ensuring accountability and transparency. The GCF is supposed to channel "a significant share of new multilateral funding for adaptation" and is mandated by the COP to balance its allocation between mitigation and adaptation. It is intended to play an important role in scaling-up global funding for adaptation actions – provided the fund itself is funded adequately, predictably and sustainably.

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