

concrete adaptation projects clearly visible to the private sector, for example through support for micro-finance and risk management schemes.

From Copenhagen to Cancun

Negotiations in Copenhagen almost agreed on a text on adaptation, but a lack of coordination between parties meant it was not completed. If text can be finalised in Cancun this will help speed up the process of delivering on funding pledges, putting obligations of Parties on adaptation on par with existing obligations for emissions reductions.

There are increasing calls for the existing mechanisms for adaptation funding to be rationalised. One possible way forward would be for the Adaptation Fund to become the model for 'the adaptation window' of the proposed new Global Fund, in which existing adaptation finance instruments might be eventually subsumed. The design of a financial mechanism that works for adaptation together with a reiteration of substantial financial commitments specifically for adaptation will be critical for success in Cancun.

References and useful link

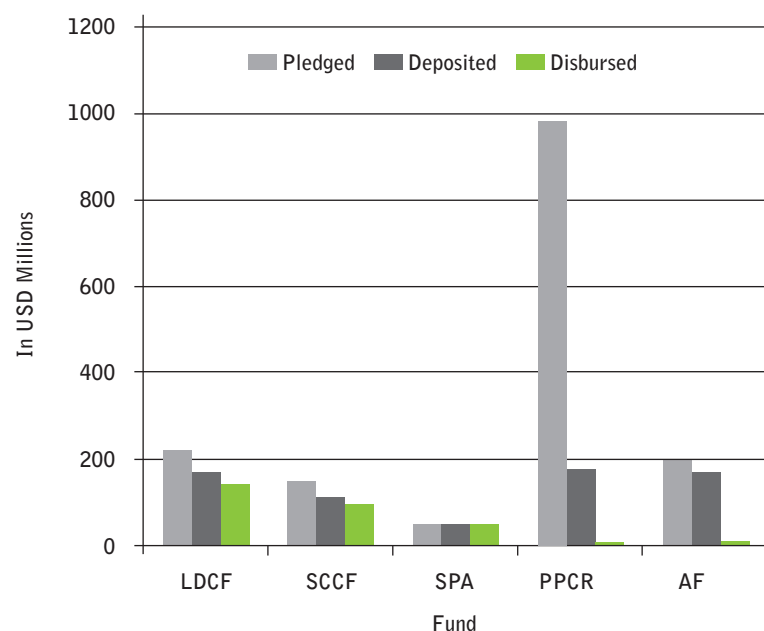
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Chart: Adaptation funding going through dedicated multilateral climate funds



Source: www.climatefundsupdate.org/; access on 11/02/2010.



Climate Finance Fundamentals

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BRIEF 3

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Adaptation Finance

The annual cost for developing countries to adapt to a changing climate has been estimated by the UNFCCC Secretariat at \$28-67 billion in 2030. Other estimates are even higher. This represents a new challenge for the international community to ensure adequate levels of funding. Among the limitations of existing funding initiatives two are prominent: the severe fragmentation across different initiatives and the limited scale of finance that has been delivered to date. One critical issue, as yet unresolved, is the relationship between adaptation finance and official development assistance (ODA) for developing countries. Today, most bilateral contributions to international adaptation funds are considered as contributing towards ODA. New sources of financing for adaptation will be necessary to add to what exists at present. The exploratory work of the high-level advisory group on climate change financing is helping to define these instruments, although there is little sign that anything new will come into being in the immediate future. A better definition of the roles of public and private sources of finance is also required. The Cancun COP represents an important opportunity to galvanise further action on adaptation and its financing.

Global Adaptation Finance

Adaptation finance is required to fund new activities that are required in response to the impacts of climate change, for example flooding or coastal erosion. These costs incur on top of existing development finance needs. Such finance may be sourced from the public or private sector and may be raised by different instruments in different forms (e.g. grants or loans). Funding is also necessary to implement activities that vary in scale, location and technological adoption. There is considerable complexity to adaptation finance.

Financial needs for adaptation – There have been several recently published estimates of financial needs for adaptation. A World Bank study in 2010 estimates that it will cost \$70 - \$100 billion each year (at 2005 prices) to adapt to climate change between now and 2050. The UNFCCC secretariat has estimated that additional investments and financial flows of \$60-182 billion for adaptation are needed globally in 2030: of these, \$28-67 billion are needed in developing countries. Parry and colleagues (2009) examined the UNFCCC's figures and suggested these have been underestimated for three reasons:

- (i) The cost associated with ecosystems, energy, manufacturing, retailing, and tourism have not been covered.
- (ii) The sectors that have been included have been only partially covered.
- (iii) The additional costs of adaptation have sometimes been calculated as 'climate mark-ups' against low levels of assumed investment.

Overall, there is divergence between the cost estimates of the World Bank on one side and those from the African Group, G77, and Oxfam on the other. Each has its own interests in supporting different estimates and with it a differing role for public versus private financing: the World Bank, representing its donor shareholders, tends to estimate lower values overall and a larger role for the private sector, whereas other groups, taking the viewpoint of potential recipients, tend to estimate higher values with a larger share of it coming from public sources.

■ **Its relationship with ODA** – There is a close relationship between adaptation and development. The impacts of climate change threaten the sustainability of many development programmes, for example health problems exacerbated by climate risks such as the lack of drinking water. The World Bank estimates that up to 40% of development financed by overseas assistance and concessional loans is sensitive to climate risk.

In turn, sustainable development can reduce vulnerability to climate change, because vulnerability depends on factors linked to development. Adaptation activities are therefore often regarded as synonymous with development activities and key to good development practice. Likewise, many development organizations classify significant portions of their existing development contributions as 'climate-relevant' aid. However, this is a highly contentious issue at the international level because not all adaptation is development, and not all development reduces vulnerability to climate change adaptation.

Climate change is the result of unsustainable development pathways. As shown in Brief 1 of this series, 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 is therefore *additional* to existing aid commitments. For the same reasons, public funding for climate change adaptation should normally be delivered in the form of grants, not loans. However, significant problems

emerge when trying to define additionality from public sources. Currently four different definitions are in use:

- (i) Climate finance classified as aid, but additional to (over and above) the '0.7%' ODA target;
- (ii) Increase on 2009 ODA levels (or another reference year) spent on climate actions;
- (iii) Rising ODA levels that include climate change finance, but where such finance is limited to a specified percentage;
- (iv) Increase in public climate finance not connected to ODA: a complete separation between ODA and climate finance.

Further effort is required to agree upon a common definition – if indeed this is possible. Currently almost all international climate funding instruments are classified as ODA transfers. 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 Instruments

The five main multilateral adaptation finance instruments that have disbursed funds to-date are:

■ **The Least Developed Countries Fund (LDCF)** primarily supports the preparation and the implementation of National Adaptation Programmes of Action (NAPAs), and has disbursed \$142 million since 2002. It is administered by the Global Environment Facility (GEF), an operating entity of the financial mechanism of the UNFCCC. All Least Developed Countries are eligible for support. Proposals submitted for funding under the LDCF are reviewed in light of agreed project criteria drawn from the UNFCCC COP guidance.

■ **The Special Climate Change Fund (SCCF)**, also set up in 2002 and administered by the GEF on behalf of the UNFCCC COP, has disbursed \$97 million to-date in support of long-term adaptation measures that increase the resilience of national development sectors to the impacts of climate change.

■ **The Strategic Priority on Adaptation (SPA)** 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. Projects were integrated into national policy and sustainable development planning on the basis of information provided in National Communications or other national studies, including NAPAs.

■ **The Pilot Program for Climate Resilience (PPCR)** is a programme under the World Bank administered Climate Investment Funds. It was set up in 2008 with the objective of providing incentives for integrating climate resilience into national development planning. \$9 million has been disbursed to a small set of 12 pilot countries and regions. Funding from this pilot programme is planned to cease after 2012. However, in the absence of a comprehensive new international climate agreement by this date, this 'sunset clause' might be extended.

■ **The Adaptation Fund (AF)**, was established under the Kyoto Protocol and made operational in 2009. Funding for project activity is expected to be disbursed to the first project in Senegal in November 2010. It is the only multilateral adaptation finance mechanism that allows developing countries direct access to its resources. All the others require an implementing agency such as UNDP or the World Bank to intervene.

■ **Shortcomings** – The high level of fragmentation among these and other funds represents one of the most urgent shortcomings of the international architecture. The lack of consolidation of funding streams at the international level is reflected in a weak consolidation at the national level in recipient countries. This prevents countries from creating synergies between adaptation goals and other development priorities; and hinders the assessment of developed countries' compliance with their financial commitments.

Another issue to consider is the scale of adaptation funding delivered to-date. Just looking at dedicated climate funds, mitigation activities

currently represent 82% of total climate finance, with adaptation representing only 8% (\$587 million). This is very much less than the estimated needs and runs counter to the balanced allocation between mitigation and adaptation called for in the Copenhagen Accord.

■ **New instruments?** – The future of adaptation funding depends, in part, on the possibility of creating new instruments in order to fill the existing financing gap. A number of new sources have recently been examined through the work of the high-level advisory group on climate finance (AGF), including:

- (i) Public carbon market revenues (including the international auctioning of emission allowances and auctioning of allowances in domestic emission trading schemes);
- (ii) Revenue from the taxation of international transport (both the aviation and maritime sectors);
- (iii) Financial transaction taxes.

The international community has yet to agree which instrument or, more likely, which combination of instruments will bring about the necessary level of adaptation finance.

Role of Public versus Private in Adaptation Finance

The public nature of the environment makes public funding sources for adaptation indispensable. Public funds provide the basis for encouraging the private sector, individuals and civil society to invest in adaptation projects. They also need to secure investment in necessary adaptation projects deemed 'unprofitable' by the private sector. Having said that, 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. A major limitation of private sector finance is that it is concentrated in a small number of high growth countries. In 2004, around 90% of private investment flows into Asia went to China (67%), India (14%) and Malaysia (9%). As LDCs are often considered high risk areas for investors, the UNFCCC has a role to play in finding new ways for adaptation projects to attract private investment. One strategy is to make