Financing Adaptation to Climate Change

Background note

This note is intended to provide background information in advance of a Ministerial breakfast meeting on the topic of *"Climate Change and Development: Progress on Finance for Adaptation"*) to be held in Delegates Dining Room 6 at UN Headquarters from 8 to 9.45am on 24 September 2008). As governments, private sector, and civil society gather in New York to discuss accelerating progress on the MDGs, this meeting will address the importance of adapting to climate change if we are to meet and sustain these development goals. The event provides a unique opportunity to engage ministers from developed and developing countries, the UN and other parts of the international development community on an agenda that is integral to the success, or failure, of future poverty reduction efforts.

The event will feature a discussion on the need, level, potential sources and effective delivery mechanisms for financing adaptation in developing countries. This discussion will also consider the critical role that Governments, international institutions such as the UN and the Multilateral Development Banks, and others have to play in assisting developing countries in providing scaled up resources to implement development plans that would address climate change effects.

1. What is the relation between climate change and development?

Climate change will exacerbate development challenges and make it harder to achieve and sustain MDG achievements and other development goals. Economic, social and environmental sensitivity to climatic conditions and poverty-driven low adaptive capacity compound poor peoples' exposure and amplify their existing challenges. Managing the inevitable impacts of climate change will therefore be critical in ensuring and sustaining development achievements.

Adaptation is an integral and indivisible part of sustainable development. Managing the impacts of a changing climate increases the need and urgency for *climate resilient* development that takes account of the new and additional risks created by climate change. Ensuring adequate, predictable, and additional financing is available and integrated within development budgets will be critical to implementing climate resilient development plans in developing countries, particularly in the least developed countries and other vulnerable countries. The developed countries have a critical role to play in assisting the developing countries that are particularly vulnerable to the adverse effects of climate change in meeting costs of adaptation.

2. How will developing country development planning and Official Development Assistance be affected?

Managing the risks of climate change implies a new approach to development. In addition to progress on overall development, which in turn helps to build general resilience, climate-sensitive policies, programmes and measures will need to take account of climate risks; climate-relevant activities that help build adaptive capacity will need to be scaled up (e.g. irrigation and social protection schemes); new climate-specific measures will need to be undertaken (e.g. managing the risks of glacier-melt flood risk); and contingency funding will be required to manage residual impacts of climate change.

Some of these measures can be undertaken at no or minimal additional cost, and deliver co-benefits beyond managing climate risks. Overall, however, the cost of implementing climate resilient development will typically be significantly greater than traditional development paths.

3. What will the cost be?

Estimates of the level of funding required to assist developing countries in managing the impacts of climate change vary widely. However, there is general agreement that the cost to the public and private sector could be in the range of tens of billions of dollars per year. The UN's latest Human Development Report (HDR) estimates that additional adaptation finance needs will amount to US$86 billion annually by 2015. Oxfam puts the price tag at US$50 billion per year, and the UNFCCC puts it at US$28-67 billion by 2030. In addition to the costs of adaptation there will also likely be costs incurred in managing the residual climate impacts, which will occur regardless of improved adaptation efforts. These costs (e.g. through reconstruction and humanitarian spend) are only factored into the HDR estimates.

More comprehensive and country-specific work is urgently needed to understand the additional costs of implementing climate resilient development at a national level (the current cost estimates are aggregated among all developing countries). The UK, the Netherlands and the Swiss are co-funding a research study with the World Bank to help address this gap and better understand the benefits and costs of adaptation in developing countries.[1]

4. Where will the money come from?

Four broad categories of funding mechanisms are being discussed that could generate additional resources to support adaptation in developing countries, particularly the LDCs and other poor and vulnerable countries, and other climate change financing needs (e.g. avoided deforestation and clean technology). Each approach will need to be assessed according to its ability to meet the criteria established in the Bali Action Plan: adequacy, predictability, sustainability and additionality.

- *Financial pledges* via general expenditure by national governments, without a specifically identified funding source. Pledges could be made unilaterally or be internationally coordinated, with each country raising revenues in their normal way.

[1] The study will be focusing on seven developing countries. This includes: Ghana, Mozambique, Ethiopia, Bangladesh, Vietnam, Bolivia and two SIDS yet to be determined.
http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/ENVIRONMENT/EXTCC/0,,contentMDK:21581098~pagePK:210058~piPK:210062~ theSitePK:407864,00.html

- *Auctions of emissions allowances* as cap-and-trade systems emerge, by either pre-announcing some of the revenue from permit (Assigned Amount Units, AAU) auctions as a funding source, or pre-assigning a portion of AAUs. Germany, for example, plans to raise €120m for adaptation financing from a portion of its carbon allowances auction revenues during the second phase of the European Trading Scheme. Other countries as well are discussing this possibility, in the light of a recommendation made by the EUCIE, to use twenty percent of the carbon market revenues for national and international climate policies, including adaptation in developing countries.

- *Levies on the carbon market* such as an extension of the levy on Clean Development Mechanism credits (currently funding the Adaptation Fund) to e.g. Joint Implementation. At this evolutionary stage of the Carbon Market, additional measures to secure adaptation financing from the carbon market must be managed in a way which does not undermine the regime or hamper international negotiations towards delivery of a Global Carbon Market. Mobilizing adaptation finance through levies has the advantage of also providing an incentive to reduce emissions.

- *Global carbon tax mechanisms*. The Swiss government has proposed a carbon tax levied by each country according to its economic capacity and its responsibility for climate change. Other proposals include taxes on air tickets and bunker fuels. Levies on petrol, electricity supply and emissions from industry have also been suggested

5. What are the adaptation finance delivery mechanisms?

Wherever finance originates from, the right institutional arrangements are required to support the purpose of reducing the impact of climate change by increasing climate resilience and to respond to the challenges posed by climate change financing. This implies the need for adaptation financing to be blended with development finance to support integrated, climate change resilient development plans. This will facilitate development pathways being altered for climate resilience and integration into national plans.

International funds must be disbursed through mechanisms that are effective, efficient and fair, ensuring that resources reach the countries and communities that need them most on an equitable basis.

Much has been learned from more than 30 years of official development assistance about how to deliver public finance effectively and efficiently to developing countries. Effective delivery requires strengthening and not undermining country ownership and leadership and good governance. Key principles around climate change financing could be based on those of the 'Paris Declaration for Aid Effectiveness' (ownership; alignment, harmonization, result orientation and mutual accountability).

There are several multilateral adaptation funding mechanisms already in place, from the Global Environment Facility and the two UNFCCC funds it manages, to the more recently established Adaptation Fund. However, the available resources are nowhere near the amount needed. Meeting adaptation funding would therefore require additional resources from other sources. The World Bank Climate Investment Funds and the EU Global Climate Change Alliance will also soon be operational, providing prototypes of governance arrangements based around the criteria described above. With such a multiplicity of funds targeted at adaptation bringing convergence (clarifying the additionality of adaptation, and avoiding duplication) to these mechanisms and drawing out key lessons will be critical to coherent, efficient and effective support for adaptation to climate change.

Specific funds for adaptation have advantages, such as predictability and transparency, and can be easily linked to future UNFCCC commitments. They could be designed to finance specific needs, such as technology transfer or the funding of incremental costs. But there are also significant disadvantages, including heavy (multilateral) bureaucracy and disincentives for mainstreaming adaptation or for the development of a more sustainable and coherent approach towards adaptation.

Identifying and understanding where and how these (and other) existing mechanisms need to be developed and/or new institutions established to deliver the services described above will be a priority for both the international climate change and development communities. A coherent approach is needed herein to facilitate the effective and efficient use of multilateral and bilateral aid, market based instruments and funding, and other non climate specific funding. It is therefore crucial that within the scope of the UNFCCC and at national level, finance ministers, development ministers, ministers of foreign affairs and environmental ministers get together to discuss a coherent approach towards financing adaptation.