Adaptation Finance
How to Get Out from between a Rock and a Hard Place

Nancy Birdsall and Michele de Nevers

Summary

Adaptation to climate change in developing countries is to a large extent about building resilience, including social and institutional responsiveness to change. In that sense it is about "development." However, adaptation finance is not development assistance. It is better thought of as a financial transfer based on the "causal responsibility" for the disproportionate costs to the poor of climate change associated with carbon emissions of the rich. Our proposals start from the premise that if adaptation transfers are to be effective and sustained, the habits, culture, and practices of traditional aid programs need to be set aside. The climate community can set the groundwork for an overall approach to adaptation transfers that benefits from hard lessons learned over several decades about what makes traditional aid more effective: channeling aid through recipient countries' own budgets and systems; making recipient governments primarily accountable to their own citizens for measured results (and not just to donors for tracking money); full transparency to both taxpayers in donor countries and citizens in recipient countries including timely publication of disbursements and systematic reporting of results; and multilateral funding whenever possible to reduce the high transactions costs and the lack of predictability associated with more politically driven bilateral programs.

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Contents

Preface in the form of a plea to our readers 1

Introduction 3

Principles and guidelines 5

Obligations of funders 5

Allocation across recipients: Entitlements 9

Access of recipient countries to their entitlement 10

Management of funds 11

Governance and Transparency 12

In conclusion 14

Annex I – Adaptation Costs and Financing 16

Annex II 17

References 18

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Preface in the form of a plea to our readers

This paper is about official transfers to finance adaptation to climate change in developing countries. Michele and I have struggled to explain the logic of the principles and recommendations we set out here to readers from at least four separate policy communities or, better said, subcultures. (We asked for comments on an earlier draft from about a dozen people representing different subcultures; the comments we received were alarmingly different, in some cases revealing our own failure to state clearly our arguments, but in other cases revealing an alarming abyss of misunderstanding across communities.) I believe we struggled not only because the jargon and the experience and expertise of people in these different communities differs, but because experience and expertise are associated with more basic differences in starting assumptions and in priorities where choices have to be made.

The separate communities or subcultures include:

- the climate community of environment officials and advocates, shaped by at least two decades of enlightened but tendentious and unsuccessful efforts to forge a global treaty;
- the development community of finance and development cooperation officials and advocates, shaped by at least two decades of enlightened but largely failed efforts to reform the aid system and improve the effectiveness of aid transfers;
- the UN-oriented community, including international and national NGOs and other "activists and advocates", focused on open and just processes and on protection of people and their social and environmental rights;
- the World Bank (and other multilateral banks) community, including private sector "pragmatists", focused on efficiency and effectiveness of transfer programs.

Each of these communities is further divided between those from the rich world of traditional donors, and those from the developing world of traditional recipients and within communities there are often important differences between officials and non-officials.

Of course many people participate in more than one of the four communities. It is in those overlaps of shared priorities that there is the potential to find common ground.

The rock in our title refers to the fundamental principles of justice and fairness in a world of sovereigns that ought to guide the amount and allocation of transfers of adaptation finance across countries; the hard place refers to the practical reality that the effectiveness of those transfers matters for taxpayers in contributing countries and beneficiaries in recipient countries – and that showing those transfers are effective will affect as time goes along their size.

We are not sure we have got the tradeoff between principles of fairness and justice and practical realities of effectiveness right or well stated in this paper. But we think the

conversation, negotiations and agreements that have been forged so far have been struggling with that tradeoff and that the different communities are committed to finding common ground. , We hope that by making the tradeoff explicit, we are advancing the conversation, and ask for your tolerance where we are off-base whether in tone or in fact.

Nancy Birdsall
President
Center for Global Development

Introduction

Adaptation to climate change in developing countries is to a large extent about building resilience, including social and institutional responsiveness to change. In that sense it is about "development". However, adaptation finance is not development assistance. Unlike development assistance, it is not a charitable transfer.[1] It is better thought of as a financial transfer based on the "causal responsibility" of richer to poorer countries for the disproportionate costs to the poor of climate change associated with emissions of the rich.[2]

Ideally the resulting obligations of the rich to the poor would be embedded in a treaty or treaty-like agreement, and would be treated as a needs-based entitlement or need-based allocation to recipients. But a legally binding, treaty-based obligation is not on the table. Adaptation finance is likely instead to take the form of annual voluntary transfers from funders to recipients.[3] In this note we propose an approach to such transfers that would distinguish them (indeed we hope would liberate them) from traditional ODA (overseas development assistance) with all its failings.[4] We discuss briefly the *obligations* of net funders and the *allocation* of any multilateral or pooled adaptation funds across net recipients. We then turn to the difficult issues of recipients' *access* to their allocations and to the management of adaptation funds provided by contributions. Finally we discuss issues of governance and transparency.

Our proposals start from the premise that if adaptation transfers are to be effective and sustained at the high levels needed and promised (at least implicitly) over the next several decades, the habits, culture and practices of traditional aid programs, which despite

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[1] Annex I.

[2] "There is therefore a double inequity in climate change: the rich countries have special responsibility for where the world is now, and thus for the consequences which flow from this difficult starting point, whereas poor countries will be particularly badly hit…. And, given the responsibility of the rich countries for the bulk of the current stock of GHGs, and the poverty and vulnerability of developing countries that would be hardest hit, the analysis suggests that rich countries should bear the major responsibility for providing the resources for adjustment…. it would place at least a moral, if not a legal, responsibility on those groups or nations whose past consumption has led to climate change." Stern 2007.

[3] While there is no legal agreement that adaptation funding is compensation or reparation for damages under the polluter pays principle, rich countries have acknowledged that poor countries vulnerable to the costs of climate change should receive financial support to grapple with the impacts. We use the term "funders" rather than donors, in part to distinguish the *obligation* (moral if not legal) to provide funding for adaptation from voluntary contributions to development assistance, which can be promised or withdrawn at will. In addition the word "donors" is closely associated with traditional Western official aid programs; yet many middle-income countries may become net funders of adaptation programs in poorer countries. China, Brazil, India and other large emerging markets are already making net transfers to other countries, as are many private and philanthropic entities.

[4] On failings see Birdsall, 2004; Birdsall and Savedoff, 2010; Barder and Birdsall, 2012 (forthcoming).

considerable good will and effort have not yielded easily to any serious reforms[5], need to be set aside. For adaptation transfers it is possible to imagine a fresh start, less burdened than is the official aid system by such problems as high transactions costs, considerable fragmentation (with well over 100 official bilateral and multilateral aid agencies), and major uncertainties about the timing and size of flows for recipient countries. The climate community can set the groundwork for an overall approach to adaptation transfers that benefits from hard lessons learned over several decades about what makes traditional aid more effective: channeling aid through recipient countries' own budgets and systems; making recipient governments primarily accountable to their own citizens for measured results (and not just to donors for tracking money); full transparency to both taxpayers in donor countries and citizens in recipient countries including timely publication of disbursements and systematic reporting of results; and multilateral funding whenever possible to reduce the high transactions costs and the lack of predictability associated with more politically driven bilateral programs.[6]

In fact these lessons from the aid system apply equally to mitigation financing, and we recognize that it is not always easy to distinguish between "adaptation" programs and "mitigation" programs; assistance to farmers to adapt to increasing risk of drought can reduce incentives to move into forested areas. However in this paper we treat adaptation financing separately because of the different underlying principles that should motivate the amounts and the allocation of those amounts across recipient countries. It is certainly the case that failure to build on these lessons will not only make adaptation finance itself less effective; it will also add to the tensions between the traditional donors and the developing countries that have helped forestall effective steps to deal with climate change mitigation.

In that spirit, our recommendations for departure from the usual donor practices are directed primarily to the traditional official donors of ODA as well as large philanthropic funders of adaptation in low-income countries such as the Gates Foundation – which could in fact lead the way in implementing a simpler, more effective approach. Because there is considerable overlap between adaptation programs and development programs (because development and growth enhance the ability to adapt), public and philanthropic development agencies are bound to be heavily engaged in their implementation. Our recommendations are also of course directed to the official environment negotiators who would do well to avoid the pitfalls and benefit from the experience of the traditional development community in the management of financial transfers.

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[5] "While many donors and partner country governments have made progress towards the targets that they set themselves for 2010, few of them have been met. Partner country authorities appear to have gone further in implementing their commitments under the Paris Declaration than donors…". Of thirteen measured targets to improve the effectiveness of aid for which the donors are responsible, just one has been met: the one regarding their coordination with each other. OECD-DAC, 2011

[6] On the higher overall quality of multilateral programs, see Birdsall and Kharas, 2010.

At the same time we recognize that the traditional donors, those who have in principle agreed to provide funding for adaptation, face a fundamental dilemma in raising, allocating and managing their transfers. They are between a rock and a hard place. On the one hand, in line with the Paris Declaration, for adaptation they presumably want to minimize the ineffectiveness and indignities of the current official aid system by emphasizing recipient country "ownership" of priorities and the use of recipient country systems for the management and implementation of any programs or projects. On the other hand, they cannot and will not raise billions of dollars from their own taxpayers for transfers to other countries without constant assurance that the resources provided are being utilized reasonably well. Among the many difficulties of doing so are the reality of weak capacity, corruption and other symptoms of poor governance in many of the low-income developing countries where adaptation finance is most needed.

Our proposed rules (or guidelines) for access by recipient countries to adaptation funds and for management of those funds within countries take into account that dilemma.

We hope our ideas provide guidance for whatever approach is taken to adaptation funding and management in the Green Climate Fund[7] and in other funding programs created by multilateral, bilateral and private funders of adaptation over the next decades.

Principles and guidelines

What are the principles and rules that should guide the obligations of funders (and who are "funders")? What are need-based "entitlements" and how should they be allocated across recipients (including why "entitlements")? And how will access to and delivery of funds, and the management of funded programs work within countries?

Obligations of funders

In Cancun developed countries confirmed their agreement to provide resources approaching $30 billion in fast-start finance (FSF) for the period 2010-2012, with a "balanced allocation between adaptation and mitigation," and committed to a goal of mobilizing $100 billion per year by 2020 for developing countries. [8] The commitment refers to both public and private funding and includes both mitigation and adaptation. Thus there is no specific amount

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[7] At the UN Climate Change Conference in Durban, South Africa in December 2011, governments agreed to a Green Climate Fund with thematic windows, including one for adaptation, and established an Adaptation Committee of the UNFCCC to be made up of 16 persons to serve in their individual capacity. UNFCCC, 2011(Michele: See the change in the bibliography – it's a good guess on my part that's all.

[8] The relevant language is: "scaled-up, new and additional, predictable and adequate funding…to developing country Parties." (While the term "new and additional" has not been defined in the convention, it is generally understood to mean that climate finance should not be diverted from development assistance.)

committed, even in principle, for adaptation. Though there might be some private investment in infrastructure in some developing countries that would be for adaptation, for the most part funding for adaptation will need to rely heavily on public sources, and much of it will need to be grant-based.[9]

We do not in this paper deal with the amounts of countries' adaptation funding obligations; we do not promote a structured burden-sharing formula such as with IDA. Nor do we deal with sources of financing beyond tax-based contributions from contributing countries. (One of the main challenges of adaptation funding is convincing taxpayers and legislators to pay at all. A number of promising proposals have been put forth for how to mobilize global funding for climate finance that would rely less on domestic tax systems, including in the report of the Secretary General's Advisory Group on Climate Change Financing (AGF), the LDC Group's International Air Traffic Adaptation Levy, recent reports to the G-20 by the IMF and World Bank, a report to the G-20 from Bill Gates and others.[10] But these have not been adopted yet, although several EU countries are seriously considering a financial transaction tax.)

We are instead concerned that the transfers -- $100 billion a year or more or less in 2020 and after – are thought of not as charity but as an obligation grounded in the concept of "causal responsibility". To the extent that principle can be embedded in the "system" that emerges, it will affect for any given envelope which countries face the obligation and how the resulting transfers should be allocated. Regarding obligations, any and all countries over a certain income level and some combination of past and current per capita emissions (including eventually countries that are not now "developed" but whose per capita income and emissions reach some agreed threshold) should be obligated to provide adaptation

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[9] Whereas it may be possible to mobilize significant private financing for mitigation investments in developing countries, for adaptation this will be more challenging. Most investment in mitigation will take place in relatively creditworthy middle-income countries, which will be the largest sources of future GHG emissions, and in large infrastructure sectors such as energy. These countries and sectors are more are attractive to private investors and in many cases investments will generate revenues and be profitable. While some adaptation investments, such as urban infrastructure, may also attract private finance, many adaptation investments will be concentrated in countries and sectors with poor prospects for attracting private investment. In part this is due to the fact that the most vulnerable countries are lower income countries in Africa and Asia and, as noted in a recent report by Transparency International, 2011, many also have a poor track record in the area of good governance. Sectors that will be hard hit by climate change, such as water and agriculture, have not traditionally attracted private investment. Thus public sources of funding will be particularly important for adaptation, at a time when developed country budgets are already stretched due to the financial crisis and, in the case of Japan, the 2011 tsunami and resulting problems in the nuclear industry.

Our reference above to mostly grant-financed takes into account the possibility of highly concessional loans for some developing countries to finance adaptation programs.

[10] See United Nations, 2010. See also The Guardian, 2011, and Oxfam, 2011, reporting that the World Bank and Gates support proposals to fund adaptation costs among other ways with new taxes on shipping and aviation fuels.

funding.[11] Each country's specific obligation should be determined by a formula that takes into account historical emissions of greenhouse gases (starting from some agreed date); [12] current and near-term projected emissions of greenhouse gases; and ability to pay (income per capita). The obligation should probably be related to some combination of diminishing weight given to historical stock and increasing weight to current flow. Annex II outlines one proposal for how the criteria could be determined and how a funder country's obligation could be assessed.

Adaptation Finance Endowment Fund

It could be possible to create an endowment fund, much like a pension fund, to fund adaptation. The source of funding could be from anywhere – public budgets, foundations, personal charity. Funding countries could choose to place resources in the endowment as an alternative to bilateral or multilateral project based funds like the Green Climate Fund – or the Green Climate Fund could itself sponsor an endowment-like fund. Each recipient country would have an account, like a pension beneficiary, and could draw on the account once it meets certain criteria (see below on access by recipient countries). This would allow for funds to be invested and grow during periods when recipient countries were unable to access their funds (because they didn't meet the criteria). It could fund disaster relief as well as up-front adaptation. A Trustee could approve withdrawals against the criteria outlined below.

Our approach relies on the assumption that at least some publicly financed adaptation funding will be managed through a collective funding pool (such as the proposed Global Adaptation Window of the Green Climate Fund – and the box on the idea of an endowment-like fund). That would be desirable to cover at least some portion of if not all adaptation transfers, as pooling minimizes the high transactions costs associated with the traditional fragmented aid system and could ensure all eligible recipient countries have minimal and minimally predictable coverage. A collective funding pool could rely on some combination of (annual) public budgetary support from net contributors and some portion of any funds collected under a mechanism such as a currency transaction fee air passenger

[11] Determining the formula for the obligation could be complicated and politically delicate but needs to be undertaken as a matter of priority. Just the definition of historic responsibility is contentious. See, for example, Rock Ethics Institute 2009

[12] The year 1990 is frequently proposed as the starting date for assessing historical GHG emissions as it is the benchmark year for reducing emissions of GHGs under the Kyoto Protocol. Other possible starting dates could be 1992 when, at the United Nations "Earth Summit" in Rio de Janeiro, the UN Framework Convention on Climate Change (UNFCCC) was produced, or 1994 when the treaty entered into force. The Kyoto Protocol, an update to the UNFCCC treaty, was adopted in 1997.

fee that is outside government budgetary processes. Collective public revenue (but not any private or philanthropic support through or independent of pooled financing) would presumably reduce proportionately the formal obligations of net contributing countries.

Bilateral funders could meet their funding obligation through any combination of contributing to a pooled fund for adaptation like the Green Climate Fund, or an endowment fund, or to the multilateral banks for their adaptation programs, or managing their own bilateral programs.

Separate from adaptation funding, many donor countries have already made voluntary commitments to provide funding for development assistance (e.g., the target of 0.7 percent of GDP in ODA financing or funding to achieve the MDGs). With this dual commitment, we see the question of how the funds are labeled (climate vs. ODA) as straightforward. [13] Funding countries label the transfers they commit as applying either to their traditional ODA programs or as applying to their obligation to finance adaptation. We hope that all obligated countries would contribute at least some funding to a pooled adaptation fund; that funding would presumably be labeled "climate" and not ODA. For other funding, regardless of purpose or channel, essentially it is practical to leave the labeling to the funder to decide. The emphasis should be on funders' responsibility to eschew double-counting particular transfers in both categories. Full and transparent reporting of their funding by category should be the norm, making it possible for third parties to monitor fulfillment of both their commitments to ODA and their obligations to adaptation funding.

Of course it will not be easy for countries that are likely to have funding obligations to agree among themselves on a particular formula for setting those obligations. However we believe it is worthwhile as a start that countries agree on the principle that there is such an obligation. In the absence of any enforcement mechanism this would at least make it possible for citizens and civil society advocates to measure countries' actual funding against one or another formula over time.

[13] Climate change will impose additional costs to development (and may require entirely new development strategies). Developing countries feel strongly that adaptation funding needs to be additional to development finance so that they don't have to absorb the cost of dealing with climate impacts at the expense of, say, education or health. Currently most adaptation funding is reported by donors as ODA and contributes to their ODA targets. If donor countries count this also as adaptation funding, developing countries are right to see this as double counting.

Allocation across recipients: Entitlements

All countries below a certain income threshold and with demonstrated negative climate impacts would have an *entitlement* [14] to adaptation funding. (Some eligible countries may opt to forgo receiving adaptation finance; China has already done so.) A country's entitlement could be defined as a rolling multi-year (say, three-year) average. As with the obligation formula, the entitlements should be based on a formula which would generate changing allocations across countries over time. The allocation formula should reflect physical vulnerability and, as an indicator of lesser resilience, lower per capita income. Wheeler, 2011, proposes an allocation formula that takes into account physical vulnerability, "resilience" (income and governance) and implementation capability; given our approach to access and management set out below, we would not incorporate governance nor implementation capability into the allocation formula itself, but would only include physical vulnerability and income. Governance and implementation capability instead should affect the choice of implementation modality, as we discuss below.

As with obligations of one set of countries, it will not be easy to reach agreement on a formula for allocation, and for many practical reasons, including the ability to implement adaptation programs, transfers in any one period are unlikely to end up strictly in line with any formula. However we believe it is useful for countries to agree in principle on the principle of a formula, and for citizens and civil society groups to periodically assess allocation of funds labeled adaptation against that ideal.

Indeed ideally an allocation formula would be incorporated into a treaty as the counterpart to the obligations of countries making net transfers. But as we noted above, potential funders are unlikely to bind themselves to a treaty dictating their funding obligations; similarly potential recipients are unlikely to agree to a formula for allocation among themselves of what will never be "enough" funds. (Consider for example the question of weighting the costs of coping with sea level rise compared to the costs of coping with displacement of people or with a change in agricultural vulnerability to pests.) But as a first step the principle of a reasonable formula for allocation, like the principle of obligations, and based on likely vulnerability and ability to cope (resilience), could be endorsed by all countries.

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[14] We recognize the sensitivity of the word "entitlement" but think it is an important principle.

Access of recipient countries to their entitlement

With the issues of access and management or implementation of funded programs we move from principles to practical rules. Perhaps the only principle worth honoring on these issues is simplicity.

Actual access to adaptation funding would take one of two forms depending on a country's fiduciary capacity. In the case of countries with adequate capacity, access to their allocation would be virtually automatic upon their submission of a brief three-year adaptation plan (with annual updates to what would be rolling three-year plans).[15] They could use their allocation for the kinds of investments in infrastructure and agriculture associated with the need to adapt to changes and increase resilience, or as in the case of budget support in traditional aid programs, simply use their allocation to help finance their own climate-resilient development or growth plan. Countries that had a Poverty Reduction Strategy Plan could simply propose to accelerate their proposed investments as specified in that plan. The logic of financing accelerated "development" and growth is well recognized in recent work on resilience; for example there is evidence from responses to natural disasters that the best single investment in resilience for people and for an economy may be girls' education[16] Countries would also have the option of proposing use of their adaptation entitlement to leverage in one way or another private domestic or international financing of their adaptation programs.

Countries without adequate fiduciary capacity would trigger access to their allocation by submitting not only a three-year adaptation plan but also a proposal for outsourcing the management and implementation of their plan to a pre-approved third party. (They could also propose to support primarily their traditional adaptation-enhanced development programs.) The third party could be an NGO, a consulting firm such as PWC (Price Waterhouse Cooper) or McKinsey, the World Bank or other multilateral development bank, a bilateral donor, a local or external policy research institute, etc. – the country would choose among approved entities.[17]

Two issues arise. First, who approves the annual submissions? Second, who decides whether a country meets some minimum standard of adequate fiduciary capacity? On the first, one option is for the Adaptation Committee of the UNFCCC (set up in Cancun and further

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[15] The Cancun Agreements stipulate that the use of adaptation funds would be based on National Adaptation Plans (NAPs) which are to be broader and programmatic than the largely project-based NAPs. The National Adaptation Plan foreseen at Cancun would be acceptable but need not be the only acceptable form of plan.

[16] See Wheeler et al., 2010 and Wheeler and Hammer, 2010

[17] One basis for approval of third-party entities would ideally be their ability and willingness to assist countries in improving their own systems.

developed at Durban in December 2011[18]) to be responsible for approving the annual submissions. The committee is made up of individuals serving in their personal capacity, with the majority to come from what are likely to be recipient countries of adaptation transfers. In Durban it was asked to provide guidance to governments in preparing their national adaptation plans and to compile a roster of experts on adaptation issues; the review of adaptation plans could be assigned to these experts.

On the second, the issue is more politically sensitive. The reality is that for all practical purposes, it will be the net contributors who will want to control at least indirectly that judgment; if they do not they will be far less likely to contribute to the collective pool (as opposed to meeting their funding obligations through bilateral programs or not meeting their obligations at all), as they will have no mechanism for assuring their own taxpayers about the appropriate use of their "contributions". (In this realm of realpolitik, the distinction between an obligation and a contribution is not useful.) The net country contributors would presumably make or assign to a third party[19] an annual judgment about the fiduciary capability of net recipients; the net contributors could as groups change the "judge" from time to time by consensus. [20]

Management of funds

All net recipient countries could outsource implementation of their funded adaptation programs; countries without adequate fiduciary capacity would have to do so. As is the case with the United Nations Adaptation Fund, eligible implementing agencies would themselves need to be certified with respect to fiduciary capability. Funds would be transferred in annual tranches. A country's annual entitlement if not transferred in any particular year (for lack of a

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[18] The Adaptation Committee reports to the COP (the Conference of the Parties, i.e. the governments participating in the UN process).

[19] For example the World Bank or one of some grouping of the regional multilateral banks. Or the board of the collective pool could rely on third-party data on corruption and financial management such as that published at the University of Maryland (policy measures) or by Daniel Kauffman (now at Brookings Institution), as does the United States Millennium Challenge Corporation in its annual assessment of country eligibility.

[20] Funders will need to decide on an accreditation standard, process and agency. We recognize that in practice this will not be easy and that capacity varies across sectors and agencies within any country as well as across countries. Much work has been done in this area and it is not easy. The need for accreditation highlights the urgency of moving forward on the Paris Declaration Country Systems agenda. We also recognize that the momentum in climate funding is for project based support that increasingly incorporates all the bells and whistles of development finance. For instance the Adaptation Fund is now moving to add environmental and social safeguards to its accreditation process for implementing entities and the discussion of the GCF design in Durban incorporates environmental and social safeguards. We resist the temptation to transplant these aspects of the aid architecture, which do involve tradeoffs between country ownership and donor readiness to sustain transfers, onto climate finance.

plan or fiduciary certification), would be retained for a maximum of three years and would then return to the pool.

For countries that meet the fiduciary management standard, the adaptation plan could include direct cash transfers to their citizens.[21] In the case of countries failing to meet that standard, one could also imagine, for example in case of a drought or other natural disaster, that net contributors might agree to direct cash transfers to citizens of those recipient countries.[22]

Governance and Transparency

The governance of the process we have proposed need not be complicated. We set out a few ideas here; we recognize that our proposals do not cover all issues, technical and political.

To implement in some form the set of principles outlined above will require a disinterested group prepared to utilize its own expertise and to outsource or delegate certain functions. Many of those functions are related broadly to governance of the global adaptation "system" (beyond direct utilization of funds that might be pooled in the Green Climate Fund) and do not involve direct financing, but instead making the kinds of decisions about eligibility of countries and of implementing entities we outlined above, as well as monitoring and reporting. Since these are broadly consistent with the functions foreseen for the Adaptation Committee of the UNFCCC, one option would be for these functions to be the responsibility of that Committee. The Committee could be responsible, for example, for annual publication of net contributor obligations, net recipient entitlements and ex post annual allocations, and ideally, for publication of real time, open, internationally standardized, reusable detailed (transaction by transaction) data on financial transfers[23] as is currently becoming the standard for traditional ODA. The Committee could also have oversight of the process for approval of plans; standard setting on fiduciary capability and eligibility of third-party implementation entities; and could be responsible for periodic review of the obligation and allocation algorithms and of the formulae themselves as data and experience accumulate The only approvals requiring an independent judgment pertain to the

[21] Recipient countries would have the option of using the same party to both prepare and implement programs but would not need to do that; using different entities is more likely to ensure reasonable competition and minimize conflicts of interest.

[22] This would be analogous to [proposals to distribute oil rents] to the population through cash transfers—as a potential tool to mitigate some of the governance risks associated with oil revenues by giving citizens a stake in their own resource wealth. See Gelb and Majerowicz, 2011.

[23] The climate conference in Cancun established an Adaptation Committee to promote the implementation of stronger action on adaptation by providing technical support and guidance to countries, strengthening knowledge-sharing and promoting synergy between a range of stakeholders. The Durban conference further clarified the membership and indicative activities of the Adaptation Committee.

approval of an adaptation plan and the fiduciary standard; both would ideally be outsourced by the Adaptation Committee to other agencies or expert groups as noted above. The broad issue of what types of "plans" meeting what standards are adequate and what third party implementing agencies (private and public) are eligible at what cost could be dealt with periodically by an agreed set of independent technical experts designated by the Committee.

The make-up of the Adaptation Committee is to be weighted slightly in favor of developing countries, and thus of countries likely to be receiving transfers (in line with their entitlements). As a starting point we believe that makes sense, as adaptation transfers, like traditional aid transfers, are most likely to be effectively used at the country level if the recipient countries have a major hand in their management – ensuring greater ownership of entitlements by recipient countries and greater legitimacy of the adaptation transfer system itself. In that sense, the mandate of the Adaptation Committee would be defined not only by what to do, as in the above tasks, but by what not to do. It would be responsible for avoiding the kind of paternalistic oversight process that applies to many aid processes.[24] A country's entitlement would be based on vulnerability criteria (see above); the transfer of funds would be on the basis of the approved adaptation plan and each country's or implementation agency's fiduciary capability.

As we note above, however, the practical reality for countries with obligations under our first principle, i.e. those countries with higher income and emissions per capita, is that they will have difficulty fulfilling their obligations if their legislators and taxpayers are not assured that their transfers are being well used. This is the dilemma for the "system" referred to in our title –that the system can fall between the rock of "ownership" and "legitimacy" and the hard place of "effectiveness". This dilemma for countries with obligations should provide a kind of discipline on the individual members of the Adaptation Committee, to avoid politicizing and favoritism in for example the likely debate over the formulae that would provide the benchmarks for obligations and entitlements and debate over the standard that countries need to meet to have their adaptation plans approved without major intrusions of "donors" on those plans.

A related option would be for the Board of the Green Climate Fund to periodically review both the legitimacy and the effectiveness of the overall global adaptation system, including independent evaluation and publication of the Adaptation Committee's work.

The Cancun Agreements for the Green Climate Fund stipulate a Board with a governance structure in which 50 percent of both voice and votes is held by funders and 50 percent by recipients; this is likely to apply to the Global Adaptation window as well. At any one time, a middle-income country might be a net contributor or a net recipient and over time countries

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[24] See footnote 5, and World Bank, 2004.

are likely to shift from one category to the other, with consequent changes in their voting rights. While the governance structure may shift over the longer term, and should incorporate flexibility to do so, there is logic to starting with a 50:50 distribution. Neither net funders nor net recipients should be able to impose something the other group does not want. Adjustments within each group to voice and votes could be made every three years, whatever the formula is that governs allocation of voice and votes within each group. Both groups should have effective veto power on key decisions such as choice of the chair of the board and the chief executive.

This structure at the Green Climate Fund would ensure that in the implementation of adaptation programs the countries with obligations (and thus the countries providing net financing) would have a mechanism for more direct observation of how country adaptation programs are working. That would be the case whether countries use their entitlements to increase resilience through development and growth programs, or to adapt directly to changes including through infrastructure, agriculture, migrant support in the case of internal displacement and so on, and whether the resulting funds are used to leverage or not complementary private investments.

What about transparency? As we suggest above, the Adaptation Committee would be responsible for annual publication of net contributor obligations, net recipient entitlements and ex post annual allocations; publication of real time, open, internationally standardized, reusable detailed (transaction by transaction) data on financial transfers, including allocations both through bilateral channels as well as the window/committees or forum; and a summary of third party verification of adaptation plan implementation. [25] It would also be responsible for ensuring that all data on use of funds are available to the general public; and that among other things the citizens of net recipient countries have access to their annual entitlement numbers and to the extent to which their government is accessing the relevant amounts.

In conclusion

Adaptation finance is not aid. There should be a formula-driven mechanism to assign obligations for making transfers based on income and emissions. The formula for mandated funding should evolve over time, for example with diminishing weight given to historic emissions if historic emissions are included in the formula. Allocation of funds to recipient

[25] In this context it may be useful to learn from the experience of the International Aid Transparency Initiative which is now working on common information standards for all aid flows, covering agreement on what will be published, for example detailed project information, expected outputs and outcomes, and conditions; common definitions for sharing information, to enable better comparability between donors and countries; a common electronic data format, that will facilitate the sharing of aid information, and reduce transaction costs; a code of conduct setting out what donors commit to publishing, how this will be made available, and how donors will be held accountable for compliance.

countries should also be formula-based and treated as an entitlement. The formula should take into account income per capita income and physical measures of climate vulnerability. Country allocations should not be penalized for weak governance or implementation capacity; these should influence only the timing of access to funds and implementation arrangements. The arrangement for actual access to entitlements should be clear and simple, avoiding the high costs and indignities associated with traditional aid flows, while taking into account the reality that net funders cannot politically sustain flows of funding without ongoing assurances, including for their taxpayers, that the funds are being responsibly and effectively used. Access should be based on simple criteria such as an adaptation plan and fiduciary capability if not of the recipient country then of an approved third-party implementation agency. Countries with weak governance and management capability should be able to contract out the preparation of their adaptation plan as well as the implementation of the adaptation program. Third party verification should be used to ensure that adaptation plans are implemented and funds used appropriately.

Where climate finance is concerned, different communities have different aims. In this paper we are trying to propose solutions that balance competing interests with inescapable tradeoffs. On the one hand that risks leaving everyone unhappy. On the other we think it may be a healthy start to finding common ground.

Annex I – Adaptation Costs and Financing

The Intergovernmental Panel on Climate Change (IPCC) defines adaptation in their 4th Assessment report as "adjustment in natural or human systems in response to actual or expected climatic stimuli or their effects, which moderates harm or exploits beneficial opportunities." Adaptation finance (like mitigation finance) needs to complement development investments and adaptation actions (and mitigation actions) need to be integrally linked with development investments. The cost of adaptation is the additional investment needed above and beyond a baseline investment path, i.e., the additional cost of making sure that countries are well positioned to adapt to climate change and that development investments and development progress can withstand the negative impacts of climate change. Some investments will be wholly additional to development investments, such as the cost of protective sea walls or building higher bridges. Many adaptation investments, however, will involve reinforcing, accelerating or making shifts in development plans: switching crops, setting aside land to absorb storm surges, etc. Resilience may entail the additional cost of building in physical and institutional redundancy and improving capabilities. The optimal adaptation investment strategy in a particular country or setting may well include measures such as educating girls or improving governance or regulatory quality since these increase society's resilience in the face of unpredictable changes in the natural environment. While adaptation is integrally linked to development, the World Bank estimates that the cost of adaptation in developing countries will be about $75-100 billion by 2020, above and beyond the baseline cost of development.

The UNFCCC recognizes that "the contribution of countries to climate change, and their capacity to prevent and cope with its consequences, vary enormously. The Convention and the [Kyoto] Protocol therefore foresee financial assistance from Parties with more resources to those less endowed and more vulnerable.…To facilitate this, the Convention established a financial mechanism to provide funds to developing country Parties. The Parties to the *Convention* assigned operation of the financial mechanism to the Global Environment Facility (GEF). The financial mechanism is accountable to the COP…. In addition … Parties have established three *special funds*: the Special Climate Change Fund (SCCF) and Least Developed Countries Fund (LDCF), both under the Convention; and the Adaptation Fund (AF), under the Kyoto Protocol."[26]

Funding to climate change activities is also available through bilateral, regional and multilateral channels. The principal sources of adaptation funding currently are the Adaptation Fund (AF) and the Pilot Program for Climate Resilience (PPCR), one of the sub-funds of the Climate Investment Funds. The Adaptation Fund, a financial mechanism under the Kyoto Protocol, provides project grants that are financed with 2% of the Certified

[26] See UNFCCC http://unfccc.int/cooperation_and_support/financial_mechanism/items/2807.php

Emission Reduction (CERs) issued for projects of the Clean Development Mechanism (CDM) and donations. The AF expects total available resources to be between USD 250-350 million by 2012. As of July 2011 the AF had approved 11 projects ranging in size from $3 – 9 million. Projects must be managed by authorized implementing entities. In addition to traditional agencies such as UNDP, the MDBs, UNEP and WFP, the AF has authorized three national implementing entities. The PPCR is a multi-lateral fund implemented through the MDBs. As of September 2011, pledges made to the PPCR, totaled $986 million, of which $614 million grant resources and $372 million concessional loans. As of November 2011 a total of $12 million had been committed to 18 countries.

Annex II

An "obligation- based" funding formula should be based on a combination of historical and current emissions, population and income criteria. An example of such an approach is developed in "Differentiating (Historic) Responsibilities for Climate Change, Summary Report," Benito Muller, Niklas Hoehne, Christian Ellerman, 2007. The paper takes historical emissions, called "causal contributions," up to 1990 (54% for Annex 1 countries), modified by a "strict responsibility" assessment that adjusts for a per capita allocation of the 7 GT CO_2 per annum absorbed by oceans. With this adjustment "strict historic responsibility" is attributed as follows: the US with 25.6%, followed by the EU15 (15.9%), OPEC (7.4%), Russia (7.3%), China (6.4%), Brazil (5.2%), the 76 countries of AOSIS and the LDC group (4.1%), Japan (2.8%), and finally India with next to no responsibility (0.3%). India's very low share (compared to its "causal contribution" of 3.9%) is due to the large population of India and the fact that the basic allowances were allocated on a per capita based 'lump sum' thus allowing the not so poor to benefit from the surplus basic allowances of the poor. The paper then further modifies responsibility by a reduction for the "limited responsibility" of people earning less than $1/day. Under this approach country responsibilities are as follows: US (20.3%), EU15 (12.4%), China (11.5%), OPEC (9.5%), Russia (6.8%), Brazil (5%), Japan (3.8%), AOSIS+LDC (4.7%%), and India (0.6%).

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