

Financing Adaptation in Developing Countries

Assessing Demand and Supply Side
Challenges

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About the Finance Working Group

The Finance Working Group (FWG) is an open partnership bringing together a range of expert perspectives from the global north and south on the progress made toward financing climate action, co-chaired by Charlene Watson of ODI and Raju Pandit Chhetri of Prakriti Resources Centre. The FWG aims to support the official UNFCCC processes as they relate to finance and is organized around two complementary themes: the provision of support to developing countries to mitigate and adapt to climate change and the consistency of finance flows with low-emission, climate-resilient development, as outlined in Article 2.1(c) of the Paris Agreement.

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+ 1. Introduction



The subject of climate finance has become increasingly critical in our collective efforts to combat the escalating impacts of climate change. As the world grapples with the urgency of addressing climate-related challenges, the availability, access and adequacy of adaptation finance support have taken centre stage. This paper delves deep into this crucial topic, shedding light on its significance and highlighting the pressing need for a more comprehensive understanding of the problem at hand. In an era where transformative climate finance is essential to drive sustainable development, build climate-resilient societies and contribute to reducing the potentially massive loss and damage from climate impacts, a precise framing of the issues is paramount. By dissecting the complexities of climate finance, we can unearth the underlying gaps and needs, ultimately paving the way for more robust and effective approaches and avenues to tackling the climate finance needs.

Adaptation finance plays a pivotal role in supporting projects and endeavours aimed at addressing the challenges posed by climate change. This critical financial resource pool encompasses both private and public funding streams, operating on various scales, from the local and national to the global level. Its primary purpose lies in providing essential support to countries, communities and individuals as they strive to adapt to the multifaceted consequences of climate change (Censkowsky, 2022).

Developing countries bear the brunt of climate change effects disproportionately. Aspects like geographic position, socio-economic divides and underdeveloped infrastructure intensify their vulnerability. Furthermore, limited adaptive capacities in these regions magnify their climate risk exposure (Adger et al., 2006). This is attributed to numerous factors including economic status, wealth and income and expenditure.

The importance of climate finance cannot be overstated. It underpins the transition to a low-carbon, climate-resilient future, affecting economies, livelihoods and ecosystems. Our imperative is understanding the nuances of the multifaceted challenges in financing climate action. Accurate framing allows us to identify shortcomings and inefficiencies, guiding us towards precise solutions that address the core issues. Correctly understanding the problem empowers policy-makers, stakeholders and the global community to make informed decisions and allocate resources judiciously, fostering a more equitable and sustainable world.

In this paper we delve into the challenges faced in climate adaptation finance, looking at both the supply and the demand aspects. For clarity, by supply side we mean factors that are controlled by finance providers and intermediaries in a broad sense. These determinants of adaptation finance are understood and written about more substantively than the demand side challenges, which mainly relate to the systemic and operational conditions within finance-receiving countries that affect adaptation finance. We also



examine the approaches available to tackle these challenges. We find that the language employed in narratives around challenges associated with climate finance in general tends to focus on supply-side issues. The subsequent section discusses solutions to address these challenges comprehensively. This includes analysing climate finance delivery based on commitments, such as the \$100 billion target and doubling adaptation finance. Additionally, we explore discussions related to the processes within and outside the UNFCCC that can contribute to addressing climate finance challenges. This includes reform agendas within international financial institutions (IFIs), as well as bilateral and regional initiatives, alongside resilience partnerships that make significant contributions. Finally, we present some high-level policy recommendations based on the analysis.

+ 2. Understanding the challenges from the supply of international climate finance

Gaining insight into the challenges posed by the supply side of international climate finance is instrumental in addressing the complexities in a structured manner. Examining the supply side brings to the fore issues related to the sourcing of financial resources for adaptation efforts. It highlights the constraints and limitations faced by various stakeholders, including governments, international financial institutions and private entities in providing adequate funds. In this section we discuss three pivotal challenges that underpin the complexities of climate finance: availability, accessibility and adequacy.

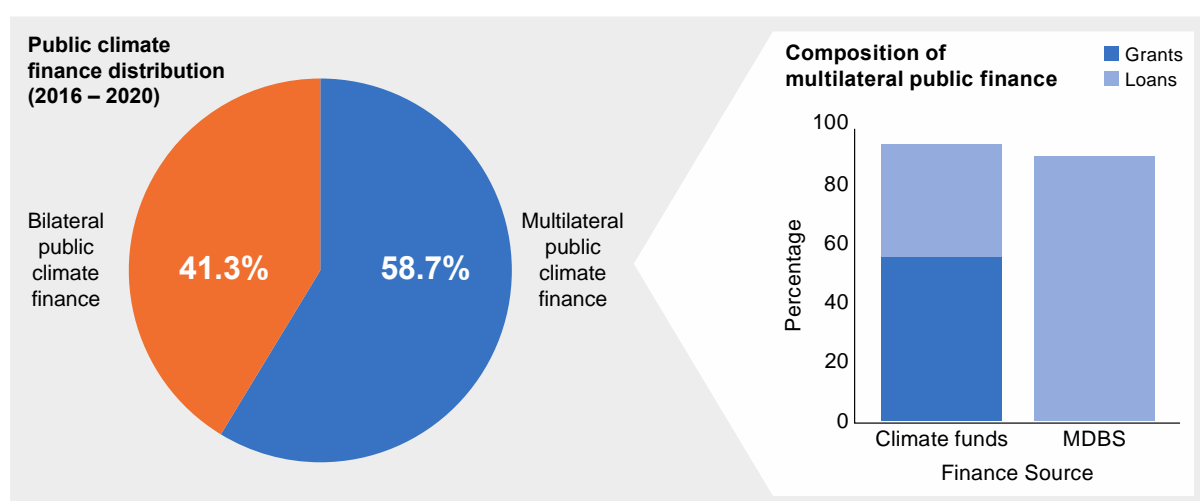
2.1. Availability

The primary challenge in addressing climate adaptation finance revolves around the sheer scale of financial resources required and allocated for adaptation initiatives. Studies suggest that adaptation costs for developing nations might increase to \$160–340 billion by 2030 and \$315–565 billion by 2050 (United Nations Environment Programme, 2022). As the impacts of climate change become increasingly severe the costs of adaptation soar, making the gap significant between the demand for climate finance and the availability of resources. Accessing adequate adaptation finance from multilateral and bilateral climate finance mechanisms, such as the Green Climate Fund (GCF), the Global Environment Facility (GEF), the Adaptation Fund, the World Bank, the International Monetary Fund (IMF) and wealthy countries, is the only way for developing countries, particularly the most vulnerable, to implement these initiatives that would include their adaptation priorities and needs. These needs could be presented in different forms within a national strategy or plan document including in the UNFCCC Nationally Determined Contributions (NDCs) or National Adaptation Plans (NAPs) or other national communications (UNFCCC, n.d). Finance requirements for identified priorities and needs are very high and will likely increase if mitigation action does not reduce the need for adaptation.

Current global adaptation finance flows from bilateral and multilateral sources including the financial mechanism of the UNFCCC has been below the current needs of developing countries (United Nations Environment Programme, 2022). It is crucial to emphasise that there is no presumption or requirement for all climate finance to flow exclusively through the financial mechanism of the UNFCCC. However, these mechanisms do have a significant role in advancing global cooperation on climate finance. For example, the GCF, designed solely to channel climate finance for climate projects, is grappling with funding deficits against projected demand from developing countries as current pledges and replenishments significantly reduce. These delays in fulfilling commitments and meeting funding targets obstruct the timely flow of finance to adaptation action (Schalatek, 2023).



A critical aspect of assessing the availability of finance is the nature of the funding itself. A significant proportion of climate finance, as discussed in the section on adequacy, comes in the form of concessional loans rather than grants: between 2016 and 2020, 59% of total bilateral public climate finance and 84% of total multilateral public finance (OECD, 2022). Among multilateral public finance sources, multilateral climate funds were offering a higher proportion of grants (56%) in comparison to loans (39%), possibly a result of their sole purpose to focus on climate finance. In contrast, multilateral development banks (MDBs) primarily provided loans, accounting for 91% of their allocations (OECD, 2022). Bilateral and multilateral climate funds, although constituting a smaller portion of the climate finance landscape, allocated a more significant share of funds in the form of grants compared to MDBs (OECD, 2022).



In the context of adaptation finance, studies have shown that developed countries have fallen significantly short of their commitments. In 2019, developed countries pledged to at least double their adaptation finance commitments, increasing their funding to \$40 billion (Lissner et al., 2022). According to ODI research, only 11 countries have fulfilled their share of adaptation requirements. Adaptation finance also falls far short of that programmed towards mitigation (Pettinotti et al, 2023).

The private sector's¹ involvement in addressing climate finance availability is gaining attention. However, limited data reveals that the private sector has not played a significant role in adaptation finance, with a stark contrast between the \$300 billion directed towards mitigation and a mere \$1 billion for adaptation (Buchner et al, 2021). This imbalance is largely due to the lower financial returns from adaptation projects, making private investment less appealing. Developing countries are cautious about relying heavily on the private sector, citing the urgent nature of climate challenges and the need for immediate solutions.

¹ In this context, when we say private sector, we are referring to companies and investors from developed countries investing in developing countries and not local/national small scale and medium enterprises in developing countries contributing to the adaptation finance process.

2.2. Accessibility

In addition to availability, access to finance for adaptation is even more challenging compared to mitigation due to the complexities associated with adaptation projects. Mitigation measures are typically straightforward, while adaptation projects can be complex and time-consuming processes involving a meticulous assessment of climate rationale; the link between climate, climate impact, climate action and the societal benefit of a particular action, as compared to what would happen without the intervention.

Developing countries, particularly least developed countries and small island states, face significant challenges trying to access climate finance. For example, GCF approval time for projects in Least Developed Countries (LDCs) is a median of 21 months, with some projects taking as much as five years (Djabare et al, 2021). Staffing issues and complex application procedures burden these nations as funding requirements include extensive documentation, detailed project proposals and adherence to specific guidelines.

While the experiences of developing countries in securing financing, whether in the form of grants or loans, differ significantly, those reporting challenges often attribute these to compliance with procurement procedures and understanding donors' eligibility requirements and conditionalities, with demands for extensive technical details related to environmental and social safeguards, gender impacts and climate rationale, which can become cumbersome. It is important to ensure that projects address environmental and social impacts, including gender considerations, but concerns arise when these requirements become mere box-ticking exercises to meet donor demands, rather than genuinely strengthening these areas. This reflects an underlying lack of trust and patience in supporting the development of national governance structures and mechanisms. Furthermore, conditionalities can arguably impact the flexibility and ownership of adaptation projects. Embracing soft conditionalities, such as requiring projects or programmes to demonstrate that they are participatory, consensus-oriented, equitable and inclusive, is increasingly seen as a norm (Schalatek, 2012). Conversely, hard conditionalities, like results-based payments, tend to be situation-dependent and contingent upon specific agreements regarding anticipated outcomes.

Linked to demand-side challenges, discussed in the next section, macroeconomic factors in the country, such as inflation, debt ratings, security concerns and currency instability, compound existing weaknesses in public financial management, further complicating the accessibility and management of donor grants and finance. The internal mobilisation of financial resources is further complicated by economic instability and global market volatility.

2.3. Adequacy

Adequacy in adaptation pertains to the sufficiency of financial resources allocated for adaptation action. This can be in terms of scale, type, predictability and timeliness. Ensuring that funds are disbursed in a predictable manner is imperative for the effective



implementation of adaptation projects. Delays will result in missed opportunities and heighten the vulnerability of communities, especially in the face of extreme weather events and other climate-related emergencies.

The issue of adequacy arises due to the disparity between the actual funding received and the costs involved in implementing comprehensive adaptation measures. Available adaptation finance does not match the magnitude and urgency of adaptation needs. Figures highlighted previously indicate that the requirement far exceeds the current level of climate finance – including for mitigation efforts – and it is beyond the unmet annual target of \$100 billion. This limitation can impede the ability of these countries to execute transformative adaptation projects and initiatives and limit them to incremental progress.

In addition, different forms of financial instruments, such as grants, concessional loans or equity investments, can have varying impacts on the adequacy of adaptation efforts. Grants, for instance, provide direct financial support without the burden of repayment, making them more accessible for countries with limited fiscal capacity. However, loans might also entail repayment with interest, potentially increasing the financial burden on already resource-constrained nations. Thus, determining whether the mix of financial instruments is adequate and aligned with adaptation priorities is a crucial aspect of the adequacy assessment.

+ 3. Understanding challenges from the demand side



Efforts to address climate finance in general typically lean towards the supply side – emphasising the availability of and access to financial resources from different sources. However, a comprehensive approach to climate finance should equally consider the challenges posed by the demand side. In this context, ‘demand side’ refers to recipients, or the countries and communities seeking financial support to adapt to and mitigate the impacts of climate change. Countries rely not only on internationally mobilised resources for climate action – domestic resources are as important, if not more so. In this section, we analyse the internal issues – to the finance seeker – associated with climate finance. Understanding these demand-side challenges is critical to achieving the goals of effective and equitable climate finance, and will help in recognising and addressing the challenges and barriers developing countries face when attempting to mobilise internal financial resources for climate adaptation, and attract and utilise internationally mobilised resources.

3.1. Economic fundamentals and capacity

Developing countries can face significant challenges rooted in their economic fundamentals. The fundamentals of an economy can be understood through indicators like the rate of economic growth, inflation rate and unemployment rate, which together paint a picture of a country’s economic wellbeing and situation. A weak economic base characterised by low GDP, modest per capita income and limited resources restricts fiscal capacity. Such fragile economies find it hard to allocate significant funds for climate adaptation. Concurrently, systemic issues like unemployment, income disparity and under-developed infrastructure limit resource mobilisation and accentuate the impacts of climate change, making adaptation even more important.

Economic fundamentals such as limited GDP, dependency on climate-sensitive sectors like agriculture and lack of economic diversification constrain nations from using national public finance resources for adaptation (Brown, 2015). Global market volatility, paired with domestic economic instability, often magnifies budgetary constraints (Brown, 2015). Budgetary constraints prevalent in many developing countries make it challenging to dedicate adequate resources for climate adaptation (Brown, 2015).

3.2. Immediate socio-economic priorities

Addressing social and economic issues while also prioritising climate change adaptation can be overwhelming. Developing countries often face a combination of pressing



problems including poverty, unemployment and health crises. Poverty is widespread, with millions struggling to meet their needs. An estimated 7% of the global population – some 575 million people – will still be living in extreme poverty by 2030 (United Nations, 2023). Fragile social systems are further strained by health crises due to poor access to healthcare and sanitation. In these circumstances, allocating resources to climate change adaptation becomes extremely challenging. This is not to suggest that investments in climate change adaptation are somehow detached from broader investments in addressing social issues; in fact, they are interconnected and mutually reinforcing. For instance, social protection schemes such as the Mahatma Gandhi National Rural Employment Guarantee Act of India (MGNREGA; see Box 1) are designed to bolster development and economic growth through employment by addressing root causes of vulnerability to climate impacts, including but not limited to those triggered by climate change.

The core issue lies in the fact that many developing countries find themselves in a perpetual state of crisis management, leaving little room for designing long-term interventions that simultaneously address climate resilience and broader development goals. As a result, they struggle to allocate resources to the establishment of the robust institutions and mechanisms essential for effective governance and proactive problem-solving. The need for transformational adaptation calls for a shift from a reactive stance to a proactive one, working towards comprehensive solutions that not only respond to immediate crises, but also bolster resilience across interconnected aspects, including social development and climate resilience needs.

Box 1 The Mahatma Gandhi National Rural Employment Guarantee Act of India

The Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) of 2005 was implemented to improve the livelihood security of rural households by providing at least 100 days of guaranteed wage employment a year to every household whose adult members volunteer to do unskilled manual labour. Field execution is known as the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS).

3.3. The need for integration of adaptation financing into broader economic thinking

As indicated in the previous section, the complexities and challenges associated with adaptation financing are deeply intertwined with broader economic factors and considerations. For example, inflation is a critical economic factor affecting adaptation projects. Rising prices of materials, labour and essential resources create a heavier financial burden, making inflation management a major decision factor. Debt ratings and borrowing costs also significantly impact adaptation financing, particularly when loan-based financing is the form of financing available. Countries with lower credit ratings or

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high debt levels face difficulties in borrowing for climate projects. Lower credit ratings result in higher borrowing costs, increasing the expense of accessing loans for climate-related endeavours. Debt burdens will in turn limit the availability of funds for adaptation as a substantial portion of the budget is directed towards debt servicing.

Currency stability and exchange rates are key factors in adaptation financing that can introduce uncertainty and risk, with exchange rate fluctuations and currency devaluation potentially diminishing the value of funds allocated for adaptation efforts. Other factors, such as security concerns, introduce further complexity to adaptation financing challenges. In regions affected by security issues or conflict, the allocation and management of adaptation funds become more complicated. These challenges may discourage international donors and private investors from participating in adaptation financing in areas marked by persistent security issues.

In light of these challenges, it is essential to recognise the interconnectedness of adaptation efforts with economic development and growth. The success of adaptation financing is not merely about securing funds, but also about integrating adaptation into broader economic goals and strategies. Several strategies can be adopted to address these challenges.

- The more straightforward response would involve **providing technical assistance and resources to help developing countries** navigate the complex application process and help them progressively comply with the requirements of multilateral and bilateral climate finance mechanisms. While building technical capacity, there are possibilities to streamline procedures for developing countries to access multilateral funds. The harmonisation of procedures, including accreditation and access processes, would reduce the transaction costs associated with seeking financial support. For example, a collaborative effort in shaping a streamlined accreditation approach, like the Climate Investment Funds (CIF), coupled with standardised documentation and climate rationale justification across various funds like GCF and GEF, would prevent a situation where more time is spent on funding applications than on the actual implementation of projects.
- **Integrating climate risks into macroeconomic planning and modelling economic scenarios** represents a pivotal step in addressing demand-side challenges. Climate adaptation efforts, including how climate finance is channelled towards these efforts, should be integrated into national economic development strategies. The traditional approach to economic planning must evolve to account for the ever-growing impact of climate-related disruption. By aligning adaptation efforts with a country's broader economic goals, such as investment in climate-resilient infrastructure, this ensures that adaptation becomes an integral part of a country's economic planning and decision-making processes. Such integration allows adaptation projects to serve dual purposes, not only enhancing climate resilience but also contributing to economic development. This entails a need for a comprehensive assessment of how climate change can affect various sectors of the economy, usually undertaken through the national development planning



process or through formulation of NDCs and NAPs. This assessment would consider the potential consequences of extreme weather events, shifting weather patterns and rising sea levels on industries such as agriculture, energy and transportation. By doing so, governments and policy-makers can better understand the vulnerabilities of their economies and develop strategies to mitigate these risks. This approach should go beyond simply identifying vulnerabilities and exploring economic opportunities. For instance, the transition to a low-carbon economy and the development of clean energy technologies represents significant economic opportunities. By emphasising the potential benefits of climate action, governments can align long-term climate strategies with economic growth and job creation. Such opportunities will pave the way for reducing reliance on fossil fuels and develop cleaner, more efficient technologies, they open doors to new industries, job markets and international collaborations. This, in turn, can lead to economic diversification and resilience, reducing dependence on sectors vulnerable to climate-related disruption.

- **Improving governance and transparency is also a key response** to addressing the demand side. Addressing corruption, improving governance efficiency and increasing transparency are prerequisites for effective adaptation financing. These steps are vital in ensuring that allocated funds are used for their intended purposes, that project proposals are properly evaluated, and that resources are distributed effectively. Corruption can divert funds away from their intended projects and initiatives. This misallocation of resources can lead to consequences when funds earmarked for climate adaptation are redirected elsewhere. Governance inefficiencies worsen the situation, with delays, lack of coordination and ineffective implementation of policies. Furthermore, the lack of transparency in transactions and decision-making processes creates an environment that can easily be exploited. To address these challenges effectively requires an approach that includes governance reforms, transparency initiatives and clear policy frameworks. It is through efforts to overcome these obstacles that developing nations can create an environment conducive to utilising adaptation financing effectively, while building resilience against climate change impacts.
- **Improving and strengthening delivery channels and mechanisms in country** is important. A critical component of delivery mechanisms is the governance arrangements for the flow and allocation of the money, including how planning is done and decisions are made, and by which actors and institutions. The quality of the governance and decision-making on how the finance is used is just as important as the quantity of finance flowing. Efforts are being made by LDCs for example under the flagship LDC Initiative for effective adaptation and resilience (LIFE-AR), to address such challenges through a finance delivery mechanism. LDCs have made a commitment to improving their systems at different levels starting from the national level and going all the way down to the local level.² This

² See LIFE-AR at the LDC Climate Change webpage for more www.ldc-climate.org/tag/life-ar/

includes enabling communities to handle and utilise both public and private resources for their adaptation requirements. These mechanisms encompass governance, planning and financial structures that support the realisation of the LDC Vision. They can be either public or private and aim to build climate-resilient societies, economies and ecosystems.

- It is important to **bridge between domestic ability and international mobilisation needs**. A core issue is the mismatch between the financial resources that developing countries can mobilise domestically and the substantial funding required for effective climate adaptation. This bridge between domestic financial capacity and international funding needs is where adaptation financing must find its place. International support, whether from developed countries, international financial institutions or private sector investments, plays a pivotal role in filling this gap. However, this must be done in a way that respects the sovereignty and priorities of each country, while promoting inclusivity.

3.4. Absorption of internationally mobilised funds

Mere mobilisation of financial resources is not the endpoint; their effective utilisation remains paramount. There have been concerns about potential misallocation or misuse of adaptation funds, emphasising the need for strong governance, transparency and monitoring. Effective absorption of international aid is fundamentally influenced by institutional capacity and governance. While countries might have access to international funds, they often lack robust institutional mechanisms for efficient allocation and use. This inefficiency is often the result of bureaucratic delays, corruption and inadequate expertise.

3.5. Indebtedness and fiscal space constraints of the public sector

The availability of fiscal space plays a role in determining a country's ability to increase spending without jeopardising its fiscal sustainability. Fiscal space essentially determines the degree of flexibility a nation has in allocating its resources, including when considering obtaining loans for climate adaptation projects. This concern becomes particularly relevant for LDCs and small island developing states dealing with high levels of debt, as they may hesitate to accumulate more for fear of worsening their existing fiscal challenges. One study finds that it is not possible for the majority of LDCs to finance their adaptation needs through borrowing alone, even if they wanted to do so (Patel et al., 2022).

Substantial debt burdens are a reality for many developing nations. Between 2010 and 2021, total public debt of developing countries rose from 35% of GDP to 60% in 2021 (GCRG, 2023). External public debt, representing the portion of a government's debt owed to foreign creditors, has also increased, from 19% of GDP to 29% of GDP by 2021 (GCRG, 2023). Repaying this debt has become much costlier, further constricting fiscal capacity, and it is challenging to match funds, a frequent prerequisite for tapping into international financing (Chabert et al, 2022). Many global funding mechanisms require countries to contribute a matching portion of the funds they request.



3.6. Private sector involvement in climate adaptation: operational and regulatory impediments

Given the constraints on public finances, tapping into the abundant financial resources of the private sector is crucial (Buchner et al., 2014). International private sector finances can play a role in supporting adaptation in developing countries through various mechanisms, particularly debt instruments like direct project financing and credit lines extended to local financial institutions. To reach vulnerable communities, innovative approaches such as microfinance products may be required. However, there is a lack of mechanisms to foster public-private partnerships and incentives for adaptation investments, and the private sector frequently deems climate adaptation less lucrative, favouring mitigation initiatives (Buchner et al, 2014).

In this context, policy-makers should focus on creating regulatory clarity and offering incentives to encourage private sector participation. This involves establishing transparent and consistent regulatory frameworks, providing financial incentives for businesses that could help de-risk investment and fostering public-private partnerships (PPPs), which can reassure investors and help distribute the financial risks.

The domestic private sector in developing countries predominantly consists of small and medium-sized enterprises, which make up around 80% of total businesses (Endris and Kassegn (2022)). These enterprises are in dire need of investment and support from public sources to effectively adapt to changing markets, including shifts in demand driven by evolving customer needs and preferences, as well as transformations on the supply side, such as adjustments in business processes, supply chains and sourcing strategies, all influenced by climate-related impacts and other external factors. Emerging private sectors, especially in LDCs, face hurdles in undertaking long-term projects due to constraints in resources and expertise (Brown, 2015).

In many developing countries, financial markets, and the finance sector more broadly, remain under-developed, lacking the sophistication essential for funding grand adaptation initiatives (Canales, 2017). The scarcity of advanced financial instruments, coupled with restricted access to credit, can obstruct efforts to accumulate private adaptation financing. Simultaneously, many companies find themselves without comprehensive data on climate risks and the associated financial repercussions, thereby constraining informed investment. It is also notable that developing country private entities tend to emphasise immediate profits over enduring sustainability, making them reluctant to invest in long-term adaptation projects (Canales, 2017).

Initiatives should be designed to empower SMEs with essential resources, expertise and financing options for climate adaptation, including strengthening women's involvement through women-led SMEs or sectors important to women. Institutional capacity-building support should be offered to help these enterprises gain a better understanding of climate impact, vulnerability and risk and integrate effective climate resilience strategies in their investment plans. Access to credit is also needed for SMEs to meet the costs of adapting to current and future climate impacts. Encouraging information-sharing on climate risks

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and financial impact assessments, fostering innovation in financial products such as microfinance solutions, and providing long-term incentives for sustainable adaptation projects are essential.

Aspect	Demand Side Challenges	Supply Side Challenges	Implications to Developing Countries
Economic and Fiscal Constraints	<ul style="list-style-type: none"> Weak economic fundamentals. High indebtedness and fiscal space constraints. Dependency on climate-sensitive sectors. 	<ul style="list-style-type: none"> High finance requirements for adaptation. Predominance of loans over grants. 	<ul style="list-style-type: none"> Strained financial resources limit effective climate action. Increased debt burden hinders sustainable development.
Governance and Institutional Capacity	<ul style="list-style-type: none"> Governance inefficiencies and corruption Challenges in absorbing and utilizing funds. 	<ul style="list-style-type: none"> Complex financing approval processes and compliance demands. Need for robust institutions for finance management 	<ul style="list-style-type: none"> Delays in project implementation. Reduced effectiveness and efficiency of climate adaptation efforts.
Private Sector Involvement	<ul style="list-style-type: none"> Operational and regulatory challenges. Underdeveloped financial markets. 	<ul style="list-style-type: none"> Limited private sector investment in adaptation. Need for incentivizing private sector engagement. 	<ul style="list-style-type: none"> Difficulty in attracting private investment for climate projects. Missed opportunities for innovative financing and technology.
Socio-Economic Priorities and Integration	<ul style="list-style-type: none"> Balancing socio-economic needs with climate adaptation. Integrating adaptation into economic and development goals. 	<ul style="list-style-type: none"> Ensuring finance aligns with socio-economic development. 	<ul style="list-style-type: none"> Competing priorities may overshadow climate adaptation. Potential for integrated solutions to improve overall resilience.
Resource Allocation and Utilization	<ul style="list-style-type: none"> Complex procedures hampering access to finance. Economic volatility affecting resource mobilization. 	<ul style="list-style-type: none"> Insufficient and unpredictable finance flow. Inadequate alignment of financial instruments. 	<ul style="list-style-type: none"> Hindered adaptation actions due to funding gaps. Challenges in planning and executing long-term climate strategies.



+ 4. Enhancing global collective response



Two distinct but interconnected processes play a central role in enhancing global collective response to the challenge of adaptation financing. The first is the multilateral process, which serves as the official forum for bringing governments together on a global scale to formulate a collective response to the pressing challenges posed by climate change. There are arguments around the effectiveness of such processes as doubts grow about their ability to keep up with the changing climate finance landscape (Bracking and Leffel, 2021). Simultaneously, another set of processes encompasses the global, regional and national levels. These processes, often referred to as complementary or parallel mechanisms, are equally critical in the broader landscape of climate action.

In this context, it is imperative to recognise that there is no one-size-fits-all solution. While country-led multilateral processes hold the potential to enhance international cooperation, it is equally important to consider alternative forms of engagement and other processes outside formal multilateral frameworks. These alternative avenues can provide flexibility and innovation. Initiatives at the regional and national level, for example, have a role in fostering collaboration among nations, enhancing support for adaptation and finding tailored solutions to address the unique challenges faced by the region and its communities. Thus, in this section, we look at how the global collective response to climate change can be enhanced through these interconnected processes.

4.1. Response through the global climate process

The global climate negotiation process provides a platform for shaping commitments and mobilising the financial resources to combat climate change. Within the UNFCCC process, there have been numerous attempts to plug the gaps in climate finance for developing countries. In 2009 developed countries pledged to provide \$100 billion annually for climate action in developing countries, but have consistently failed to meet this target (Pettinotti et al, 2023). There is a chance of reaching this target by 2023, although it may take until 2025 for actual accounting to occur (Federal Foreign Office, 2023). The gap between statements and concrete financial commitments has raised doubts about developed nations' willingness to fulfil their promises. Building trust through action is crucial for reinforcing the integrity of international climate finance.

Beyond trust-building, it is important to address underlying differences in how the target can and should be met. One aspect of this is clarity and agreement on what counts as climate finance. Lack of agreed accounting systems and practices has raised the pressing need to establish a clear definition of climate finance and the accountability framework for delivering on the \$100 billion commitment. One issue is that climate finance counts the full value of loans and not its grant equivalent, and development aid counts grant

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equivalent. It is important that the new climate finance goal changes this accountancy practice and uses grant equivalent terms, as not doing so wrongly incentivises the provision of more loans (Zagema et al., 2023). To ensure that the promised funds reach developing countries and are efficiently used, it is crucial to have a framework that incorporates tracking mechanisms, robust reporting and strict accountability measures. A transparency arrangement capable of capturing the mobilisation and provision of finance from both public and private sector sources will be necessary. Particularly related to finance from private sources, current mechanisms have not been able to provide timely and complete information useful for accountability.

The New Collective Quantified Goal (NCQG), set to replace the \$100 billion climate finance goal in 2025, holds immense potential to address the underlying challenges of climate finance. At COP21, parties decided, based on Article 9.3 of the Paris Agreement, to set the NCQG from a floor of \$100 billion annually taking into account the needs and priorities of developing countries (UNFCCC, 2016). However, unlike its predecessor the NCQG process could avoid a quantum-only framing by also enabling countries to consider the challenges around supply and demand side problems, reflecting better solutions in a fair and implementable final goal. It should go beyond raising funding targets and look at how climate finance should be provided, distributed and allocated. With countries grappling with the realities of climate change impacts, there is increasing understanding that financial support must not only be increased, but also structured in a way that effectively addresses the particular circumstances and priorities faced by vulnerable nations.

The climate negotiations surrounding the NCQG present a pivotal opportunity to address climate finance challenges, and particularly those from the supply side. Parties must decide which funding sources should be considered in achieving the goal, including private and innovative sources. The main challenge lies in ensuring consistency with existing provisions for climate finance, and determining whether only voluntary contributions from developed country Parties should be considered, especially with regard to climate justice and fairness. A major difficulty is ensuring that climate finance of quality is accessible to countries that are vulnerable or lack capacity. The NCQG needs to address issues related to fairness, streamlining processes and simplifying access to finance, while also considering the impact on the debt burdens of developing nations.

One critical aspect emphasised by developing countries is the distinction between Official Development Assistance (ODA) and climate finance – the additionality question. It is imperative not to rebrand ODA as climate finance. While ODA is essential for addressing broader development challenges, climate finance serves the specific purpose of helping countries combat and adapt to the adverse effects of climate change. While there are challenges in drawing a clear demarcation between adaptation and development, a categorical understanding of adaptation finance as ODA would likely render some developing countries, and in particular SIDS, ineligible as ODA eligibility is based on a country's gross national income (GNI) per capita. Thus, particularly for countries that do not qualify for more concessional-type finance options, the new goal should consider



grant-based climate finance, not necessarily as aid, but as a commitment that needs to be met (Sacherer and Michaelowa (2022)). As we explored in our discussion of demand-side issues, an integrated approach in terms of development and climate financing is essential. However, for the purposes of accountability and predictability, there needs to be clarity on what constitutes climate finance. There have been multiple attempts to define climate finance within and outside the UNFCCC without much result. It is important that the NCQG is not bogged down in similar methodological debates. There is, still, a need for accountability. In designing the new goal, countries should address the accountability challenge, possibly including clear guidance on what countries can include so there is greater clarity as to whether they have met their climate finance obligations under the goal.

In the dialogues under the NCQG process thus far, one early challenge was the structure of the goal. Parties and experts could be categorised in two main groups – one that only sought a goal with a singular overarching quantum, and one that argued for the construction of a goal made up of sub-goals or specific targets. In terms of the sub-goals, there are various proposals. Popular options include thematic goals, i.e. adaptation, mitigation and loss and damage, and financial instrument-related targets, i.e. grants, loans or concessional loans. Considering how adaptation financing fared in the finance received by developing countries as part of the \$100 billion goal, sub-targets for adaptation might be useful. Increasing the proportion of grants in climate finance commitments will also be very relevant as adaptation requires more public resources compared to mitigation efforts. A more useful commitment if implemented would be to set grant commitments for adaptation financing.

The stickier points in the NCQG are becoming clearer even in the technical dialogues currently under way. These include whether the NCQG encompasses domestically mobilised finance as opposed to only finance from developed to developing countries, whether there are qualitative elements in the goal, the role to be played by the private sector and the catalytic place of public resources in the mobilisation of private resources, transparency and accountability arrangements, and the review and long-term implementation of the goal. Our analysis of the demand- and supply-side problems of making adaptation financing work will hopefully help in some of these discussions. For example, proposals brought forward by developed country parties on private sector engagement tend to ignore demand-side issues. As discussed in Section 3, private sector investment, both domestic and international, is hampered by complex challenges. The current discussion on climate finance mobilisation has currently neglected the systemic challenges in developing countries and suggested solutions only economies at certain levels of development could utilise. Similar arguments can be made about the inclusion of domestically mobilised finance in the NCQG quantum. Some qualitative elements being proposed are disguised conditionalities that developing countries will need to abide by if they want access to finances. Top-down designed results-based financing, for example, could erode country ownership and the accessibility of finance.

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Another important milestone in the negotiation process is the Global Stocktake (GST) under the Paris Agreement aimed at assessing and enhancing global climate ambition every five years. The upcoming GST at COP28 will play a pivotal role in evaluating the progress made since 2015 and encouraging Parties to update and improve their climate commitments. However, the technical outcome of this stocktaking exercise on financing climate action is expected to reveal a significant gap in meeting the financial needs for low-emission, climate-resilient development. This presents an opportunity to collectively address demand-side challenges at the political level by presenting a comprehensive vision for reallocating and scaling up finance for climate action. The finance discussions under the GST must elevate commitment and action in terms of guidance to parties and non-parties about transformation at the necessary scale and pace. This transformation is complex and interconnected, involving various layers of the financial system, both domestically and internationally.

The outcomes from the GST need to provide a holistic and actionable vision for financing climate action. These outcomes need to emphasise the need for scaled-up capital allocation, reduced investment costs through concessional and risk-taking capital, debt restructuring when necessary, increased climate finance provision, an exploration of innovative financing sources, and simplified access to climate finance driven by local needs. The GST will be an opportunity to advance the redirection of capital towards climate solutions on both global and national scales. As such, the outcome of COP28 could, between the cover decision and the political outcome of the GST – make a relevant platform for advancing some of these recommended outcomes. This entails reforms within the global and national financial system, encouraging corporations to commit to substantial climate objectives, engaging with investors, implementing regulatory changes and aligning financial policies to enhance adaptation action. It is imperative to address the potential risk of exacerbating debt crises, particularly in light of domestic economic conditions. Therefore, the GST outcomes should underscore the importance of debt-free and cost-effective financing alternatives.

Adaptation finance challenges could also be addressed through the outcome of the Glasgow Sharm El Sheikh Work Programme (GlaSS) established under the Global Goal on Adaptation (GGA). The GGA, initially a major win for developing countries at COP21, faced six years of limited progress in terms of its operationalisation and implementation (Beauchamp and Motaroki, 2022). Within the adaptation theme of the global climate process, the unpacking of the GGA and its framework over the past year has put means of implementation, including finance, capacity and technology transfer, at the heart of the negotiations. Developing countries have been holding a strong position that advancing progress on the GGA framework necessitates a fundamental conversation on finance, technology transfer and capacity building.

Addressing climate finance within the GGA has its own set of challenges, however, especially considering the negotiations on the NCQG that are set to conclude next year. There is a concern that prioritising finance discussions might lead to delays or leave the NCQG as a mere placeholder. However, it is important to recognise that, without means



of implementation, many of the GGA targets and indicators may not be achieved. The cumbersome and protracted funding access processes only serve to disadvantage developing countries lacking the human and financial resources to navigate these complex systems. Addressing shortcomings through an iterative policy cycle of adaptation that was established under the Cancun Framework, which includes providing support for assessing impacts, vulnerabilities and risks, planning, implementation and monitoring, evaluation and learning, could help in achieving effective and equitable global climate adaptation.

There is debate about whether finance should serve as an enabler for implementation or if it should also have its own specific outcomes. Securing resources for climate adaptation plans and priorities identified through different planning processes is vital for the success of the GGA. Developing countries are proposing that finance under the goal on adaptation should not be treated as a separate pillar but rather as an integral part of the goal, that connects various dimensions and appears throughout the iterative adaptation cycle.

Considering the interconnected nature of finance and adaptation, one could argue that addressing finance issues within the GGA goes beyond setting targets; it must also tackle broader challenges to ensure its effectiveness. Developing countries have been calling for financial support not only for the elaboration of their NAPs and the development of Monitoring, Evaluation and Learning (MEL) systems for adaptation, but also for implementing adaptation actions (Beauchamp and Motaroki, 2022). The GGA framework needs to be the ambition mechanism for adaptation that will then drive adaptation action and support. In this way, it is not a mechanism to set and meet targets, but it is more about addressing underlying challenges and enhancing the mobilisation of resources, knowledge-sharing, and the coordination of adaptation efforts on a global scale. Under the GGA framework, the climate finance discussion should not solely be about efficiently allocating resources to planning processes, but should work towards addressing the finance gap in the iterative adaptation cycle and, therefore, supporting action at scale.

4.2. Reforms outside the climate negotiation process

There is a common misconception that climate action must always compromise economic development, and that lower-income nations should instead prioritise poverty alleviation. However, it is increasingly evident that inaction on climate change hinders and slows inclusive development and poverty reduction, and that action on climate change, when properly structured, creates significant advantages and possibilities. Therefore, it is important to explore other processes that would catalyse adaptation action, reduce debt burdens and promote sustainable development. One example is the ongoing conversation around reforming the international financial architecture.

The need for financial reform has become increasingly urgent in light of the impact of the Covid-19 pandemic (Streimikiene and Kaftan, 2021). Many developing countries have suffered greatly from the effects of the crisis, leading to a growing recognition that significant changes are needed in the financial landscape. The economic downturn

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caused by the pandemic, along with increased spending on disaster recovery, has put a strain on national finances. This has raised concerns about countries' ability to manage their debt, sustain public expenditures and secure funding for future development initiatives.

In response to these challenges there is a growing consensus that global financial reform is not only desirable, but also an urgent necessity. Such reform needs to consider measures to strengthen healthcare systems, build climate resilience and adaptive capacity, support economic recovery efforts and provide debt relief for nations burdened by high levels of debt. Additionally, there is a call for an equitable distribution of resources (i.e leaving no one behind or a concentration of support to certain countries) and international cooperation aimed at addressing the challenges faced by developing countries in the post-pandemic era. At COP27, developing countries expressed dissatisfaction with the status of climate finance, the significant portion of which is provided in the form of loans, which places further burdens on economically strained nations (Alayza et al, 2022). This dissatisfaction is not limited to the climate process and the negotiations on finance, but there is a growing recognition that global public financial systems, including development banks, need comprehensive reform. This recognition aligns with the increasing demand for expanded climate finance, acknowledging that debt issues hinder developing countries' efforts to address climate change.

According to the IMF, 60% of low-income countries are already in or facing a high risk of falling into debt distress, and nearly 70% of climate finance is being provided in the form of loans (Chabert et al, 2022). These loans are contributing to the escalating debt crisis following Covid-19. There is a limit to how much debt developing countries can handle before it becomes unmanageable and disrupts their economies.

The Bridgetown Initiative, led by Prime Minister Mottley of Barbados, emphasises the need to reform the financial system. The initiative gained support from leaders in both developed nations and developing countries, including President Macron of France and Prime Minister Modi of India. Aimed at addressing the intersection of three global crises – debt, climate change and inflation – the initiative proposes new financial instruments and the reform of existing institutions to fund climate resilience and the achievement of the Sustainable Development Goals (SDGs) (Prime Minister's Office, Barbados, 2022). While such reform initiatives are not solely focused on adaptation finance, there is a strong climate rationale. The initiative makes the case for grants and concessional financing instruments for adaptation and loss and damage finance, as opposed to mostly loan-based public financing for mitigation action. As the impacts of climate change affect countries' ability to service their debts, this problem will intensify if the necessary adaptation measures are not implemented to protect vulnerable countries and communities.

There are also continuing efforts by more established institutions and processes towards reform of the global financial system. These reforms involve financing organisations, including MDBs such as the World Bank, international financial and monetary policy



bodies such as the IMF, private sector finance providers, intermediaries and credit rating agencies. Without systemic improvements in these areas, simply reforming MDBs will not create a lasting impact. Implementing reforms to the architecture of the global financial system will strategically position MDBs to play a more effective role in tackling challenges related to the availability, adequacy and accessibility of financial resources. However, without financial stability support from the IMF, for example, a country might not be able to absorb the resources available to it from the banks even if they come at the most favourable concessional rates. Issues addressed in our demand-side analysis, including currency-related risks, indebtedness and limits to fiscal space, could be improved by a better-designed intervention from a system of global finance capable of understanding and solving these issues. The current system is not fit for purpose, hence the need for reform.

Dealing with climate adaptation finance presents a range of multi-dimensional challenges that require a nuanced and flexible approach. A one size fits all strategy will not be adequate because they encompass issues related to systems, capacity and commitment which demand diverse responses. The world needs a global arrangement that can support financial stability, provide resources for economic growth and social development, finance climate mitigation, adaptation and loss and damage needs, and enable inclusive engagement. Some reform proposals have garnered more support and momentum than others. For instance, the inclusion of climate event-triggered debt-deferral clauses in finance deals is being considered. The recapitalisation of MDBs, however, is a harder sell. Reforms to the governance structures of the World Bank and the IMF, including decision-making and the distribution of shareholding, are not being seriously contemplated.

Developing countries are also interested in reforms that will enable them to absorb more international financing. One such area is reform of the credit rating system and infrastructure. Developing countries complain that the small number of private entities that control credit worthiness assessments overestimate the risks and undervalue their abilities. The institutional dominance of these rating agencies is prompting alternatives. The African Union is developing a rating agency for its members, for example. With climate transitions creating new opportunities for new, economically valuable resources such as carbon sinks and minerals important for energy transition, the argument is being made that these need to be reflected in countries' creditworthiness. This could unlock more resources as countries begin to be rated more favourably.

As discussed in the previous section, it is important to adopt a multifaceted approach that leverages both the current global climate negotiation process and climate finance architecture reform. These measures can drive changes in how climate finance is provided. The climate negotiation process can collectively raise global ambition to establish adequate financial targets and encourage developed nations to fulfil their commitments to provide financial support. Similarly, reforms to the climate finance architecture can enhance the efficiency and effectiveness of existing financial mechanisms. This involves streamlining fund allocation processes, exploring new financial

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instruments and diversifying funding sources to make climate finance more robust and adaptable.

To effectively address the demand aspect, countries must establish systems that promote transparency, accountability and efficient utilisation of climate finance resources. This includes establishing climate finance delivery systems and mechanisms for tracking and reporting on climate expenditures, ensuring that funds reach their intended beneficiaries and building local capacity to manage and implement climate projects effectively. Encouraging transparency and accountability of private sector actors through disclosure mechanisms and other relevant regulatory tools will also be important.



+ 5. Recommendations for Developing Countries



Our analysis has identified enormously complex interdependent challenges that developing countries have to overcome in relation to adaptation financing. With such diverse challenges, ranging from the supply-side issues of availability, adequacy and access, to demand-side problems associated with economic fundamentals, lack of own resources and limited absorption capacity and fiscal space, it is difficult to point to easy solutions. Addressing these challenges requires an integrated and fundamental transformation at all levels of governance, in the public and private sector. For the purpose of enhancing adaptation financing, these transformations need to enable developing countries to effectively use their own resources and mobilise international finance in the form of grants, concessional financing and loans that do not exacerbate indebtedness and fiscal unsustainability. Our recommendations focus on what developing countries can do and how international processes and support should respond to adaptation finance challenges.

1. An integrated policy approach to improve the economic fundamentals of developing countries is crucial.

Improvement on adaptation finance cannot be achieved in isolation. Targeted policy interventions can only go so far. Developing countries should, in their planning, identify system-level challenges and solutions in addition to the usual sectoral issues. Climate finance in general and adaptation finance in particular need to be factored and contextualised in the prevailing realities of the individual developing country. This helps in designing bespoke solutions for adaptation finance challenges in the specific country concerned. Developing countries have to effectively balance short-term priorities and long-term resilience objectives on a daily basis. This should aim to embed long-term resilience into interventions even on short-term goals. Integrating resilience in all aspects of planning and implementation could help countries get more out of the limited resources they have.

It is highly unlikely that adaptation needs will be met by public sources exclusively. Therefore, it is crucial that countries empower their domestic private sector – first by seeking to develop its private sector through international support and then playing an active role in enable public actions and finance to mobilise domestic private finance – and create a suitable environment for international investment. It is important to find ways to improve the overall trajectory of the economy towards the utilisation of all available resources and stakeholders. Without adequate capacity to absorb capital, the abstract possibility of finance availability is of no use to developing countries. Developing countries, therefore, should create the policy, regulatory and operational environment for the development of their economy in general and the financial sector in particular. **Finance-**

providing countries should also invest in improving the finance sector in developing countries through direct public investment, encouraging their private sector to invest in developing countries, capacity development and technology transfer.

2. Recognise the demand-side challenges for developing countries in international processes and design appropriate solutions

Dedicated international processes for climate finance and broader finance reform processes should understand and actively engage in finding ways of alleviating the problems faced by developing countries. For example, the NCQG process should consider how international climate finance from developed countries to developing countries can specifically target and cater for adaptation needs. This involves the right quantification of adaptation needs. If the goal involves private sector sources, it should recognise the inherent deficiencies of the private sector in developing countries and their limited absorption capacity. A goal that merely puts forward a number and commitment to mobilise through the private sector will not go far in improving adaptation finance.

In this regard, negotiations on the operationalisation of Article 2.1.c of the Paris Agreement could provide the space for an important discussion on how to improve the overall finance ecosystem in both developed and developing countries to create more finance flows that are aligned with and contribute to the fulfilment of climate goals. Developed countries could consider how to allocate more public resources for climate action and incentivise their private sector to engage in investments in developing countries. **They can, for example, create guarantee mechanisms, invest in public-private partnerships, regulate their private sector to fight exploitation and corruption, and apply different levers including technical assistance and cooperation to facilitate the development of public and private sector capabilities in developing countries.**

The global financial architecture reform agenda should also pay attention to the particular needs arising from climate change-related financing concerns of developing countries, especially related to adaptation and loss and damage. Reforms should not feed into the current trend that favours finance for mitigation action and should recognise the importance and peculiarities of adaptation financing needs. Any reforms to the global financial architecture in support of climate action should not erode the reliability and predictability of development finance, however. The allocation of resources for climate action, however small, by developing countries is often made possible because they can access financing for their other priorities through development finance mechanisms. The reform of the global financial architecture should result in more resources for developing countries without increased indebtedness and improved access for financing for both development and climate priorities. Key improvements could include better allocation of resources in terms of available resources including through capital increase or operational changes to free up capabilities for multilateral development banks. The reform should also give a serious chance to negotiations on debt relief.



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