

## The Adaptation Fund in the debate on the post-2012 financial architecture

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### Summary

*The Adaptation Fund under the Kyoto Protocol has made significant progress over the last months, with the Adaptation Fund Board having worked dedicatedly on the complex issues the members have to deal with. In addition to its innovative features which were constituted already in Bali, the focus on most vulnerable communities as well as the very transparent work process are remarkable developments. Nevertheless, the Fund also suffers from its scarce resource base, which e.g. makes it difficult to support programmatic approaches in a larger number of developing countries. It is the time to place the Adaptation Fund – or at least its rules and basic provisions - more at the heart of the institutional debate under and outside UNFCCC, since its key features set precedents for the desired institutional criteria also in other funding purposes than adaptation. It even resembles many of the proposals for the financial mechanism as outlined by the US government, the recent joint proposal by the governments of UK, Mexico, Norway and Australia, and also by the G77 and China. But giving the Fund a stronger future role faces political and legal (which are also political) difficulties which are in particular linked to the fact that the US are not a Party to the Kyoto Protocol. These can be overcome if the political will emerges, but may result in certain changes in the key features of the Fund which have to be weighed off against the potential benefits of a much stronger role.*

*A Copenhagen outcome should be based on this foundation and seek to strengthen the role of the Adaptation Fund, both through a strong and public support for the work of the AFB as well as a concrete amount of resources that would flow into the Fund as fast-track finance, but also through agreement on reliable finance mechanisms beyond 2013.*

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### Background

In 2007 at the Climate Summit in Bali (CMP13), the Parties to the Kyoto Protocol agreed on the institutional arrangements of the Adaptation Fund (AF), which in principle was agreed on in the Marrakech Accords in 2001. The Fund has some unique and very innovative features and may become a new model for international cooperation, depending on its further development.<sup>2</sup> This paper describes progress achieved in the development of the Adaptation Fund and discusses possible options for the role of the AF in a post-2012 financial architecture.

### **1. Setting precedents: The Adaptation Fund's innovative features**

The AF has several unique features to do with the way it is owned, funded and governed. Together, these give it the potential to contribute significantly to international cooperation on adaptation, and in addition set precedents which will likely be relevant also for climate financing beyond adaptation. Some of these features were agreed already in Bali, while others evolved through the work of the

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<sup>2</sup> Kent et al., 2009

Adaptation Fund Board. The AF is now an existing institution, using the Global Environment Facility (GEF) which provides secretariat services, and the World Bank serving as a Trustee.

**Direct access:** Part of the Bali decision was that developing countries will be able to access resources from the Adaptation Fund through direct access, which in principle significantly increases the ownership of developing countries. The Adaptation Fund Board (AFB), the governing body of the AF, has developed a direct access approach which will work through the accreditation of domestic National Implementing Entities (NIEs). These would basically fulfil the same tasks that now the multilateral implementing entities such as World Bank, UNDP and others fulfil. The NIEs would primarily have oversight functions. Of crucial importance to the credibility of this approach are sound fiduciary standards, which the AFB has developed through careful considerations and based on expert input and lessons learnt from other processes.<sup>3</sup> It remains to be seen from practice if the standards the AFB has adopted will also be manageable by developing countries, which of course is a key requirement.<sup>4</sup>

**Innovative funding mechanism.** Fund revenues are obtained primarily from a 2 per cent share in the proceeds from the Kyoto Protocol's Clean Development Mechanism (CDM) project activities. This means that the Fund is self-financed through the carbon market, independently from and in addition to contributions from developed countries. By 2012, it is estimated that the Fund will possibly contain around USD 450 million from CER sales.<sup>5</sup> The revenue raised, however, will not be enough to cover the deficit in adaptation funding. Current estimates for adaptation in developing countries vary, but it can be assumed that this will cost a minimum of US\$50 billion each year.<sup>6</sup> There is a clear need for a major boost in adaptation funding. For the future debate it is important that the AF will receive funds from other sources than the CDM levy, such as government contributions or innovative finance mechanisms, assuming it continues to play a role in the future architecture.

**Representative Governance:** The AF is supervised and managed by the **Adaptation Fund Board** (AFB). This Board works under the authority of, and is accountable to, the Meeting of the Parties to the Kyoto Protocol. In practice this means that the Board works quite autonomously, after the Conference of the Kyoto Parties (CMP) adopted key guidance documents (the documents proposed by the Board were accepted by the CMP largely unchanged).<sup>7</sup> This also shows that the key question is not whether the Board works "under authority" or "under the guidance" of the COP/CMP, but how the relationship is set up in detail, what documents need to be adopted by the COP/CMP, and what is in the sole responsibility of the Board.

The Adaptation Fund Board has 16 members (and 16 Alternates): two represent each of the five UN regional groups, one represents Small Island Developing States (SIDS), one represents the Least Developed Countries (LDCs), two represent the Annex 1 (developed) countries and two represent the Non-Annex 1 (developing) countries. This results in an overall majority of developing countries. This representation enshrines the UNFCCC principle of equitable and balanced representation of all Parties in the governance structure more than the governance composition in any other of the existing Funds. Nevertheless, establishing active civil society participation in the decision-making of the Fund would be an important advancement, as analyses from other funding mechanisms in the light of the need for pro-poor adaptation funding governance suggest.<sup>8</sup>

At the moment, the Members and Alternates represent a broad spectrum of expertise, from finance experts and development practitioners to fund managers and adaptation experts, which is one reason for the profoundness of many debates in the Board. Some of them are also active negotiators for their constituencies under UNFCCC (which does not necessarily contrast being an expert). Thus, formally there is no strict distinction between "technical experts" and "policy-makers". Decisions are taken by consensus, and so far all decisions have been taken this way, sometimes after in-depth discussions of

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<sup>3</sup> AFB, 2009a

<sup>4</sup> AFB, 2009b

<sup>5</sup> AFB, 2009c

<sup>6</sup> See e.g. World Bank, 2009

<sup>7</sup> See decision 1/CMP.4; Müller, B. 2009a

<sup>8</sup> CARE, Germanwatch and Bread for the World, 2009

certain issues. The general North-South divide which often characterises the UNFCCC negotiations is not representative for the AFB discussions.

### **New features: Focus on most vulnerable communities and transparent policies**

Furthermore, two other very important features should be mentioned which evolved through the work of the Adaptation Fund Board: The focus on most vulnerable communities and the transparency of the whole AFB's work.

The **strategic priority that “in developing projects and programmes, special attention shall be given by eligible Parties to the particular needs of the most vulnerable communities”** is a crucial element in the AF provisions. This priority has been adopted by the AFB by consensus, without controversial debates, at the 3<sup>rd</sup> meeting in September 2008. It is a kind of qualification in order to channel resources to serve those who are most in need.<sup>9</sup> It should not to be seen as a prescriptive conditionality imposed by developed countries in the context of the Copenhagen negotiations. *First*, because the identification of most vulnerable communities is still fully left to the countries. Of course, it should happen in inclusive, transparent and consultative processes therein. *Second*, this priority already has been agreed upon by all 189 Kyoto Parties, when they adopted the Strategic Priorities, Policies and Guidelines of the Adaptation Fund in Poznan. By decisions at the 7<sup>th</sup> meeting in September 2009, the AFB also made this priority a distinct element of the guidelines to prepare project proposals.<sup>10</sup>

In addition, the AFB has developed over the time a very **transparent working mode**. All documents are available on the website, the AFB meetings are being webcasted so that everyone can follow the debates. All interested observers are allowed to participate and even to sit in the meeting room of the AFB, except for very few closed sessions.<sup>11</sup> While the Board previously had decided that all project and programme proposals submitted by Parties would be put on the AF website, it has now also adopted a provision which requires the AF Secretariat to provide facilities on the website where public comments can be made during the project review and approval period.<sup>12</sup> While no details could be developed yet, this basic decision is an important signal that the AFB takes serious transparency. In setting up this procedure, lessons can be drawn from the CDM process, where a fix public comment period to the Project Design Documents (PDDs) has been an accepted element in the project approval process.<sup>13</sup> With these steps the AFB has achieved a level of transparency which partially even seems superior to that of for example the Climate Investment Funds (CIFs) managed by the World Bank.<sup>14</sup>

### **Where does the Fund stand now?**

Just three weeks before Copenhagen, the Adaptation Fund Board concluded its 8<sup>th</sup> meeting. It is true that the AFB has not yet invested one single dollar into adaptation projects, after 20 months of existence. However, the performance of for example the Pilot Programme for Climate Resilience (PPCR) under the World Bank Climate Investment Funds is not better, aiming to distribute first funds by the end of 2010. And also the “delivery capacity” of the UNFCCC Funds managed by the GEF is not too overwhelming.

The AFB has followed the approach that is favoured by many: First get the structures right. And the AFB managed to pass key milestones at the right time: It agreed all documents that were required for adoption by the CMP in Poznan with consensus. During 2009, it adopted the operational policies and guidelines including sound fiduciary management standards for national implementing entities. It also issued an invitation to developing countries to nominate National Implementing Entities (NIEs). Furthermore, the AFB also decided to accept the host country offer from the German government, which will now proceed the required legislative process to give the AFB own legal capacity as soon as possible, as decided by the CMP in Poznan. At its recent meeting, the AFB also held intense

<sup>9</sup> See Germanwatch/Bread for the World, 2008

<sup>10</sup> See Harmeling and Kaloga, 2009

<sup>11</sup> Observers just have to register in advance via an organisation accredited by UNFCCC; only in the case of debates about the CER monetisation policies sessions have been closed, in order to avoid possible market distortions..

<sup>12</sup> Adaptation Fund 2009b

<sup>13</sup> Procedures on public availability of the CDM PDD, para 40 of the CDM Modalities and Procedures, EB 09 Report, Annex 7

<sup>14</sup> Mueller, B. 2009b

discussions about the future results-based management framework, another important element in a credible funding system. It is expected that a call for proposals will be sent out to Parties in the first months of 2010 and first projects be approved soon thereafter.

Some doubt that the AFB can serve as a model because it appears to be too politicised. However, on the one hand this reputation seems to build on the very early days of the AFB, when there was, inter alia, also a lot of mistrust towards the GEF which provides secretariat services to the Fund which resulted in a partially politicised atmosphere. Additionally, the controversial debates in Poznan around the legal capacity issue were led by others than the AFB members, more high-level negotiators who have never been to an AFB meeting. Thus, the way the debate developed in Poznan was absolutely not representative for the work of the Board, and the progress the AFB made during this year should be acknowledged.

In terms of the overall interim institutional arrangements, one can say that the cooperation between the AFB, the AFB Secretariat, the GEF and the World Bank has significantly improved since the first half of 2008. Now the GEF only plays a background role, assisting the dedicated AF Secretariat staff. Also, there has been no obvious reason for conflict during the last months which questioned the role of the World Bank as a Trustee.

### **Scarce resources create specific challenges**

There are two challenges for the Adaptation Fund which are linked to the scarce resources available. To understand this link is important because these two challenges are reasons for the scepticism from some developed countries towards the Adaptation Fund.

*First*, there is a fear that the AF would primarily fund single projects, rather than moving to programmatic approaches (although the latter ones are part of the AF's mandate). However, given the large number of potential recipient countries the resources available are simply insufficient to fund broader programmes in developing countries. Taking the Bali Action Plan definition of particularly vulnerable countries (LDCs, Small Island Developing States and African countries prone to droughts, floods and desertification), there are at least 100 countries on the list. Dividing up the pie of expected revenues of USD 450 million until 2012 leaves about 4 million per country on average, not including other eligible developing countries. The cost estimates reveal a sharp contrast. A recent World Bank study estimated the adaptation needs in the group of low-income countries – which largely overlaps with the Bali Action Plan definition – to be in the order of USD 25 billion annually during the coming decade 2010-2019 and rising to almost 40 billion in 2050.<sup>15</sup>

*Second*, given the scientific and political complexity of defining “particularly vulnerable countries”<sup>16</sup>, and the scarce resources available, it is extremely difficult to take decisions on resource allocation on a country basis, as is being discussed in the Adaptation Fund Board, although the AFB already adopted guiding criteria. The AFB has not yet taken a detailed decision on this matter.<sup>17</sup> However, by some this situation is seen as an evidence that developing countries are not able to divide a pie in a fair manner among themselves. But if the resources available would be somewhere near the actual needs, this challenge would likely be much easier to handle.

## **2. The Adaptation Fund in the AWG-LCA negotiations**

Within the current negotiations towards a Copenhagen agreement, the Adaptation Fund has played almost no (explicit) role. The developing countries (G77 and China) have proposed new institutional arrangements under the Convention, which would include inter alia a funding window for adaptation. However, their submissions do not refer to the KP Adaptation Fund.<sup>18</sup> The Alliance of Small Island States (AOSIS) specifically calls for a new Adaptation Fund under the Convention, without any reference to the KP Adaptation Fund.<sup>19</sup> While the EU has not referred to a future role of the Adaptation Fund in their written submissions, it at least acknowledged in Poznan that the AF could play an important role in the future.

One of the very few examples of explicit recognition of the Adaptation Fund in the AWG-LCA negotiations was the submission from India, which stated that “the Adaptation Fund Board could itself

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<sup>15</sup> World Bank, 2009: 88

<sup>16</sup> See Klein, 2009

<sup>17</sup> See Kaloga/Harmeling, 2009:

<sup>18</sup> G77 and China 2008

<sup>19</sup> AOSIS, 2008

be given an expanded mandate and a strengthened structure”, as part of a reformed financial mechanism under the Convention. Given the fact that it is a Protocol Fund, “the AF Board could be subsumed into” such a reformed mechanism, for example taking up the role of an operating entity.<sup>20</sup> This position is similar to what the broad NGO alliance Climate Action Network International (CAN-I) suggested in the context of its proposal for an Adaptation Action Framework.<sup>21</sup> Subsuming the AF under the Convention, however, may create the need to expand or reorient the governance composition.

This also points to the likely key reason why the AF is given so little attention in the AWG-LCA debate, despite its innovative features: the fact that the AF is under the KP, and that there is a distinction within the negotiations (and within the heads of many negotiators) between KP and LCA negotiations. However, the AF has also to be seen as an element of the financial mechanism under the Convention, since the KP is a Protocol to the Convention.

The key problem here is – and also one key argument for the proposal to set up a new Convention Adaptation Fund – the absence of the USA in the Kyoto Protocol. And of course, given the critical responsibility the USA as a causer of anthropogenic climate change, the country should contribute its fair and reliable share to cover developing countries needs for adaptation.

### **Broadening the funding base**

Some scepticism from developing countries towards the AF stems also from the observation that even the AF will not have enough resources available to cover the adaptation burden, despite its innovative and new source. Under certain conditions, with a second commitment period of the Kyoto Protocol and sufficiently strong mitigation targets for Annex I countries, the AF could generate much more resources from the CDM levy than is expected by 2012.<sup>22</sup> However, since the US will not become a Party to the KP, any trading mechanism set up under the Convention not subject to a similar levy as the CDM levy would have a comparative advantage compared to the CDM, which KP developed countries probably would not like.

Nevertheless, the debate on the funding source of the AF should not be limited to the levy on a trading mechanism since by its mandate the AF can receive money from a variety of sources. There seems to be no legal argument why the AF could not be funded by any type of future funding source that would be agreed upon (under the KP or under the Convention), be it auctioning of AAUs, mandatory assessed contributions or levies on aviation and maritime transport, like the LDCs have proposed (for aviation). Parties would just have to agree on that when they agree on the use of resources from the possible sources (of course there is the limit of political will). It would even be an option that AAUs go directly into the AF’s account, which could then be monetised by the Trustee of the AF like it is done with the CERs.

### **3. Assessing the potential role of the AF in post-2012**

There are good reasons why assessing the potential role of the AF in a post-2012 climate regime is useful, independent of its KP character. Although the author and many NGOs advocate for a continuation of the KP, this does not mean that a KP Fund could not also take up a role in a new legally binding agreement under the roof of the Convention, as an essential element of the KP. However, since the consideration of the future financial architecture (for adaptation funding and beyond) should follow the rule “form follows function”, the role of the existing institutions (or potentially new ones) has to be assessed with regard to how they fit to the required purpose, and before new ones are established.

#### **What is the future purpose for adaptation funding?**

The future role of the AF and the scale of resources to be provided to it can not be discussed independently from the purpose that the adaptation challenge in developing countries demands. While there is undoubtedly the need to fund specific adaptation projects and programmes, as is the current

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<sup>20</sup> India, 2008; see also Mueller, 2009c

<sup>21</sup> CAN International, 2009: the Adaptation Funding Window [...] “Be governed by an Adaptation Funding Executive Board (AFEB) based on the governance and operational principles of the Kyoto Adaptation Fund Board (which could be expanded to take up the role of, and essentially become, the AFEB), to manage operations of the Adaptation Funding Window.”

<sup>22</sup> However, there are also strong arguments for a substantial reform of the CDM, to increase its environmental integrity. This may reduce the number of approved projects and thus the issued CERs.

mandate of the Fund, the real challenge and future task lies in the implementation of comprehensive and flexible national adaptation strategies (or adaptation components of a national climate change strategy, low-carbon development strategies etc.). It is important to understand that such distinct strategies as such are not a contradiction to the integration of adaptation into national development processes, but can rather serve as a driver for this integration process. Independent of the specific form of such strategies, it will require to build up capacity to develop and implement these strategies on the developing country-level.

One of the most interesting examples in that regard is that of Bangladesh's National Climate Change Strategy and Action Plan, which combines both a long-term visionary strategy and elements of a near-term action plan on different aspects of adaptation, including measures to integrate and mainstream adaptation into sectoral policies. The estimated costs are said to be in the order USD 5 bn for the first five years.<sup>23</sup> Funding and implementing such a strategy is not a task of the Adaptation Fund in its current setting, and there is no doubt that no international funding mechanism would be fit for this purpose if it would be tasked to approve every single project implemented under this strategy. This would overwhelm such a mechanism or require a massive amount of a capacity in that mechanism. The responsibility for this implementation must be primarily on the national level.

If the global community takes serious the challenge of adaptation (and the polluters their responsibility), than funding this kind of strategies must become the key objective of adaptation funding, which, however, also requires an appropriate institutional setting on the developing country level (and it should not exclude the possibilities for receiving funds just for specific projects). Developed countries are demanding that developing countries develop comprehensive and integrative strategies on adaptation, so the logical next step is that appropriate support for their implementation is being provided, at least for those countries particularly vulnerable.

So how does the institutional set-up the AFB has developed fit in here? The key element in the direct access approach are National Implementing Entities, which basically substitute the role that otherwise the Multilateral Implementing Entities do play. Their current task is foreseen as follows:

*“National Implementing Entities (NIE) are those national legal entities nominated by Parties that are recognized by the Board as meeting the fiduciary standards established by the Board. The NIEs will bear the full responsibility for the overall management of the projects and programmes financed by the Adaptation Fund, and will bear all financial, monitoring and reporting responsibilities.”<sup>24</sup>*

Additionally, it is interesting to look at the way the AFB discusses the distinction between project and programme support. Whereas the AFB can get a concrete idea of a project submitted, because it has to be characterised with a certain level of detail, expecting a programme proposal to show the same level of detail for each project implemented under the project is unrealistic and would overload the proponent as well as the AFB members. In contrast,

*“the whole idea of the programme is that the Board can delegate the design and implementation of projects to an authority in which it has confidence – confidence that it can design a strategic plan and operationalise the projects required to achieve the strategic objectives.”<sup>25</sup>*

With this approach the AFB is taking steps to devolve responsibilities to developing countries, and, in the case of programmes, even decision-making power, since the decision on specific projects to be funded under a programme would not be taken by the AFB, but the entity which implements the whole programme: The AFB would only approve the programme and assess if it trusts the competence of the entity, and if this is the case disburse funds to this entity for the implementation of the programme. This entity would then be accountable for appropriate use of the resources to the AFB. The way a financial mechanism could in the future fund national adaptation strategies is not too much different, just on a much larger scale. As said before, the Bangladesh strategy consists of a number of thematic programmes and its implementation requires much more resources than just a single programme.

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<sup>23</sup> Bangladesh, 2008

<sup>24</sup> AFB, 2009b

<sup>25</sup> See Kaloga and Harmeling, 2009

Thus, through this direct access model the AF has comparable advantages to the World Bank or the GEF with regard to the devolution of decision-making power to developing countries, while at the same time keeping open the way through the multilateral entities for countries which still lack institutions with the appropriate capacity.

### What is the role for the AF in the future climate finance architecture?

Setting up a new fund under the Convention would take time, cost resources and would likely also generate certain political fights. The AF itself is an example for that, but now it has become an existing and maturing institution. And it is not ensured that the outcome of such debates under the LCA track would be as good as the AF's basic conditions. As soon as the AF has its legal capacity, probably before the end of 2010, it will be a strong operating entity which, in contrast to the GEF or the World Bank, can deliver on direct access. With this own legal capacity, in theory the AF could also become the nucleus for a broader reformed financial mechanism, for example in the sense the G77 and China envisage, or one operating entity. The functions attributed to the National Implementing Entities (NIEs) could very likely also be expanded to other funding purposes, beyond adaptation, since so far they are primarily oversight functions. The challenge of broadening the resource base has already been discussed.

### The USA, the KP and the AF

Since the AF is a Fund set up under the Kyoto Protocol, the USA do not yet play any role in it. However, given they are the historically largest polluters developing countries reasonably demand that the USA contributes to fund the adaptation burden significantly. Legally speaking, the AF could receive funds also from non-KP Parties (see above).<sup>26</sup>, but at the moment it is politically very unlikely that the US would just feed resources into it, as long as it is (called) a KP Fund. To some extent, the call for a new Convention Adaptation Fund by AOSIS is based on this perception, as well is the hesitance by KP developed countries to put additional resources into the AF.

There has not yet been any active attempt by the US negotiators to acknowledge the progress the Adaptation Fund made, at least not publicly in the negotiations. However, the US in Bangkok in September 2009 have made an own proposal for a financial architecture, and comparing this with the Adaptation Fund reveals that there are a lot of similarities and areas of convergence (see table 1), which should form the basis for a more constructive assessment of the potential role of the AF. In this comparison has been included the finance proposal submitted in Copenhagen by UK, Mexico, Norway and Australia.<sup>27</sup>

Table 1: The Adaptation Fund and other finance proposals

Criteria	US finance proposal	UK, Mexico, Norway and Australia	Adaptation Fund	Comment
<b>Country ownership</b>	integrates its funding, planning and activities with country-driven development strategies and programmes	Delivery of funding should be in line with developing countries' national sustainable (low carbon and climate resilient) development plans and priorities and country-led.	Projects and programmes funded under the AF should also take into account, inter alia, national sustainable development strategies, poverty reduction strategies, national communications and national adaptation programmes of action and other relevant instruments, where they exist.	<b>CONVERGENCE</b> <i>All three give high priority to consistence with national development strategies of different kind</i>
<b>Direct access</b>	Support project, programmes and activities administered by [...] domestic institutions in host countries	There should be direct access to international finance where fiduciary standards allow and country level trust funds should be considered, among other alternatives,	Direct access as key principle, implemented via National Implementing Entities (NIEs)	<b>IMPLICIT CONVERGENCE</b> <i>The US proposal does not explicitly propose direct access, but mentions which resembles the AF's NIE approach, the UK et al. proposal explicitly</i>

<sup>26</sup> This has also not been restricted by the recently adopted „Guidelines for accepting donations” (AFB/B.8/11)

<sup>27</sup> UK et al., 2009

Criteria	US finance proposal	UK, Mexico, Norway and Australia	Adaptation Fund	Comment
		where direct access is not possible.		<i>demands direct access connected to fiduciary standards, like AF</i>
<b>Fiduciary standards</b>	Fiduciary responsibility and strong accounting	<i>See direct access and simplified procedures</i>	Key Points on fiduciary standards: Financial Integrity and Management; Managing and disbursing funds efficiently and with safeguards to recipients on a timely basis; Institutional Capacity; Transparency and Self-investigative Powers	<b>CONVERGENCE</b> <i>The standards adopted by the AFB give high priority to fiduciary responsibility.</i>
<b>Simplified procedures</b>	Creating simplified administrative procedures	Should deliver expedited and more predictable access to finance	Short and efficient project development and approval cycles and expedited processing of eligible activities shall be developed, simplified procedures for small-scale projects.	<b>CONVERGENCE</b> <i>The AF explicitly aims at developing a simpler and more rapid project cycle</i>
<b>Governing Board Composition</b>	governed in a transparent, effective, and efficient manner with balanced representation between net contributors and net recipients	It should have a high-level board under the policy guidance of, and accountable to, the COP, with equal representation of developed and developing countries, and an equitable, efficient and transparent governance structure.	taking into account fair and balanced representation among these groups as described before, resulting in developing country majority follows	<b>DIVERGENCE</b> <i>Although the language proposed by the US could still be interpreted in a way similar to the AF composition, the US made clear that a developing country majority is not acceptable for them; "equal representation" in the UK et al. option is not in line with AF</i>
<b>Implementing entities and executing entities</b>	Projects administered by multilateral development banks, domestic institutions in host countries, or by other actors including the private sector and civil society	It could deliver funding through institutions as identified by the developing country, in partnership with other domestic and international public and private financial institutions.	National Implementing Entities (NIE), Multilateral Implementing Entities (MIE), Executing Entities (incl. NGOs)	<b>CONVERGENCE</b> <i>All three are open to multilateral as well as national implementing entities; "Administered" in the US proposal resembles the actual meaning of "implementing" in the AF</i>
<b>Trustee</b>	operates with an existing multilateral financial institution as its trustee	To ensure rapid start-up and efficiency, the administration of such a Green Fund could be entrusted to an existing international financial institution	World Bank as Trustee; AFB as existing international institution (soon with legal capacity)	<b>CONVERGENCE</b> <i>The current Trustee of the Adaptation Fund is the World Bank, an existing multilateral financial institution; the AFB itself with its legal capacity (soon) can also be regarded as a financial institution</i>

Source: own compilation based on USA, 2009; UK, Mexico, Norway and Australia, 2009; and AFB documents

### **Developing country majority - a reason for developed countries to fear the AF?**

One feature that is said sometimes to be unacceptable for the US Senate and Congress is the governance structure of the Adaptation Fund which gives the majority to developing countries. An equal representation would be the maximum the US would give, is rumoured. However, the

experience of the Adaptation Fund raises doubts if this majority must be a reason to fear for developed countries. So far, the AF has managed to take all decisions by consensus, sometimes after very intense debates. Here it is irrelevant which of the groups has the majority. If consensus is not reached, decisions can be taken with a 2/3 majority. This can only be achieved across the Annex-I/non-Annex-I country groups. Nevertheless, adjusting the governance composition to provide space for the US could be an option if this would result in a significant financial strengthening of the AF.

### **Towards a de-proliferation of Funds?**

From many different sides there is the argument that already too many Funds exist and instead of new ones the coordination between the existing Funds should be improved. What is true is that a smaller number of Funds would possibly result in a simpler funding system, in particular for recipient countries who would have less transaction costs and who are the ultimate beneficiaries. However, more decisive is if the existing institutions are fit for the purpose or can be made fit. If not, then there are good reasons for a new approach. And there is also enough experience that shows that reforming institutions is a quite challenging and long-lasting task. The innovative features of the AF and its potential to fit for the described purpose has already been outlined.

One important question is if there is a reasonable potential to e.g. reduce the number of Funds. For example, theoretically the Least Developed Countries Fund could be merged with the Adaptation Fund, which is expected to have a higher and faster “delivery capacity” than the Global Environment Facility, where the approval of projects often takes two years or more. Transferring the resources contained in the LDCF Trust Fund into the AF Trust Fund would also not constitute a significant barrier, depending on agreement by the contributors.<sup>28</sup> Probably the only, but valuable reason for not merging the two funds is that LDCs are not (yet) especially recognised in the provisions of the Adaptation Fund, and thus they risk losing their specific prioritisation. This could be captured theoretically by creating a separate window or at least an earmarking of funds in the Adaptation Fund. The PPCR managed by the World Bank so far has no formal relationship with the UNFCCC, since it was set up outside. It is not yet a legitimate player, also because of its less balanced governance structure (compared to the AF). From its objective, it is so far probably the closest to the described purpose, putting a focus on assisting selected developing countries in mainstreaming adaptation into their policy and planning processes. However, the way it works and the efforts and time that are required to disburse funds just to the selected 9 countries raises doubts if this approach allows for the necessary progress for a number of 100 or more countries.

## **4. The Adaptation Fund in post-2012: four scenarios**

Basically, there are a number of potential scenarios for the future of the AF. Decisions in Copenhagen will determine which direction the Fund will go.

### **Dying out**

The first scenario could be described as “dying out”. In case there would be no agreement on a second commitment period under the KP, the legal basis for the AF would expire in 2012 and it would die out. This may be favoured by some developed countries and other existing institutions, to reduce institutional competition with this innovative Fund.

### **Drying up**

This second scenario describes that the AF could dry up because it will not contain sufficient resources for providing a serious response for developing countries in coping with the adverse effects of climate change. This could happen if the CDM levy continues to be the only source and if this instrument will be limited in its scale. One point of debate in the AWG-LCA negotiations is to restrict the project-based mechanisms to poorer developing countries such as the LDCs, but to establish sectoral crediting mechanisms for emerging economies. If these would not be linked to the AF, this situation would likely result in significantly less resources from the CDM levy for the AF. If developed countries would decide against putting voluntary or mandatory contributions into the AF, another potential

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<sup>28</sup> The opposite has already happened, when the AF „borrowed“ money from the LDCF to finance its initial work before CERs could be monetised.

source would be omitted. This scenario could also become reality if a new Convention Adaptation Fund (or adaptation window of a larger Fund) would be created and it is decided to channel resources into the new Fund.

### **Scaling-up under the KP**

Assuming the continuation of the two tracks, the AF could also be scaled-up as a KP Fund through decisions that channel additional resources into the AF. Since the US will likely not put budget resources into the Fund (although it is legally possible), this could be done through innovative, additional and budget-independent revenue mechanisms, such as an air passenger levy or auctioning of emission permits in maritime transport and aviation. (But it is very unlikely that the US would support an instrument based on international maritime transport and aviation emissions to support a fund which is based within the KP; and it's also very unlikely KP developed countries would agree to transfer AAUs into the AF if the US is not on board.) Although this option is not preferred by the author, a hybrid solution could also be to keep the AF as the instrument which is financed solely independently from government budgets and which focuses on project and programme support, and have the PPCR as the Fund to assist more comprehensive mainstreaming and integration strategies and which is fed from assessed contributions from developed countries, including the US (and possibly put under the guidance/authority of the COP).

However, also the EU and a number of other developed countries have positioned itself to go for a one-track approach (in the case of EU including all the KP essentials). This means that an agreement on the two tracks is not certain at all.. Nevertheless, in any case the Adaptation Fund should be seen as such an essential.

### **Scaling up under the Convention**

This leads back to the question of how the AF could fulfil a role under the Convention track. Assuming political barriers would be overcome to give the AF (or the AFB) a role under the Convention, there are (at least) two different roles that could emerge. First, functioning as an operating entity under a broader, more comprehensive reformed financial mechanism and under the authority of the COP and an appointed Executive Board.<sup>29</sup> Second, just becoming the Convention Adaptation Fund which would avoid the need to again set up new structures and repeat learning processes. This could for example be the case if no such reformed financial mechanism structure would be agreed on. Third by adding additional windows to the Adaptation Fund (maybe one focused on least developed countries or one on REDD). In all three cases the relevance of the instrument could be increased through scaled-up financial resources from whatever generating mechanism will be agreed upon.

However it is obvious that there are legal and political barriers (eventually all legal barriers are political ones because political will can change the legal frameworks). For example, the KP AFB operates "under the authority and guidance of the CMP", "shall be fully accountable to the [CMP]" (Decision 1/CMP.3) and its administration is to be met from "a share of the proceeds from certified project activities". So the AFB and the CMP would have to accept guidance from the COP, which, however, is not politically impossible given the almost 100% congruence between CMP and COP Parties.

A minimum way of safeguarding the progress achieved in the AF could also be that it is agreed that a new Fund takes over the key documents agreed on by the AF (legally stronger than just cross-referencing), but this would probably still result in a duplication of governing structures.

Finally, it is obvious that the United States' failure to ratify the Kyoto Protocol would be a serious obstacle to the existing Adaptation Fund Board, without structural change, becoming the Board to manage a future fund under the Convention. Given the large convergence between the US finance proposal and the features of the Adaptation Fund, and the progress of the latter, it should be seriously discussed if there are ways to give the AF a larger role in the future regime. One open question is, whether the US would be ready to accept the present governance structure with a developing country majority. If not, developing countries would have to weigh off changes in the unique governance structure against the possible advantages of a much stronger funding instrument. And as has been described before, the governance majority if rather a symbolic feature in a system where simple majority is not sufficient and consensus is aimed to be achieved.

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<sup>29</sup> See Mueller and Gomez-Echeverri, 2009

## **5. Conclusions**

The Adaptation Fund under the Kyoto Protocol has made significant progress over the last months, with the Adaptation Fund Board having worked dedicatedly on the complex issues the members have to deal with. In addition to its innovative features which were constituted already in Bali, the focus on most vulnerable communities as well as the very transparent work process are remarkable developments. Nevertheless, the Fund also suffers from its scarce resource base, which e.g. makes it difficult to support programmatic approaches in a larger number of developing countries. It is the time to place the Adaptation Fund – or at least its rules and basic provisions - more at the heart of the institutional debate under and outside UNFCCC, since its key features set precedents for the desired institutional criteria also in other funding purposes than adaptation. It even resembles many of the proposals for the financial mechanism as outlined by the US government, the recent joint proposal by the governments of UK, Mexico, Norway and Australia, and also by the G77 and China. But giving the Fund a stronger future role faces political and legal (which are also political) difficulties which are in particular linked to the fact that the US are not a Party to the Kyoto Protocol. These can be overcome if the political will emerges, but may result in certain changes in the key features of the Fund which have to be weighed off against the potential benefits of a much stronger role.

A Copenhagen outcome should be based on this foundation and seek to strengthen the role of the Adaptation Fund, both through a strong and public support for the work of the AFB as well as a concrete amount of resources that would flow into the Fund as fast-track finance, but also through agreement on reliable finance mechanisms beyond 2013.

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