Background document #6

What elements should be considered in a discussion about funding for 'loss and damage'?

COP27 in Egypt concluded by agreeing to create new funding arrangements and a dedicated loss and damage fund to assist developing countries in responding to loss and damage. A 'transitional committee' will recommend how to operationalise the new funding arrangements and the fund at COP28, with a first meeting of the transitional committee to be held no later than March 2023. This note highlights a number of problem statements that need to be resolved to seek effective funding for loss and damage.

Understanding what and who needs to be funded determines how to fund

Research on loss and damage if often theoretical in nature. The where and what type of action and support is needed, what works and in which contexts, and how such action and support can be delivered has been less well addressed (Thomas et al, 2020).[1] Limited processes exist for systematically collecting, recording or reporting information on loss and damage and related financial needs by countries under the UNFCCC hindering our ability to establish how to fund loss and damage needs.[2] Countries are increasingly undertaking assessments and gathering data on their needs, but this is no small undertaking. Assessments need to identify populations impacted both directly and indirectly, including economy wide impacts, and any distinguishing features of the populations experiencing greatest loss and damage such as the elderly, sick or a certain income grouping, for example.[3]

Focussing on funding the *addressing* of loss and damage is a commonly mentioned 'gap', while averting and minimising loss and damages can be considered under mitigation and adaptation funding (Schafer et al, 2021). Of course, there are also clear funding gaps for both mitigation and adaptation: total global climate finance flows are estimated at $653 billion annually, in 2019/2020 (CPI, 2022), while needs are in excess of $4-6 trillion as noted in the Sharm El Sheik Implementation Plan (UNFCCC, 2022).

---

[1] In part, this is because the Paris Agreement does not provide a formal definition of 'loss and damage'. Though it remains true that the UNFCCC uses a framing of L&D as comprehensive risk management and categorises a series of activities (a framing that is also not always used outside the UNFCCC): Article 8.4 provides a positive list of areas for cooperation and facilitation to enhance understanding, action and support for loss and damage. They are: early warning systems; emergency preparedness; slow-onset events; events that may involve irreversible and permanent loss and damage; comprehensive risk assessment and management; risk insurance facilities, climate risk pooling and other insurance solutions; non-economic losses; and resilience of communities, livelihoods, and ecosystems.

[2] The biennial transparency reports' common tabular formats for support provided, mobilised, needed and received include provisions for reporting columns for loss and damage. Such reporting is not mandatory, however.

[3] Furthermore, while attribution science has made huge progress in recent years, particularly through probabilistic event attribution, attributing all losses and damages caused by weather-related events to climate change is still not possible (Otto et al., 2016).

Even narrowing to the addressing of loss and damage, the actions to are numerous and wide reaching, requiring different types and form of funding. For example:

- *Extreme weather events require a different response to slow-onset processes.* While both might require planning processes, slow-onset events with no clear start or end dates are unlikely to benefit as much as rapid onset events from financial mechanisms like insurance (Pandit Chhetri et al., 2021; Mustapha, 2022).
- *People experiencing the same event have differing needs.* Climate hazards affect people in different ways depending on the severity of the hazard and people's levels of exposure, vulnerability and adaptive capacity. A state-wide social protection system is unlikely to support those that are unregistered or without official status.
- *Non-economic loss and damage will elicit different needs to economic losses and damages.* The loss of resources, goods and services could result in rehabilitation or rebuilding of particular assets for a community and associated costs, but such actions fall short of addressing non-economic loss and damage such as loss of life, cultural identity, biodiversity and mental health for example, that could instead require truth seeking, apologies or memorialisation (Steadman et al., 2022) (and where lessons exist from transitional justice literature, see Klinsky, 2018).

A related question is who the funding will be channelled too? The funding options are different if we are supporting a government, a sub-national government, who may be in a position to take on a government bond, compared to a business that may have insurance options, a community with no formal way to receive funds or a household without a bank account.[4]

A mosaic of funding options exist but need to be mapped to identify gaps in funding arrangements and how each option best aligns with needs

Where estimates of loss and damage finance needs do exist, they are rarely accompanied by an understanding of the roles of differing sources of finance – domestic, international, public and private – and how they may interact. This challenges the ability of recipients and contributors of finance to put finance to work in the most efficient and effective ways possible.

There will no doubt be a strong role in addressing loss and damage for public finance, with concessional international public finance playing a key role in the most vulnerable countries. A broader consideration of wider sources and the systems governing them – including how they could be established or backed up by international concessional public finance – could result in more systemic changes in the way that risks are managed in countries, private institutions and in the financial system more broadly.

Various international architectures exist that could or do support the financing of addressing loss and damages. This includes parts of the humanitarian financing system, disaster risk reduction and management financing, development finance and climate finance (Richard and Schalatek, 2017: UNFCCC, 2019): while these 'buckets' exist with differing motivation, all are falling short of developing country needs in terms of quantity and access. In 2019, COP25 loosely anchored loss and damage financing in the UNFCCC climate finance architecture by asking the Board of the Green Climate Fund 'to continue' providing financial resources for activities relevant to averting, minimising and addressing loss and damage. The danger of this approach, as with using other existing architectures,

[4] There are questions of power and influence here also. A state might not know, or might not have in mind the best interests of a small community (such as in fragile and conflict states), in the same way that international consultants will not necessarily know what works best for nation or community.

is that governance, investment and results frameworks currently in place largely do not always seek to ensure and measure outcomes from a loss and damage perspective. In the case of the GCF, it is designed to seek mitigation and adaptation outcomes and the accredited entities – through which projects are implemented – to the GCF do not necessarily have expertise on loss and damage (Chhetri et al., 2021). Mapping the overlaps and identifying gaps in existing architectures is a critical next step in the mosaic of loss and damage financing.

At a domestic level, there is likely a role for fiscal policy and public investment in loss and damage funding, though this will be on a spectrum of adaptation – loss and damage. These may include policies to create contingency funds, contingent credit lines and catastrophe bonds, but can also be extended to include policies that direct public spending on social protection policies and insurance penetration (Chhetri et al., 2021; Watson, 2021; Mechler and Deubelli, 2021). Fiscal policy, financial policy and regulation and public investment are central to motivating private actors, ranging from households, through corporations to financial actors (Whitely et al., 2018) and these levers, as well as industry-led initiatives and information instruments can further private finance for addressing loss and damage; for example, by encouraging comprehensive risk management in day-to-day business operations.

There are so many more details to cover in considering options to fund the addressing of loss and damage. For example, how it will be governed, whether mechanisms will cover full or incremental costs and how it will be measured and accounted for, under which systems? (see also Sindra-Sharma et al., 2022). In all of these financing discussions it should not be forgotten that we are trying to get money to the most vulnerable and most impacted by climate change, which demands we pay attention to not burdening them with complex procedures of access to finance or a huge burden of proof that a climate-related weather event has indeed been caused by climate change. It is imperative that the right kind of finance reaches those who are about to experience loss and damage, or have just experienced it.

The money is unlikely to come from one source, though international concessional public finance must play a role

A key question remains on where the money will come from for addressing loss and damage. Developed countries are historically responsible for climate change and the polluter pays principle and adoption of Common But Differentiated Responsibilities and Respective Capabilities, within the UNFCCC context paves a clear way for developed countries to fund the averting, minimising and addressing of loss and damage in developing countries, particularly those most vulnerable to climate change impacts and given high and growing indebtedness of these countries in light of interlocking crises.

Grant and highly concessional international public contributions for addressing loss and damage are a key option. Central is for such loss and damage finance to complement and not detract from adaptation and mitigation finance in developing countries and to be provided, mobilised and accessed in ways that promote equity and justice (Mustapha, 2022). An open question – one that was heard loud in Egypt - is whether larger developing countries, or those with large foreign exchange reserves or sovereign wealth funds will voluntarily contribute towards addressing loss and damage too.

Other international finance 'sources' that have been raised in this context include the use of Special Drawing Rights (SDRs) of the IMF, debt swaps and taxes on financial transactions or fossil fuels (see the annex accompanying this document; HBS, 2021). The use and re-allocation of SDRs is complex, however, and costs are likely involved in reallocation or donation of these, given the nature of this reserve asset created and managed by the IMF (Plant, 2021). Climate-related debt swaps are, in theory, financing structures where a creditor allows debt to be reduced by conversion to local currency, paid at a lower interest rate or written off if the money saved is used to invest in climate or perhaps for addressing for loss and damage. In reality, such structures can involve high transaction costs, have uncertain private creditor interest and aren't suitable for countries with major debt issues (UNFCCC, 2022). While, for taxes, key questions are their sustainability and who the tax burden will be held by or transferred to (for example, SIDS might loose on tourism if costs of flying go up with an aviation tax).

As noted above, domestic policy and spending will also contribute to funding loss and damage action. In considering the breadth of actions, some may not require new and additional public expenditure. Actions may well be revenue neutral or could be funded by a redirection of existing expenditure (e.g. fossil fuel finance).

Finally, when considering sources of loss and damage finance, within the UNFCCC, liability of developed country Parties for loss and damage is addressed in decision language[5] and, alongside compensation, is generally considered unconstructive language towards progress in funding loss and damage. Liability terminology, however, may not be necessarily bad should certain corporates be held liable and/or governments make such corporates liable.

Conclusion

This short note deliberately falls short of outlining key design elements of a global loss and damage fund. It does, however, surface a number of problem statements that will need to be addressed in order to seek to design such a fund, or indeed financing arrangements: Parties and civil society will need to undertake this work over the next year. What is clear, however, that it will be a hard job to characterise best to worst financing options for addressing loss and damage, or to pit one option against another. Given the mosaic of needs for addressing loss and damage and the high level of the financing needs we face globally, it is possible we need all financing options to come into play at scale and with some urgency.

References

Climate Policy Initiative (2022). *Global Landscape of Climate Finance. A decade of data: 2011-2020.* Report. Climate Policy Initiative, London. Available at: https://www.climatepolicyinitiative.org/wp-content/uploads/2022/10/Global-Landscape-of-Climate-Finance-A-Decade-of-Data.pdf

Heinrich Böll Stiftung (HBS) (2021). *Lessons from COVID-19 for addressing loss and damage in vulnerable developing countries. Unpacking Finance for Loss and Damage*. Paper One. HBS, Washington. Available at: https://us.boell.org/en/2021/04/06/why-do-developing-countries-need-support-address-loss-and-damage

Klinsky, S (2018) *An initial scoping of transitional justice for global climate Governance*. Climate Policy, 18:6, 752-765, Available at: https://doi.org/10.1080/14693062.2017.1377594

Mechler, R., and Deubelli, T. (2021). *Finance for Loss and Damage: a comprehensive risk analytical approach*. Current Opinion in Environmental Sustainability, Volume 50, pp. 185-196. Available at: https://www.sciencedirect.com/science/article/pii/S1877343521000518

[5] Article 8 of the Paris Agreement recognises the importance of averting, minimising and addressing loss and damage on a 'cooperative' and 'facilitative' basis. Liability and compensation is further referenced in the text of Paris Decision 1/CP.21, paragraph 52, where the Conference of the Parties agrees that 'Article 8 of the Agreement does not involve or provide a basis for any liability or compensation'.

Mustapha, S. (2022) *Using the right mix of financial instruments to provide and mobilise climate finance: lessons for the Global Stocktake*. Part of the Financing Climate Action: iGST Discussion Series. Available at: https://www.climateworks.org/wp-content/uploads/2022/11/Using-the-Right-Mix-of-Financial-Instruments-to-Provide-and-Mobilize-Climate-Finance_iGSTFinance_Nov2022.pdf

Otto, F., James, R. and Allen, M. (2016) *The science of attributing extreme weather events and its potential contribution to assessing loss and damage associated with climate change impacts*. Oxford: Environmental Change Institute. Available at: https://unfccc.int/files/adaptation/workstreams/loss_and_damage/application/pdf/attributingextremeevents.pdf

Pandit Chhetri, R., Schaefer, L. and Watson, C. (2021) *Exploring loss and damage finance and its place in the Global Stocktake.* Part of the 'Financing Climate Action: iGST Discussion Series'. Available at: https://www.climateworks.org/wp-content/uploads/2022/04/Loss-and-Damage-Finance-iGST.pdf

Plant, M (2021). *The Challenge of Reallocating SDRs: A Primer*. CGD notes. CGD, London. Available at: https://www.cgdev.org/publication/challenge-reallocating-sdrs-primer

Richards, J.A. and Schalatek, L. (2017) *Financing loss and damage: a look at governance and implementation options.* Washington DC: Heinrich Boell Stiftung. Available at: www.boell.de/sites/default/files/loss_and_damage_finance_paper_update_16_may_2017.pdf?dimension1=Division_OEN

Schäfer, L., Jorks, P., Seck, E. et al. (2021) *National and international approaches to address loss and damage from slow-onset processes: status quo, challenges, and gaps*. Report. Germanwatch, Bonn. Available at: https://www.germanwatch.org/sites/default/files/Part%202%20-%20National%20and%20international%20approaches%20to%20address%20loss%20and%20damage%20from%20slow-onset%20processes_1.pdf

Sharma-Khushal, S., Schalatek, L., Singh, H., and White, H. (2022). *The Loss and Damage Finance Facility: Why and How.* Discussion Paper. CAN International, Christian Aid, Heinrich Boell Stiftung, Practial Action, Stamp Out Poverty. Available at: https://drive.google.com/file/d/1Oz2BVe38btPhSE6SoiMbVHNIXv6MBUsM/view

Steadman, S., Gilmour, A., Colenbrander, S. and Watson, C. (2022). *What do we have to lose? Understanding and responding to climate-induced loss and damage to cultural heritage*. Report. ODI, London.

Thomas, A., Serdeczny, O. and Pringle, P. (2020) Loss and damage research for the global stocktake. Nature Climate Change, 10, 700. Available at: https://www.nature.com/articles/s41558-020-0807-z

UNFCCC (2022). *Sharm El Sheik Implementation Plan.* Advance unedited version. UNFCCC, Bonn. Available at: https://unfccc.int/sites/default/files/resource/cop27_auv_2_cover decision.pdf

UNFCCC (2019). *Elaboration of the sources of and modalities for accessing financial support for addressing loss and damage.* Technical paper by the Secretariat. UNFCCC, Bonn. Available at: https://unfccc.int/sites/default/files/resource/01_0.pdf

Watson, C (2021) *Fiscal and Financial Policy and for Climate Change Adaptation and Resilience Building in ACP Countries.* ICR Facility, Brussels. Available at: https://www.icr-facility.eu/fileadmin/files/downloads/icreports/fiscal_and_financial_policy-en.pdf

Whitley et al., (2018). *Making finance consistent with climate goals: insights for operationalising Article 2.1.c of the UNFCCC Paris Agreement*. ODI, WRI, E3G and RMI. Available at: https://odi.org/en/publications/making-finance-consistent-with-climate-goals-insights-for-operationalising-article-21c-of-the-unfccc-paris-agreement/

Acknowledgements

Charlene Watson (Overseas Development Institute) authored this document.