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Policy pointers

Finance designed for mitigation, adaptation, or disaster relief is not enough to tackle loss and damage. National governments and finance providers must develop tailored approaches.

No single financial instrument is sufficient either. A 'layered' combination of instruments is needed to tackle the different forms of loss and damage that will affect different people in different places over time.

Finance must be designed to support those affected by loss and damage without eroding hard-won development gains. It must be responsive, agile, anticipatory, locally accessible and build long-term resilience.

Instruments designed to deliver loss and damage finance should be guided by the principles of climate justice and locally led climate action.

Financing loss and damage: four key challenges

Loss and damage is a complex and multidimensional phenomenon that is evolving rapidly as the climate crisis intensifies. Across the global South, vulnerable people are being pushed beyond the limits to adaptation. In this briefing, we argue that governments must use a suite of 'layered' financial instruments to tackle the complexity of loss and damage risks at national and local levels. This will help to ensure that the right type of finance can be delivered to the right interventions, in the right place and at the right time, in ways that are locally accessible, flexible and appropriately targeted. We also outline four key challenges to consider when designing finance for loss and damage: developing appropriate financing principles; improving access and flexibility; prioritising grants over loans; and ensuring redundancy in the system.

Communities and ecosystems around the world are already experiencing the adverse impacts of climate change.[1] Extreme weather events — such as cyclones, floods, heatwaves and droughts — are increasing in frequency and intensity, while slow-onset processes — such as sea-level rise and desertification — gather pace. Lives and ecosystems are being lost. Livelihoods, settlements and infrastructure are being damaged. And the cultural heritage, social fabric and long-term life chances of poor communities and countries are being eroded with devastating consequences for people, nature and economies.[2]

Efforts to mitigate or adapt to climate change are needed to avert and minimise the loss and damage that high-risk communities and countries will experience in the future. But these efforts are insufficient to address climate impacts that are unavoidable, or which will be unavoided.[3] Across the global South, poor households and marginalised groups are rapidly approaching, or have already passed, the limits to climate adaptation, exposing them to unavoidable loss and damage in the near future.[4,5] The slow pace and large gaps in climate finance also mean they will not escape the residual loss and damage risks they face due to inadequate mitigation and adaptation efforts over recent decades.[6,7]

Why we need urgent action

Loss and damage is characterised by the complex and multidimensional nature of the impacts and risks that climate change imposes on different people and places over time.[8] Levels of exposure, vulnerability and adaptive capacity vary dramatically between people, locations and ecosystems, depending upon a complex set of environmental, social, political, geographic and economic factors. They will also vary greatly over time as climate hazards evolve, intensify, intersect and compound one another due to global heating.

Unmanaged and ad hoc responses to individual climate shocks can push people into poverty as they are forced beyond the limits to adaptation. For many, the loss and damage they incur after a single event pushes them to adopt negative coping strategies.[9] People are often forced to sell assets, reduce food consumption, degrade environmental resources, remove their children from school, engage in distress migration, or fall into modern slavery.[10] These actions gradually erode their ability to maintain their lives, livelihoods and wellbeing with dignity.

The complex nature of loss and damage means that no single form of finance is sufficient

Delivering finance: the importance of layering instruments

The complex nature of loss and damage means that no single form of finance is sufficient to address the diverse range of impacts that countries and communities will, or may, experience in the coming years. Tackling this complexity requires national governments, and other stakeholders at local, national and international levels, to use a variety of different financial instruments to address the various impacts and risks that are likely to affect different people in different places over time.[10] Layering will help ensure that actions are robust, build resilience and support highly vulnerable people to avoid a vicious downward spiral after each consecutive shock.

One approach that national governments and finance providers can use to do this is the 'layering' of varied interventions to address different forms of loss and damage over different time horizons simultaneously.[10] For example, finances to support emergency response, post-disaster recovery and rehabilitation can be layered alongside other forms of finance designed to address the unavoidable and residual risks of climate-related loss and damage — such as disaster risk reduction, social protection, planned relocation and facilitated migration — as well as long-term climate adaptation.

Layering in this way can ensure that actions taken to address different forms of loss and damage are complementary, effective, build resilience and support highly vulnerable people to avoid a vicious downward spiral after each new shock. Such layered approaches must recognise and prioritise the forms of loss and damage that disproportionately affect people living in poverty and marginalised groups, especially women, children, older people, people living with disabilities, Indigenous peoples and other minorities.

Creating the right forms of finance

The particular nature of loss and damage risks[11] demands that financial instruments used to address them must have different characteristics from those used to support sustainable development, adaptation, mitigation, disaster relief and recovery. While disaster relief and disaster risk finance can help people cope with and recover from climate shocks, they cannot help people deal with the full range and scale of loss and damage that they will face over time. Similarly, while adaptation finance can help people build the capacities they need to minimise or avoid loss and damage in the long run, it cannot address the residual risks they face from climate shocks due to adaptation failures.[10]

To address loss and damage effectively, the right forms of high-quality finance must be delivered in the right quantities, to the right place, at the right time, to address particular climate impacts or risks. Layering diverse forms of finance in complementary ways would allow national governments and their finance providers to use a variety of instruments to deliver the range of actions required. To do this, national governments and civil society actors must be able to access forms of finance that are appropriate, accessible, flexible and timely. But this is challenging to arrange — especially in least developed countries (LDCs) that do not enjoy favourable terms from donors and finance institutions.[12,13] Mobilising and delivering the right kinds of finance in volumes that match the scale of the loss and damage problem is a significant barrier to action.[14,15]

Some progress is being made to unlock these barriers through the United Nations Framework Convention on Climate Change (UNFCCC), from the agreement to include loss and damage in the Paris Agreement, to the Glasgow Dialogues on loss and damage finance that began following the 2021 UNFCCC Conference of Parties (COP26).[16] But progress is slow. The Santiago Network on Loss and Damage is not yet operational, and the establishment of a loss and damage financing facility may take years. Until new and additional financing exists, the adverse impacts of climate change must be tackled using the tools and instruments that affected countries have at their disposal now.

Luckily, various sources of finance exist that could be used to address loss and damage or which can be tailored to do so.[10] For instance, debt relief opens fiscal space for governments to tackle emerging instances of loss and damage, while reinsurance facilitates risk pooling to share the burden of a given disaster. Other sources include official development assistance (ODA), innovative finance, philanthropy, reinsurance and national budgets, including both on-budget finance and individual household savings and assets.[10] However, these types of finance must be tailored to address the complex nature of loss and damage impacts and risks, and to deliver climate justice.

Financing loss and damage: four key challenges

Based on extensive research and consultation with developing country stakeholders, we have identified four key challenges that governments and finance providers must address when planning and designing finance delivery mechanisms for loss and damage.

1. Adopt appropriate financing principles

Finance providers must adopt appropriate principles that support the delivery of high-quality finance to address loss and damage effectively. Different principles guide different forms of finance. For instance, climate, humanitarian and development finance are guided by principles outlined in the Paris Agreement, the Grand Bargain and the Paris Declaration on Aid Effectiveness, among others. These principles are shaped by the power relations and political compromises involved in drafting those agreements, and by the risk appetites and risk management tools used by finance providers, such as the conditionalities, justification requirements and co-funding they demand from recipients.[17] These characteristics mean that some forms of finance are more or less appropriate than others for particular forms of action, depending on the types of action required or the recipients involved.

Unfortunately, the principles that guide existing forms of finance are not well aligned to those recommended by researchers to guide the delivery of loss and damage finance (Box 1).[16–19] These principles are closely aligned to the principles for locally led climate action, that have now been endorsed by over 80 governments, global institutions, and local and international NGOs.[20] Therefore, it is time for international donors and finance providers to design mechanisms to deliver loss and damage finance that follows these principles: finance that is locally appropriate; fosters devolved decision making; addresses structural inequalities; and prioritises finance that is accessible, flexible, predictable and long-term for the countries and communities that need it most.

2. Improve access and flexibility

Many forms of finance that are currently available to LDCs and small island developing states (SIDS) have significant barriers to access, which obstruct high-risk countries from taking action when and how they want to.[14] For instance, the Green Climate Fund (GCF) is the only entity mandated by the UNFCCC to finance action to address loss and damage. But it cannot deliver the funds needed to meet the scale of the challenge, and is unable to respond to immediate needs when countries experience loss and damage. On average it takes 5.5 years for an LDC that is not yet accredited to the GCF to receive finance directly to address loss and damage, which is wholly inappropriate.[21]

These barriers to access derive from the 'accreditation and project proposal'-based approach the GCF uses to guide investment decisions. This approach is onerous, highly conditional and impedes many of the poorest developing countries from accessing urgently needed funds. It is also inflexible. This project-based approach fails to support the comprehensive and layered approach required to finance the variety of actions that countries need to use to address loss and damage effectively over a variety of time horizons and with the flexibility to finance action at the local level.

Finance providers must therefore design and adopt new ways of providing access to finance to LDCs and SIDS in ways that recognise the risks they face, meet their needs and acknowledge their constraints, whilst meeting the principles of climate justice.

3. Prioritise grants over loans

The majority of finance provided to LDCs and SIDS to address loss and damage comes in the form of

Box 1. Loss and damage financing: selected principles

Loss and damaging financing should:

- Be delivered on the basis of solidarity, equity and justice, not as charity or relief
- Be based on principles of Common But Differentiated Responsibilities and Respective Capabilities (CBDR-RC) of Parties to the UNFCCC — historical responsibility, capacity to pay, polluter pays
- Focus on addressing the vulnerabilities of the people who are most at risk, especially in LDCs and SIDS, and include finance to address non-economic loss and damage
- Not increase the debt burden of recipients (provided as grants not loans)
- Not be delivered through projects but through strategic holistic programmes
- Deliver sustainable long-term support, addressing extreme events and slow-onset processes
- Be fair, feasible, predictable, adequate and transparent
- Be additional to other forms of finance (such as development, adaptation, mitigation, disaster risk reduction), and must be traceable and distinguishable
- Be nationally owned and accessible to the most vulnerable
- Use new or existing national and local systems to identify loss and damage, disburse finance to communities and individuals, and enable locally led action
- Be delivered in a timely manner, appropriate to disaster response and recovery
- Be governed under the UNFCCC.

Box 2. An example of how to create redundancy

Ethiopia's Productive Safety Net Programme (PSNP) provides a good example of a social protection system that layers different finance mechanisms to meet varied needs and create redundancy:[25]

1. Predictable transfers of food and cash help very poor households meet their basic needs during 'normal' periods.
2. During a climate-related emergency, shock-responsive contingency budgets are deployed to support affected households, helping to avoid erosion of development gains by adopting negative coping strategies.
3. Ex-ante contingency funds are triggered by early warning systems, delivering financial support to a wider pool of transitory poor households, helping them to prepare, cope and avoid sliding into poverty due to loss and damage.

loans for disaster recovery and reconstruction. However, this type of finance is unjust. The victims of the climate crisis — who have done least to create it — bear the burden of the costs.[22] It is also inappropriate to the fiscal realities of most poor countries, who must choose between paying their debts or addressing the climate risks they face. They also face becoming trapped in a debt spiral as they try to recover from each new shock.[23]

Finance providers must ensure that finance to address loss and damage in LDCs and SIDS is made available in the form of grants and untied from political or trade-related favouritism. Grants avoid adding to national debt burdens and represent the most risk-tolerant form of financing compared to concessional or market rate loans. Risk-tolerant finance[24] allows for innovation and the incubation of new responses to loss and damage (both institutional and technological). This can help facilitate better response, recovery and rehabilitation from disaster. Such finance is critical, especially in this period where governance systems are just getting to grips with what it takes to address loss and damage effectively.

4. Ensure redundancy in the system

Finance to address loss and damage must be provided without increasing the burden on the poorest, most vulnerable and most badly affected households. This will be no easy feat to achieve. But there are examples of innovative mechanisms that aggregate varied flows of finance to allocate them effectively to meet varied needs. These include social protection, solidarity funds and community-driven development funds. Such mechanisms address the varied risks of vulnerable people in comprehensive and coordinated ways, balancing present and short-term needs with the longer-term goals of climate justice. And when these mechanisms are layered, they ensure redundancy in the system.[10] If one activity is overwhelmed by a shock and can no longer provide enough support to prevent recipients from breaching their coping capacity, it ensures there is alternative support available (Box 2).

Conclusion

Until a global loss and damage financing facility exists, governments and other stakeholders in affected countries must tackle the adverse impacts of climate change using the existing tools and instruments already at their disposal. Most importantly, it is those people who are most at risk who have the best knowledge of their needs and priorities. Financing to address loss and damage must therefore be designed to support locally led action, based on local risk assessments, without eroding hard-won development gains. This challenge will not be easy. But it is a vital task that can be tackled quickly and effectively if governments work with finance providers, civil society actors, academic institutions, and affected and at-risk community members to identify and craft locally appropriate and mutually acceptable solutions.

Clara Gallagher and Simon Addison

Clara Gallagher is a researcher in IIED's Climate Change Group. Simon Addison is a principal researcher in IIED's Climate Change Group.

Knowledge Products

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Contact
Simon Addison
simon.addison@iied.org

Clara Gallagher
clara.gallagher@iied.org

Third Floor, 235 High Holborn
London, WC1V 7DN
United Kingdom

Tel: +44 (0)20 3463 7399
www.iied.org

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Notes

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