

ADAPTATION FINANCE GAP

WHY IS ADAPTATION FINANCE STILL IN THE SHADOWS?

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Introduction

Climate impacts are accelerating faster than the pace of international finance designed to manage them. While global climate finance reached an estimated USD 1.3 trillion in 2021–2022, only a small fraction — roughly 7–10% — was directed toward adaptation efforts in developing countries, despite rising climate vulnerability and economic exposure (CPI, 2024). Moreover, new evidence shows that adaptation flows from developed to developing countries declined from USD 28 billion in 2022 to USD 26 billion in 2023, contrary to the urgent need to scale up action (UNEP, 2025). This widening adaptation finance gap poses a direct risk to human security, infrastructure resilience, and long-term development prospects, particularly in least developed countries (LDCs) and small island developing states (SIDS).

This policy note asks: ***Why is adaptation finance still in the shadows?*** It summarizes that a combination of structural financial barriers, difficulties in measuring impacts, and governance fragmentation suppresses the flow of funds toward resilience. By synthesizing recent OECD, UNEP, IMF, UNFCCC, and other institutional findings, the note outlines the key drivers of underinvestment in adaptation and provides actionable recommendations structured for decision-makers in the climate-finance community — including negotiators, donors, researchers, and development banks. The goal is to support a more credible, equitable, and results-driven adaptation finance framework in the post-2025 era.

Why is Adaptation Finance in the Shadows: Key Reasons

1. Structural Economic and Financial Reasons

- Debt burden and financial constraints: Many countries are unable to make room for capital investment due to their debt burden. Climate investment often relies on public borrowing which is politically unpopular.
- The perception of “high-risk, low-return”: Climate projects are seen as long-term, with uncertain returns and exposed to political risks. Financial institutions price climate projects as risky assets. Most of the project's benefits are aimed at reducing risk and loss; it is difficult to generate direct profit (Hallegatte, Li, & Banaji, 2024).
- Low commercial returns in adaptation projects: Adaptation does not attract investors as much as mitigation because it does not directly generate financial returns. Moreover, the financial returns of most adaptation projects cannot be easily and immediately measured, such as in carbon market (WRI, 2024). Recent analysis shows that adaptation finance accounted for only around **5% of total tracked climate finance** in 2021–2022, highlighting a major mismatch between funding flows and adaptation needs (GCA, 2024).

2. Policy and Governance-Related Shortcomings

- Fragmented international architecture: UNFCCC, MDBs, donor agencies, VCM, Article 6 are disconnected systems. No central authority or standardization causes fragmented and irregular flow of funds.
- Data, reporting, and measurement shortcomings: The impact, risks, and co-benefits of climate projects are not clearly measured. Standard metrics for measuring adaptation success are lacking; without defined and trackable KPIs, progress cannot be transparently monitored (WRI, 2024). Lack of information reduces investor confidence.

- Highly complex funding mechanisms: Green Climate Fund application processes are cumbersome and can take years. Countries and communities cannot access funds due to “bureaucratic barriers” (Lo, 2025).

3. Market and Finance Sector Dynamics

- Failure to mobilize the private sector: Climate finance is still donor-driven. The private capital share is low because risk-sharing mechanisms (guarantees, blended finance) are not sufficiently developed. Financial markets require mechanisms based on long-term “loss protection” rather than risk sharing and direct profit.
- Trust issues in carbon markets: Market Integrity is under question and crises in VCMs have shaken trust. The cross-border market has not taken hold because Article 6 has not progressed.
- Persistence of fossil fuel subsidies: As of 2023, Annual around \$7 trillion in fossil fuel subsidies climate finance is not even being heard (Black et al. 2023). Public support is going to the wrong areas.

4. Social and Political Economic Factors

- Concerns about just transition: Unemployment, energy prices, and social costs make politicians hesitant. Therefore, climate finance can be seen as a “risky political agenda.”
- Short-term policy cycles: Climate investments span 10–20 years; government incentive cycles are 4–5 years. Projects with no political payoff are postponed.
- Fragile state capacity: Many countries lack the institutional capacity to design, manage, or report on projects. Even if funds are available, they cannot be used effectively.
- Financial market immaturity: 1.3 billion adults still live outside the banking system; however, it has been observed that 75% of those affected by natural disasters (in low-income countries) have a financial account. This indicates that the potential for

adaptation financing to reach local communities is not being utilized (World Bank, 2024).

5. Geopolitical Tensions and Insecurity

- North–South trust crisis: Developed countries have not fully met past commitments (e.g., \$100 billion). The “trust deficit” has increased in developing countries ((IMAL Initiative for Climate & Development, 2024).
- Conditions attached to finance: Reform obligations attached to loans create political costs. Some countries perceive climate finance as “a new conditional development tool.”
- Geopolitical Competition (US–China, EU–Russia, etc.): Climate finance is often shaped by geopolitical interests. This creates a flow of funds based on political priorities rather than “real climate impact.”

Policy Recommendations

This section outlines actionable and evidence-based reforms to improve the quantity and quality of adaptation finance. The measures target key breakdown points across the system (from target-setting and capital mobilisation to access, governance, and accountability) and highlight opportunities for immediate progress by policy makers and financial actors. Therefore, it needs to be;

1. Reframing the Global Climate Finance Goal

- Established a new collective quantified goal (NCQG) for annual climate finance targeting at least USD 1 trillion by 2030, including explicit sub-targets for

adaptation finance, grant/loan ratios, and allocations to the most vulnerable countries.¹

- Defined a dedicated adaptation-finance sub-target within the NCQG (for example: starting at USD 40 billion per year and increasing over time) to ensure adaptation receives equitable attention.
- Introduced transparent and measurable criteria for the NCQG, including minimal grant shares (e.g., minimum 30% grants or 50% in high-risk countries), and required reporting on private vs public mobilised capital.

2. Scaling Up and Improving Adaptation Finance

- Prioritised grants (rather than loans) for adaptation in the most vulnerable and highly indebted countries to avoid increasing debt burdens.
- Developed and adopted standardised metrics and outcome indicators for adaptation projects (e.g., number of people made resilient, reduction in economic losses, km of resilient infrastructure) and tie disbursement to results (UNEP, 2024).
- Expanded “readiness” and capacity-building funds so that cities, local governments and community-based organisations can access adaptation finance directly and more easily.

3. Reforming Multilateral Development Banks (MDBs) & Mobilising Private Capital

- Reformed MDB capital and risk frameworks so that climate-aligned investments face lower capital charges or benefit from tailored risk-sharing mechanisms.
- Expanded blended finance instruments: first-loss facilities, guarantees, hedging mechanisms for local-currency risk to catalyse more private-sector investment into climate projects (OECD, 2023).

¹ Derived and interpreted by the author based on major institutional references such as the IMF, UNEP, OECD, etc., in terms of number

- Extended blended finance and private investment mobilisation beyond mitigation into the adaptation and loss & damage domains (e.g., disaster-resilient infrastructure bonds, catastrophe insurance instruments).

4. Redirecting Fossil-Fuel Subsidies Towards Climate Finance

- Developed a phased timetable to eliminate inefficient fossil-fuel subsidies, while simultaneously implementing social-protection and just-transition measures to mitigate political and social risks (International Energy Agency, 2011).
- Instituted “budget-tagging” rules so that at least a specified percentage (e.g., 50%) of savings from fossil-subsidy removal is ring-fenced for climate finance (especially adaptation and resilience).
- Introduced or strengthened carbon pricing and taxation of fossil-fuel firms, and ensured revenues are channelled into climate-finance instruments and funds.

5. Unlocking the Debt - Climate Finance Nexus

- Scaled up debt-for-climate swap initiatives, meaning that restructuring or canceling debt in exchange for investments in climate-resilient infrastructure, adaptation, or nature-based solutions.
- Embedded Climate-Resilient Debt Clauses (CRDCs) in sovereign bond issuances, allowing for automatic restructuring or payment deferral in the event of climate-related shocks.
- Align IMF and MDB climate-finance offerings (e.g., IMF Resilience & Sustainability Trust) with national debt-sustainability frameworks to support climate investments in high-vulnerability countries without exacerbating debt stress.

6. Strengthening Monitoring, Reporting & Governance

- Developed an international common accounting standard for “what counts as climate finance”, aligning definitions across donor countries and institutions (UNFCCC, 2022).
- Required comprehensive, project-level data disclosure from all major climate-finance providers (MDBs, bilateral donors, climate funds, private investors) — including country, theme, instrument type, grant/share, and expected outcomes.
- Introduced quality indicators for climate-finance use: not just dollar volume but number of people made resilient, tonnes CO₂ avoided, economic losses prevented, and required funders to report against these KPIs.

Conclusion

Strengthening adaptation finance is not merely a technical upgrade to the climate-finance system, it is an urgent requirement for safeguarding development and protecting lives already on the frontline of climate impacts. The reforms proposed in this note can help close the widening adaptation finance gap by ensuring that funds are more predictable, accessible, and aligned with resilience outcomes. Delivering on these priorities ahead of the post-2025 climate-finance framework will be critical for restoring trust between developed and developing countries and ensuring that global climate action protects those who need it most

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