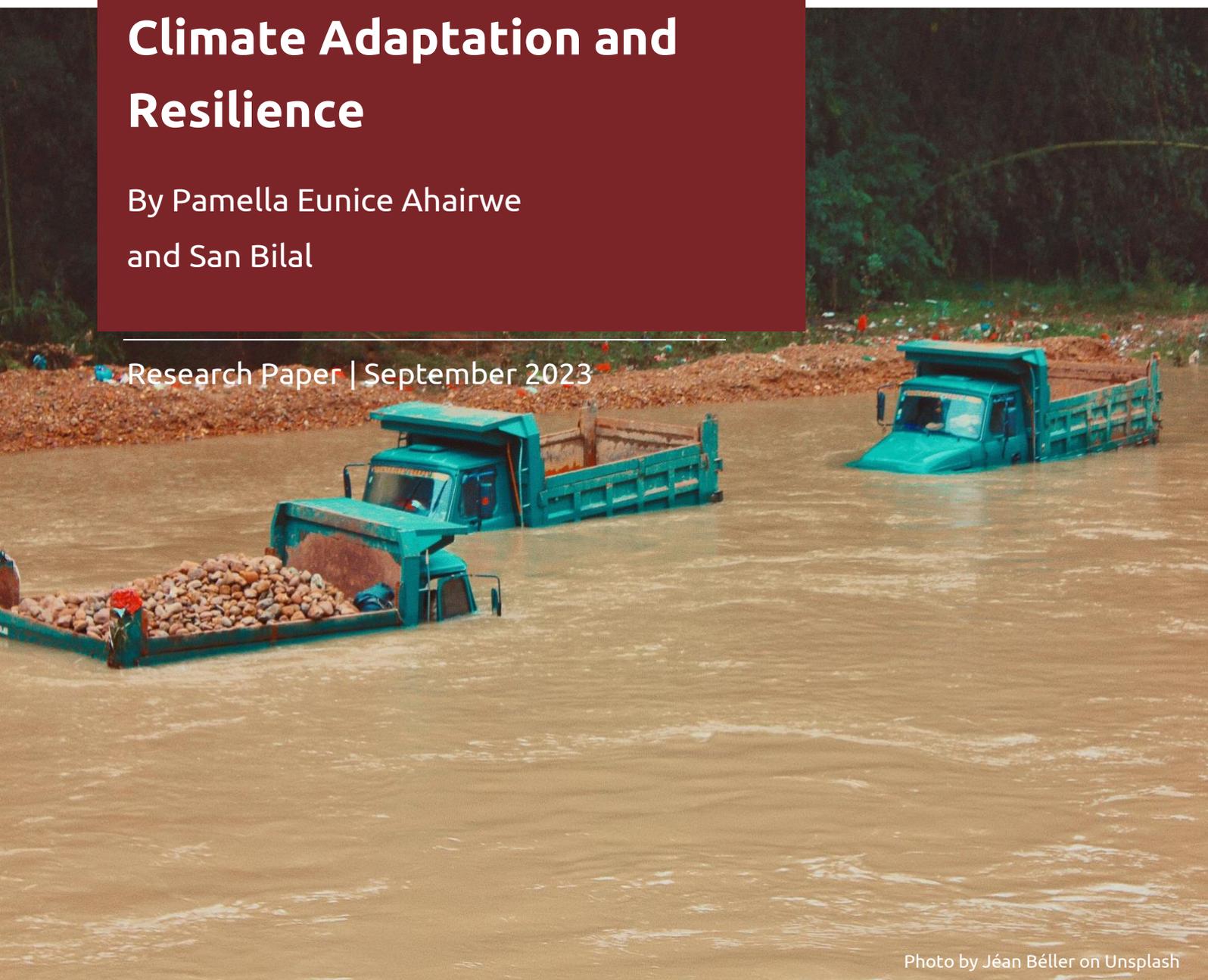


Mobilising (European) Development Finance for Climate Adaptation and Resilience

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Executive Summary

This paper looks at the potential of European development financial institutions in supporting climate adaptation and resilience in developing countries. While global adaptation finance has more than doubled since 2016, from USD 10.1 billion to USD 28.6 billion in 2020, it is still too low to meet estimated adaptation costs, which vary between USD 160 billion to USD 340 billion by 2030 (UNEP 2022). Broadly, adaptation finance accounts for only a small share - generally below 10% - of climate finance.

International and European financial institutions for development have the power to lead in closing the adaptation financing gap. However, they encounter challenges related to low, unclear, and missing adaptation finance objectives, limited synergies in the adaptation financing space, and a lack of bankable projects. The European Union (EU), its member states and their financial and technical institutions for development, including the European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), the European Development Finance Institutions (EDFI), the public development banks (PDBs) regrouped under the Joint European Financiers for International Cooperation (JEFIC), and the technical and implementing agencies in the Practitioners' Network for European Development Cooperation (PN), can address these challenges to mobilise the level of adaptation finance that is necessary for building global resilience. This could be achieved by:

1. embracing innovative financial instruments that aim to support climate adaptation and resilience projects in the most vulnerable countries.
2. ensuring a stronger focus on adaptation by setting explicit financial targets that primarily target climate adaptation as opposed to the current broad climate finance goals. This should particularly be relevant for the European development finance institutions (DFIs) and public development banks (PDBs).
3. adopting better risk-mitigation mechanisms that enable DFIs and PDBs to accurately measure and price risk associated with adaptation projects to encourage additional public and private investments in adaptation initiatives.
4. establishing greater synergies between public actors focused on enhancing climate adaptation and resilience in developing countries, especially development cooperation institutions (e.g., donors and development agencies) and DFIs and PDBs.
5. supporting the development of pipelines of sustainable and transformative adaptation projects and strengthening the local eco-systems for adaptation and resilience, for example, by creating a conducive policy environment, regulation, local markets and local private and public actors capacities.
6. instituting ambitious grants or overseas development assistance targets for adaptation, focused on: (i) non-bankable segments of the adaptation operations as a public good; and (ii) helping leverage at-scale public and private finance for impactful adaptation endeavours.

Besides the obvious positive impact on developing countries, by adopting more innovative comprehensive approaches to mobilise development finance for climate adaptation and resilience, the EU can contribute to reducing some of the negative

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cascading cross-border risks that global warming affecting developing countries can have on Europe, including in terms of knock-on effects between continents escalating through security relations, international trade, financial markets, food insecurity, social unrests and displacement of people.

A summary of specific challenges associated with advancing adaptation finance – and corresponding recommendations for European DFIs and PDBs – is offered below. These Recommendations are unpacked and explained in more detail in Section 3 of this report.



Challenge 1: Adaptation finance targets are either low, unclear or missing
Recommendation 1: Set clear financing targets and adopt transparent reporting
Recommendation 2: Adopt innovative financing approaches to meet adaptation costs



Challenge 2: Limited cooperation within Europe and outside Europe
Recommendation 3: Strive for result-oriented partnerships
Recommendation 4: Advance blended adaptation finance approaches



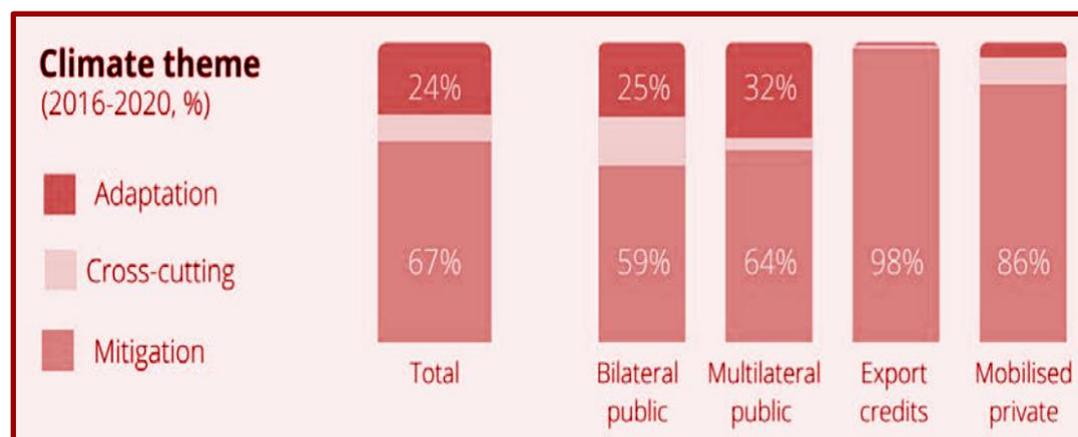
Challenge 3: High risks and unbankability of adaptation projects
Recommendation 5: Develop a pipeline of bankable projects
Recommendation 6: Adopt a systematic approach to measuring adaptation risks

1. Climate finance and the adaptation orphan

Climate change continues to expose developing countries to various existential perils that necessitate timely and decisive global responses. Bilateral and multilateral financial institutions for development have significantly increased their climate finance commitments and disbursements.¹ While their focus largely remains on financing climate mitigation, especially the green energy sector, they have also intensified their efforts to help address the consequences of climate change. Their commitment is evidenced by the notable upward trend in climate adaptation financing, which has almost tripled from USD 10.1 billion in 2016 to USD 28.6 billion in 2020 (OECD 2022a).

However, adaptation finance accounts for about a quarter of total climate finance support to developing countries, with public finance, as illustrated in Figure 1, and only about 10% of overall climate finance (OECD 2022a; Prasad et al. 2022; Songwe et al. 2022). Moreover, the current levels of adaptation financing remain largely insufficient to meet the projected adaptation costs that are estimated to vary between USD 160 billion to USD 340 billion by 2030 (UNEP 2022). Conservative estimates suggest that Africa currently needs USD 21.9 billion (53% of total climate finance) annually for adaptation (GCA 2022). This discrepancy highlights the disparities that exist between financial commitments and the ever-increasing costs of climate action in developing countries.

Figure 1. Climate finance provided and mobilised by developed countries to developing countries



Source: OECD (2022a)

The bias in mitigation is also evident among public financial institutions in general, as they directed a significant portion of their loans (71%) and equity (89%) toward climate mitigation between 2016 and 2020 (OECD 2022a). The commonly cited

¹ Financial institutions for development include both public development banks (PDBs) and development finance institutions (DFIs).

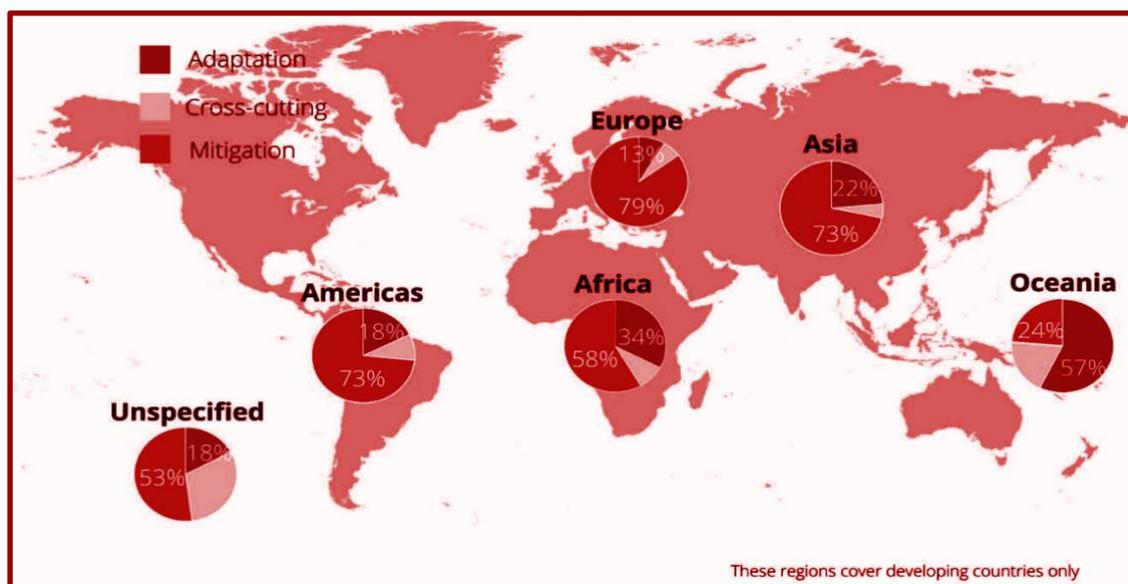
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arguments for supporting climate mitigation projects are the need to reduce climate change and achieve the net-zero target, as well as their superior financial viability compared to adaptation projects. Adaptation finance is constrained by the uncertainty about the economic consequences of climate impacts, the lack of proper assessment of climate risks which are under-priced, capital market constraints, a lack of economies of scale and limited efficiency of adaptation technologies (Prasad et al. 2022; Songwe et al. 2022). The high risks for low returns in climate investments, and lack of investment opportunities, the two major hurdles identified to mobile private capital for climate investment (OECD 2022a), are particularly acute in adaptation projects. Yet, properly structured and complemented by additional public intervention when needed, private investments in climate adaptation in developing countries can be profitable, including for European investors and businesses (Choi et al. 2023; Proparco 2022; Randall et al. 2023; Tall et al. 2021).

This is all the more needed as developing countries, and in particular low-income countries, notably in Africa, are particularly vulnerable to climate change to which they only marginally contributed (IPCC 2023; López-Calva 2023; Songwe et al. 2022; UNCC 2022). According to the 2022-2023 European Investment Bank (EIB) Climate Survey covering 10 African and Middle Eastern countries, 88% of the respondents felt that climate change is already affecting their everyday life, 61% indicated that climate change and environmental damage have affected their income or source of livelihood, and 52% responded that their family already incurred losses due to climate change (EIB 2023a; EIB 2023b).

With limited financial means and capacity, they are highly dependent on international action to mitigate climate change and to provide the necessary financial, technical and institutional support for adaptation efforts. While adaptation support is greater in poorer countries, as illustrated in Figure 2, further mobilising resources at scale for addressing climate adaptation and resilience, including from the private sector, should therefore be a priority for the international community, and in particular the European Union (EU) as the leading development actor.

Figure 2. Climate finance across developing country regions (2016-2020, percentage)



Source: OECD (2022a)

The mismatch between adaptation costs and financial commitments raises concerns about the effectiveness of current financing approaches. It also underscores the need for more innovative and context-specific strategies that could be used to mobilise investments at scale. However, such strategies can also aim to leverage financing from both the public and the private sector to further support developing countries to adapt to the consequences of climate change. It also suggests the need for more comprehensive approaches to tackle climate adaptation and resilience by mobilising a range of actors and instruments in a more coordinated and complementary manner, combining various sources of finance, technical expertise and capacity support to mitigate climate change, but also to address and adapt to the negative effects of climate change, reducing vulnerability and increasing the resilience of developing countries.

Encouragingly, current forecasts indicate that financial institutions for development are on track to achieve the USD100 billion goal for both adaptation and mitigation this year, a commitment they made at COP15 in 2009 (OECD 2022a). The European Union (EU) has, in this regard, pledged to contribute to the annual USD 100 billion target until 2025, with a specific focus on supporting adaptation.² Whether the aim is to fulfil the broader COP15 objective or finance the long-term adaptation costs in developing countries, European PDBs and DFIs can serve as pioneers in leading the way. The European financial architecture for development (EFAD), with its rich ecosystem of financial and technical instruments and institutions, including a wide set of European financial institutions for development, can serve as a pioneer in leading the way (see Box 1; Bilal ed. 2023; Bilal et al. 2022; Karaki and Bilal 2023a; Knaepen and Dekeyser 2023).

European DFIs and PDBs have already demonstrated their potential to assume a greater role in unlocking finance and championing novel financing strategies that are vital for addressing climate change. Yet, their efforts to bridge the existing gaps in adaptation financing remain extremely limited. Collectively, European DFIs and PDBs enable the EU to consistently emerge as the foremost contributor to public climate finance in developing countries. In 2021, the EU, its member states and the EIB allocated €23.04 billion to financing climate action.³ Additionally, the EU established the Adaptation Fund and pledged €100 million at COP26 in 2021 to support developing countries in coping with the impacts of climate change.⁴

² [International climate finance: How the EU supports climate action in developing economies across the world.](#)

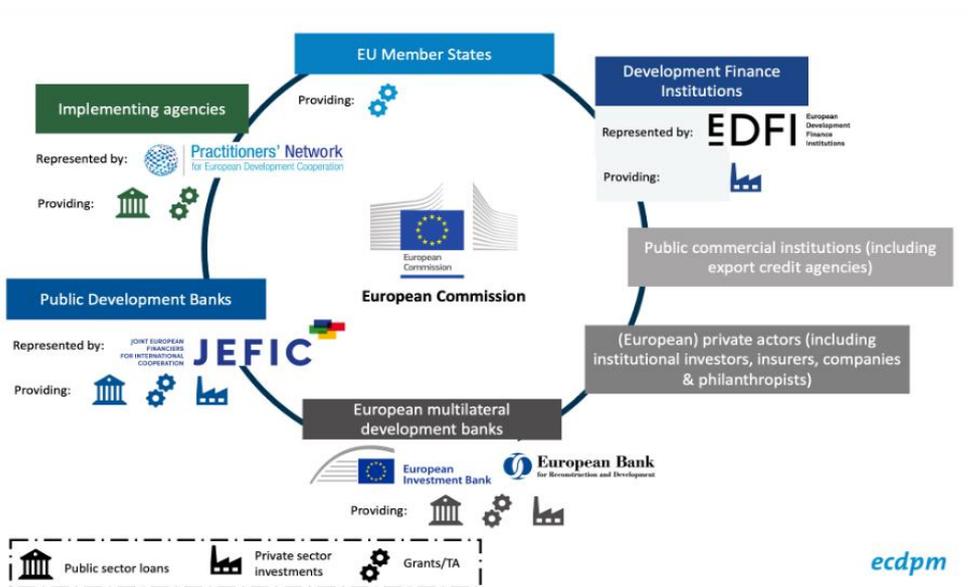
³ [International climate finance: How the EU supports climate action in developing economies across the world.](#)

⁴ [Adaptation Fund.](#)

Box 1. A rich set of European financial and technical institutions for development

The European financial institutions for development encompass:

- multilateral development banks (MDBs), i.e. the European Investment Bank (EIB) and its external operations arm EIB Global, fully owned by the EU, and the European Bank for Reconstruction and Development (EBRD), with a shareholding majority by EU member states. EBRD mostly invests in non-sovereign initiatives, while the EIB is mandated to invest primarily in sovereign projects including the establishment of socioeconomic infrastructure that partly aims at achieving adaptation objectives and creating long-term economic resilience (EC 2019).
- EU member states’ public development banks (PDBs), regrouped under the Joint European Financiers for International Cooperation (JEFIC), which invest mainly in sovereign and sub-sovereign operations; and
- the 15 European development finance institutions (DFI), regrouped under the Association of European DFIs (EDFIs), focused on non-sovereign (private) operations.
- The EU institutions, notably the European Commission, and the EU member states, including with their development technical and implementing agencies, such as the ones in the Practitioners’ Network for European Development Cooperation (PN) are key actors in a rich European ecosystem for development and climate action, which could be more effectively leveraged to support climate adaptation and resilience in developing countries (EDFI 2023a).



Moreover, the new Global Europe programming under the Neighbourhood, Development and International Cooperation Instrument (NDICI) provides the EU with an opportunity to finance climate change adaptation via various channels, including through technical assistance, blended finance and guarantees for European DFIs and PDBs. Under this process, the EIB plays a critical role, notably for sovereign operations, together with the EBRD, PDBs and DFI for commercial sub-sovereign and non-sovereign operations, under the European Fund for Sustainable Development Plus (EFSD+) (Bilal 2021a; Di Ciommo and Ahairwe 2021).

This offers European DFIs and PDBs a collaborative platform that can be leveraged to bolster support for climate adaptation, moving away from solely focusing on short-term climate objectives such as the current target of USD 100 billion. The foundation that the NDICI provides, and more broadly, the EFAD, also allows for an action plan that could prioritise long-term financial requirements for climate adaptation in developing countries that equally align with the broader long-term objectives of the European Green Deal.

Boosting adaptation financing requires European DFIs and PDBs to dedicate greater attention and efforts to adaptation and resilience action, beyond climate mitigation projects that tend to overwhelmingly dominate their climate portfolio. The adoption by the EIB of an explicit climate action plan is a first step in that direction, though it falls short of explicit targets and commitments for its operations in developing countries (Ahairwe 2021; Ahairwe and Bilal 2019; Bilal and Ahairwe 2020; EIB 2021b). The set-up of the Adaptation & Resilience Investors Collaborative (ARIC), an international partnership of development finance organisations from G7, European and beyond countries, launched at the 2020 Finance in Common Summit, is another encouraging endeavour, which should be further enhanced (BII 2022a; BII 2022b).

Financial institutions for development and climate, together with other development and climate actors, should also seek to tackle challenges more effectively within the contextual framework of developing countries, fostering local ecosystems, encouraging citizen ownership of projects, and inspiring political will and commitment. The European DFIs and PDBs could better base their investments on adaptation scientific evidence, which currently has limited uptake (IPCC 2023). They should also better assess climate risks, both to prioritise their actions, and also to more accurately estimate the returns from climate adaptation investments (Ahairwe et al. 2022).

The bankability approach aligns with the interests of European PDBs in maintaining their AAA ratings and earning returns on loan investments to ensure fund continuity (Attridge and Engen 2019). However, when European financial institutions for development excessively focus on financial additionality at the expense of development impact, they deprive themselves of an opportunity to address the climatic catastrophes that developing countries face.⁵

Extreme weather events like floods, storms, and heatwaves disrupt operations for 58% of businesses in Asia and Africa, resulting in additional costs that further impede the financial viability of these enterprises (BII 2022a). European DFIs and PDBs can extend financial support to such businesses, in line with their development mandate, by adopting innovative financing and engagement strategies that will increase the resilience, and thus the profitability, of these businesses.

⁵ [Development Finance Institutions: Profitability Promoting Development.](#)

Besides the obvious positive impact on developing countries, by adopting more innovative comprehensive approaches to mobilise development finance for climate adaptation and resilience, the EU can contribute to reducing some of the negative cascading cross-border risks that global warming affecting developing countries can have on Europe, including in terms of knock-on effects between continents escalating through security relations, international trade, financial markets, food insecurity, social unrests and displacement of people.

This policy paper delves into the investments that the European DFIs and PDBs are presently making to support climate adaptation in developing countries. It presents different endeavours that illustrate the efforts of (European) DFIs and PDBs in supporting adaptation projects (Section 2). Furthermore, it outlines the challenges that European DFIs and PDBs encounter in their endeavours to expand the financing of climate adaptation activities (Section 3). Ultimately, it offers policy recommendations on how European DFIs and PDBs can exploit their power to mobilise additional financial resources to enhance the adaptive capacity and build the resilience of developing countries against the impacts of climate change.

2. Climate adaptation investments of the European DFIs and PDBs

The analysis of climate finance shows that the European DFIs and PDBs have diversified their investment portfolio to cover both climate mitigation and adaptation projects for public and private domains. Nevertheless, a significant imbalance persists in these investments, as evidenced by the disproportionately lower funds allocated to climate adaptation projects. We explore these discrepancies further in Sections 2.1 and 2.2.

2.1 Adaptation finance at the aggregate level

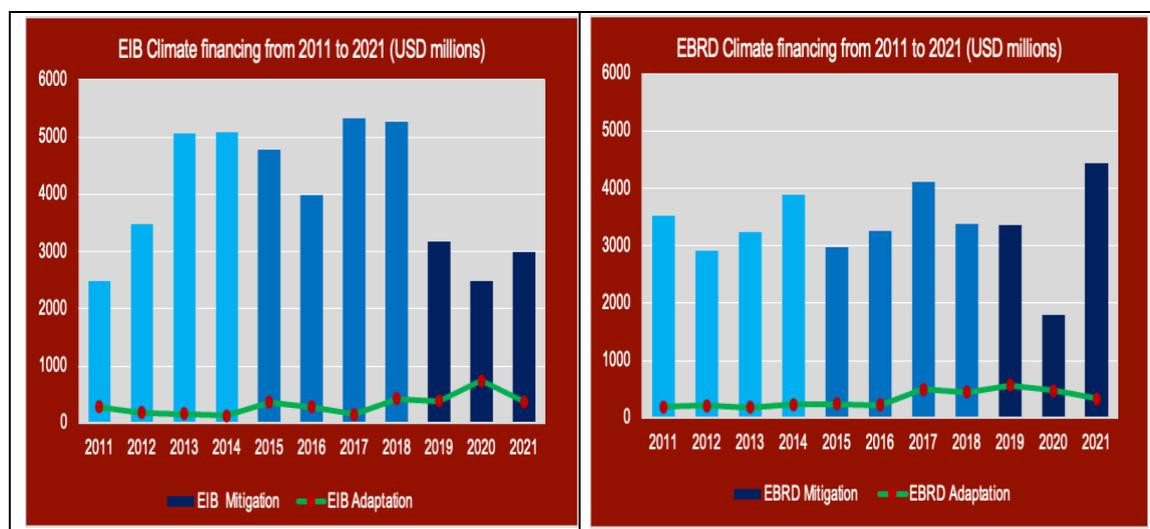
The EIB and the EBRD, the two prominent MDBs in the European financial architecture for development and climate action, have achieved ambitious climate finance commitments: they are fully aligned with the goals and principles of the Paris Agreement and committed that climate action finance accounts to at least half of their overall investments. Yet, their climate operations are overwhelmingly dominated by climate mitigation, with grossly insufficient attention to climate adaptation, as illustrated in Figure 3 and Table 1.

In contrast to the financing of mitigation projects that increased during the peak of the COVID-19 pandemic in 2021, the financing allocated for adaptation initiatives declined, further exacerbating the existing disparities. EIB Global, the external arm of the EIB, allocated approximately 88.7% (USD 2.99 billion) of its 2021 total climate finance (USD 3.371 billion) to climate mitigation, leaving only about 11.3% (USD 381 million) for climate adaptation, a cut by half compared to

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2020 (USD 743 million), as illustrated in Figure 3 (MDBs 2022a).⁶ In 2022, the share of adaptation finance further fell to 10.3% (€0.4 billion), as shown in Table 1.

Figure 3. Comparison of mitigation and adaptation financing for EIB and EBRD from 2011 to 2021⁷



Source: Authors' compilations from Joint Reports on MDBs over the period 2011 to 2021

The EIB has set an additional target to dedicate to adaptation action 15% of its overall climate finance, within and outside the EU, by 2025 (EIB 2021b; EIB 2023c; EIB 2023d). It is regrettable, though, that the EIB has not set a specific, higher adaptation target for EIB Global, which operates in developing countries, most affected and vulnerable to climate change. Yet, EIB Global will be allowed to cover up to 100% of an adaptation project investment cost in small island developing states (SIDS) and least developed countries (LDCs, when necessary, because of their vulnerability to climate change, as opposed to the 50% traditional limit for EIB financing participation in general (EIB 2021b). To effectively fulfil its development and climate objectives, EIB Global should put much greater emphasis on climate adaptation and resilience, which remain too marginal in its portfolio.

The EBRD mainly invests in private-sector-led non-sovereign operations in Central and Eastern Europe, Central Asia, and North Africa. Its investments towards adaptation reached about €3 billion in more than 400 projects in the last 10 years, €567 million of which was invested in North Africa (EBRD 2022). But adaptation finance decreased from USD 481 million in 2020 to USD 336 million in 2021, and only about USD 259.23 million (€246 million) in 2022, making up only 4.17% of its total climate finance, as shown in Figure 3 and Table 1 (EBRD 2023; MDBs 2021; MDBs 2022a). While the EBRD has set well-defined programmatic and policy approaches to supporting climate adaptation from 2023 to 2025, it still has no clear climate

⁶ Notably, Figure 3 also reveals an unprecedented decline in mitigation finance for the EIB from 2019 compared to previous years, which could be partially attributed to the MDBs introduction of country income-group reporting in the same year

⁷ Author's compilations using Joint Reports on MDB's climate finance data from 2011 to 2021. These reports have been updated over time as distinguished by colour. From 2015, climate finance figures reflect modifications in the IDB, WB Groups, and EU reporting (MDBs 2016). From 2019, data is reported separately in two main groups of developing countries - low-income and middle-income economies, and developed countries - high-income economies (MDBs 2020).

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adaptation finance target, and climate adaptation clearly seems to lack priority in its agenda.

Table 1. Adaptation action, climate finance and total commitments (2022, percentage and billion €)

Financial institution	EIB*	EIB Global	EBRD	KfW Development Bank	AFD	4 European DFIs	EDFI total
Share of adaptation in climate finance	4.9%	10.3%	4.2%	29.5%	36%	8.7%	2.1%**
Climate adaptation	€1.9 bn	€0.4 bn	€0.246 bn	€2.13 bn	€2.16 bn	€0.061 bn	€0.061 bn
Total Climate finance	€35.1 bn	€4.1 bn	€6.36 bn	€7.2 bn	€6 bn	€0.7 bn	€2.9 bn
Total commitments	€62.6 bn	€8.5 bn	€13.1 bn	€10.9 bn	€9.4 bn	€2.1 bn	€8.7 bn
Share of climate finance to total commitments	56%	48%	48.5%	66%	64%	33%	33%

Note: *Covering all EIB operations, within and outside the EU.

**Incomplete reporting by European DFIs on adaptation.

Source: Compiled from annual reports and complemented by additional data shared with the authors by AFD, EDFI, EIB and KfW Development Bank.

As European MDBs, the EIB and EBRD possess the potential to make substantial contributions to bridging the gap between climate adaptation costs and adaptation financing in developing countries, estimated to range from USD 160 billion to USD 340 billion by 2030 (UNEP 2022). To effectively meet this financial demand, the EIB, EBRD and the other European national PDBs and DFIs will need a major shift in their priorities and strike greater balance between their mitigation and adaptation efforts.

During the COVID-19 pandemic, MDBs that included the EIB and EBRD found ways to link some mitigation projects with COVID-19-related endeavours, which led to increased mitigation financing in 2021. Within the social sectors such as education and health, investing in easing the impact of COVID-19, such as worsening gender inequality, was well-integrated with climate mitigation demands. MDBs invested in

business ideas that sustained girls in school while ensuring the construction of energy-efficient buildings, the use of renewable energy and carbon sinks as well as carbon dioxide emission reduction systems, which consequently increased financing for climate mitigation (MDB 2021). There are also several opportunities to strategize adaptation finance to fit within broad sustainable development goals such as reducing income inequality, ending hunger, and eliminating poverty.

Climate finance has also become a priority for most European PDBs and several DFIs, as shown in Table 1.

Other pertinent European financial institutions for development that provide climate finance are EDFI members. Together, they contributed approximately €3.3 billion (a 45% increase from 2021) to supporting climate finance in developing countries (EDFI 2023b). While EDFI members do report on their overall climate finance, they do not systematically report on their climate adaptation activities. The picture based on incomplete reporting suggests that about 2% to 3% of EDFI climate finance is dedicated to adaptation in 2021-2022, which accounts for less than 1% of their overall activities (around 0.7% in 2022). These incomplete figures are likely to reflect the lower bound of overall EDFI members' adaptation investment, as several EDFI members have not reported their adaptation activities. Focusing only on the four European DFIs that have reported on their adaptation activities to EDFI, about 9% of their new climate investment finance is dedicated to adaptation in 2022, which accounts for around 3% of their overall new investments.

These results suggest that DFIs can engage in climate adaptation and mobilise private finance for it when they wish to. Some European DFIs have even allocated 30%, 45% and above 60% of their climate finance to adaptation investments during the 2021-2022 period.⁸ But the low general average clearly points to the overall lack of priority for adaptation activities by European DFIs. The incomplete reporting also suggests that more efforts should be made by EDFI members to increase the transparency of their climate finance, in particular about adaptation activities and activities combining both mitigation and adaptation. The Association of EDFI can usefully promote further harmonisation of practices, including on public reporting, by European DFIs, under the EDFI umbrella.

European national PDBs could also enhance their reporting practices, which could be facilitated under the JEFIC umbrella (see Box 1 above). This would require a more ambitious common reporting than currently outlined in their first JEFIC annual report (JEFIC 2023). While JEFIC reports that about two-thirds of its funding commitments in 2022 went to climate action projects (i.e., €13.7 billion new climate action commitments for a total combined volume of more than €21 billion), it does not specify the share of commitments to climate adaptation.

The KfW Development Bank, the German PDB, dedicated nearly 30% of its €7.2 billion climate finance to adaptation operations (i.e., €2.1 billion) in 2022. When adding climate action commitments that combined both mitigation and adaptation (amounting to an additional €1 billion in 2022), the share of climate finance that includes adaptation action reaches about 44%. KfW Development Bank also seems to focus its adaptation operations on vulnerable and poorer countries, with the share of climate finance for adaptation actions only rising to 35.8% for sub-Saharan African countries, and 39% for LDCs in 2022.⁹

⁸ EDFI data shared with the authors.

⁹ KfW Development Bank data shared with the authors.

The French PDB Agence Française de Développement (AFD) also adopted an ambitious green agenda, including a full (100%) alignment of all its operations to the Paris Agreement and almost two-third (64%) of total AFD commitments dedicated to climate finance in 2022. AFD €2.16 billion commitments to climate adaptation amounted to 36% of its €6 billion commitments in climate finance and 23% of AFD total €9.4 billion commitments in 2022. The KfW Development Bank and AFD climate actions illustrated that it is possible to have a more ambitious agenda for financing adaptation and resilience, in particular through public (sovereign) operations.

This requires a dedicated agenda, however. For instance, the Italian PDB Cassa Depositi e Prestiti (CDP) does not yet finance climate adaptation at the international level (and adaptation accounts for only 1% of its climate action, in Italy).¹⁰ As the oldest national promotional development bank in Europe, but a new one acting in developing countries (Bilal 2021b), CDP illustrates the fact that climate adaptation requires a dedicated strategy and effort by PDBs and DFIs, which is also one of the reasons why CDP has become an active member of the Adaptation & Resilience Investors Collaborative.

While European DFIs and PDBs have rightly emphasised the importance of climate finance in their portfolio, their level of engagement in climate adaptation, as summarised in Table 1, remains overall very limited, far below the European rhetoric and ambitions to support adaptation, let alone the needs of development countries.

European DFIs and PDBs can also benefit from EU-level funding in the form of guarantees, blended finance and technical assistance, to help them invest in more impactful ways, in poorer and vulnerable countries, based on EU partner countries' needs and EU priorities. In this regard, the emphasis should also be on supporting climate adaptation projects in the Global South (Bilal 2021b; Bilal and Karaki 2022; Gavas and Perez 2022; Lundsgaarde et al. 2022).

The EU set up an ambitious guarantee mechanism under the European Fund for Sustainable Development Fund Plus (EFSD+), which is also destined to play an important role in the implementation of the EU Global Gateway aimed to mobilise €300 billion of sustainable investment, also contributing to the implementation of the external dimension of the EU Green Deal (Teevan et al. 2022). The EU has not publicly communicated the specific composition of the first batch of investment proposals by DFIs and PDBs under the EFSD+. Yet, informal reporting suggests that while climate mitigation and, in particular, sustainable energy transition accounts for a large share of the guarantees sought, only a few proposals partly tackle climate adaptation, confirming the strong bias of (European) DFIs and PDBs in favour of mitigation compared to adaptation.

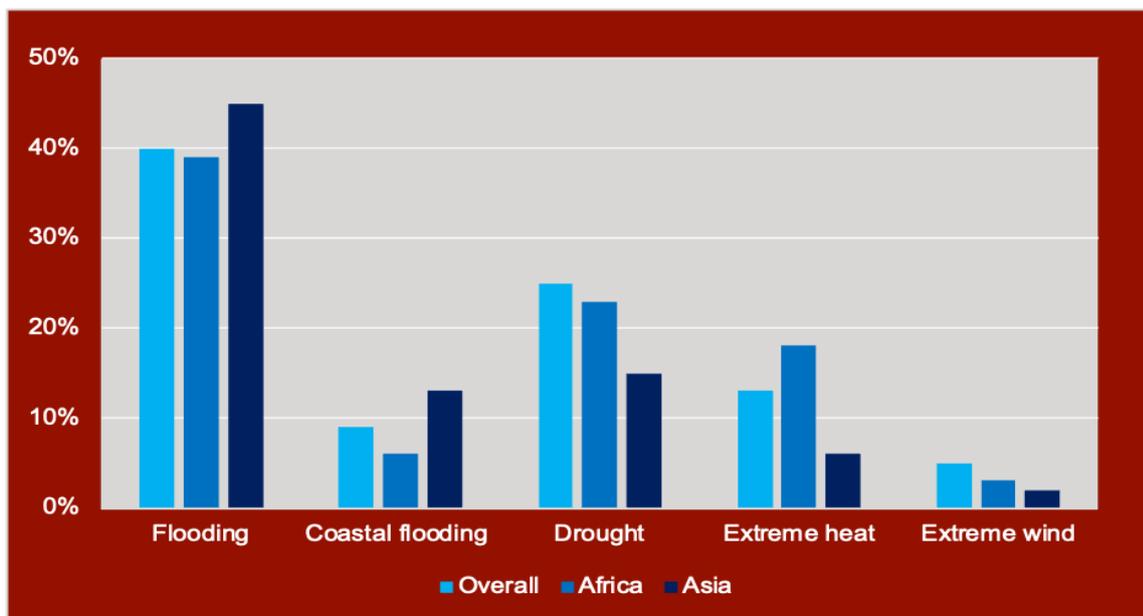
Whether at the EU or national level, European PDBs and DFIs can collaborate to mobilize additional finance for climate adaptation operations via blended finance approaches (Bilal 2020). Blended finance is particularly a relevant investment approach for adaptation projects that are often assessed as risky as it allows for risk sharing by various financial institutions. Under the EFSD+ and through enhanced cooperation under the European financial architecture for development (notably between the EIB, EBRD, EDFI, JEFIC and PN, as illustrated in Box 1 above) and with international and local partners, European DFIs and PDBs, can tap into each other's skill sets including local presence, investment knowledge, and experience to extend their support of adaptation projects, especially in the most vulnerable countries.

¹⁰ CDP information shared with the authors.

2.2 Adaptation finance at the project level

European DFIs and PDBs have made significant investments in diverse sectors regarding renewable energy, water management, infrastructure development, forestry, agriculture, and disaster management. These initiatives aim to enhance resilience and strengthen the adaptive capacities of countries, communities, and individuals already grappling with the impacts of climate change. European DFIs and PDBs strive to address the multifaceted consequences of climate change that intersect with various socio-economic and political challenges. Floods, for instance, as the leading climate physical shock (Figure 4) disrupt business operations and also worsen public health issues. When they occur in countries with inadequate drainage and waste management systems, they make the populace vulnerable to waterborne diseases (Ramiaramanana and Teller 2021).

Figure 4. Number of businesses affected by physical climate shocks in Asia and Africa for the year 2020



Source: Authors' compilations using data from BII (2022a)

Extreme floods are increasingly impacting the operations of numerous companies in developing countries. In South Asia and Africa, floods affect a wide range of businesses, including electrical utilities, agriculture firms, and real estate ventures. The frequency of occurrence of these floods increased up to 58% in 2021 from 48% in 2020 (BII 2022a). Droughts, which are the second most common physical shock to businesses (Figure 4), also pose a threat to food security in countries where agriculture systems, including farming and livestock, depend on natural weather conditions. Reduced agricultural output not only lowers earnings by farmers; it also hampers government revenues and limits the extent to which governments can provide public services. This calls for emergency interventions and impedes the progress of individuals and countries as a whole.

2.3 Public climate adaptation investments

European PDBs have provided a moderate share of adaptation finance to deal with the prevalent climate consequences in developing countries largely via the public sector. A considerable portion of this financial support has been allocated to essential water and waste management projects to help countries tackle flooding, establish sewage treatment facilities and ensure clean water access for economically disadvantaged individuals. Another portion of adaptation finance has been channelled into projects that aim to improve adaptability to water variations due to climate change, as exemplified in Case 1 for Burkina Faso (see box below).

Among the European financial institutions for development, the EIB stands out as the foremost investor in water-related sectors, with a particular focus on water and waste management. It has identified key priority areas such as addressing water scarcity, managing flooding risks, building resilient cities, disaster risk management, safeguarding food and ecosystems, and supporting health, education, and public research. These focal areas serve as guiding principles to steer the efforts of the EIB and enhance its investments in adaptation projects (EIB 2021a).

Case 1: Investment in Burkina Faso for solar power and flood protection¹¹

In 2021, the EIB and AFD jointly invested €38.5 million in solar power and flood protection initiatives in the city of Ouagadougou under the operation of the National Electricity Authority Sonabel. Ouagadougou city suffered floods that destroyed more than 24,000 homes and caused extensive damage to approximately 150,000 properties. The AFD and EIB financial and technical support aimed to accomplish two major objectives. First, to ensure the construction of a 5-kilometre water evacuation channel to improve flood protection in Ouagadougou. Second, to increase renewable energy and energy efficiency power generation capacity from the current 37 Megawatts to 50 Megawatts in alignment with the Paris Agreement's objective of limiting global warming to 2°C. These efforts would not only bolster energy access; they would also help to adapt to the consequences of climate change such as flood risks, improve public health by addressing associated water-borne diseases and instances of malaria, and create stability in the city which would reduce migration.

The EIB has made several other water-related investments, but public information available on these projects barely mentions the extent of their adaptation focus. In 2017, the EIB invested €102.5 million in Zambia under the management of the Zambian Ministry of Finance and the Lusaka Water and Sewerage Company (LWSC). This investment was intended to support the development of water infrastructure that would promote sanitation and reduce water-borne diseases, some of which are due to poor drainage systems and flooding.¹² The EIB also invested €125 million in Benin to rehabilitate water drainage systems and reduce flood risks. It also allocated €116 million to the Lesotho Lowlands Water Development Project, aiming to enhance climate resilience and access to clean drinking water (EIB 2021a). Besides the EIB, other European PDBs have also invested in climate adaptation projects in

¹¹ [Burkina Faso: EUR 38.5m EIB backing for solar power and flood protection.](#)

¹² [EIB broadens support for water infrastructure in Zambia.](#)

developing countries. EBRD, for instance, is a prominent investor in infrastructure projects that are intended to build resilience to climate change and guard against floods, as presented in Case 2 (see box below).

Case 2: Investment in Infrastructure in Morocco to build resilience to climate change¹³

In 2022, the EBRD extended a €40 million loan to the Agence Nationale des Ports (ANP), a state-owned entity in Morocco to enhance the resilience of ports in the Atlantic Coastline. This initiative received additional backing from the Global Environment Facility (GEF), which contributed a USD 5.7 million investment grant. The GEF and the EBRD further provided grants of USD 500,000 and USD 1 million, respectively, to support technical capacity development. The EBRD envisioned this funding as a construction package that would be employed for the development of necessary infrastructure to enhance the resilience of Morocco ports to climate hazards such as rising sea levels and floods from storm surges, mainstreaming climate adaptation measures in the Moroccan port sector. It will also foster a multi-stakeholder expert dialogue aimed at facilitating climate-related decision-making and improving environmental management and standards by the ports' national agency (ANP).

European PDBs and DFIs have also invested in disaster risk management projects, providing decisive emergency assistance to protect and help countries navigate the unforeseen consequences of climate change. Kreditanstalt für Wiederaufbau (KfW) demonstrated its commitment to climate resilience and adaptation by promptly extending support to Mozambique following Mozambique Cyclone Idai, as illustrated in Case 3 (see box below).

Case 3: Investment in disaster risk management in Mozambique

Following the damages caused by Cyclone Idai in Mozambique in 2019, KfW collaborated with the Swedish government to provide a €14 million grant to the Mozambican government to support the reconstruction and repair of the damaged schools, road infrastructure, drinking water supply systems, power plants, and transmission lines. The KfW and Swedish government financing aided in the swift restoration of the Mavuzi and Chicamba hydropower plants in Manica province, including beyond disaster relief aid, through the fortification of riverbanks and the improvement of access roads helping Mozambique to not only adapt but also build resilience to natural disasters. KfW's assistance was supplemented by additional support from other European PDBs, such as the €100 million loan and €10 million grant from the EIB.

¹³ [EBRD and ANP promote climate resilience of Moroccan port sector.](#)

British International Investment (BII) takes a multifaceted approach to climate adaptation by targeting women that are facing the consequences of climate change. Women are disproportionately affected by climate change due to the nature of their social, economic, and cultural status. They make up 50% of the smallholder farmers whose enterprises are prone to crop failures due to droughts and floods (BII 2020). Providing climate adaptation solutions that target them accounts for gender inequalities.

2.4 Private climate adaptation investments

European PDBs channel a significant share of their adaptation investments via the public sector systems of developing countries. However, European DFIs and PDBs have collaborated with the private sector, including venture capital funds, equity funds, and financial intermediaries, to help developing countries adapt to climate change. These collaborations typically aim to assist micro, small, and medium enterprises (MSMEs), that mostly engage in agricultural productivity, to manage the adverse effects of climate change on their business operations.

The agriculture sector employs 48.8% of the total population in Africa and about 60% of the sub-Saharan African (SSA) total population (FAO 2022; Pais et al. 2020). Its participants are predominantly smallholders producing output for at least household consumption and at most for micro or small businesses. The consequences of climate change, such as droughts, water scarcity, and floods, threaten the potential of the smallholder agricultural actors who produce 80% of Africa's food to meet food security needs.¹⁴ These are worse in Africa, where a third of global droughts take place, with Kenya and Ethiopia being hit the most (Kemoe et al. 2022). Supporting adaptation for smallholder farmers and more broadly sustainable food systems is critical (D'Alessandro and Rampa 2022; Dekeyser and Rampa 2023; Knaepen 2022). European DFIs also invest in MSMEs engaged in agriculture to build their resilience and capacity to adapt to climate change. An example of this is illustrated in Case 4 (see box below), and investments of this nature have partly made the agriculture sector benefit the most from blended adaptation finance transactions (Convergence 2022).

Case 4: Investment in smallholder agriculture farmers in Africa¹⁵

In 2021, the Dutch development bank (FMO), in collaboration with AFD Group, including Proparco, and other international donors such as the Soros Economic Development Fund, Children's Investment Fund Foundation, IKEA Foundation, and Global Social Impact, provided USD 58 million in equity to the Acumen Resilient Agriculture Fund (ARAF). This equity fund aims to support the development of an agribusiness ecosystem to improve the livelihoods of smallholder farmers and build their resilience against climate change. ARAF hopes to use 30% of the fund to target individuals living below the poverty line to help reduce poverty while enhancing climate resilience through impactful investment in agriculture startups in East and West Africa (Proparco 2022). By supporting smallholder farmers who produce 80% of the food in Africa, ARAF stands to invest in climate-smart

¹⁴ Change starts here: Small farmers with a big message for the world.

¹⁵ [Acumen Closes \\$58 Million Impact Fund, the First to Drive Climate Adaptation for Smallholder Farmers.](#)

agriculture to promote food security, as well as improve employment creation and sustainability. In addressing the consequences of climate change, ARAF will work towards controlling soil degradation, severe storms, and shifting weather patterns. This will be achieved through fostering an ecosystem that encourages relevant innovative solutions and enhances climate resilience through aggregated platforms and financial mechanisms. ARAF also invests in aggregator companies that provide bundled solutions such as climate resilience inputs.

The European DFIs and PDBs can invest in agricultural adaptation projects that support the adoption of climate-smart methods. Among these institutions, FMO is a prominent player with a clearly defined agricultural focus, investment goal, and strategy. It invests in agribusinesses to improve food security, promote sustainability, advance alignment to climate objectives, and boost economic development.¹⁶ FMO's efforts in collaboration with British International Investment (BII) have successfully raised approximately USD 1.1 billion for the African agrifood technology industry since 2017 (AgFunder 2022). This funding intends to bolster economic livelihoods, improve food security, develop adaptation capacity, and build resilience against climate change.

All in all, Cases 1 to 4 show how European financial institutions for development can provide targeted climate adaptation finance to both the private and public sectors. These institutions offer a substantial amount of funding, albeit, their investments are not always explicitly designated for adaptation purposes, even when they do contribute to adaptation efforts. This lack of clear earmarking makes it challenging to assess certain investments as adaptation finance based on publicly available information. Some actions related to climate disaster relief are categorised as adaptation while contributing little to sustainable adaptation and resilience to climate change in developing countries. European DFIs and PDBs should, therefore, better identify and report on their projects' contribution to climate adaptation and resilience, following common international standards. Some of the financing provided by these institutions may also benefit both mitigation and adaptation, which should also be reported as such.

Several mitigation projects often have adaptation benefits. This is the case with some forestry, water infrastructure, and road infrastructure projects, which aim to mitigate climate change and promote broader economic development. Most of these projects indirectly offer advantages such as improved drainage systems and flood controls in developing countries. For some businesses, tracking adaptation finance proves challenging as it is integrated into their capital and operating expenses (Prasad et al. 2022). This also makes it difficult for financing institutions to monitor and report adaptation financing. Finance for climate adaptation is also broadly assessed *ex-ante*. Thus it is hard to accurately present its effects or evaluate its performance compared to initial plans. Common international climate change and adaptation metrics should be adopted by all European DFIs and PDBs, to ensure coherent and harmonised reporting on climate adaptation endeavours.

¹⁶ [FMO - Agribusiness Financing from farm to fork.](#)

3. Recommendations to leverage additional adaptation financing

European DFIs and PDBs have made progress but they still encounter challenges that limit their ability to support climate adaptation in developing countries. While these challenges are diverse, they can be grouped into three distinct categories, as presented in Figure 5.

Figure 5. Challenges European financial public institutions face in advancing adaptation finance



3.1 Framing of adaptation objectives

Challenge 1: Adaptation finance targets are either low, unclear or missing, which makes the European DFIs and PDBs continue to lag behind in meeting the adaptation costs of developing countries.

European DFIs and PDBs have taken significant steps to increase their climate finance, but this is too often about mainly mitigation, with still insufficient dedicated strategies for adaptation and resilience action, which accounts for 10% or less of European MDBs and DFIs climate finance, as discussed in Section 2.1 and shown in Table 1. EIB has set an adaptation target, but rather low, at 15% of its climate action, and not specific to EIB Global for its activities outside the EU.

Other European DFIs and PDBs do not set public targets on their adaptation ambitions and have not outlined specific adaptation strategies or action plans,

although some of them are actively investing in climate adaptation. EDFI and JEFIC could usefully help them set clearer adaptation goals, possibly along the lines of the EIB and at least the COP27 MDBs Joint Statement (MDBs 2022b). They could also highlight better practices and improve explicit adaptation reporting, based on the international methodology for adaptation finance tracking (MDBs 2022c), as these will affect the extent to which they can commit to investing in developing countries. AFD and KfW Development Bank in particular, whose share of adaptation action in climate finance stands at 36% and 29.5% respectively in 2022, could share lessons from their respective adaptation strategy and action with other European PDBs, MDBs and DFIs. The lack of climate adaptation ambitions and targets also creates uncertainty about climate investments, which constrains the implementation of adaptation action and increases maladaptation.

Recommendation 1: Set considerable and clearly defined adaptation financing targets and adopt transparent reporting

Financial institutions for development should:

- adopt an explicit approach to boost their adaptation activities,
- set considerable and clearly defined adaptation financing targets that align well with the adaptation costs of developing countries,
- aim to increase their share of climate financing that is directed to adaptation projects in line with the projected adaptation costs,
- adopt transparent reporting on adaptation, disaggregating their climate finance reporting to indicate the respective share of adaptation and mitigation, and activities combining both adaptation and mitigation.

EDFI and JEFIC could help coordinate a common approach among European DFIs and PDBs, including EIB Global and EBRD. The European Commission, through the NDICI EFSD+ and blending instruments, could also incentivise a greater focus on adaptation finance and the adoption of explicit monitoring and reporting criteria for adaptation. Implementing monitoring and evaluation mechanisms would also encourage European DFIs and PDBs to systematically disclose volumes of their adaptation finance committed annually, whether individually or jointly.

While EDFI reports total climate finance, it is currently working towards being able to report climate finance that is directed to adaptation projects. However, it might take some time for EDFI to be able to report this kind of data by each financial institution. This is due to the nature of its business model, which involves diverse institutions that progress at different paces. However, accurate adaptation financial reporting remains an essential aspect of understanding where European DFIs and PDBs are investing most, based on their unique objectives and how they can expand to where financing is needed the most. Data reporting will also help these institutions understand their competitive nature in developing countries and help them work towards collaborative approaches to share risks in countries where they are all equally present. Besides, it would also need to focus on the extent to which climate adaptation is mainstreamed to consider its effects on gender, income inequality, social unrest, and migration dynamics.

Recommendation 2: Adopt innovative financial approaches tailored for adaptation

DFIs and PDBs should consider:

- the adoption of a range of modalities and instruments to increase adaptation activities, including green, sustainability and sustainability-linked bonds,
- the use of financing strategies such as seed capital, patience capital, guarantees, and concessional loans, the adaptation benefit mechanism (ABM) and result-based financing, which can be tailored to socially and gender-sensitive impactful adaptation projects,
- the identification and sharing of better practices for boosting adaptation finance, and consider co-investment for adaptation operations, possibly joining and/or further elaborating on initiatives such as the Adaptation & Resilience Investors Collaborative.

Boosting adaptation finance necessitates reforming approaches and adopting new modalities and instruments, when appropriate, including beyond the traditional investment loan/debt, equity, and grant approaches that the majority of the financial institutions mostly use, as illustrated in Table 2 and Figure 6.

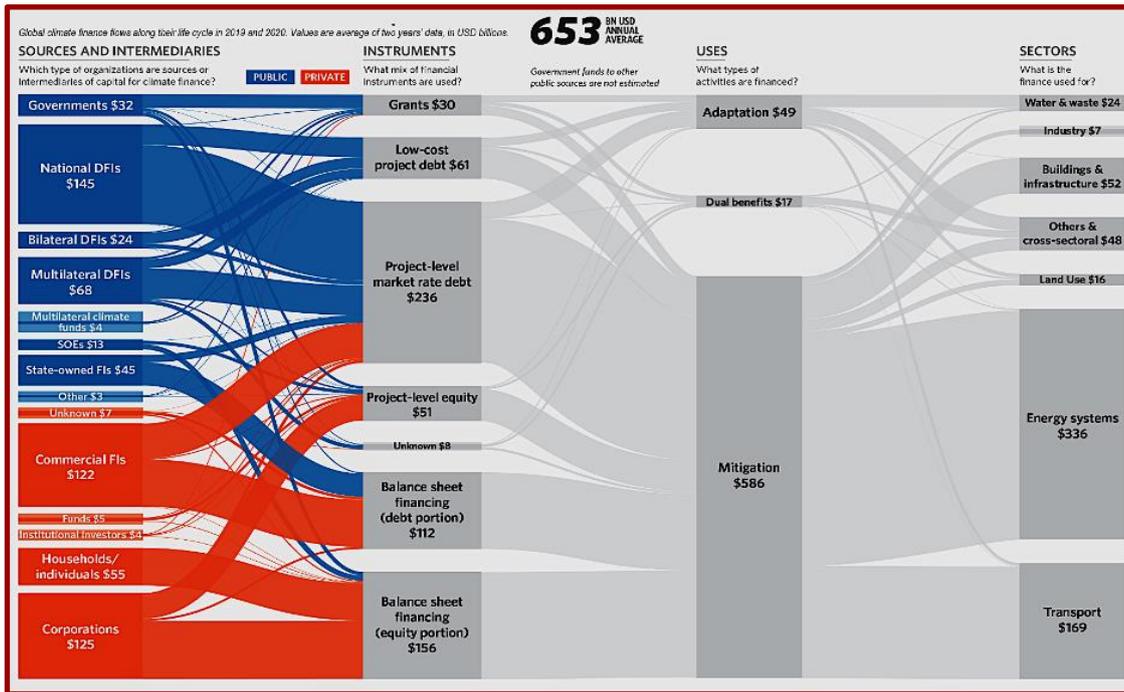
Table 2. MDBs adaptation finance to developing countries by type of instrument in 2021 (\$ millions) ¹⁷

Instrument type	Adaptation finance
Equity	22
Grant	2 631
Guarantee	145
Investment loan	11 055*
Line of credit	40
Policy-based financing	1 490
Results-based financing	1 179
Other instruments	1 050
Total	17 611*

Source: MDBs (2022a)

¹⁷ *Signals the exclusion of climate adaptation finance from AIIB for three projects reported amounting to \$20 million to avoid double counting. For more, refer to MDBs (2022a).

Figure 6. Landscape of climate finance in 2019-2020 by financial instruments



Source: CPI (2022)

European DFIs and PDBs can further adopt innovative and sustainable financial instruments that encourage long-term investments in adaptation projects. This could partly be through long-term impact bonds for adaptation projects. European DFIs and PDBs have embraced innovative financial solutions such as green bonds to boost climate finance. However, most of the funding under green bonds is channelled to climate mitigation solutions.¹⁸ While climate mitigation is essential, there is a need to strike a balance with adaptation by taking on innovative financial solutions that are adaptation-focused.

Adopting innovative financial approaches might entail making use of financing strategies such as seed capital, patience capital, guarantees, and concessional loans that are tailored to socially impactful adaptation projects. European DFIs and PDBs may also use more of the adaptation benefit mechanism (ABM) or result-based financing for adaptation projects that are currently being endorsed by, for instance, the Africa Development Bank (AfDB), as discussed further in Case 6. The adaptation benefit financing mechanism requires that financial institutions finance adaptation projects based on the benefits associated with them. These benefits can be the extent of damages and vulnerabilities that a proposed project intends to address or the magnitude of resilience it will create as measured in monetary value.¹⁹ Monetised adaptation benefits also cover co-benefits such as the ecosystem-aligned benefits that are common with the establishment of resilient infrastructure systems.

Broadly, some innovative financial approaches that European DFIs and PDBs can adopt to boost their financing of adaptation projects are presented in Table 3.

¹⁸ [Green bonds.](#)

¹⁹ [EIB at COP27: MDBs to expand support for countries seeking climate-resilient sustainable transition.](#)

Table 3. Innovative financial strategies that European DFIs and PDBs can adopt

Financial instrument	Remarks for European DFIs and PDBs
Debt swaps	Debt swaps are financial transactions where creditors forgive a portion of a country's sovereign debt in exchange for investment in sustainable development. They can be part of innovative solutions to provide additional resources in support of developing countries to address climate adaptation and resilience. European PDBs can play a critical role in upscaling debt swaps by directing them to also support adaptation projects (Karaki and Bilal 2023b).
Green, social, sustainability and sustainability-linked (GSSS) bonds	European PDBs can either directly issue green, social, sustainability and sustainability-linked (GSSS) bonds (OECD 2022b), or support the local issuance of such bonds, building on the EU Global Green Bonds Initiative and Sustainable Advisory Hub. This can help identify and build a pipeline of bankable projects for the use of the proceeds of the GSSS bonds with a focus on adaptation and resilience projects. The Green and Resilience Debt Platform by the EIB and the Green Climate Fund, in partnership with UNDP and UNCDF, is an illustration of the EU Global Green Bond Initiative and its potential for adaptation (EIB 2023e).
Catastrophe Bonds	European PDBs can support developing countries via catastrophe bonds or "cat bonds." This protects businesses against natural disaster risks such as floods and cyclones, which are common in some developing countries like Mozambique, Malawi, and Zimbabwe. With cat bonds, the climate change risks are borne by investors, which keeps businesses afloat.
Social impact bonds (Pay for success contracts)	European PDBs can leverage resources for social impact bonds or performance-based contracts to invest in adaptation projects with a social impact. MSMEs can repay their loans based on how well they have achieved a predefined goal. This type of financing works based on a measurable adaptation impact.
Results-based or performance-based financing approach	The results-based financing approach is similar to the ABM. It is not tied to the present but to the future bankability of the project. European DFIs and PDBs can offer financial support to adaptation projects based on their projected outcomes concerning meeting set adaptation or climate resilience objectives. Businesses are then allowed to make payments upon successfully achieving the established goals.
Payment for ecosystem or environmental services (PES)	European DFIs and PDBs can adopt the PES approach, where they provide financial incentives to asset owners who offer adaptation necessary services. This could be through, for instance, forestry conservation, crop diversification, flood regulations, and land restoration. PES allows funding institutions to invest in adaptation projects that preserve critical ecosystems and build resilience in developing countries.
Adaptation Fund	European DFIs and PDBs can establish, together with donors and their implementing agencies, adaptation funds that provide adaptation-tied financial resources to projects in developing countries. Adaptation funds might offer grants, equity, technical support, advisory services, and loans to support MSMEs that work towards building resilience or helping developing countries adapt to climate change.
Climate Insurance	European DFIs and PDBs can invest in climate insurance systems to help developing countries manage financial risks that stem from the consequences of climate change. Climate insurance can be used to compensate individuals and businesses that are affected by extreme weather events. This protects businesses from financial shocks and improves their bankability for local and international financial institutions.

Microinsurance	European DFIs and PDBs can invest in insurance projects that aim to cover micro and small businesses. This will help them deal with the consequences of climate change, especially those due to agricultural losses from extreme weather events.
Project preparation or design stage financing	European DFIs and PDBs can provide finance, together with donors when needed, that is directed at supporting early-stage development of adaptation projects. This support which can either be technical, advisory, or financial, will facilitate projects in design formulation, initial planning, feasibility assessment, and adaptation viability.
Climate innovation funds	European DFIs and PDBs can provide finance that is aimed at supporting MSMEs that offer innovative solutions in dealing with climate change consequences. This kind of financing can be intended to support new ideas, research and development, and adaptation technology initiatives that can build resilience to climate change.
Revolving funds	European DFIs and PDBs, and in particular EIB Global, can establish revolving funds to provide much-needed financial support for adaptation projects in developing countries. This could be through re-establishing investment packages from development country-specific loans that have been repaid. Revolving funds would create a sustainable source of funding for adaptation projects.
Adaptation investment windows	Several climate banks have been established globally. The EIB also re-establishing itself as a climate bank. However, these sometimes focus highly on mitigation. Establishing adaptation investment windows with the sole goal of supporting adaptation projects can accelerate adaptation-tied financing, especially in low-income countries.
Structured blended finance	European donors, with their DFIs and PDBs, can also adopt a structured blended finance approach by mobilizing resources from the public and private sectors and using them to support adaptation projects through different financial instruments, including concessional loans, mezzanine financing, equity, grants, guarantees to promote impact, risk sharing, and catalyze the role of the public sector.

The financing strategies mentioned in Table 3 should also be tailored towards country-specific characteristics to address political economy-related challenges. Research evidence shows a correlation between climate disasters and conflict. Fragile countries such as Somalia, Ethiopia, Eritrea, and South Sudan have a high probability of experiencing more conflicts as a result of extreme weather events like droughts and floods.²⁰ Such conflicts are common in agricultural and pastoral communities where droughts increase food insecurities. European DFIs and PDBs can utilise grant-based financing options to empower fragile and conflict-affected contexts to build resilience against climate change and reduce the conflict-associated costs of the consequences of climate change.

3.2 Synergies in the financial framework

Challenge 2: Insufficient cooperation among European DFIs and PDBs, limiting the use and potential benefits of the blended finance approach to promoting climate adaptation finance in developing countries

European PDBs and DFIs have progressively collaborated among themselves and with other European development actors, as well as with other international PDBs such as the AfDB, World Bank Group, Inter-American Development Bank (IDB), and Asian Development Bank (ADB) among others to promote adaptation financing in

²⁰ [Climate change raises conflict concerns.](#)

developing countries. However, the current collaboration efforts underutilise their potential to espouse more coordinated financing and make them prone to fragmentation challenges (Hodson and Howarth 2023). The lack of strategic synergies creates unharmonized climate taxonomies and adaptation finance standard differentials. This leaves adaptation financing, climate risk pricing, and policy conditionalities beyond the EU uncoordinated as each European financial institution for development assesses these terms differently.

Fragmented financial strategies do not only affect European PDBs and DFIs; they also make it burdensome for the recipients of adaptation finance to meet the unique standards set by each institution. European PDBs have only collaborated to a limited extent on data reporting metrics, although the EIB has successfully coordinated the MDBs' joint methodology for tracking climate change adaptation finance (MDBs 2022c). By following the EIB and EBRD, other European PDBs and DFIs could benefit from and build upon the MDBs methodology by tracking their adaptation finance progress more harmoniously. The current lack of coordination in the search for bankable projects in developing countries creates unnecessary competition. This leads to overconcentration of climate finance in a few countries and on mitigation projects, as further discussed later and as illustrated in Figure 9 (Wieser et al. 2019; DFIs 2023).

Global blended climate finance approaches have had a limited focus on climate adaptation, with only 14% (15% in 2019-2021) of historical transactions purely focusing on adaptation (Convergence 2022). Considering all blended finance, out of the total mobilised finance amounting to USD 108 billion, a mere USD 6.9 billion has been exclusively allocated to adaptation projects (Convergence 2022). This remains too low to finance large-ticket infrastructure projects such as road infrastructure, drainage, and irrigation systems that are critical in building resilience against climate change in several developing countries. Only 14% of the adaptation funds were redirected toward SSA despite the region's critical need for adaptation finance (Convergence 2022). While the role of the private sector is usually understated, its potential to contribute towards adaptation objectives should not be overlooked.

The European and other DFIs have not fully engaged with the private sector based on the adaptation urgency demands and in line with the IPCC recommendations of prioritizing adaptation science (IPCC 2023). At the European level, DFIs and PDBs have insufficiently collaborated on climate adaptation financing with the private sector and with the public sector. This is mostly due to the nature of the promotional landscape in Europe that pools resources together from different stakeholders who have divergent goals and objectives. Some of these objectives include low risk and still high return appetite, based on a shorter time horizon, which prevent them from aligning with adaptation project features that might require patience capital, better risk assessment and more appropriate risk mitigation mechanisms (Ahairwe et al. 2022; Bilal and Karaki 2022).

Besides, the focus on a project-based approach of collaboration by many European DFIs and PDBs has led to limited engagements with local stakeholders, including local development banks and financiers in developing countries, for more transformative endeavours. A project-based approach is demand-driven and this limits the extent to which institutions both in Europe and developing countries can come together to comprehensively mobilize blended finance for adaptation projects. Demand-driven financing encourages collaboration based on the need of a few potential projects. This results in limited risk sharing and low levels of funding

for policy-based solutions such as climate adaptation literacy and research, especially in low-income countries.

Recommendation 3: European DFIs and PDBs should strive for result-oriented partnerships among themselves, with European and international donors and their technical agencies, the public sector, and private actors in developing countries

European DFIs and PDBs should consider:

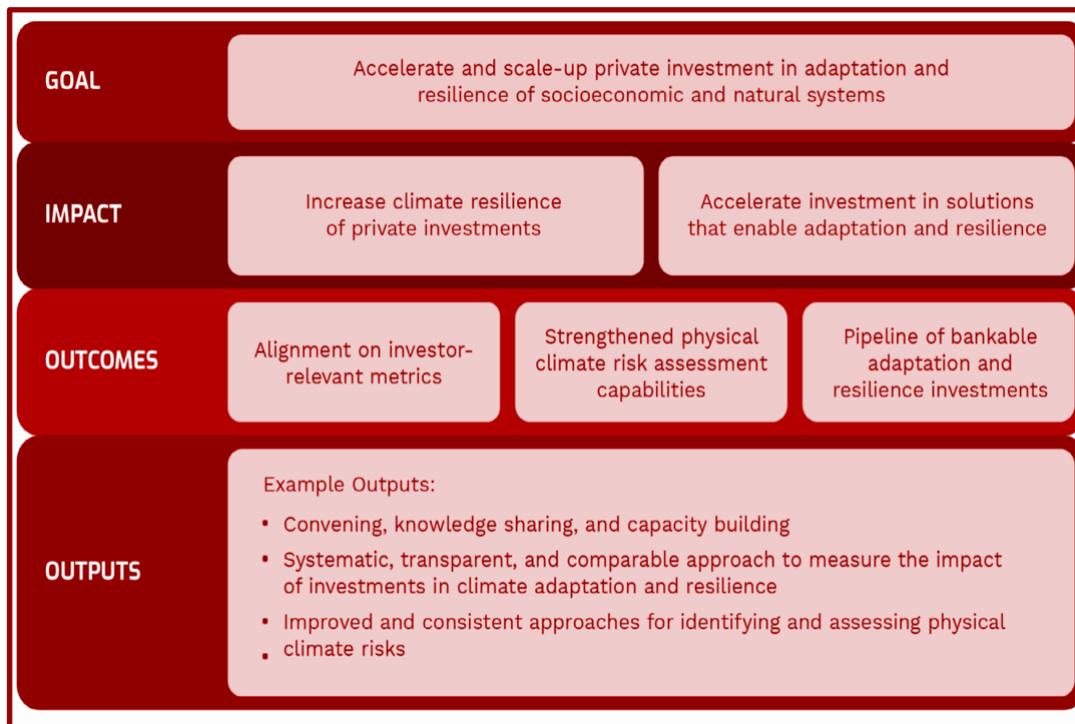
- establishing result-oriented partnerships that can inspire more action-oriented collaborations towards supporting adaptation projects in developing countries,
- adopting common approaches and initiatives, building on the Adaptation & Resilience Investors' Collaborative,
- fostering cooperation on climate adaptation with European donors and their development agencies, building on the EDFI, JEFIC and PN Statement of Intent on enhanced collaboration of the three networks, and taking advantage of their respective financial and technical expertise, local presence and networks
- identifying broader synergies with other international development actors on adaptation, and
- engaging and strengthening local ecosystems for transformative approaches towards adaptation and resilience.

In 2022, the Group of Seven (G7) DFIs which include EDFI members such as FMO, AFD and Proparco, CDP, Finnfund, Swedfund, and BII under the Adaptation & Resilience Investors Collaborative network made a step in the right direction by selecting UNEP-FI as the initiative secretariat to help them invest more in the private sector of developing countries.²¹ They also established a collaborative theory of change presented in Figure 7 and principles that are focused on increasing adaptation finance, resilience to climate physical risks, building a pipeline of bankable projects, and promotion of collaborations with the private sector (CPI 2022).²²

²¹ [Adaptation & Resilience Investors Collaborative reaches key milestone with appointment of its Secretariat.](#)

²² [International Collaboration of development finance organisations agree new steps to increase the resilience of economies threatened by the climate emergency.](#)

Figure 7. G7 DFIs' collaborative theory of change to boost private sector adaptation finance



Source: CPI 2022

However, the G7 DFIs still fall short of meeting their set objectives regarding adopting a common methodology for identifying eligible adaptation and resilience investments, tracking adaptation and climate resilient finance, and developing comparable adaptation impact metrics. This continues to affect the extent to which they can direct more investments toward adaptation projects. While synergies are encouraged, European DFIs and PDBs should avoid fractured collaborations that lead to different metrics from various collaborative networks, as these still lead to fragmentation problems. Harmonizing the G7 DFIs collaboration agenda with broad EU-level principles for climate adaptation might ensure that all European DFIs and PDBs have a standardised understanding of climate adaptation taxonomies and principles and can report their data coherently and comparably.

European DFIs and PDBs need to collectively speak in a coherent manner on collaborating at the international level with other donors, impact funders, development agencies, civil society organisations, and the private sector to boost financing, technical, and policy support for climate adaptation. Synergies with the private sector should go beyond financial mobilization to exploit the rich pool of impact-focused entrepreneurs that offer innovative climate adaptation solutions (Choi et al. 2023). They also broadly express a preference to finance MSMEs via financial intermediaries, especially commercial banks, but there are concerns about the extent to which these banks provide microcredit to the most vulnerable and intended MSMEs (Gajigo et al. 2023). Collaborations with microcredit institutions might be a more practical solution for increasing smaller-ticket adaptation finance that goes to MSMEs.

European DFIs and PDBs should collaborate on implementing effective mechanisms for conducting impact assessments on their adaptation finance projects under the

EFSD and EFSD+. These assessments are crucial for financial institutions to understand the systematic impact, learn from past investments, identify externally valid success stories, and capture unintended consequences of adaptation financing. Impact assessment reports would help reveal any biases in adaptation finance, provide context-specific evidence and lead to informed recommendations on the way forward.

There is a common argument that low-income countries require smaller loans, which may discourage many European DFIs and PDBs that typically offer larger loans. However, the impact assessment report on EIB investment activities in Africa, the Caribbean, and Pacific countries challenges this notion. While a significant portion of ACP funding was allocated to large enterprises, the majority of approved projects belonged to the 'missing middle' category, which required smaller-ticket loans ranging from USD 25,000 to USD 2 million (EIB 2017). This contrast between the number of enterprises supported (transactions made) and the amount of funding allocated often leads to confusion in the development finance realm.

European DFIs and PDBs experience limitations in their capacity to engage in adaptation due to the lack of bankable projects, unfavourable ecosystems, and large ticket-size limitations. Combining and synergising their efforts with development cooperation institutions in adaptation and resilience, European DFIs and PDBs could jointly cooperate on the development of sustainable pipelines of transformative adaptation projects and the strengthening of local eco-systems for adaptation and resilience, including improving the policy environment, regulatory setting, the building of local markets and the strengthening of local private and public actors' capacities for adaptation. By more directly engaging with the local entities, European financial and technical development institutions could jointly enhance the resilience and adaptation capacity in developing countries (see Appendix).

The *EDFI, JEFIC and PN Statement of Intent on enhanced collaboration of the three networks* could provide an opportunity for European DFIs, PDBs and technical implementing agencies to co-design cooperation mechanisms for more impactful adaptation operations in developing countries (Bilal and Karaki 2022; EDFI et al. 2023; Karaki and Bilal 2023a). Such concrete cooperation already exists, as in the case of the Dutch Fund for Climate and Development between the Dutch DFI FMO and Dutch technical agency SNV, which also include an international private actor - Climate Fund Managers - and an international civil society organisation - the World Wide Fund (WWF), working closely with local stakeholders on adaptation investments, thanks to the Dutch government support in the form of grants, as in Case 5 (Karaki and Bilal 2022).

Recommendation 4: Advance adaptation-specific blended finance approaches that utilise the potential of the public and private sectors in developed and developing countries alike.

European PDBs and DFIs should strive to:

- mobilise impactful private finance for adaptation
- synergise public and private finance and operations in adaptation and resilience
- boost the use of blended finance mechanisms and transactions in adaptation

- build synergies with private actors, including institutional investors and foundations with patient capital, civil society and public entities on adaptation
- simplify modalities to facilitate access to blended finance for adaptation, allowing smaller ticket size financing, including through aggregation vehicles, targeting more complex and vulnerable contexts.

Although public financing is essential, it will not sufficiently close the adaptation gap (Tall et al. 2021). Financing from the private sector will be substantial in helping meet some of the adaptation costs. However, European DFIs and PDBs are struggling to create synergies with the private sector. Many private actors see climate change as a risk only, and climate adaptation as an additional cost-reducing net return, rather than a risk-mitigation investment which may generate positive returns over time (Ahairwe et al. 2022). Blended finance approaches should aim to crowd in the private sector, potentially mitigating some of these perceived risks, and accompanying adaptive investment with technical assistance and other measures. Blended finance has already shown its potential to contribute towards closing the adaptation gap by providing about 36.23% (USD 2.5 billion) of the total (USD 6.9 billion) blended adaptation transactions to date (Convergence 2022).

To meet the current adaptation costs - building climate resilience and addressing the adaptation challenges through innovative solutions, the European DFIs and PDBs need to adopt blended finance approaches that can leverage financial and technical resources from the public and private sectors. A successful blended finance-focused approach between the public and private sectors can be achieved through many innovative solutions that are focused on vulnerable countries and communities. For example, climate adaptation funds can be created for low-income countries to target private sector financiers while tapping into initiatives that are already in motion, such as the Adaptation Fund and the Dutch Fund for Climate and Development, as presented in Case 5 (see box below). By engaging with local stakeholders, developing bankable adaptation projects, and aggregating them into bigger ticket-size portfolios able to attract international investors, including DFIs, such initiatives can unleash climate adaptation investments at a large scale and for greater impact.

Case 5: The Adaptation Fund and the Dutch Fund for Climate and Development²³

The European DFIs and PDBs can further invest in or collaborate under the adaptation fund. The Adaptation Fund was established under the Kyoto Protocol of the UN Framework Convention on Climate Change to help vulnerable communities in developing countries that are the hardest hit by extreme weather events, desertification, and rising sea levels yet have contributed the least to the global warming problem. The fund aims to help them adapt to climate change and address problems of food insecurity, water scarcity, diseases, and heat waves based on country-specific needs and priorities. Since 2010, the Adaptation Fund has committed over USD 1 billion to adaptation projects globally, with the EU broadly leading in leveraging resources and providing over 95% of the annual voluntary pledges. The European Commission further committed €100 a million at COP26 in 2021 to the fund.²⁴

²³ [The Adaptation Fund](#) and [NEWS FMO, SNV, WWF and CFM consortium wins tender to manage €160 million Dutch Fund for Climate and Development](#).

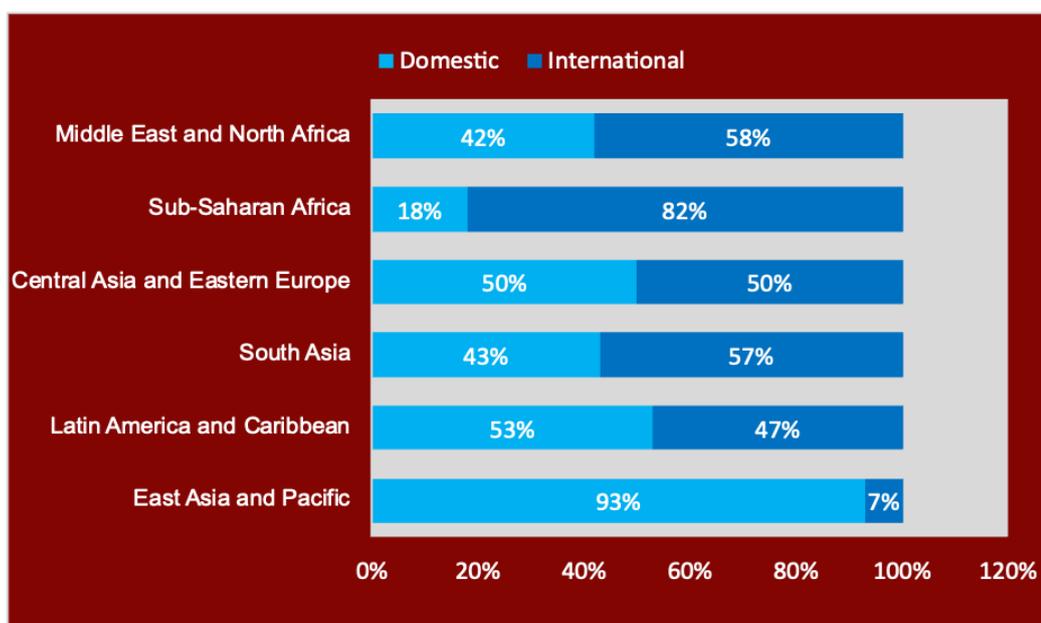
²⁴ [International climate finance](#).

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The Dutch government provided €160 million for the Dutch Fund for Climate and Development (DFCD), a climate resilience fund that is dedicated to supporting locally-led bankable climate adaptation projects which benefit vulnerable people and landscapes. The DFCD is set up and managed by the FMO in collaboration with SNV Netherlands Development Organisation, the World Wide Fund for Nature (WWF), and Climate Fund Managers. Its major goal is to support vulnerable groups, especially women and youth adapt to climate change and build resilience. DFCD mostly focuses on developing bankable projects of small ticket size, through an origination facility, for water and sanitation and environmental protection, and for land use management, agroforestry, sustainable land use and climate resilient food production in developing countries (at least 25% of least developed countries). At least 50% of its investments must be in adaptation, with a target of 65% (Karaki and Bilal 2023b).

Blended finance should also exploit the strength of different regions. Some regions, such as East Asia and Pacific, Latin America and the Caribbean, and Central Asia and Eastern Europe, have a great local potential that European DFIs and PDBs can exploit to mobilize additional resources locally from the public and private sectors, as illustrated in Figure 8. However, other regions, such as SSA, depend greatly on external resources, which highlights the need to leverage resources from international donors to boost support for adaptation. Efforts should also be made to leverage resources from local governments, including national development banks and financial institutions that usually have a development mandate and a focus on social impact-related projects, features that adaptation projects exhibit.

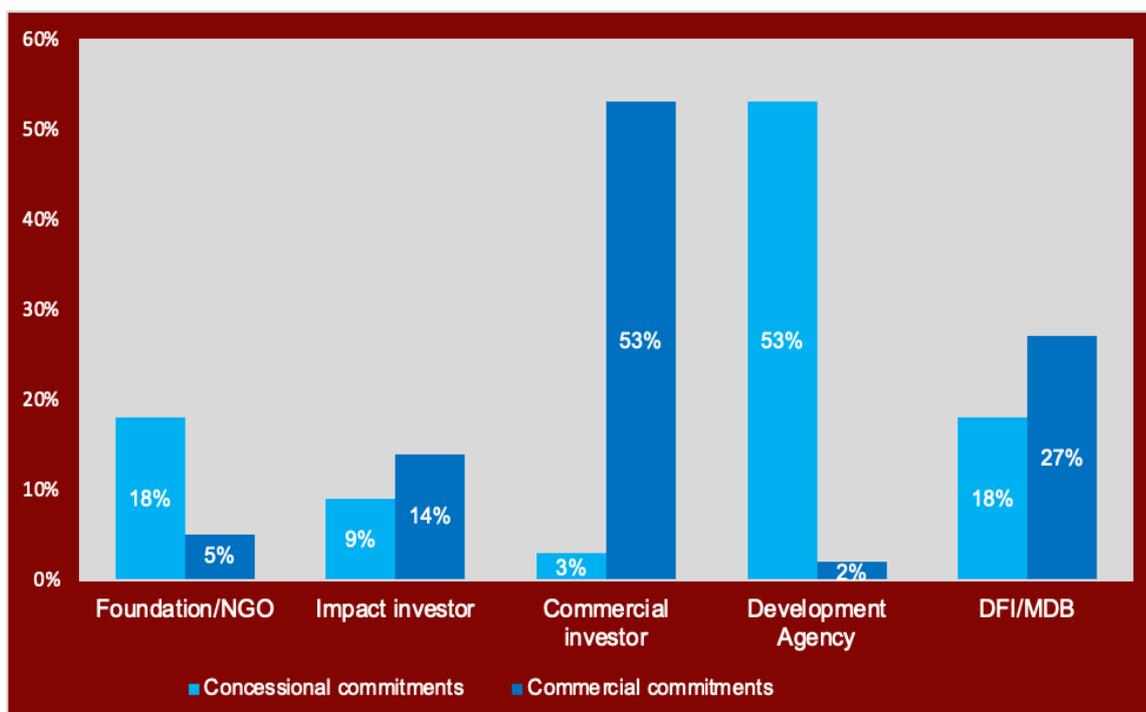
Figure 8. Climate Finance by regional distribution 2011-2020



Source: CPI (2022)

Additionally, European DFIs and PDBs can further leverage financial and technical support from private sector players who have shown strong leadership in blended adaptation transactions. Some of these include commercial investors who contributed 53% of the total commercial blended adaptation transactions, as presented in Figure 9, despite the perceptions that adaptation projects are not bankable. Blended finance allows risk sharing, which can enable both European DFIs and commercial investors to take on higher-risk projects. Leveraging resources from impact investors, foundations, and development agencies in Europe and beyond also allows the financing of risky projects through grants, concessional loans, and equity financial instruments. These financial strategies facilitate project growth and allow the eventual economic viability of adaptation projects.

Figure 9. Share of commitments to adaptation and hybrid blended finance for 2019-2021



Source: Convergence (2022)

3.3 Bankability of adaptation projects

Challenge 3: Many adaptation projects in developing countries are not perceived as bankable and are associated with high levels of risk

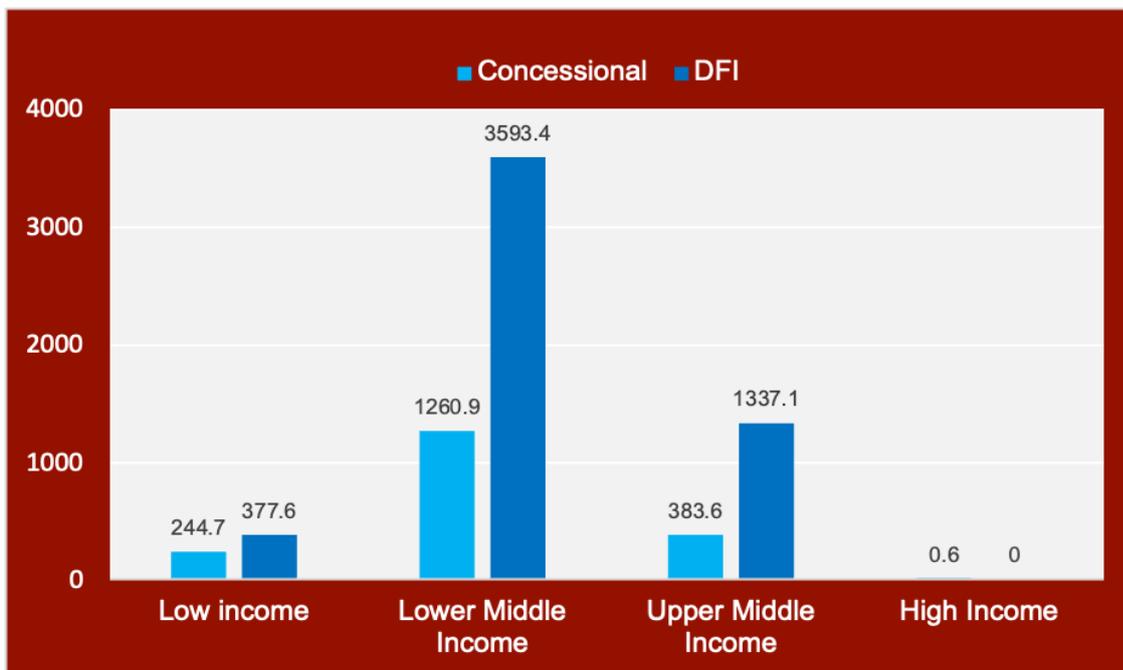
Given the nature of their risk appetite and the need to maintain their AAA credit rating, European financial institutions for development search for bankable adaptation projects, yet these are usually scarce in developing countries (Attridge and Engen 2019). According to Convergence (2022), DFIs broadly stress that low adaptation finance is due to the lack of a business case; but what makes ‘a business case’ is often simply a question of how an ‘adaptation project’ is defined. Most

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financial institutions providing climate finance are profit-maximizing and provide mostly debts - 61%, equity - 34%, and grants - 5% (Naran et al. 2022). Evidence from CPI indicates that loans - 84% dominate the financial instruments used for climate financing, and these are mostly offered at the market rate as opposed to concessional rate -16% (Naran et al. 2022). The market rate financing of adaptation projects explains the need for DFIs to search for projects that are economically viable and which can repay the loans at a relatively higher premium. As a result, financial institutions, including many European DFIs and PDBs, scramble to identify the complete few bankable adaptation projects and compete for them (Gavas and Perex 2022).

Most adaptation projects are usually social impact-focused rather than profit-focused. They are also associated with high physical risks - chronic risks such as gradual global warming and acute risks such as extreme weather events that impose unplanned financial costs, damages, and losses on individuals, businesses, and governments. All these features make adaptation projects barely bankable for many financial actors, especially in low-income countries, making investing in them economically unattractive for most European DFIs (Ahairwe et al. 2022). When European DFIs and PDBs are not tied by climate adaptation investment goals, they might prefer to invest in less risky mitigation projects and middle-income countries. These are also usually countries with sizeable projects that attract large-ticket investments. As a result, a large percentage of financial commitments for European financial institutions for development are concentrated in middle-income countries that have viable and bankable projects that most DFIs search for, as depicted in Figure 10.

Figure 10. Concessional and DFI new commitments by income group in 2021 (USD million)



Source: DFIs (2023)

European PDBs and DFIs have taken critical steps to integrate climate risks into their portfolio, but for many, progress is limited as they are currently often not able to accurately measure risks at the project level, especially those associated with adaptation (Ahairwe et al. 2022). Climate damages that occur at regional and national levels continue to broadly increase the project risks for some financial institutions even when these might not have a micro-level effect. Climate risk mispricing at the micro level or project level in some countries might unfairly present some projects as unbankable (CDC 2020). Broadly challenges such as lack of proper methodologies, a macro focus at the national or regional level, and lack of standardized data lead to poor integration of climate adaptation risks, making European DFIs and PDBs overestimate risks associated with adaptation financing, further discouraging investments in the same (Ahairwe et al. 2023).

Recommendation 5: Support the development of a pipeline of bankable projects to ensure business case development and future financing of adaptation projects by the European DFIs and PDBs and other financial institutions.

European DFIs and PDBs should prioritize

- supporting the development of the pipeline of bankable adaptation projects, together with other development actors and local stakeholders,
- fostering an enabling environment and local eco-system for the development of transformative adaptation and resilience initiatives which are financially viable,
- mobilising patient capital combined with technical expertise to foster the local capacity for generating sustainable pipelines of adaptation projects.

By adopting this progressive financing model, they can enhance their support for adaptation projects that have significant social and developmental impacts, which are often overlooked by institutions that overly focus on immediate bankability. Many adaptation projects, such as road infrastructures, housing systems, and water management systems, are public sector-led and aim to mitigate flood risks while fostering the growth of business ecosystems. Although these projects may not yield immediate financial returns, they offer long-term social and public benefits.

Other projects, such as irrigation schemes to combat drought, are mostly private-sector-led and require patient capital, concessional financing, and technical advisory services during the project's initial stages. By providing such support, European DFIs and PDBs can create opportunities for viable businesses to emerge, attracting private investors and fostering collaborations that enable more blended finance mobilization. Adopting such an approach would not only encourage the development of new businesses, it would also align with the investment interests of the European DFIs and PDBs.

One way to develop bankable projects is to follow these key steps. First, there is a need to identify priority sectors that offer significant socio-economic adaptation benefits and align with the objectives and focus areas of European DFIs and PDBs. Second, it is essential to conduct a thorough market analysis and due diligence is crucial to assess the project's adaptation benefits. Third, an ex-ante results assessment is needed to ensure the likelihood of the project's success. Lastly, European DFIs and PDBs might consider providing patient capital to promising projects that have the potential for long-term viability.

The AfDB, which is the leading investor in adaptation projects by share of climate finance, is already implementing this kind of approach via its Adaptation Benefit Mechanism (ABM) as presented in Case 6 (MDBs 2022; AfDB 2020). ABM is a unique model of supporting the adaptive capacity of developing countries in mostly the agriculture sector, paying specific consideration to irrigation, food security, and crop diversification as presented in Case 6 (AfDB 2020).

Case 6: Building a Pipeline of bankable projects via the Adaptation Benefit Mechanism²⁵

The Adaptation Benefit Mechanism (ABM) is a results-based financing approach that allows the channelling of financial and technical support to activities that promote resilience to climate change. ABM allows individuals, MSMEs, and countries to pay upon the delivery of adaptation and resilience results or “adaptation benefits” (AfDB 2020). By waiting to pay until results are generated, ABM allows DFIs to support adaptation projects that would otherwise not be supported. It also allows support for adaptation projects that might have otherwise been too risky to finance, building their reward-to-risk profile and helping them grow into financially viable or bankable adaptation projects.

Supporting the development of a pipeline of bankable projects has the potential to strengthen the adaptive capacity and resilience of developing countries via building new solutions. De-risking investments in the private sector through paying costs incurred in delivering adaptation benefits, as confirmed by the adaptation benefits certificates issued by a reputable international organisation, can also encourage innovations and attract other investors via blended finance facilities. The support of project development can ensure that project managers make the necessary and effective foundational project preparations, build essential technical expertise, and acquire the right technology and machinery for the long-term sustainability of projects as they work towards bankability. This approach requires that European DFIs and PDBs support adaptation project start-ups via seed, patience capital, equity, and grants and give projects enough grace periods to deliver results and be able to generate profits to be financially viable, upon which European DFIs can provide commercial finance at market rates.

Support of bankable projects should also extend to cover MSMEs and households that are affected by climate change consequences. European DFIs and PDBs in most in-need countries might need to strive for inclusivity and lower their risk appetite by providing risk-free or low-risk capital. In this case, collaborations with micro-credit institutions that have established a long record of eliminating poverty by investing in vulnerable groups and businesses might be an essential step for European DFIs and PDBs with the same mandate. Microfinance institutions such as Brac have built experience and synergies that have helped them adopt innovative approaches, such as the graduation model presented in Case 7, to address poverty challenges. Such a model that has demonstrated its success via a series of research studies can be extended to cover adaptation-specific individuals, micro, and small enterprises that are common in the agriculture sector (BRAC 2021).

²⁵ [Adaptation Benefit Mechanism \(ABM\)](#).

Case 7: Supporting the most vulnerable via a graduation approach²⁶

European DFIs can adopt a graduation approach that has already been demonstrated to work effectively in promoting the provision of finance for vulnerable individuals. A graduation approach or model is an initiative by Brac, one of the world's largest international non-governmental development organisations, which is based in Bangladesh. Brac aims to put "the furthest behind first" in the fight to end global poverty.²⁷ Its graduation approach is a multifaceted model that aims to end the poverty trap and make vulnerable individuals self-sufficient through (1) providing them with immediate relief to meet their basic needs (meeting basic needs stage), (2) supporting them to develop income-generating activities (income generation stage), (3) providing income management skills and boost savings (financial support and savings stage), and (4) promoting inclusion and behavioural change (social empowerment stage). Several research studies via randomised control trials have provided evidence that the graduation approach works, with about 95% of vulnerable individuals being able to graduate out of extreme poverty with benefits that last for about 7 years after the program (Brac 2021).

Multiple development institutions, including MDBs and development agencies such as the World Bank, IFAD, DFID, and UNICEF, alongside governments in developing nations, have collaborated with Brac to address the challenges of global poverty in Africa and the Middle East. European DFIs and PDBs can also establish partnerships with micro-credit institutions to specifically assist individuals who are most adversely impacted by climate change events like floods, droughts, and storms. These partnerships will mitigate risks for these individuals, enabling their transition towards self-sufficiency, financial stability and bankability. Such initiatives gained momentum during COVID-19. The FMO, for instance, provided a loan of 50 million via Equity Bank Kenya to support MSMEs that were affected by COVID-19. Extending these efforts to MSMEs affected by climate change consequences will enhance the position of the European DFIs and PDBs in supporting adaptation efforts in developing countries.²⁸

Recommendation 6: Adopt a systematic approach to measuring climate risks by integrating risks and opportunities in the adaptation finance cost-benefit analysis

European DFIs and PDBs need to:

- adopt a systematic approach to measuring adaptation risks by integrating risks with opportunities in their cost-benefit analysis models (Ahairwe et al. 2022),
- share better practices on climate risk assessments and how to integrate them into their business model to better address adaptation and resilience, building on the EIB and EBRD know-how and the EDFI and JEFIC community of practice, as well as other international initiatives.
- consider a broader range of risk mitigation mechanisms and agents, including public and commercial insurance and reinsurance,

²⁶ [About the Graduation Approach.](#)

²⁷ [Putting the Furthest Behind First.](#)

²⁸ [Equity Bank Kenya and NASIRA sign guarantee program for COVID-19 support.](#)

- mobilise patient capital with a longer time horizon to better capture the benefits of adaptation and resilience projects over time, and
- more explicitly identify the developmental, social and economic benefits of climate adaptation projects.

Often European DFIs and PDBs look for well-packaged bankable projects among developing countries, communities, and people that are highly susceptible to climate change. This results in 'too much money chasing too few projects'. European DFIs and PDBs need to look beyond the risks associated with investing in adaptation projects and assess the social and economic likelihood of creating ecosystems that can spur development in the long term.

Adopting tools that enable European DFIs and PDBs to measure associated benefits in the long and short terms following their social impact objectives can boost investment in adaptation projects. The AfDB ADM example presented in Case 6 and innovative financing strategies presented in Table 2 are some of the investment strategies that European financial institutions for development can adopt to tap into the long-term benefits of supporting adaptation projects.

4. Cascading risks and European interests

Climate change is a global phenomenon, affecting all countries to various degrees. Yet, developing countries are often less able to cope with and, therefore more vulnerable to the effects of climate change, while bearing less responsibility for the historical emission of CO₂. Their climate vulnerability hinders their sustainable development perspectives. As such, they rightly deserve specific attention and support from richer economies, such as the EU.

Development finance is one of the ways the EU can help foster the long-term climate adaptation and resilience of many developing countries. It is also one of the means development and climate actions can be reconciled in the international agenda. By mobilising its public development banks and development finance institutions for climate adaptation actions, in complementarity and synergy with its other development cooperation and climate diplomacy endeavours, the EU and its member states can play a lead role in responding to the climate adaptation and resilience needs of more vulnerable and poorer developing countries.

Yet, greater focus and coherence of European development finance and efforts for adaptation action is also beneficial for the European Union. Indeed, it can help address some of the climate risks cascading across borders and between continents risks, entailing knock-on effects on the EU. Such cascading risks include possible international trade disruptions and higher price volatility for EU imports due to climate change in developing countries, as well as greater food insecurity, higher political instability and possible climate-related conflicts in some poorer countries, leading to unwarranted displacement of people and possible tensions between the EU and its partners.

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A greater European emphasis on adaptation finance may also support the broader objectives of the European Green Deal and climate diplomacy, fostering goodwill and appreciation by some developing countries whose adaptation concerns can be seriously addressed by the EU (Dekeyser and Rampa 2023; Jayaram and Lazard 2023; Knaepen and Dekeyser 2023).

Last, but not least, in a more geopolitical EU eager to also promote its own value and interests, including economic ones, mobilising at scale private and public finance for climate adaptation abroad may also help generate profitable opportunities for European private financiers, investors and businesses in the climate adaptation sector (Karaki et al. 2022).

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