



Beyond Financial Flows: *Differentiating Climate Finance and Carbon Finance in the implementation of the Paris Agreement*

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Sources of climate finance and carbon finance can be complementary but should not be conflated. Implementing the Paris Agreement in a robust manner requires that both are delivered responsibly.

International carbon markets, especially under Article 6, should unlock higher climate ambition, not financing mitigation that would have otherwise occurred. Clear attribution between climate finance and carbon finance is thus needed.

Clear accounting and attribution rules are essential to safeguard environmental integrity and prevent double claiming. A four-pronged assessment based on purpose, financial terms, mitigation attribution and ambition-can help with this.

01 · CONTEXT

Why it is important to distinguish climate finance from carbon finance

Climate finance and carbon finance may support the same mitigation activity, but they perform different functions. The United Nations Framework Convention on Climate Change (UNFCCC) Standing Committee on Finance describes climate finance as “reducing emissions and enhancing sinks of greenhouse gases and aims at reducing vulnerability of, and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts” [1]. Carbon finance, by contrast, is finance explicitly linked to the pricing, generation, acquisition or transfer of quantified greenhouse gas emission reductions or removals or associated compliance based allowances or carbon tax revenue. While carbon finance can incentivise mitigation and generate positive adaptation and sustainable development co-benefits, its transactional nature creates important limitations. In particular, the use of mitigation outcomes to ‘offset’ emissions elsewhere means that it does not necessarily deliver additional net mitigation or increased climate ambition. The two can thus be complementary in delivering mitigation but are not automatically fungible [2]. This nexus remains critical to address. The New Collective Quantified Goal (NCQG) developed under Article 9 calls for developed countries to take the lead in mobilising at least USD 300 billion annually by 2035 and calls on all actors to scale finance for developing countries to at least USD 1.3 trillion annually by 2035 [3].

Article 6 markets can mobilise investment towards this, but the volume of carbon finance transactions is not equivalent to climate finance support. Indeed, carbon markets appeared in negotiating proposals but were not expressly identified in the final NCQG decision [3]. While this omission does not itself establish its categorical exclusion as a form of climate finance, it raises several key questions which are often conflated [4] :

- **What is the financial transaction actually financing?**
- **Who is entitled to claim the resulting mitigation?; and**
- **Under which ledger, if any, may the finance and/or mitigation outcome be reported?**

It is therefore important to consider what the definitional bounds of climate and carbon finance mean operationally for mitigation financing under the Paris Agreement.

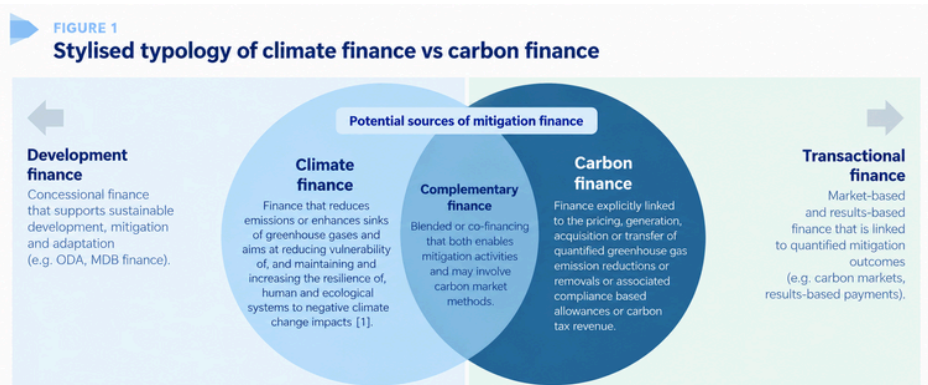
02 · CORE PRINCIPLES

A Functional Classification Framework

While both climate finance and carbon finance drive mitigation they can collectively be called forms of “mitigation finance”. Climate finance should support developing countries’ mitigation priorities, including their ability to implement their nationally determined contributions (NDCs). Carbon finance involving transferred mitigation outcomes should unlock additional mitigation ambition rather than substitute or subsidise Host Party’s own NDC implementation plans [5]. Complementary financing has separate but defined roles for both the climate finance and carbon finance function respectively.

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As shown in **Figure 1** Climate finance can support mitigation, implementation, adaptation, readiness or resilience; it can use quantified indicators without transferring an offsetting claim. Carbon finance is linked to the purchase or remuneration of quantified mitigation, including where a buyer acquires a transferable unit. Complementary financing arrangements combine climate and carbon streams that materially enable the same intervention and therefore require explicit allocation of funding, outcomes and claims [2]. All three are needed to realise the goals of the Paris Agreement. However, there is evidence that where these are blended via a complementary financing approach not all tCO₂e benefits should go “all to carbon market” [6].

03. PRINCIPLES

How to distinguish between climate and carbon finance

01: Aim Is the payment intended to enable an activity, institution, transition or resilience outcome, or to acquire a quantified emissions reduction, removal or equivalent allowance?	02: Arrangement Is the financial transaction a grant, concessional loan, investment, results-based payment or exchange for a unit? What type of economic or reputational benefit does the payer receive?
03: Attribution Who retains the right to count or claim the resulting mitigation as part of a given inventory, adjusted emissions balance or registry?	04: Ambition Does the financing enable new, enhanced or accelerated mitigation ambition, or support the implementation of existing commitments?

04 · PRINCIPLES IN PRACTICE

Applied examples

Case	Example	Type	Rationale	NCQG Eligible*
<i>Climate finance support for Article 6 readiness</i>	UNDP, Advancing Carbon Market Readiness in Mongolia	Climate Finance	Funds institutions, registries, MRV and authorisation capacity; no mitigation unit is acquired.	Yes
<i>Climate funded project that uses carbon market methodology</i>	GCF FP138 solar mini-grids, Senegal	Climate Finance	Use of a carbon methodology does not itself transfer mitigation outcomes or associated claims.	Yes
<i>Project funded by climate finance that subsequently produces credits</i>	Ouarzazate concentrated-solar project, Morocco	Complementary Finance	Potential additionality risks so proportional allocation needed.	Partial
<i>Proportionally attributed complementary financing</i>	Japanese Joint Crediting Mechanism (JCM)	Complementary Finance	Climate financed mitigation remains with the host; carbon financed mitigation may be transferred.	Partial
<i>Purchase of Article 6 ITMOs</i>	Authorised ART-TREES credits	Carbon finance	Payment acquires quantified mitigation outcomes, transferring the associated accounting benefit through a corresponding adjustment.	No
<i>Voluntary purchase of credits without Article 6 authorisation</i>	Corporate purchase of Verra Verified Carbon Units (VCUs)	Carbon finance	Payment acquires quantified emissions reductions or removals represented by carbon credits, potentially supporting corporate climate claims, without transferring the host country's NDC accounting entitlement.	Potentially

*Per the relevant propositions in Greiner *et al.* (2025) [4]

“...a lack of safeguards at the nexus of climate finance and carbon finance could lead to an overestimate of national mitigation effort even without formal carbon credit transfers”

05 · SAFEGUARDS

How to ensure integrity is upheld

Several safeguards help ensure that the distinction between types of mitigation finance is credibly upheld.

1. Keep financial support and purchases distinct

Disclose grants, concessional support, mobilised private finance and credits bought separately. Transaction value should not be assumed to equal support received by the Host Party so as not to divert development assistance [2].

2. Attribute finance and mitigation *ex ante*

For co-financed activities, identify each funding stream, the mitigation retained by the host, mitigation outcomes available for transfer to the purchaser and permissible claims. Carbon credits should only be issued for the mitigation outcomes they finance in a proportional manner [2].

3. Separate gross purchases from net support

Where climate finance is bundled with ITMO acquisition, assess the asset or contractual value received by the buyer. Deducting ITMO value and allocating mitigation outcomes solves related but different accounting problems [4].

4. Protect ambition

Use carbon revenue to unlock otherwise infeasible and/or higher cost mitigation rather than automatically crediting activity already enabled by climate support. Preserve space for host-country NDC priorities and ratcheting [5].

5. Report both money and tonnes

Transparently distinguish and report climate finance provided, private finance mobilised, carbon transaction values, adaptation levies and outcomes transferred or retained [7]. Do not extrapolate between money and tonnes (see Box 1).

BOX 1: EXAMPLE OF THE NEED FOR SAFEGUARDS

In defending its climate ambition, the Dutch Government relied on research attributing 7.85 MtCO₂e in annual emission reductions by 2030 to nine internationally financed programmes [8]. A subsequent assessment increased this estimate to 25.1 MtCO₂e, despite methodological uncertainties concerning attribution and projected mitigation impacts [9]. Although the Government recognised that these prospective reductions could not count towards Dutch domestic emissions targets, it still invoked international climate finance to substantiate its contribution to global mitigation. This raises concerns under three principles: **purpose**, as development finance supports quantified mitigation claims; **attribution**, as financial contributions were translated into emissions reductions without exclusive entitlement; and **ambition**, as reductions are not necessarily additional to host country commitments. As a result, this case illustrates how a lack of safeguards at the nexus of climate finance and carbon finance could lead to overestimate of national mitigation effort even without formal carbon credit transfers [10].

06 · Summary

Paris-aligned mitigation financing

Achieving the Paris Agreement requires an unprecedented scale up in both public and private sector financing. Ensuring that this finance is credibly sourced and utilised is of utmost importance to ensuring that the stretched resource can realise the most mitigation possible towards this end. The inception of the NCQG and the implementation of a new era of carbon trading under Article 6 makes this nexus more important than ever to get right.

Carbon finance can mobilise meaningful investment without that same credit purchase necessarily becoming climate finance. Mitigation related financial flows should be classified by their purpose, terms, mitigation attribution and additionality; and reported to their respective mobilisation goals under their respective Paris tracks. Articles 9 and 6 both play critical roles under the Paris Agreement. Their respective functions should be complementary, without conflating the distinct purposes they serve.

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