REFLECTION NOTE

LINKING CARBON MARKETS AND CLIMATE FINANCE – KEY INSIGHTS FROM THE CLIMATE FINANCE INNOVATORS PROJECT

By Stephan Hoch, Anna Kovács, Alexandre Dunod, Sandra Greiner, Maria Eitel

KEY MESSAGES

- **African countries have engaged in both carbon market mechanisms and climate finance instruments.** The Climate Finance Innovators project pioneered practical approaches for stronger synergies by using CDM methodologies for GCF projects, and carbon markets for upscaling GCF funding in Ethiopia, Uganda and Senegal.

- **Advancing synergies between market mechanisms and climate finance helps address the insufficient level of resource mobilisation and strengthen their effectiveness.** Carbon finance is results-based using UNFCCC-approved methodologies but needs to be complemented by upfront finance for generating emission reductions or removals. Climate finance can deploy a range of instruments, including for upfront capex investments, but benefits from enhanced results-orientation and private sector resource mobilisation from carbon markets.

- **COP29 finalised both the Article 6 rulebook and a new climate finance goal.** The A6 decision on international carbon market rules enables a decisive shift towards implementation. The new climate finance goal for 2035 is vastly insufficient but calls for innovative sources such as carbon finance to be mobilised. Countries should explore the full potential of this redefined new generation of carbon market and climate finance instruments to increase the ambition of their NDCs, due in 2025.

- **This reflection note synthesises key insights from the Climate Finance Innovators (CFI) project, supported by Germany's International Climate Initiative.** CFI explored the interface between carbon and climate finance in Africa. Key insights build on a comprehensive range of activities, including two approved GCF project approvals in Senegal and Ethiopia and support to CDM transition in Uganda, as well as capacity building, Article 6 negotiations support, knowledge generation and dissemination in partner countries and with regional alliances in Eastern and West Africa.

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Acknowledgements

Supported by

Federal Ministry for Economic Affairs and Climate Action

INTERNATIONAL CLIMATE INITIATIVE

on the basis of a decision by the German Bundestag

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This short study is part of a project under the International Climate Finance Initiative (IKI). Federal Ministry for Economic Affairs and Climate Action of Germany (BMWK) supports this initiative. The views expressed in this publication are those of the authors and do not necessarily reflect the views of the BMWK.

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LIST OF ACRONYMS

A6.4M	Article 6.4 Mechanism
AGN	African Group of Negotiators
BOAD	West African Development Bank
CDM	Clean Development Mechanism
CFI	Climate Finance Innovators
COP	Conference of the Parties
DNA	Designated National Authority
EU	European Union
ERCST	European Roundtable on Climate Change and Sustainable Transition
GCF	Green Climate Fund
LDC	Least Developed Countries
MRV	Monitoring, Reporting and Verification
NDA	National Designated Authority
NDC	Nationally Determined Contribution
OECD	Organisation for Economic Co-operation and Development
PA	Paris Agreement
PACM	Paris Agreement Crediting Mechanism
PoA	(CDM) Programme of Activity
RE	Renewable Energy
SBs	Subsidiary Bodies
SBI	Subsidiary Body for Implementation
SBSTA	Subsidiary Body for Scientific and Technological Advice
SCF	Standardised Crediting Framework
SD	Sustainable Development
UNFCCC	United Nations Framework Convention on Climate Change

1. INTRODUCTION

The Climate Finance Innovators Project, supported by Germany's International Climate Initiative (IKI) has pioneered linking market mechanisms and climate finance. The project activities focused on supporting African countries and project implementers to generate practical experience with such linkages to balance respective strengths and weaknesses. These efforts were complemented by support to African negotiators for contributing to finalise the Paris Agreement (PA) Article 6 carbon market rules, capacity building for partner countries and regional alliances and institutions, as well as knowledge creation and outreach at relevant regional and international fora.

The project ended in January 2025, right after COP29, when Parties to the Paris Agreement took far-reaching decisions: The Article 6 rulebook has redefined multilateral rules for international carbon markets which are significantly stronger compared to the Kyoto Protocol era. COP29 also formulated a new long-term climate finance goal of USD 300 billion per year by 2035, supplemented by a call to reach USD 1.3 trillion from a variety of new and innovative sources, including carbon markets. This newly agreed goal is vastly insufficient to meet investment needs of current NDCs, not even considering that these urgently need to become more ambitious. This backdrop underlines the relevance of how climate finance and carbon markets can be reinforced through stronger linkages.

This brief reflection note offers some key insights based on the experiences generated through the Climate Finance Innovators IKI project. The paper begins by laying out the initial purpose when global carbon markets had collapsed in the mid-2010s, and Africa's Clean Development Mechanism (CDM) pipeline needed to explore support beyond carbon finance. The paper proceeds to show how climate finance can be strengthened by drawing on CDM methodologies and other elements, and vice versa, showcasing practical case studies from Ethiopia, Senegal and Uganda. Furthermore, the paper captures key insights from capacity building and negotiation support. The reflection note closes by offering concluding thoughts on the key takeaways from the project for the new generation of carbon market and climate finance instruments.

2. INITIAL PURPOSE OF STRENGTHENING SYNERGIES BETWEEN MARKET MECHANISMS AND CLIMATE FINANCE

Ten years ago, carbon market development in Africa and globally was at its low point. Ensuring equitable access to the benefits of the CDM for African and Least Developed Countries (LDC) had been a key concern in UNFCCC negotiations as well as related capacity building efforts since the early days of the Kyoto Protocol, as predominantly major emerging economies were reaping the benefits from CDM. This led to important CDM reforms such as simplification of methodologies and introduction of programmatic approaches, which spawned an emerging carbon market portfolio in many African countries.

After international carbon markets and thus demand for CDM credits had crashed after 2012, these achievements were in jeopardy. The second commitment period to the Kyoto Protocol until 2020 was characterised by low global mitigation ambition, with countries such as Canda pulling out. The European Union (EU) had stopped accepting international carbon credits for its EU Emissions Trading System (ETS) after 2020, leading to a demand implosion for CDM credits. These developments also put the hard-won progress made regarding Africa's access to the carbon market at risk (Greiner et al 2018).

As a result, the demise and lack of certainty about the future role of carbon markets in the Paris Agreement required African CDM host countries and carbon market implementers to identify alternative sources of finance for their activities. The African carbon market pipeline had been characterised by a strong focus on sustainable energy access in the CDM (clean cooking, off-grid and grid-connected renewable energy), with nature-based solutions primarily supported by the voluntary carbon market. From 2010-2016, the GCF was just beginning to define its rules and procedures and approved the first projects. Countries had just submitted their first generation of NDCs, which often remained vague on climate finance needs, and did not pay particular attention to carbon markets. While the PA had just defined an unexpectedly robust role for carbon markets in its Article 6, the operationalisation remained unclear, and indeed required almost a full decade of further negotiations to agree on a detailed Article 6 rulebook at COP29 in 2024. Against this backdrop, the Climate Finance Innovators project set out to explore practical linkages between climate finance and carbon markets in Ethiopia, Uganda and Senegal, complemented by capacity building, UNFCCC negotiations support, knowledge generation and outreach. As both climate finance and carbon markets are becoming more relevant for developing countries to go beyond their current NDC ambitions, the potential of such synergies remains highly relevant but needs to be reassessed in light of the PA rulebook.

3. KEY TAKEAWAYS

3.1. LINKING CARBON MARKETS AND FINANCE

The conceptual idea that carbon and climate finance instruments have both strengths and weaknesses that can partially balance each other out through stronger linkages seems to have been indicatively confirmed by practical experiences in the CFI project.

The results-orientation of climate finance benefits from carbon market methodologies
The carbon market's core strength is its results-orientation since carbon finance is based on the ex-post certification of mitigation impacts. A toolkit of UNFCCC-approved baseline and monitoring methodologies has emerged, which often serve as a benchmark for measuring mitigation impacts beyond the CDM, not only in voluntary carbon markets, but also for climate finance. While the GCF initially left the MRV approach entirely to Accredited Entities, there is an emerging informal practice that GCF projects are building on carbon market methodologies for MRV purposes. This does not mean that carbon credits have been generated, except for in individual cases such as FP026 (Sustainable Landscapes in Eastern Madagascar) led by EIB, where REDD+ credits rightly had to be cancelled in order to avoid 'double-dipping', meaning that the same mitigation outcomes would have received double financing if it had received both GCF and carbon finance for the same ton of CO_2e reduced.

Mobilising upfront investments and predictable resource flows
This results-based nature of carbon finance, however, is at the same time also a weakness of carbon market instruments, since projects need to mobilise initial investments to be able to generate the mitigation outcomes for which carbon credits can be issued. This challenge is amplified by the volatile nature of carbon prices which makes carbon finance difficult to factor into investment decisions. It is a core strength of climate finance institutions that they can provide a range of financing instruments such as grants, loans, equity and risk guarantees, with much higher predictability. Therefore, climate finance can help overcome some barriers such as high capital costs for capex investments more effectively than carbon markets. Yet, such climate finance is limited, and carbon revenues incentivise the private sector to innovate and provide technical expertise that government-led activities may lack.

Further simplification of access to carbon markets and climate finance is needed
A joint barrier of carbon markets and climate finance institutions is that the costs of accessing these resources are high especially for low-income countries, due to complex bureaucratic requirements and data needs as well as long and not always predictable timelines. This situation is underlined by the low number of national GCF direct access entities as well as local technical experts who know how to navigate carbon project documentation requirements. Therefore, significant simplification of access procedures without compromising environmental and social integrity is an important future challenge.

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3.2. PRACTICAL EXPERIENCES WITH GCF PROPOSALS

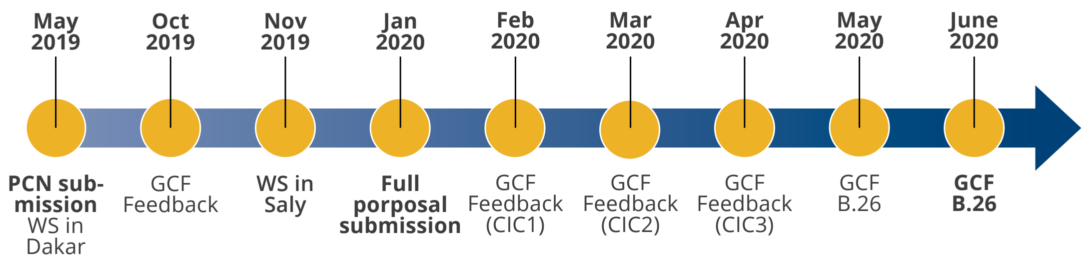
The first GCF funding approval (financing solar mini-grids in rural Senegal) supported by the CFI project was approved in 2020 for Senegal, with the West African Development Bank (BOAD) as GCF Accredited Entity. Senegal aims to achieve universal electricity access, focusing on the most vulnerable and disadvantaged people in rural areas. Many rural communities are hardest to connect due to high investment costs, low returns and currency risks. CFI has been supporting BOAD and the Senegalese Rural Electrification Agency (ASER) as the implementing entity for the GCF approved ASER Solar Rural Electrification Project (FP138).

The GCF contributes concessional investment to de-risk local operators' participation and secure the best combination of tariff and service from the licensed solar energy mini-grid networks, meters and public lighting. GCF funding enables ASER to deploy 100 % solar mini-grids in 1,000 isolated villages across Senegal through private rural electrification concessionaires. ASER's activities are particularly relevant for linkages between carbon markets and climate finance, as the agency also implemented a registered CDM Programme of Activity (PoA) for rural electrification with support from the World Bank. In parallel, this PoA also explored Article 6.2 piloting through the Standardized Crediting Framework (SCF).

The GCF project connected with these carbon market activities by using the same CDM monitoring, reporting and verification methodology (AMS.III-BL "Electrification of rural communities using renewable energy") for its MRV framework. While the chosen approach stopped short of generating carbon credits as this was seen as a risk for GCF approval, it offered a harmonised approach for both carbon and climate finance support for rural electrification through the UNFCCC-approved CDM methodology, which enables Senegal to consistently and transparently track the GHG impact of ASER's activities over time. This approach can be subsequently integrated into reporting on mitigation outcomes both to the GCF and to UNFCCC as part of reporting on progress made to achieving NDC targets. As outlined in the report Financing sustainable energy access in African NDCs, Africa's clean energy transition depends on unlocking finance through innovative linkages between carbon markets and climate finance. By aligning energy policies with NDCs, leveraging carbon pricing mechanisms, and increasing investment in off-grid renewable energy, African countries can achieve sustainable energy access while meeting climate commitments.

Beyond mitigation, the gender and social connections result-based payment mechanism, inspired by the original World Bank carbon-finance JAPPALE voucher programme to reduce electricity connection costs for eligible social services and women and youth-led enterprises 'PREM' (Multi-Sectoral Energetic Projects), stimulate anchor load demand and enhance the sustainability of the mini-grids operation.

ASER and other Senegalese agencies could not apply to GCF directly as there was no appropriate national GCF Accredited Entity. Working with BOAD as Accredited Entity was an effective choice, as this regional financing institution could not only meet GCF requirements, but also mobilise significant co-financing from World Bank, KfW and the private sector. Navigating the iterative GCF funding application was challenging yet constructive since the project design evolved substantially, e.g. by removing short-lived 'lower tier' technologies (e.g. solar lamps), switching from hybrid mini-grids (backed by diesel-generators) to 100 % solar mini-grids in response to GCF policy, as well as strengthening the role of productive use technologies such as water pumping.



Despite a strong regional lead by the BOAD, which enabled successful approval by the GCF Board in August 2020, the Funded Activity Agreement only became effective in September 2022 before the first disbursement could occur, due to thorough legal review and admin processes, lengthy condition precedents clearance and limited local implementation capacities. Therefore, a key insight is that the GCF review process can help improve project design, but also remains a barrier for access to finance, as procedures were bureaucratic and time-consuming, not always with clear timelines and often short turn-around periods.

In **Uganda**, the project attempted to develop a similar approach as in Senegal. Based on extensive consultations with government, private sector and development partners, a GCF concept note focusing on **private sector-led deployment of off-grid solar mini-grids** with a strong role for productive use applications has been developed and submitted to the GCF (Working title: De-risking private sector investments in RE Mini-grids and low-emission rural industrialization in Uganda). While this concept was strongly anchored in Uganda's NDC and existing off-grid renewable energy access initiatives, the funding proposal eventually had to stop based on challenges in formulating a viable set-up of GCF Accredited Entities and executing entities. Had it advanced, the concept note design may have taken a very similar approach as in Senegal, building on CDM methodologies for MRV and exploring synergies with a CDM PoA operated by Uganda's Rural Electrification Agency (REA). Therefore, the lack of nationally Accredited Entities, partially owing to the requirements for accrediting national institutions such as REA, also emerged as a major barrier to accessing GCF funds.

In **Ethiopia**, the CFI project successfully supported the Ministry of Finance as GCF direct access entity in mobilising a USD 45 million grant, complemented by USD 5 million own co-financing to support **solar water pumping for irrigation, livestock, and drinking water** (FP243 Climate-resilient community access to safe water powered by renewable energy in drought-vulnerable regions of Ethiopia). In terms of project design, the GCF proposal again employed the CDM methodology appropriate for SWP but did not directly connect to a carbon market programme, not least because the key GCF results area was adaptation focusing on the number of households benefiting from the supported measures. However, the Development Bank of Ethiopia manages a CDM Programme for off-grid electrification, which has been registered for off-grid solar water pumping, but has so far only disseminated solar household lighting technologies. Again, a conservative approach was chosen that only used the CDM methodology for MRV, but did not aim at generating carbon credits. Still, the paradigm shift and exit strategy in the funding proposal considers the possibility of replicating the GCF supported activities beyond the boundaries of the GCF funded project through results-based climate finance, which may include carbon finance. Such an approach can strongly benefit from the strengthened enabling environment for solar water pumping (regulatory improvements, training), but allows for a clear demarcation between GCF funded measures, and those supported by the carbon market.

While this funding application took even longer than in Senegal, hampered among other factors by conflict in one of the proposed intervention areas, the perseverance and ownership of the Federal Ministry of Finance as Accredited Entity and sector ministries were critical to successfully navigate the GCF funding application process.

In summary, all GCF funding proposals supported by the CFI project focused on sustainable energy access and showed potential direct linkages to relevant CDM PoAs in the partner countries. Yet, due to the lack of a clear GCF position on carbon markets, the funding proposal designs restricted themselves to drawing on the UNFCCC-approved CDM methodologies for the MRV framework to enable harmonisation across different climate finance sources in partner countries but did not create direct links to carbon market implementation. To be clear, any resulting carbon credit directly generated with GCF funding should be cancelled to avoid double dipping, which aligns with the IKI guidance on carbon credits. Still, the GCF funding creates a powerful precedent for disseminating new technologies, which require further upscaling for sector-wide implementation. Here, carbon markets should play a stronger role in the future based on the PA Article 6 rulebook. As the GCF is part of the UNFCCC Financial Mechanism, such linkages should be explored more systematically, considering COP29 decisions on carbon markets and climate finance.

3.3. CAPACITY BUILDING

In addition to the practical exploration of the links between market mechanisms and climate finance based on GCF funding applications in partner countries, capacity building played a strong role. The emphasis was on supporting Accredited Entities in navigating the GCF funding application requirements as well as raising awareness among Article 6 DNAs and GCF NDAs for the relevance of harmonising activity-level MRV with NDC accounting and reporting. Moreover, all approved GCF projects mobilised through the CFI project included **substantial technical assistance grant elements, which will strengthen national capacity and the enabling environment for the roll-out of supported technologies** (policy and regulatory development, MRV capacity including digitalisation, design of financial instruments, knowledge sharing, etc.).

The project also provided significant technical contributions to the **Eastern and West African Alliances on Carbon Markets and Climate Finance**, which were founded during the early stage of the CFI project duration. The Alliances provided innovative country-led platforms to exchange their experiences on a peer-to-peer level, with an initially strong focus on Article 6 readiness, given the consequential negotiations on the Article 6 rulebook which took place at the same time. Moreover, both subregional Alliances were hosted by the UNFCCC Regional Collaboration Centres in Lome and Kampala, ensuring close alignment with UNFCCC capacity building. Key activities included preparatory and on-site negotiations support, technical workshops and knowledge products such as the following four Article 6 pilot studies

- Moving towards next generation carbon markets – Observations from Article 6 pilots
- Update June 2019: Moving towards next generation carbon markets – Observations from Article 6 pilots
- Article 6 piloting: State of play and stakeholder experiences
- The landscape of Article 6 implementation,

as well as country carbon market portfolios across both UNFCCC and VCM crediting programmes to support countries in better understanding which carbon market activities are being implemented in their countries. Under VCM crediting programmes, country approval was often not required in the Kyoto period, which left host country governments in the dark about carbon credit transactions. As all countries have NDC targets since 2021, it is becoming increasingly important that countries have a full understanding of all carbon market activities and transactions within their jurisdictions. The West African Alliance is now also supported by IKI, and the success of these Alliances is underlined by their replication in Central Africa and even the Eastern Caribbean.

Through a series of workshops for peer-to-peer exchange, technical issues in Article 6 negotiations, and enhancing synergies between the Alliances and ongoing initiatives, the CFI project also supported African countries in enhancing their understanding of carbon markets and the role they can play in implementing conditional NDC targets, as well as their preparedness to engage in UNFCCC negotiations. This included both sub-regional workshops through either the West or the East African Alliance as well as interregional workshops bringing together countries from both Alliances.

The CFI project has also provided support to the West African Development Bank (BOAD) together with the West African Alliance, both on workshops and on the preparation of a climate finance proposal for the International Climate Initiative, thereby complementing capacity-building on carbon markets with support on climate finance initiatives.

A related key focus of capacity building within regional alliances but also partner countries was the ongoing **transition of activities from the CDM to the PACM**. This need for capacity building was identified as a clear unaddressed gap in Article 6 readiness support by other development partners and seemed crucial for the CFI project considering the initial starting situation for the project described above. This line of work directly supported CDM activities in Ethiopia, Uganda, and Senegal, managed by both government agencies and the private sector, to apply for transition to UNFCCC, and generated innovative knowledge products on benefit sharing and fee structures, share of proceeds, as well as work on eligibility criteria and technical procedures for CDM transition in Ethiopia, Senegal and Uganda.

The CFI project's capacity building activity have therefore taken a holistic approach focusing on both practical implementation of Article 6 as well as supporting Article 6 negotiations in the UNFCCC process, culminating in the adoption of the high-level Article 6 Rulebook at COP26 in Glasgow and the finalisation of technical Article 6 rules at COP29 in Baku. The interplay between supporting partner countries, subregional Alliances and climate negotiators proved to be very effective.

3.4. RULEMAKING AND NEGOTIATIONS

Throughout its implementation, the CFI project offered negotiation support to African stakeholders, aiming to enhance their ability to represent their interests in ongoing Article 6 negotiations, thus ultimately contributing to that Article 6 rules better reflect African circumstances than CDM rules did. This support comprised both technical advice as well as on-site negotiation support and resulted in the following policy briefs:

- COP28 Digest: Relevance of Key Outcomes for Carbon Market Implementation in Africa
- COP27 digest: Moving towards the operationalisation of Article 6-backed carbon markets in Africa
- COP26 digest: The significance of Article 6 and CDM transition outcomes for Africa
- Closing the deal on 'CDM Transition' – How COP 25 defined new guardrails for compromise and what they mean for Africa
- The Paris Agreement: The future relevance of UNFCCC-backed carbon markets for Africa
- Prospects for Africa's CDM activities under the Paris Agreement
- Progress and potential of CDM reform and post-Paris market mechanisms for Africa

The CFI project supported African negotiators' engagement in the UNFCCC process, including preparations for and effective participation at Subsidiary Body meetings (SBSTA and SBI, and the yearly Bonn Climate Change Conference) and COPs, between 2018-2024. The project has supported African negotiators throughout the preparation for adopting the "Paris Rulebook" for Article 6 at COP26 as well as subsequent conferences culminating in COP29 and the operationalisation of Article 6. In preparatory meetings of the African Group of Negotiators (AGN) before SBs and COPs, the project has delivered negotiation support consisting of an analysis of relevant negotiation texts, providing a forum for discussion and clarification of a unified African position, discussions on priority options, and presentations from experts on main negotiation issues. In addition, the CFI team provided an avenue for ad hoc discussions and daily coordination meetings of the AGN.

Moreover, the project generated contributions to CDM Executive Board meetings, informal forums such as conferences and expert roundtables on Article 6 negotiations, including the ERCST Informal Forum on Implementation of Article 6, African Climate Weeks, the Innovate for Climate conferences and the OECD Climate Change Expert Group. The CFI played an instrumental role in the planning and delivery of several COP and SB preparatory events for African negotiators in collaboration with the AGN and Conservation International. These preparatory meetings on Article 6 have become key events in the agenda of African carbon markets negotiators. After the closure of the CFI project, they can be carried forward by the East and West African Alliances, which the CFI project has brought into the partnership. The CFI engagements have been enabled by collaboration with country partners and organisations, particularly with the West African Alliance on Carbon Markets and Climate Finance and the Eastern Africa Alliance on Carbon Markets and Climate Finance. Overall, this line of work has contributed to shaping carbon market rules with African interests in mind.

4. CONCLUSION AND OUTLOOK

The CFI project is coming to an end when both climate finance and carbon markets are moving into a new era of implementation, based on the COP29 outcomes on the Article 6 rulebook and the long-term finance goal. While both climate finance and carbon markets have been redesigned and are somewhat strengthened, their implementation in support of host country NDCs is just beginning. Currently, finance mobilisation remains highly insufficient to meaningfully address the urgency of the climate crisis and its impact in particular on vulnerable countries without sufficient domestic resources.

Hence, the initial question for the CFI project on how a deeper focus on synergies between market mechanisms and climate finance enhances their ambition and integrity remains highly relevant but will play out against a completely reconfigured context, where all countries have national climate targets. Clarity on the rules for carbon markets and climate finance at the UNFCCC level is therefore a welcome step in the right direction but has not yet enabled a substantially increased urgency of accelerating the pace of NDC implementation. Looking forward, the experience generated in the CFI project points in several directions on how the practical implementation of both carbon markets and climate finance can be strengthened by working towards stronger linkages of these instruments to strengthen their impact and effectiveness.

More ambitious practical implementation of concrete activities that are actively exploring such synergies is crucial to better understand the potential and optimise their application. This means that from a climate finance perspective, testing whether and how existing GCF projects can be upscaled with carbon market activities to achieve the desired paradigm shift is a crucial opportunity. GCF projects already using carbon market methodologies as a basis for their MRV framework and being implemented by organisations with carbon market experience are the most appropriate cases in point. The PACM is the ideal avenue for such activities, as the GCF is a key institution of the UNFCCC financial mechanism. Therefore, both the Ethiopian and Senegalese GCF projects are well-suited candidates based on their MRV frameworks and (potential) linkages with existing carbon market programmes.

Furthermore, a stronger dedication to harmonise MRV methodologies for all types of carbon market and climate finance instruments will strongly support host countries in accounting and reporting to UNFCCC on progress made towards achieving their NDC targets.

Yet, significant additional gaps remain. The GCF still has no formal position on the linkage between carbon finance and GCF support projects. The understanding of carbon finance in the financial industry remains very low, contributing to the difficulty for carbon market activity developers to overcome the barrier of mobilising initial investments. Most importantly, both carbon market demand from NDCs and the willingness to mobilise public climate finance fall significantly short of the level of ambition that the long-term objectives of the Paris Agreement would require. Increasingly, hope is placed on private sector climate finance, i.e. the contribution of both the PACM and voluntary carbon markets as a source of international finance to support developing countries in their mitigation and adaptation efforts. This is not just enshrined in the new long-term climate finance goal agreed during COP29 but also a pillar of the EU's Call to action for Paris Aligned Carbon Markets, International carbon pricing and markets diplomacy. Working towards stronger linkages between carbon markets and climate finance may help to address some of these challenges, and the experiences generated by the Climate Finance Innovators project may help inspire more ambitious action going forward.

CLIMATE FINANCE INNOVATORS

LINKING CARBON MARKETS WITH CLIMATE FINANCE IN AFRICA