Taxonomy for Climate Finance

Why in news?

The 2024 Union Budget features a plan to create a climate finance taxonomy, aiming to boost capital for climate adaptation and mitigation.

What is climate finance?

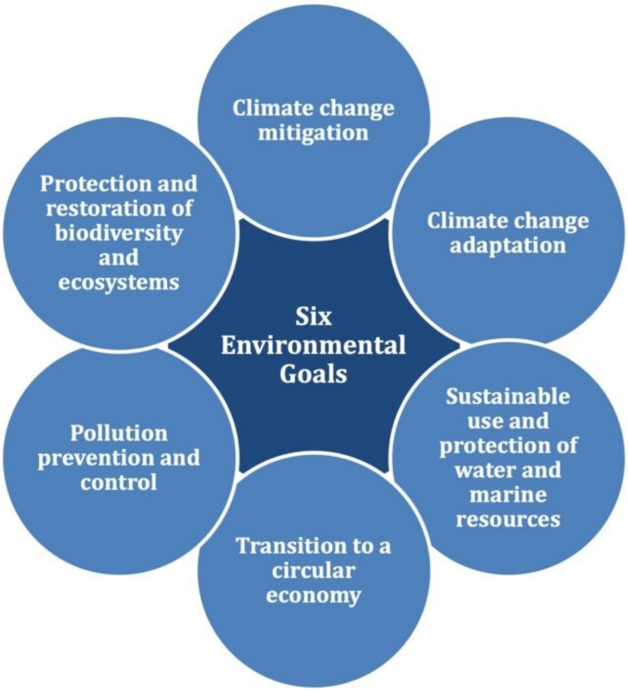
- **Climate finance** – It refers to local, national or transnational financing, drawn from public, private and alternative sources of financing that seeks to support mitigation and adaptation actions that will address climate change.

Sources of Climate Finance
• **Public Finance**- Government funds and international financial institutions (e.g., World Bank, IMF). • **Private Finance**- Investments from private entities, including banks, corporations, and venture capitalists. • **Blended Finance**- Combines public and private resources to leverage additional investment for climate initiatives.
Types of Climate Finance
• **Mitigation Finance**- Funds to re*duce or prevent greenhouse gas emissions,* such as renewable energy projects, energy efficiency improvements, and sustainable agriculture practices. • **Adaptation Finance**- Funds to projects that help communities & ecosystems *adapt to the impacts of climate change*. • It is by building resilient infrastructure or developing drought-resistant crops.

What is climate finance taxonomy?

- **Need of climate taxonomy**– *Diverse interpretations* of what is considered "green" can *fragment markets and confuse* investors.
- A *one-size-fits-all approach won't work* in climate financing as local factors has to be considered.
    - **For example**, different regions will have to adopt different pathways to reach the goal of limiting global warming to under 1.5 degrees C, as required under the Paris Agreement.
- **Climate finance taxonomy** – A system that classifies which parts of the economy may be marketed as sustainable investments.
- **Aim** – To *inform companies and investors* on making impactful investments towards environmental conservation and combating the climate crisis.
- They are also known as ***'green' taxonomies***.
- **Information provided** – It enlists about economic sectors & activities and corresponding criteria that determine if it aligns with larger climate goals.

- **Uses** – They are frequently used to *set standards* for classifying climate-related financial instruments (e.g., green bonds).
- They serve other use cases where the benchmarking feature is viewed as beneficial, including in the areas of climate risk management, net-zero transition planning, and climate disclosure.



Why climate taxonomy is important?

- **Establish clear standards** – It ensures consistent definitions and classifications of what constitutes climate finance.
- **Guides investments** – It can *help investors and credit institutions* based on how climate-aligned an entity or an activity is.
- It can also *help prevent greenwashing* by companies by setting common standards based on scientific assessments.

> ***Greenwashing** is when an organization invests in marketing campaigns that position the company as environmentally friendly rather than actually minimizing its environmental impact.*

- **Enable climate finances** – It helps in directing funds towards climate mitigation and adaptation projects.

> *According to the UNFCCC's first 'Needs Determination Report', financing of around $5.8-5.9 trillion is required to implement developing countries' climate action plans by 2030, and this does not fully include adaptation costs.*

- **Spur innovation** – By encouraging the development of new financial products and services that align with climate objectives.

- **Align with global goals** - A *localised climate finance taxonomy* can also help align a country's climate goals *with the Paris Agreement* and other international climate commitments.
- **Facilitate international cooperation** – It makes easier for countries and organizations to work together on climate finance initiatives.
- **Upholds transparency** – It ensures that investments are transparently & efficiently directed towards genuine green projects.
- **Enables accountability** – It help investors *compare investment* opportunities and *measure their environmental impact*.
- **Promote social responsibility** – By encouraging investment in activities that support sustainable development like affordable housing, access to clean water, and sustainable agriculture.

How green taxonomy is relevant for India?

- **Need** – India needs a standardized framework
  - To attract domestic and international investment
  - To guide investments in sustainable projects
  - To align funds with its national and global green transition commitments
  - To boost economic growth while combating climate change

> *According to the International Finance Corporation (IFC), a member of the World Bank Group, India needs $10.1 trillion to achieve net-zero by 2070.*

- **Factors to be considered** – Cultural nuances, geographic issues, market intelligence, scientific temper and ability to keep it simple.
- **Steps taken** – In 2021, India formed a *task force on sustainable finance* under the Ministry of Finance
  - To develop a sustainable finance framework, roadmap, activity taxonomy, and risk assessment framework.
- The Reserve Bank of India (RBI) *joined* the Central Banks and Supervisors Network for Greening the Financial System (*NGFS*).
- India has also become *part of a climate-related financial risks task force* under the Basel Committee on Banking Supervision (BCBS) and the International Platform on Sustainable Finance.

> *Many countries like China, Malaysia, and Sri Lanka have already issued green taxonomies to facilitate climate-sensitive investments. The European Union has a prominent Green Taxonomy.*

Reference

1. The Hindu | Taxonomy for climate finance