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# 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 |
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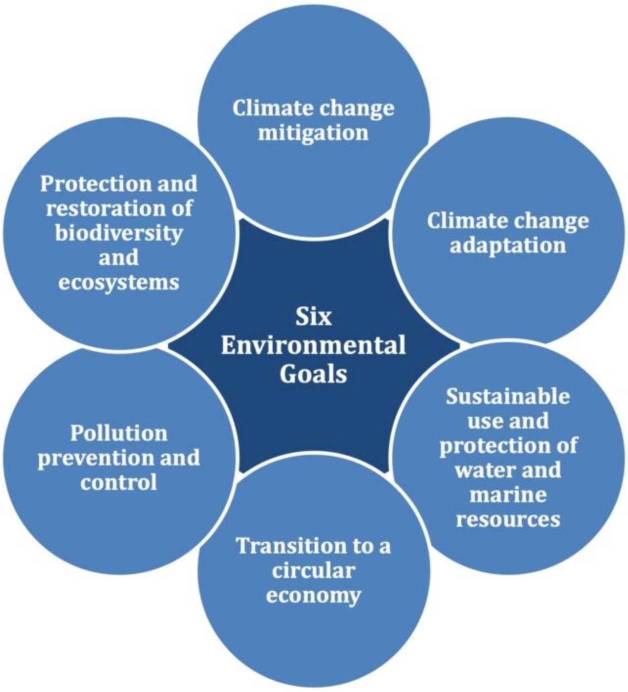
| • **Public Finance**- Government funds and international financial institutions (e.g., World Bank, IMF).<br>• **Private Finance**- Investments from private entities, including banks, corporations, and venture capitalists.<br>• **Blended Finance**- Combines public and private resources to leverage additional 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.<br>• **Adaptation Finance**- Funds to projects that help communities & ecosystems *adapt to the impacts of climate change*.<br>• 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