

Climate Finance Taxonomy

Why In News

- Presenting the **Union Budget for 2024-25**, Finance Minister Nirmala Sitharaman announced that the government would develop a '**climate finance taxonomy**' to enhance the availability of capital for **climate adaptation and mitigation**. This will help India achieve its climate commitments and green transition.



What Is A Climate Finance Taxonomy

- A **climate finance taxonomy** is a system that classifies which parts of the economy may be marketed as **sustainable investments**. It helps guide investors and banks in directing trillions toward impactful investments to tackle climate change.



- “**Taxonomies are frequently** used to set standards for classifying climate-related financial instruments (e.g., green bonds), but, increasingly, 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,” according to a report by the government of Canada.



Why Is A Taxonomy Significant

- **With global temperatures soaring**, and the adverse effects of climate change exacerbating, countries need to transition to a **net-zero economy** — the balance between the amount of greenhouse gas (GHG) that is produced, and the amount that is removed from the atmosphere.



- Taxonomies can play a pivotal role in doing this as they can help ascertain if economic activities are aligned with **credible, science-based transition pathways**. They can also give impetus to deployment of climate capital, and reduce the risks of greenwashing.
- **For India, a taxonomy could bring in** more climate funds from international sources. Currently, green finance flows in India are falling far short of the

country's current needs — **they only account for around 3% of total FDI inflows** to India, according to the Landscape of Green Finance in India 2022 report, published by Climate Policy Initiative.

- One reason for abysmally low green finance flows has been a lack of clarity in what constitutes sustainable activity. A taxonomy would change that.

Potential For Green Investments In India

- **India has a climate-smart investment potential of \$ 3.1 trillion** from 2018 to 2030, according to a report by the International Finance Corporation (IFC).
- The largest space for investment is in the **electric-vehicle segment, at \$ 667 billion** as India aims to electrify all of its new vehicles by 2030.
- India's renewable energy sector also continues to be a good investment avenue **at \$ 403.7 billion**, the report added.



Do other countries have taxonomies

- **Yes. Many countries** have either started to work on their taxonomy or finalised one. South Africa, Colombia, South Korea, Thailand, Singapore, Canada, and Mexico are some of the countries which have developed taxonomies. The European Union has done this as well.