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# GREEN FINANCE: NEED OF THE HOUR

-Paras Batra<sup>1</sup>  
- Sakshi Kothari<sup>2</sup>

## INTRODUCTION

Climate Change is not a hoax. India is one of the greatest climate vulnerable countries in the world and is ordered fifth at the Global Climate Risk Index <sup>3</sup>The problems emerging from climate change are no longer insignificant, rather it has affected the living as well as the economies across the globe. It has therefore, become the need of the hour to make sure that every action contributes in making a sustainable, green environment.

India has emphasised on the importance of green financing since 2007. The Reserve Bank of India has formulated various policies in order to encourage banks to pace with sustainability targets. Initiatives such as priority sector lending, green finance credit, green production methods and solutions were launched.

India has decided to reach net-zero emissions by 2070, but the road towards this commitment is presented with huge challenges. In September 2019, India has also targeted 450 GW of renewable energy generation capacity to reach by 2030, creating it as one of the most ambitious goals in the world.

As per the Nationally Determined Contribution (NDC) it is estimated that India will need around Rs. 162.5 lakh crores as for 2015 to 2030 for climate action. Therefore, India requires around Rs 11 lakh crores per year to meet its goal.

Whereas India's energy sector is one of the fastest rising in the world and has been attracting substantial investments, meeting the country's climate goals will require proportionate, transformative investment increases at sectoral level.

For achieving the above standards, Government cooperation in form of financial help and effective policies is very important and crucial. Although many initiatives and investment are currently done but due to irregularities, uncertainty in the green finance sector the desirable outcomes have still not

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<sup>1</sup> Assistant Professor at Geeta Institute of Law

<sup>2</sup> Assistant Professor, ICAI University

<sup>3</sup> Eckstein et al., 2019

been achieved. Also, multi sectors such as infrastructure and health (health especially after COVID) also hindered the progress of green finances in India.

The need and importance of green finance is not only limited in India but internationally as well. Hence, it is the need of the hour to the issues identify and analyse significant foundations of finance, the tools used, challenges and their impact

## **WHAT IS GREEN FINANCE?**

Green finance means financing projects which are environmentally sustainable or projects which incorporate consideration to climate change. It could be done through number of initiatives for example: by establishing green banks, issuing green funds, green bonds, levying carbon tax. Thus, altogether they form green finance.<sup>4</sup>

Green financing aim at increasing financial flows in sustainable developmental projects. By managing environmental and social risks, it ensures a good return and environmental benefit. It also develops greater accountability towards the environment.

UNEP has remained continuously occupied with institutions, countries, financial controllers in order to bring into line financial flows with sustainable development goals. <sup>5</sup>UNEP is working on the following areas in order to promote green financing:

- Promoting and supporting the public sector dealing with green finances
- Promoting PPP on financing approaches such as green bonds
- Capacity building on micro-credit basis
- Developing awareness on environmental risks and vulnerability

## **DEFINITION**

The term green finance is quite popular among institutional bodies and policymakers across the globe however, there is not any clear-cut prescribed definition of green finance.

Often the term green finance is interchangeably used with sustainable finance, climate finance and responsible finance. this overlapping and overreaching of terminologies adds more to the ambiguity among policymakers, regulators and institutional bodies.

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<sup>4</sup> <https://development.asia/explainer/green-finance-explained> (Asian Development Bank).

<sup>5</sup> <https://www.unep.org/regions/asia-and-pacific/regional-initiatives/supporting-resource-efficiency/green-financing>.

## ACCORDING TO THE DEFINITIONS GIVEN BY UNEP

- Sustainable Finance covers a wider set of investment universe with the purpose to shape an inclusive, socially, economically and environmentally sustainable world.
- Green finance comprises climate finance but also contains other environmental objectives required to support sustainability, particularly aspects such as biodiversity and resource conservation.
- Climate finance denotes 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.”<sup>6</sup>

Thus, sustainable finance is an umbrella head and Green finance is a subset of sustainable finance.<sup>7</sup>

Due to lack of formally recognised definition and usage of multiple terminologies, barriers in financial investments and lending arises. This ultimately results in improper tracking, inaccurate assessment of capital flows and thus hinders capital allocation in green economic activities.

## DEFINING GREEN FINANCE: HOW WILL IT HELP?

A proper and universal description of green finance will benefit in number of ways. Some of them are listed below-

- A formally recognised definition will help in tracking and assessing accurate capital flow into green sectors. This will in turn help in achieving India’s NDC goals.<sup>8</sup>
- A clear definition will help in improved coordination among different agencies, government and institutions working in green sector.<sup>9</sup>
- A recognised institutional definition will help in easy classification and identification of green business Which in turn will encourage investments and lending.
- A formally recognised definition would also help in identifying and controlling financial risks arising from climate change<sup>10</sup>. The corporate and financial sector will thus act upon climate change risks and opportunities.

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<sup>6</sup> <https://unfccc.int/topics/climate-finance/the-big-picture/introduction-to-climate-finance>.

<sup>7</sup> [http://unepinquiry.org/wp-content/uploads/2016/09/1\\_Definitions\\_and\\_Concepts.pdf](http://unepinquiry.org/wp-content/uploads/2016/09/1_Definitions_and_Concepts.pdf)

<sup>8</sup> (Buchner et al., 2019)

<sup>9</sup> Gianpiero T. 2009

<sup>10</sup> NGFS, 2019

- A formally recognised definition will provide and convey better reporting and disclosure to investors and financiers, reduce the risks of greenwashing <sup>11</sup>. Therefore, financial regulators and policymakers such as the Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA), Pension Fund Regulatory and Development Authority (PFRDA), and Ministry of Finance (MoF) will be much more knowledgeable and take suitable policy and regulatory decisions to manage the risks emanating from climate change (BIS, 2020).

## **EFFORTS FOR DEVELOPMENT OF GREEN FINANCE DEFINITION**

Although there are many problems with the progress of green finances and its definition in India but a number of global initiatives are being undertaken to counter it. The governments financial institutions, NGOs, commissions working together performer global formal definition of green finance and formulating policies and regulations in favour of it.

Thus, many countries, global / regional economic groups have adopted some form of definition through various approaches for the purpose of financing these green economic activities. These approaches are –

- conceptual definition,
- principle based,
- sectoral taxonomy,
- Exclusion criteria etc.

## **WHY IS GREEN FINANCE NEEDED?**

With the emerging and future problems of climate change, Green Finance is currently the need of the hour. It encourages and supports the flow of financial instruments and related services towards the development and implementation of sustainable business models, and policies.

The financial sector plays an important role in advancing sustainable economic development while directing investment to the real economy, the association of these two is crucial.

Also because of the global financial crisis in 2006-2009, the need for more sustainable business practices, Green Finance Initiatives have been referred and stressed in the 2030 Sustainable

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<sup>11</sup> European Commission, 2017

Development Goals (SDG's) Agenda by emphasizing on shifting from economic to sustainable goals while balancing both.<sup>12</sup>

Green Finance is the future of the financial sector through innovative financial mechanisms and by supporting the investments in projects with positive and sustainable mechanisms.

## **GREEN FINANCE INITIATIVES ACROSS GLOBE**

The companies across the globe make sustainable disclosure. Task Force on Climate-related Financial Disclosures (TCFD) recommended disclosures of ESG related risks, owing to which companies now report such disclosures periodically. As per data, (June 2020), 60% of the world's 100 largest public companies voluntarily adopted and supported the TCFD recommendation.<sup>13</sup>

This framework of disclosing ESG related risks have been adopted by various stock exchanges, financial market regulators and the ministries dealing with the corporate affairs in China (2008)<sup>6</sup> , Hong Kong (2012), UK (2012), India (2012), the Philippines (2013), Vietnam (2013), Singapore (2016) .

Another country, Bangladesh has been releasing uniform, risk format, mandating bi annual reporting of CSR, incentivised systematic environmental risk analysis, assessment of social risks in 2017.

France in 2015 passed The Energy Transition for Green Growth Law mandating reporting of impact of physical and transition risks on activities and assets.

Countries have also adopted directed and concessional lending. For example, a 'revolving fund' under the green re-financing scheme in Bangladesh 2009. From early 2015, Bangladesh mandated the commercial banks to allocate at least 5 per cent of their lending to the renewable energy sector and other green technologies.

Also, there are efficient micro and macro-level regulations of financial /non-financial institutions. Example China acquaint with credit restriction to the companies based on their environmental compliances; Lebanon implements a policy wherein the banks which grant loan to large share of green projects will be required to hold less reserves. <sup>14</sup>Brazil also included environmental considerations into the banks' Internal Process of Capital Adequacy Assessment.

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<sup>12</sup> <https://www.intracen.org/Why-is-Green-Finance-important/>

<sup>13</sup> Third TCFD Status Report Shows Progress & Highlights Need for Greater Climate-Related Disclosures and Transparency.

<sup>14</sup> (Dikau and Volz, 2018).

Also, many green financial institutions are established. For example: UK Green Investment Bank plc, by the UK government (2012)<sup>15</sup>

Asian Development Bank and United States Agency for International Development also offer partial credit and bond guarantees to member banks and countries for green finances. India has also joined its hands through its policies and regulations towards green finance

## **GREEN FINANCING IN INDIA**

India had recognised the importance of green finance in 2007. The Reserve Bank of India admitted the significance of climate change in its notification on “CSR, sustainable development and Non-Financial Reporting-Role of Banks.”

The National Action Plan on Climate Change (NAPCC) was also framed in 2008 to mitigating the impact of climate change<sup>16</sup>

Afterwards in 2011, a climate change finance unit was being created under the Ministry of Finance. The purpose was to coordinate between several organisations related to green Finance. Another move in advancing towards green finance was inclusion and implementation of the sustainability disclosure requirements. For Example: - Security and Exchange Board of India (SEBI) made it obligatory for top 100 recorded units based on market capitalisation at BSE and NSE to publish annual business responsibility reports since 2012 and revised it from time to time.

India started introducing many financial and fiscal schemes like FAME (Faster adoption and manufacturing of Hybrid and Electric Vehicles) scheme, ‘green car loans scheme’, production linked incentive scheme, Priority sector lending scheme to promote green financing.

Also, The Reserve Bank of India has been promoting and supporting green finance initiatives through its policies. The Priority Sector Lending (PSL) scheme offers loans upto 30 crores to firms in renewable energy sector and loans upto 10 lakhs to the households for investing into renewable energy.

The RBI is also working at sensitizing people, investors and financial institutions about the need, opportunities, and challenges of green finance.

The Reserve Bank in its Annual Report (2015-16), asserted on the growth of local green bond markets, cross-border investments in green bonds, and improvement of other green finance activities. RBI in

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<sup>15</sup> (Geddes et al., 2018).

<sup>16</sup> Jain, 2020

its Report <sup>17</sup>also observed the risks on financial assets due to climate change and the need to increase the green finance for eco-friendly sustainable development.

Certain barriers have also been recognised in the progress of green finance like green washing, multiple definitions, maturity incompatibilities among long term and short-term interests of investors, etc.,

In 2016 Indian Renewable Energy Development Agency (IREDA), also proclaimed plans to become India's first Green bank.

The green bond market is also scaling in India. As per data, by 2018 India became 12th biggest issuer of green bond in the world . <sup>18</sup>Financial/ non-financial Institutions, corporates, private banks (Yes Bank) and entities (IREDA, Indian Railway Finance Corporation) all have contributed in issuances of green bonds.

Challenges

## **LACK OF CLEAR DEFINITION**

There is no universal description of green finance. Due to lack of proper definition, various terms like climate finance, responsible finance etc are used interchangeably. These various jargons produce misunderstanding among the stakeholders. RBI stated that due to multiple green loan definitions, the financial intermediaries face problem in lending to the green sector. Lack of information on what is green activity has made it problematic to keep track of capital invested into green sectors which leads to erroneous valuation of capital assets.

## **FAILURE TO INTERNALIZE EXTERNALITIES**

The next major issue is to efficiently internalize the environmental externalities.<sup>19</sup>

Complications in internalizing them leads to insufficient capitalization of “green projects” and excessive investment in “brown projects”.

## **MATURITY MISMATCH**

Any long- term green project faces the shortage of long term funding. Resultantly, shortage of infrastructure investment is observed. This maturity mismatch problem increases manifold where long

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<sup>17</sup> RBI, Report on Trend and Progress of Banking in India 2018-19.

<sup>18</sup> Climate Bond Initiative, India Country Briefing – July 2018, July 2018

<sup>19</sup> Anouj Mehta, Sonia Chand Sandhu, et.al., Catalyzing green finance: A concept for leveraging blended finance for green development (Asian Development Bank, Manila, 2017).

term finance is required for green investments but not so much in traditional investments in the same sectors.

## **INFORMATION ASYMMETRY**

Due to lack of knowledge in environmental subject and less disclosure by the companies, the cost of green asset increases and it becomes less tempting for the purpose of investment. Moreover, the policies on green investment are uncertain. The unawareness and lack of information of commercial ability of green technology makes it more problematic.

## **POOR ANALYTICAL CAPABILITIES**

Due to unavailability of a proper method to gain and quantify the market risk that may arise from environmental exposure, it becomes very risky to invest. For giving speed to green investment projects, deep knowledge and understanding of environmental risks is required.

## **NEED FOR SENSITISATION**

India's financial sector needs more efforts to accelerate green finance. There is a lack of awareness regarding "green lending and green investment practices".<sup>20</sup> India has not aligned completely to world's efforts to accelerate green finance. It doesn't represent "Network for Greening the Financial system" which is the world's most successful network of banking regulators in the green finance system. Investors need to be sensitized as they do not consider this area of investment as fruitful.

## **RECOMMENDATIONS**

### **MAKING A PROPER DEFINITION**

The primary step in India's green financial strategy should be to provide the definition of Green finance. It will enhance the investments in green sectors. The definition should be such that it includes the international trends, outlines its objectives as well as includes stakeholders opinion. A set of basic principles should be established to describe a green activity. Steps must be taken to differentiate among the green and the non green sectors.

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<sup>20</sup> Labanya Prakash Jena and Dhruva Purkayastha, Accelerating green finance in India: Definitions and beyond , CPI Discussion brief, Climate Policy Initiative, June 2020.

## **CREATING A CONDUCTIVE POLICY FRAMEWORK**

It is extremely important to make the manufacturer comply with certain established standards and internalizing the external factors. The barriers in green investment can be overcome by minimising the financial and investment risks through public funded schemes or grants.<sup>21</sup> Tax incentives can also be provided to increase the investments.

## **INCREASING THE SUPPLY OF GREEN FINANCE**

Capacity building can assist in better valuation of the possible risks and benefits involved in green investment. An efficient way would be to provide loan or funding manuals that explicitly offer a guide to evaluate environmental risks and identify environmental opportunities. Risk mitigation tools can also be used to increase the green Finance. Guarantee scheme will be an effective way to serve as green loan guarantee tool.

## **GOVERNMENT SUPPORTED GREEN BANK**

Green bank is a financial institution which uses innovative banking techniques and market advancement tools to accelerate development of clean energy technology. In May 2016, IREDA became India's first green bank. More such government supported banks could be created to provide more amount of easy access to green bank.<sup>22</sup>

## **BLENDED FINANCE**

In terms of blended finance, different aspects of each type of capital can be used for shared purpose of increasing private investments and the impacts of climate change. The funds which contribute in increasing green Finance should be subsidized.

## **GREEN INSURANCE**

It helps in mitigation and management of ecological and environmental risks. It covers the potential liabilities arising from pollution of water, air, land or collateral damages to ecology and environment by policyholders. It prevents the risk of environmental pollution and risks are distributed.<sup>23</sup> It should be encouraged.

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<sup>21</sup> Ulrich Volz, Judith Böhnke, et.al., Financing the green transformation (2015).

<sup>22</sup> Shreyans Jain, "Financing India's green transition", (2020).

<sup>23</sup> Ibid

## **PRIORITY SECTOR LENDING**

It is a very effective measure to facilitate the identification of sustainable businesses and to improve its performance. It should be broadened to provide a wider network for a variety of renewable energy projects in both manufacturing and generation.<sup>24</sup>

## **CONCLUSION**

There has been number of initiatives in the form of policies and awareness campaigns across the globe, however, the green finance movement has not gained momentum especially in India. Indian still needs to catch up with the emerging issues and needs of green finance in order to ensure its transition towards greener and sustainable tomorrow.

There are various roadblocks in India's Green financing journey. There is a huge challenge present before developing economies like India, which is to balance both the economic growth needs and social development needs. Focus has to be on green finances which could be done by assessing and incorporating the environmental impact thought while doing commercial lending.

Banks are currently dealing with the issue of maintaining funds, verification of green finance and sustainable claims. In order to deal with these issues and accelerate the momentum of green finances, banks have to work with international financial and develop advanced green sustainable financial models suiting India. To enable banks to operate and develop this sustainable ecosystem, the policy framework is of paramount importance. An effective policy should be framed and fiscal measures like supportive taxation policy for green finance should be encouraged and developed. Also, green infrastructure investment trusts must be established.

Thus, financial system and sustainable development has to be integrated together.

In order for the above to happen, there must be awareness among the stakeholders on the environmental risks and vulnerabilities. A globally recognised definition must be developed. Also, green financial products and services and solutions must be developed and encouraged. The needs of long term environment friendly projects be fulfilled and supported.

All these measures will help in keeping both the financial/economic growth and the sustainable goals balanced and aligned. Combined efforts from all sectors, institutions, intermediaries and government

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<sup>24</sup> Rita Roy Choudhury, Priyanka Dhingra, et.al., Delivering a sustainable financial system in India, UNEP Inquiry (2016).

will only make a real and impactful difference. Public awareness, information sharing, and continuous research and development will catalyse green finance in India.

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