Bridging the climate finance gap for India's transition

India requires $2.5 trillion for climate action by 2030. While global funding commitments fall short, mobilising private capital and regulatory reforms are crucial for bridging this gap in climate finance

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By Suranjali Tandon

Every year, at the Conference of the Parties, a new estimate for climate finance needs is published. With delayed action on mitigation, climate finance needs are expected to rise. According to the Independent High-Level Expert Group on Climate Finance, developed countries need to provide $1 trillion per year by the end of the decade to help developing countries meet their targets, and $6.5 trillion per year is required by all economies until 2030. These large sums of money are even harder for developing countries to raise. Thus, the Paris Agreement obligates developed countries to support developing countries through financial resources. A formal agreement to mobilise $100 billion per year remained largely unmet until 2023. However, at Baku, member countries committed to ramping up their contribution under the new collective quantified goal (NCQG) to $300 billion. Although this is still short of the needs, the yawning gap between the funds required and those mobilised remains a critical issue.

To put this gap in perspective, India needs $2.5 trillion by 2030, which is 7.69 percent of global climate finance needs. Given that the NCQG is only a fraction of the total global requirements, it is anticipated that, much to the displeasure of developing countries, domestic resource mobilisation will play an important role in raising capital. Experts almost reflexively suggest bolstering public finances, particularly through taxes. However, a pinch of pragmatism is needed here, as those who advocate for more taxation are often averse to paying it themselves. India’s tax-to-GDP ratio has remained stable, and some argue that it is close to its potential. This means that relying on public finance should only be a last resort. This is particularly problematic for oil-producing countries, which attract capital through investor-friendly regimes. The question then is: what will shift the status quo for private capital?

In recent years, experts have weighed options such as definitional clarity, disclosure of investment practices, and nudging companies to commit to net-zero goals. But do these measures add up in a world that seems intent on drilling more oil? An honest path to transition requires acceptance of two important facts: returns will drive private investment, and oil companies are, in fact, critical to the transition. In fact, ensuring that oil companies transition faster requires that investments in other sectors and jurisdictions offer a comparable steady stream of income. Tilting incentives in favour of renewables could come in the form of regulatory changes. These include the EU’s more stringent approach to carbon pricing, which it seeks to externalise through the Carbon Border Adjustment Mechanism. Unfortunately, unless these measures are coordinated, they may become self-isolating and costly. Moreover, they overlook the differences in the pace of development and transition, as acknowledged under the Paris Agreement.

A more seasoned approach would be to mainstream climate issues so they no longer remain an 'outside' concept. This can be done through the active recognition of risks and a clear articulation of how real these risks are. Ventures that provide a business case will need to be socialised within the finance community. More importantly, countries will have to agree on the price they are willing to pay for this transition. That is, how much of their energy security, fiscal stability, and consumer welfare are they willing to sacrifice in the short run to ensure these goals are met in the long run by a green economy? Carbon markets offer a solution, but the EU’s experience demonstrates that it is a long, calibrated experiment that depends on the economic structure of each economy.

As more private investment begins to seek opportunities in developing countries such as India, their regulatory architecture will once again become relevant. Debates on capital controls and financial stability are not as attractive as de-risking climate finance, but a future where climate finance is mainstreamed will require these questions to be revisited. For India, a shallow corporate bond market, the types of assets banks can invest in, and caps and compliances for foreign investment are still important issues. In fact, to address some of these concerns, the

International Financial Services Centre was created. Although this has the potential to become a hub for climate finance, particularly given the tax incentives, there may be limits or impediments to the on-shoring of capital. All calls to attract foreign capital must also weigh the risks of foreign exchange appreciation. Perhaps it is time to write a blueprint for a regulatory landscape aligned with climate finance flows as India embarks on regulatory practices such as carbon pricing and disclosure of risks.

(Suranjali Tandon is an Associate Professor at the National Institute of Public Finance and Policy.)