1. What is a climate finance taxonomy, announced by FM Sitharaman?

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.

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.

What is the 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.

What are India's climate commitments?

India aims to achieve net-zero economy by 2070. It has also pledged to reduce the emissions intensity of its GDP by 45% by 2030, from the 2005 level. India has committed to achieve about 50% cumulative electric power installed capacity from non-fossil fuel-based energy resources by 2030 as well.

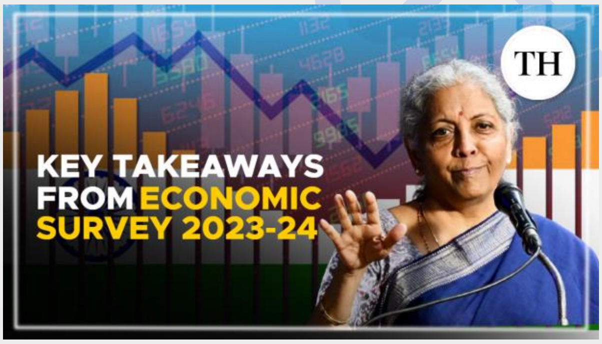
Relevance: GS Prelims & Mains Paper IIII; Economics
Source: Indian Express

2. Key takeaways from the 2023-24 Economic Survey

Why in News?

The Economic Survey for 2023-24 stands out from previous economic surveys in that it provides a more realistic picture of the challenges before India's economic growth. As such, despite India's GDP growing at more than 8% in FY 2023-24, the survey pegs the GDP growth rate for the current financial year (FY 2024-25) between 6.5% and 7%.

Here are some key challenges that the survey flags, and the recommendations it makes to address these.



The Survey's diagnosis

Global headwinds: The environment for foreign direct investment (FDI) to grow in the coming years is not highly favourable. High interest rates in developed countries have not only raised the cost of funding, but also increased the opportunity cost to invest in developing countries like India. Moreover, economies such as India have to compete with industrial policies in the developed world involving considerable subsidies that encourage domestic investment. Geopolitical uncertainties also continue to play spoilsport.

China challenge: The Chief Economic Advisor (CEA) underscored how India continues to be overly dependent on China for imports, especially for renewable energy. He also stated that China has not let go of the low-skills manufacturing space that India wanted to occupy.

AI threat: The Survey notes that while there has been a boom in telecommunications and Internet facilitated business process outsourcing (BPO), the next wave of technological evolution might bring the curtains down on it.

Tepid private investment: The Survey emphasised that the corporate sector had not responded, despite the Union government cutting taxes in September 2019 to facilitate capital formation. "…Between FY20 and FY23, the profit before taxes of the Indian corporate sector nearly quadrupled…Hiring and compensation growth hardly kept up with it," the CEA stated in the Survey.

Employment imperative: The Indian economy needs to generate an average of nearly 78.5 lakh jobs annually until 2030 in the non-farm sector to cater to the rising workforce.

Data deficiency: A constant refrain against the government has been the lack of good quality and timely data especially related to employment. In the Survey, the CEA accepted that this was indeed a gap that was holding back a proper analysis. "The lack of availability of timely data on the absolute number of (formal and informal) jobs created even at annual intervals, let alone at higher frequencies, in various sectors — agriculture, industry including manufacturing and services — precludes an objective analysis of the labour market situation in the country," it stated.

Lifestyle disadvantages: The Survey notes that "social media, screen time, sedentary habits, and unhealthy food are a lethal mix that can undermine public health and productivity and diminish India's economic potential."

Recommended solutions

Job creation by the private sector: One of the central pillars of the past two Narendra Modi governments has been the determination to reduce the role of government in the economy and incentivise the private sector to take over the dominant position. In doing so, the government had hoped that the private sector would create jobs. The Survey reiterated that hope: "…It is in the enlightened self- interest of the Indian corporate sector, swimming in excess profits, to take its responsibility to create jobs seriously."

Lifestyle changes by private sector: "India's traditional lifestyle, food and recipes have shown how to live healthily and in harmony with nature and the environment for centuries. It makes commercial sense for Indian businesses to learn about and embrace them, for they have a global market waiting to be led rather than tapped," writes the CEA.

Farm sector as the saviour: Traditional economic theories suggest that as economies develop they make a structural transition from agriculture to manufacturing and services. But the Survey states that "trade protectionism, resource-hoarding, excess capacity and dumping, onshoring production and the advent of AI are narrowing the scope for countries to squeeze out growth from manufacturing and services" and "forcing us" to turn conventional wisdom on its head. In other words, the CEA states, "A return to roots, as it were, in terms of farming practices and policy making, can generate higher value addition from agriculture, boost farmers' income, create opportunities for food processing and exports and make the farm sector both fashionable and productive for India's urban youth".

Removing regulatory bottlenecks: "The Licensing, Inspection and Compliance requirements that all levels of the government continue to impose on businesses is an onerous burden.

Relative to history, the burden has lightened. Relative to where it ought to be, it is still a lot heavier," stated the CEA. He singled out the Medium, Small and Micro Enterprises (MSMEs) as one sector that required to be relieved of regulatory burden the most.

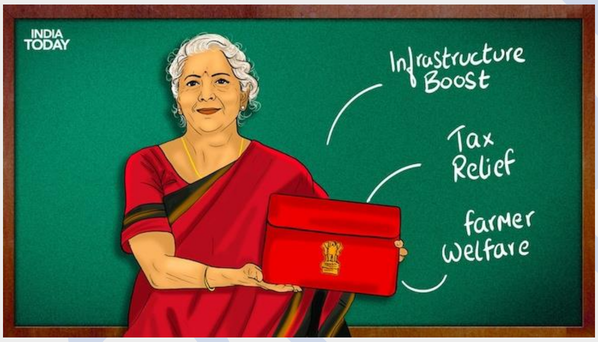
Building state capacity: The CEA noted that what was needed in the economy now was not big reforms but the grunt work. To this end it advocated building up state capacity for sustaining and accelerating India's progress.

Relevance: GS Prelims & Mains Paper III; Economics
Source: Indian Express

3. Making sense of the Budget

Why In News?
The first Budget of Modi 3.0 recognises that despite several big policy reforms and decisions, and notwithstanding encouraging growth rates of GDP, there is considerable economic distress in the country.

The Union Budget for 2024-25 — Finance Minister Nirmala Sitharaman's seventh in a row and the twelfth Budget of the Narendra Modi government — departs significantly from all previous Budgets presented by this government in its approach towards managing India's economy. Budgets serve two essential purposes.



They provide details about a government's finances, how much the government earned, how much it spent, and how much it borrowed during the past financial year, and what its projections are on all these three counts for the next financial year.

Too much borrowing by the government (technically referred to as the fiscal deficit) adds to the overall burden of the country's debt, which has to be paid by taxpayers — present or future. Prudential norms suggest that the government should always look to reduce deficits and spend in such a manner that overall debt — as a proportion of the country's total economic output or GDP — keeps coming down.

But budgets are also the most important instrument in the hands of the government to manage India's economy. Whom does the government tax and how much, where does it spend and how much — such questions qualitatively shape the fortunes of millions of businesses and billions of people across the various sectors of the economy.

Approach since 2014...
Prime Minister Modi's first two terms were unique in one very crucial respect: these were the only two governments since the beginning of economic reforms in the 1990s in which a single political party enjoyed a majority in Lok Sabha.

This situation allowed the BJP to boldly follow its economic philosophy for India's growth. Until then, ruling coalitions often pulled in different directions.

To be sure, Prime Minister Modi came to power with a bold declaration: "Minimum government, maximum governance". He appeared to believe that the Indian government should move out of the way and allow the private sector take the lead in the economy.

This meant that both in terms of the things that it did and the people that it employed, the government would shrink in size — even though the necessary governance that a modern economy requires would be protected.

In this philosophy, government revenues would go up not because the government would raise tax rates, but because it would reduces tax rates while widening the tax base and encouraging compliance.

Another necessary corollary would be strict adherence to prudential fiscal norms — driven by the understanding that if the government borrows less money from the market, it would leave more for the private sector to borrow (and presumably at lower interest rates) for their expansion needs.

While the government spends more and more on building essential infrastructure (technically called capital expenditure), the bustling private sector would provide jobs to the millions entering the Indian labour market each year.

More formalisation and digitalisation would allow the government to efficiently monitor the economy, raise resources without getting entangled in the inefficiencies that are typical of the public sector, and the rent-seeking and red-tape that are often a defining feature of large bureaucracies.

...had limited success

For the past 10 years, expectations have been running high that India would finally usher in the so-called second generation reforms — pending on the agenda since the first generation of reforms that began in 1991, opening up the Indian economy to global competition, and liberalising it internally by removing the dreaded licence-permit raj and inspector raj.

That did not happen — however, the past decade has, indeed, witnessed several big reforms that had been left on the table by previous coalition governments. These included the restructuring of India's indirect taxes (called the Goods and Services Tax), the bolstering of the insolvency architecture (now called the Insolvency and Bankruptcy Code) and a massive push towards digitalisation and the financial inclusion of millions of Indians.

Perhaps the biggest bet taken by the government was the historic cut in the corporate tax rate that was announced in late 2019. This was in line with the broader philosophy espoused by the government — that lower taxes would encourage businesses to make fresh investments, which would create lots of jobs and which would, in turn, bring all round prosperity.

But as many have pointed out, the decision was poorly timed. India's economy had started to lose momentum from 2017 onward. In 2019-20, the GDP grew at less than 4%. All the data pointed to an alarming rise in unemployment and an all-round stagnation in incomes, which together started to take a toll on overall consumption levels in the economy.

And then came the Covid-19 pandemic that destroyed incomes and ate into people's savings. Low levels of consumption since — including a K-shaped recovery where the rich recovered much faster out of the pandemic than the majority of Indians — led to an unravelling of the government's growth strategy. Most Indian businesses simply pocketed the corporate tax breaks instead of creating fresh and additional capacity because they did not see the business case for doing so.

The 2024 election

Up until the time the Interim Budget was presented on February 1 this year and perhaps ever later, the government in its statements and decisions appeared to be in denial about the broader economic distress in the country.

At the same time, it questioned the private sector for not responding to the strategy it had laid out. Finance Minister Sitharaman compared India's corporate sector to Lord Hanuman in an episode of the Ramayana where He had forgotten about His ability to fly.

Then came the results of the Lok Sabha election. Contrary to expectations of the BJP retaining, if not improving upon, its 2019 tally of 303 in Lok Sabha, the election stripped the party of the majority it enjoyed in the House. The result in UP, which sends the most members to Lok Sabha, was a serious setback.

The proposals in the Union Budget should be viewed in this background: the broader economy hasn't been doing as well as the GDP growth numbers suggest, and the government has probably learnt that there can be a political cost to denial.

Course-correction

A COALITION BUDGET: Crucial NDA coalition partners in Bihar and Andhra Pradesh, Nitish Kumar's JD(U) and N Chandrababu Naidu's TDP respectively, have had several proposals directed the way of their states. Bihar will get several road connectivity projects such as the Patna-Purnea and Buxar-Bhagalpur Expressways, and a bridge over the Ganga, flood control structures, and a new power plant in Pirpainti. The Finance Minister has announced that "new airports, medical colleges and sports infrastructure" will also be constructed in Bihar.

The FM's plan for the all-round development of the eastern regions of the country (called Purvodaya), will cover both Bihar and Andhra Pradesh, apart from Odisha (where the BJP has just won the state Assembly elections) and Jharkhand.

Andhra Pradesh will get funds for promoting industrial development and essential infrastructure such as water, power, railways and roads.

RECOGNITION OF AGRARIAN & RURAL DISTRESS: One of the oldest promises of the Modi government has been the doubling of farmer incomes. However, income growth has been disappointing, and farmers have seen repeated instances where either the prices of their produce were too low to be remunerative, or when policy measures stopped them from benefiting from higher prices.

One of the biggest policy flashpoints in the previous term (2019-24) was the three farm laws that aimed at modernising Indian agriculture. They were bitterly opposed, leading to their repeal.

The FM started her Budget speech by delineating nine top priorities, and agriculture topped the list. The Budget has promised to transform farm research, new missions aimed at boosting the output of pulses and oilseeds (which India imports in large quantities), and promoting natural farming.

FOCUS ON JOBS & SKILLS: In its previous term, the government had introduced a Production-linked Incentive (PLI) Scheme. The government would provide companies a subsidy that was linked to levels of production. Critics had pointed out that in a labour-surplus country, providing PLI was sub-optimal since it was possible for companies to replace labour with machinery and collect the subsidy.

PLI did little to boost job creation. Former RBI Governor Raghuram Rajan had pointed out that taxpayers have to shell out Rs 3.2 crore per job created at the proposed Micron semiconductor plant in Gujarat. Other economists have pointed out that previous Budgets did little to promote labour-intensive industries such as textiles and leather products.

This Budget's second biggest priority is Employment and Skilling. Within this, too, the first measure is a bunch of three schemes that follow "Employment-linked Incentive". In essence, these schemes will witness government providing financial assistance to first-time employees and their employers. It is a shift from PLI to ELI.

Apart from unemployment — which rises with educational attainment — unemployability is an acute problem. While unemployability is not new, the sheer scale of the problem with the rise in the youth population is daunting. The Budget rededicates to skilling: "20 lakh youth will be skilled over a 5-year period," the FM said.

BIG IMPORTANCE OF SMALL BUSINESSES: Between sudden unexpected shocks such as demonetisation and the pandemic-induced lockdowns to structural policy changes such as the introduction of GST and digitalisation, India's small businesses (technically called the Medium Small and Micro Enterprises or MSMEs) have taken a financial battering.

These small businesses serve a great purpose — they contribute about 45% of manufacturing output, more than 40% of exports, and more than 28% of the GDP while employing more than 11 crore people, often far from the big cities. Yet most of the policy decisions and focus — such as the corporate tax cut — continued to focus on big businesses.

The fourth top priority in the Budget is "Manufacturing and Services", but what is crucial to note is that all the initiatives under this head pertain to alleviating the stress in the MSME sector. “This Budget provides special attention to MSMEs and manufacturing, particularly labour-intensive manufacturing,” the FM said.

RECOGNISING THE CENTRE CAN’T DO IT ALONE: Over-centralisation in policymaking can undo even the best of policies when it comes to implementation since all implementation happens at the state level. The Centre having done its bit in terms of policy — be it the push towards capital expenditure or the cut in corporate tax rate or initiatives such as PLI — the Budget speech showed acceptance that genuine change requires working along with states as partners instead of political opponents. Across initiatives, the FM reiterated the need to work with the states.

While talking about second generation reforms (such as those relating to land and labour), the FM said: “Effective implementation of several of these reforms requires collaboration between the Centre and the states and building consensus, as development of the country lies in development of the states. For promoting competitive federalism and incentivising states for faster implementation of reforms, I propose to earmark a significant part of the 50-year interest-free loan.”

Similarly, while talking about industrial parks, the FM said: “Our government will facilitate development of investment-ready ‘plug and play’ industrial parks with complete infrastructure in or near 100 cities, in partnership with the states and private sector, by better using town planning schemes.”

The Budget upshot

Both in its priorities and in its approach, the Budget signals that the policy tools adopted during the time of the BJP’s single-party majority are no longer the primary instruments. The first Budget of Modi 3.0 recognises that despite several big policy reforms and decisions, and notwithstanding encouraging growth rates of GDP, there is considerable economic distress in the country.

The recognition of distress is the first step towards finding solutions. Sitharaman has stated that the government will come out with an economic policy framework which will “delineate the overarching approach to economic development and set the scope of the next generation of reforms for facilitating employment opportunities and sustaining high growth.”

Relevance: GS Prelims & Mains Paper III; Economics
Source: Indian Express