Greening India's Recovery Package

Ideas for Consideration - Summary of Discussions

Labanya Prakash Jena | Anubha Prasad | Zeenat Niazi

September 2020

CLIMATE POLICY INITIATIVE

Development Alternatives

PAGE PARTNERSHIP FOR ACTION ON GREEN ECONOMY

CONTEXT

The ongoing COVID-19 pandemic and the imposed restrictions to contain it have had a disruptive impact on the Indian economy, severely debilitating vital sectors and exacerbating unemployment. Experts across the board have forecast contraction in India's economy in FY2021, due to the drastic fall in household consumption and private investment. For the economy to recover from this downturn, Government of India has announced an economic recovery package; ~ INR 20.90 lakh crore (~ $ 0.29 trillion) - a combination of expansionary fiscal measures (~13lakh crore) and monetary stimulus (~8 lakh crore).

In this context, an active discussion has started across countries on using national stimulus packages to steer economies on a greener track with the underlying idea of a "green stimulus." **Climate Policy Initiative co-hosted a webinar titled, *"Building Back Better: Green Recovery of the Indian Economy"* with the Partnership for Action on Green Economy (PAGE - a 5 UN Agencies' collaboration of UNDP, UNEP, UNIDO, UNITAR, and ILO), and Development Alternatives Group. The webinar deliberated on directing economic stimulus packages towards greening India's economy. This summary presents considerations out of this discussion.**

ECONOMIC STIMULUS PACKAGE

The economic stimulus package, announced as around 10% of GDP, is a blend of fiscal and monetary measures, and several structural economic reforms. Although the stimulus works out to be approximately 10% of India's GDP, in reality, the fiscal cost is only1.2% of the GDP (approx.). Within the stimulus package, INR 0.9 trillion (0.4 percent of the GDP) is drawdown from existing funds available with state governments (INR 0.67 trillion) and existing budget provisions (INR 0.23 trillion)[1]. Thus the effective fiscal stimulus in terms of extra spending is INR 1.76 trillion, which is 0.8 percent of the GDP. While the structural economic reforms will help the economy in the medium to long term, the fiscal and monetary stimulus aims to expeditiously revitalize the economy.

A significant 36% of fiscal stimulus is directed at relief measures such as providing free food grains, increasing cash transfers to the poor, and boosting social sector investment. A large proportion (30%) of budgetary support is allocated for the benefits of the MSME sector – worst affected by the slump in the economy. The rest is for agriculture and agriculture-based industries, power, and other sectors. The RBI's monetary policies are directed at infusing liquidity, decreasing interest costs, and augmenting credit-flow.

The monetary stimulus measures include the reduction of Cash Reserve Ratio (CRR), Targeted Long-Term Repo Operations (TLTROs), an increase of the banks' limit for borrowing overnight, setting up special refinance facilities and the opening of a special liquidity facility (SLF). With this approach, the RBI is attempting to increase investment and demand by reducing the cost of lending, liquidity, and credit stress in the financial system. The RBI's monetary stimulus package is based on the expectation that an increase in cash circulation will revive lending to corporates and households.

The two major regulatory reforms are in the agriculture sector: 1) Amendment of the Essential Commodities Act, 1955; 2) Agriculture Marketing Reforms. The Amendment of the Essential Commodities Act includes deregulation of some agriculture food items (e.g., cereals, edible oils, oilseeds, pulses, onions, and potato), removal of stock limits of agriculture products except in exceptional circumstances, and removal of stock limits for food processors or value chain participants. The Agriculture Marketing Reforms permit farmers to sell their produce to not only the state monopoly Agricultural Produce Market Committee (APMC) and allow for a barrier-free inter-state movement of agriculture produce. The industrial policy reforms comprise the introduction of commercial mining and infrastructure upgrading in the coal sector, increasing the FDI limit in defense manufacturing, opening of commercial coal mining, space and atomic energy sectors for the private sector, opening up more airspace, and the privatization of six more airports. Sectors badly affected by the pandemic are MSMEs, retail, tourism and hospitality, aviation, automobile, and real estate. The restriction on the free passage of goods and services, muted demand, and limited cash balance has hurt the MSME sector. As per a survey conducted by All India Manufacturers Organisation (AIMO) with 46,000 SMEs, one out of 3 SMEs have termed their businesses 'beyond recovery'[2] . This translates into approximately 20 million SMEs facing severe business disruptions. The cancellation of passenger flights and unwillingness to travel (after opening the domestic air travel) has hurt the aviation sector. The lockdown and fear of the spread of the virus has severely hit the tourism and hospitality sector. The bleak future income prospects of households has collapsed demand in the real estate and automobile sector.

Apart from the immediate relief measures and incremental cash handouts to the poor, the package

1 https://indianexpress.com/article/opinion/columns/coronavirus-economic-relief-package-nirmala-sitharaman-pm-modi-6423005/

2 https://www.moneycontrol.com/news/economy/policy/msme-day-rebooting-indias-msme-sector-and-ushering-in-structural-reforms-5463131.html

concentrates on supply-side measures to increase aggregate output and generate employment. These measure include liquidity infusion by the RBI, credit enhancement through credit guarantees, emergency working capital line, subordinated debt, and liquidity infusions in DISCOMs. Additionally the economic package includes a concessional credit boost, particularly to farming, housing, fisheries and animal husbandry, farm-gate infrastructure, and street vendors. Some of the stimulus package measures were well planned before COV19, such as the revision in the definition of MSMEs, and liquidity support to DISCOMs.

WILL THE ECONOMIC STIMULUS MEASURE ENOUGH TO REVIVE THE ECONOMY?

Compared to 2019, India's economy contracted 23.9% in the April-June 2020 quarter[3] (Y-o-Y). The economy is most likely to contract further in the July-September 2020 quarter as compared to the last year, due to muted household demand and reduced private investment. Although green shoots are visible in a few sectors, most business activities are on a negative trajectory. Hence, an increase in Government expenditure amounting to only 1.2% of GDP is unlikely to uplift an economy that is expected to contract at least 9.5%[4] in FY 2021. In the short term, general risk aversion among households will persist due to health risks, rising unemployment, and bleak income prospects - the primary channels of reduction in aggregate demand. The private investment side is unlikely to accelerate due to the current situation of banks (saddled with NPAs and capital inadequacy), limited NBFC funding, and the general risk aversion environment by financially healthy corporates due to market uncertainties.

THE ECONOMIC PACKAGE IS PRIMARILY DIRECTED AT FIXING SUPPLY-SIDE ISSUES

While it is commendable to fix the supply side of the economy, it is also imperative to address insufficient demand as one of the root causes of the economic downturn. There are very few demand-side measures in the economic package, such as additional allocation for flagship employment guarantee scheme MGNREGA and an increase in cash aid to the poor, and they offer only immediate relief to the poor.

3 https://indianexpress.com/article/explained/gdp-contraction-23-9-the-economics-behind-the-math-6578046/

4 Estimates of three Global Credit Rating Agencies- Moody's, S&P, and Fitch

Households are suspending their discretionary consumption and hoarding cash due to salary cuts, job losses, reverse migration and uncertain income prospects in the near and medium-term. The recent RBI's consumer confidence surveys indicate that households' future perception of income and discretionary consumption has collapsed in recent times. There is an increase in cash deposits[5] in banks and an increase in cash circulation, which reflects the fact that consumers are not confident about their future income prospects. The prevailing sentiments explain depressed consumer demand. As the fiscal stimulus is mostly targeting the supply side, there is limited demand stimulus to uplift the economy. It is imperative to calibrate the interventions which can be used to boost demand and put the economy on a robust recovery path.

The easy monetary policies, supply of credit facilities, and better conditions of credit may not immediately result in an increased supply of goods and services, since the overall demand in the economy is low. Since corporates are not confident about the economy, there is little scope for debt capital to add new capacities. The easy liquidity is most likely to be used in refinancing existing loans, not in adding new capacities when overall demand in the economy is low. Additionally, banks are reluctant to provide easy credit due to a weak credit environment that is reflected from negative credit growth in recent times. Stimulus measures are not going to immediately add to the economy as a significant portion of the stimulus package is directed at providing credit facilities and building new infrastructure, which will occur in the medium to long-term.

There is still room to increase fiscal expenditure, directed more towards creating demand in the economy. It is noteworthy here that COVID-19 is a global shock where limited debt monetization would be acceptable to investors. There is ample liquidity in the financial system, though not enough appetite for private investment. Hence, an increase in the Government's market borrowing is neither crowding out private investment nor increasing borrowing costs for the Government itself.

UNPAID RECEIVABLES MUST BE CLEARED ON PRIORITY

The Government is offering a massive amount of credit and liquidity facilities in the economic system, particularly to the MSME sector. However, a substantial unpaid amount due to corporates and MSMEs is outstanding

5 https://www.financialexpress.com/industry/banking-finance/sudden-spike-in-bank-deposits-in-jan-may-on-account-of-rise-in-borrowings-not-savings-report/1995997/

at-both the state and central Government. There are reports which suggest that the total outstanding due to private corporates, including MSMEs, is more than

INR 5,000 billion[6]. Only DISCOMs owed power producers INR 905 billion, as of the end of March 2020, out of which INR 68.4 billion was due to renewable energy power producers (Mercom India,2020). Massive unpaid receivables not only increasethe working capital requirements of the companies, but also increase the riskiness of business and lower new investment flows. An immediate release of the private sector dues can unlock capital flows to the private sector. Moreover, this will restore faith in the 'Government's efficiency at business transactions and will uplift sentiments.

IS IT POSSIBLE TO GREEN THE PACKAGE?

Ever since countries began to feel the economic impact of COV-19, an active discussion has started, mostly led by Europe, on using national stimulus packages as a means to put economies on a greener track. The economic package is sector-neutral and silent on the country's aspiration to decarbonize the economy. According to our estimate, only ~1.5% of the economic stimulus package can directly help green projects. The rest would be utilised in areas that are either colourless or brown.

It is imperative to rejuvenate the economy, damaged by the COV19, to protect the lives and livelihoods of people who don't have safety nets. However, there is a high possibility that the policy actions directed towards a quick recovery of the economy, without a thought on environmental sustainability, could lead to either environmentally harmful or 'non-beneficial' consequences. *For example, the Government's commendable policy push along with a drastic drop in technology prices has surged renewable energy investments over the past few years. However, the Government's plan to impose tariffs on solar modules, solar cells, and inverters could weaken renewable energy's competitiveness vis-à-vis the carbon-intensive energy sector. This would derail India's transition to a clean energy path. Additionally, the opening of new coal mines and lowering of entry barriers therein send the wrong signals on India's sustainable development plans.*

Carbon emissions have decreased significantly due to the lockdown of the economy. However, the economic costs under current production and consumption patterns are too high. The Government has prioritized economic revival and environmental concerns have become somewhat secondary. A similar pattern was witnessed after the 2008 global financial crisis, when all Government stimulus measures were targeted at boosting the economy without paying any attention to the impact of these measures on climate change. Governments across the globe gave impetus to the economy, through vigorous fiscal and monetary actions, but deprioritized climate change mitigation plans[7]. These short-sighted economic stimulus measures helped the economies to recover quickly in 2010[8], while the increase in carbon emissions continued unabated. History could repeat itself. The business-as-usual economic stimulus would derail global efforts, to limit global warming to 1.5°C to 2°C, that need similar or more vigorous attention than the COVID 19 response.

Currently, the Government of India is paying all attention to quickly turning around the economy . However, it can ill-afford to ignore the looming threat of climate change and bio-diversity risk. Any deviation from India's green development plan, including the target of reducing the carbon intensity of its economy by 33 to 35% by 2030, could unnecessarily expose the country to the further risks of climate change. The Government of India has recognized and assessed this threat, laying down a series of measures to mitigate the risk. The fossil-fuel industry stocks recently collapsed recently, due to a drastic drop in oil prices and rapid divestment from the sector by global institutional investors. Moreover, the valuation of coal companies was recently eroded in India, owing to the rapidly falling cost of renewable energy and climate transition risk (policy, legal, and market risks). Hence, it is the right time for India to attract large scale capital from investors who are looking for investment opportunities in climate-friendly sectors.

Although the economic stimulus has a singular goal - reviving the economy quickly, there are specific ways the package can be deployed to help in quick economic recovery while offering long-term environmental benefits. It is possible to make the twin goals complementary instead of competing, even though the economic stimulus package is focussed on short and medium term gains and the realization of environmental benefits is long term. Hence, it is essential to explore **green stimulus economic activities and mechanisms** which support green projects but offer immediate impetus to the economy. The short-term benefits can be gauged by examining the three primary stimulus objectives: employment generation, the time required to stimulate the economy, and the actionability of the measure.

6 https://indianexpress.com/article/india/rs-3-lakh-crore-relief-package-for-msmes-but-govts-pvt-firms-owe-them-more-6410442/

7 https://www.weforum.org/agenda/2020/04/2008-financial-crisis-stimulus-packages-energy-covid19/

8 https://www.epw.in/engage/article/covid-19-crisis-economic-stimulus-packages-and-environmental-sustainability

DIRECTING EXISTING ECONOMIC PACKAGES TO BE GREEN	
Economic stimulus components	**Possible Green economic activities**
Financial Support	
Risk Mitigation	The easy availability of credit measures can ease the CAPEX and working capital needs of the MSME. A portion of a Partial credit guarantee for MSME can help the MSME sector transition to distributed solar energy, install energy efficiency equipment, and make energy efficiency retrofits. The MSME sector is struggling to transition to clean distributed solar power and energy-efficient equipment due to lack of access to debt, as they are low-rated/ unrated and lack collateral securities. A credit guarantee mechanism, a smart way of using public capital, can resolve the barrier. The adoption of distributed energy and energy-efficient equipment can also reduce MSME's energy tariff cost and improve their bottomlines. **Stimulus Goal:** These economic activities generate employment quickly, and the ecosystem is ready to carry them out.
Liquidity support for DISCOMs	The Government can direct DISCOMS to give preference to RE generating companies in clearing dues to non-renewable power generating companies. Delay in payment by DISCOMs to RE companies is the most significant risk the RE sector currently faces. This risk also weakens the credit profile of the RE player, and consequently the riskiness of the sector. Also, it exhausts the working capital of developers and makes the loan book NPA as per the new rule of the RBI. The DISCOMs receiving liquidity support can also be directed to procure more energy from RE generating companies. The preference for the RE sector sends a positive signal on India's commitment to accelerate clean energy. **Stimulus Goal:** The RE sector generates a higher number of jobs per unit of capital and create new capacity vis-à-vis the coal sector in a short timeframe.
Equity fund	A portion of equity capital allocated for MSME funding can be allocated for low-carbon businesses in the MSME sector. For example, the number of small and medium-sized rooftop solar companies has been constrained by the ability to raise debt due to a lack of equity capital availability. These companies that are past the start-up and technology development stage require further support in the form of growth capital. Equity support will help these companies raise more debt capital and scale-up quickly. **Stimulus Goal:** The availability of equity capital can enable these small-size companies to scale-up quickly, augment their capacities, and ensure their green transition.
Agriculture and animal husbandry infrastructure fund	The fund is designed for agriculture and animal husbandry infrastructure like cold chains, post-harvest, and milk plants. These projects are energy-intensive, hence Instead of using grid power (mix of coal and RE), these facilities can use clean distributed solar power as an energy source. The Government can make it mandatory to use clean energy (distributed solar, for example) as a source of energy for these facilities and plants. **Stimulus Goal:** RE energy quickly generates a higher number of employments, and the ecosystem is equipped to carry them out.

Agriculture (Additional emergency working capital and Kissan Credit Card)	Incentivize farmers to adopt sustainable agriculture practices, for example, solar water pumps, water conservation, agroecology and agroforestry, crop rotation, soil cover, etc. Sustainable agriculture practices are crucial in India's fight against climate change. Also, these practices will make farmers, the most vulnerable group to climate change, resilient against climate change risk. **Stimulus Goal:** Sustainable agriculture practices can start in a short time frame and absorb a large number of unskilled workers, primarily in the states witnessing an influx of migrant workers.
Fiscal Support	
MNREGA Scheme	Create labor-intensive green assets such as increasing forestry coverage (a small amount allocated to forestry, but can be increased further), mass-scale plantation, soil and water conservation, development of efficient irrigation systems, etc. Enhancing carbon sinks through an increase in forestry and tree cover, water efficiency, and sustainable agriculture practices is a critical part of India's plan to decarbonize its economy. **Stimulus Goal:** All these are labor-intensive projects, which can start quickly and absorb many unskilled workers in a short time frame. Moreover, these projects create sustainable assets.
Affordable housing	Align with green building standards: Green building can reduce water consumption over 20-30%, generate 50% less waste, and reduce carbon emission by 35%. Affordable housing would also reduce the Government's future subsidy burden in the later years, since the state subsidizes most of the ' households' electricity bills. **Stimulus Goal:** Housing construction projects generate employment in a short time.

All is not lost; there are some possible downstream activities to support a green economy.

Greening the electricity grid by closing down low PLF coal power plants by bidding out RE projects in the same - Retiring a significant number of selected coal power plants would save DISCOMs USD1.6 billion per annum, add ~60,000 MW of new RE into the system, and save India 113mm tonnes of GHG emissions annually (CPI, 2020)

Developing a green finance taxonomy:

- Green tagging – Tracking climate-related expenditures in national budget systems
- Designing appropriate and regulatory interventions by assessing India's progress on NDC goals
- Enabling the financial sector and corporates to act upon climate change risk and opportunities
- Better reporting and disclosure of climate change risks and opportunities

Attract foreign capital for green sectors

- Encourage companies to adopt international best practices on climate change disclosure, ESG guidelines, sustainable business practices, lending, and investment
- Create financial instruments such as green equities, green bonds, and ESG funds for foreign investors who want to invest only in green assets
- Make a separate help-desk in 'Invest India,' National Investment Promotion and Facilitation Agency, to facilitate green investment in India

Use public capital for environmental compliances (for example, set-up of wastewater and sludge treatment common facilities) of MSME clusters, since they will not be in a position to deploy additional capital to meet the regulatory compliance in the scenario of shrinking order books and a cash crunch.

Large scale grants and equity funding for carbon-mitigating technologies such as electric mobility and batteries increase in green demand generating interventions: Increase in subsidies for electric cars, tax benefits for green buildings, and energy-efficient consumer goods.

Promote public transportation through better city planning, subsidies, and incentives

ANNEXURE - SPEAKERS AND PANELISTS

1. Mr. Atul Bagai, Head, UNEP India Country Office
2. Dr. Ajay Mathur, Director General, The Energy and Resources Institute
3. Dr. Ashok Khosla, Founder, Development Alternatives Group
4. Mr. C.K.Mishra, Secretary (Retd.), MoEF&CC, Government of India
5. Ms. Mahua Acharya, Asia Director, Climate Policy Initiative
6. Dr. René Van Berkel, UNIDO Representative, Regional Office in India
7. Ms. Nadia Rasheed, Deputy Resident Representative, UNDP India
8. Mr. Kelvin Sergeant, Enterprise Specialist, ILO
9. Ms. Naina Lal Kidwai, Chairperson, Advent Pvt. Equity
10. Dr. Rita Pandey, Senior Fellow, National Institute of Public Finance and Policy
11. Mr. G. Suribabu, General Manager, NABARD
12. Mr. Manish Chourasia, Managing Director, TATA Cleantech Capital Ltd.
13. Ms. Sunita Sanghi, Senior Advisor, Ministry of Skill Development and Entrepreneurship, Government of India
14. Ms. Malini Chakravarty, Additional Coordinator (Research), Centre for Budget and Governance Accountability