G20 NET ZERO TARGET

Level Green Playing Field

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The G20 communiqué makes it clear that climate action is now at the core of international diplomacy. In the five years since the signing of the Paris Agreement, countries accounting for 63% of the world's GDP now have a mid-century net zero target in law, or in policy document. Many more are discussing a potential plan.

All eyes are on India not only because it is a large developing economy, but also because it features among the top global emitters after China, the US and the EU. India signed the Paris Agreement, committed to nationally determined contribution, and is well on its path to accomplishing these. Yet, despite GoI's admission that climate action is an important issue, it has cautiously stayed away from the net zero bandwagon.

Critics point out that the target can deflect a country towards carbon removal rather than reduction. However, the costs and span of removal can be prohibitive, making net zero still a useful concept. So, what are the benefits of signing up to such a target?

The discussions at G20 stressed that carbon pricing is a means to compel countries to act. The ways in which this price will be implemented is the carbon border adjustment mechanism (CBAM), which imposes a tariff on imported goods based on their carbon footprint. EU's plan to implement CBAM is fraught with the challenge that it can adversely impact trade with countries adopting less similar standards.

Even though countries such as India contribute to only a per cent of the imported emissions, they may be priced out of an important export market. There is a possibility of special treatment being extended to low- and middle-income countries through generalised system of preferences (GSPs). This is also in line with the common but differentiated responsibilities.

However, carbon leakage — that is, the shifting of companies to jurisdictions with lower standards and less onerous compliances — could prevent the EU from extending such preferential access. The International Monetary Fund (IMF) has also advocated for a carbon tax at $75 per tonne of CO_2, which is estimated to translate into 6% tariff on goods. It is imminent then that trade and public finance will gain prominence.

India's trade, a function of its past, is locked into value chains. For example, the rise of organic chemical exports was the result of the shift of production away from the EU. Moreover, the problem with a carbon tax in India is not only that it might be untenable, but that fuel taxes and royalties are already high. It is expected that the demand to switch quickly out of fossil fuels would, in turn, shrink India's fiscal space, compelling it to find another tax base. Private and international finance will, therefore, remain critical for achieving the transformation.

Rising extreme weather events in India, as well as investors devising their proprietary standards for just transitions, are now compelling companies to rethink business models. Large coal, cement, steel and power conglomerates have committed to sustainable practices and announced diversification. Large institutional investors, including mutual funds and private equity, are also allocating their portfolio to activities aligned with environmental, social and governance (ESG)-based indicators encoded in India's business responsibility reporting (BRR) regulations.

Navigate the maze

As the transition trickles into corners of India's economic activity, plenty of challenges await. First, the banking system represents a key source of finance. With the shift of funding away from coal plants, the value of assets may disappear, while leaving many unemployed. The transition may amplify the risk of bad loans and systemic risks.

Second, good quality reporting and objective measurement of ESG elements of investment is imperative. For this, serious thinking is required on what may remain in India's portfolio of priorities while greening the economy. There is also a need for clear identification of climate risk and embedding this in macroeconomic policy.

Third, as the sun sets on fossil fuel use, new sources of tax and non-tax revenues will need to be explored. The State's role will remain critical in this transition, and the private sector must express its willingness to allow the sovereign enough wiggle room to raise additional debt for this purpose.

Finally, developed countries raising revenue from carbon taxes must relay a clear plan to redistribute gains. This may be through finance and technology transfer to developing countries. It is essential that consumers and workers in these countries are not left bearing all costs of a transition.

Net zero target can serve as a means to design an agenda tailored to India's needs. All such challenges should be appropriately addressed to better articulate India's international position. The thinking, however, must not stop at this target. After all, climate action seeks redistribution. The pace and nature of this transition must not come at the cost of inter- and intra-nation equity.

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