A Budget amidst macroeconomic uncertainties

The Union Budget 2025-26 aims to balance fiscal consolidation, growth, climate change commitments, and the challenges of demographic transition. Key focuses include green bonds, climate fiscal instruments, boosting female labour force participation, and addressing the care economy and digital infrastructure needs

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The Union Budget 2025-26, in the context of macroeconomic uncertainties, will aim to achieve a "knife-edge equilibrium" between macroeconomic stabilisation and growth, tightening fiscal consolidation by pegging the fiscal deficit to 4.5% of GDP. If this fiscal consolidation path is achieved through tax buoyancy rather than expenditure compression, economic growth recovery should not be hindered. The recent advanced estimates of growth provided by the CSO indicate that government capital expenditure (capex) is sustaining the growth momentum, but this is being neutralised by a lack of a consumption boost. This Union Budget will focus on boosting consumption while maintaining the capex focus to support growth, including capex transfers in the form of interest-free loans to states. This forms the macroeconomic framework for the forthcoming Union Budget 2025.

Two important debates are being overlooked, as economists focus on the declining growth trends in the Indian economy. One is the pressing issue of climate change, and the other is demographic transition, with a bulging elderly population in many states, including Kerala. This has fiscal consequences, such as higher health and social security costs, and it impacts Total Factor Productivity when the dependent population rises significantly.

Climate Bonds and the Energy Transition

The shadow of climate change-related risks and uncertainties looms over the preparation of the Union Budget 2025-26. How effectively the monetary policy stance can incorporate such risks and uncertainties, within the available toolkit, remains an empirical question. There is broad consensus among economists that fiscal policy can address the climate crisis and its political economy, and national budgets have become an essential tool for fulfilling climate change commitments. A National Adaptation Communication statement is crucial in the Expenditure Budgets to ensure fiscal transparency and accountability. The Union Budget 2022–23 introduced "green bonds" for the first time in India, and the continued thematic financing of the fiscal deficit towards green infrastructure could be further enhanced in the forthcoming Union Budget 2025-26.

The National Institute of Public Finance and Policy (NIPFP) has conducted several studies on climate budget statements and fiscal policy within the framework of "environmental federalism." Against the backdrop of fiscal transition alongside energy transition policies and climate change commitments, a 2024 NIPFP paper by Lekha Chakraborty and Emmanuel Thomas analysed the baseline buoyancy of revenue from the extractive sector, highlighting the need for recalibration in subnational fiscal space in light of the energy transition. A discussion of three fiscal instruments for climate change commitments — (i) carbon tax on the revenue side, (ii) climate budget statements on the expenditure side, and (iii) ecological fiscal transfers (EFT) within Intergovernmental Fiscal Transfers (IGFT) — should be included in the Union Budget 2025-26, given India's stance in international climate diplomacy.

Three environmental functions are crucial to consider in the context of "environmental federalism":

1. Environmental quality as a pure international public good

2. Environmental quality as a pure local public good, determined decentralised, in line with the "principle of subsidiarity," to avoid a race to the bottom in tax wars aimed at attracting mobile capital

3. Environmental quality as a function of inter-jurisdictional spill-over effects (i.e., activities that flow across boundaries between jurisdictions)

Emphasising green bonds and ecological fiscal transfers (as proposed by the 16th Finance Commission) are two key policy imperatives we can expect from the Union Budget 2025. It will be a significant challenge to prepare "climate budget statements" to ensure fiscal transparency and enhanced accountability.

The Demographic Transition

The pressures from demographic transition are real. Many states are already experiencing the fiscal policy pressures arising from this shift. One potential way to address this crisis within fiscal policy frameworks is to integrate the elderly population into the IGFT, adjusting the tax transfer formula to account for this demographic shift. A NIPFP paper examines this in a counterfactual framework, proposing alternative scenarios to enhance the progressivity of IGFT. Another approach is to explicitly use the budget to announce policy measures for the care economy infrastructure, including provisions for the elderly population. The Union Budget 2024-25 may introduce a comprehensive care economy infrastructure package for India. It is worth recalling the public policy revolution in Northern Europe, where demographic transition has been integrated into public policy frameworks, particularly as more elderly individuals live alone. Existing Public Financial Management (PFM) tools, such as gender budgeting, can be analysed from a lifecycle approach, incorporating care economy concerns.

The key question is where the money for these commitments will come from. One plausible solution is the announcement of "gender bonds" in the Union Budget 2025-26, which could be integrated into the financing pattern for the deficit.

The Poly-crisis and Intensified Risks for Children

The global poly-crisis has intensified risks for children, prompting national and subnational governments to prioritise public expenditure and invest in preventing violence against children. The poly-crisis includes challenges stemming from climate change, disaster, energy transition, war, natural calamities, geopolitical uncertainties, supply-side shocks, and pandemics, all of which disproportionately affect children. The Union Budget 2025-26 may outline fiscal policy support for children, strengthening initiatives like Mission Vatsalya.

The fastest and most effective way to increase India's GDP is to boost female labour force participation. The government's existing framework of gender budgeting can be strengthened to promote "Feminisation U" in labour markets through appropriate employment policies and credit deployment, such as strengthening SHGs in the Union Budget 2025-26. Integrating public expenditure benefit incidence analysis into gender budgeting will be crucial. The government's gender budgeting efforts in energy infrastructure, such as providing clean fuel to women, are commendable and should continue.

Go Digital: The Infrastructure and the Currency CBDC

Access to digital infrastructure in public finance needs to be strengthened for women, as "cost versus access" to credit remains a significant barrier to financial inclusion. It is misguided to reject innovations in the field of money and finance, such as cryptocurrency. In the previous budget, a tax rate of 30% was announced for crypto. However, a regulatory framework is essential to prevent individuals from falling victim to "phish coins." The Central Bank Digital Currency (CBDC) has been piloted in a few cities. While CBDC is a legal tender, crypto is not, as it remains a speculative asset. Expanding the use of CBDC could significantly enhance financial inclusion, as it addresses the "access" issue for the poor. Digital currencies can also reduce transaction costs, benefiting cross-border business transactions. I hope the Union Budget will prioritise digital initiatives, including efforts to bridge the digital divide in India.