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Shaping a new era of industrial cooperation

The approaches of India and Sweden reflect a broader belief that climate action can create jobs, expand opportunity, strengthen energy security and improve lives

At a time of growing geopolitical uncertainty, energy insecurity, and economic fragmentation, the world faces a defining choice: Retreat into narrow national approaches or strengthen partnerships that deliver growth, resilience, and sustainability together.

As the United Nations marks its 80th anniversary, the value of international cooperation and multilateralism has become even more evident. At the same time, the need to reform global governance institutions to reflect contemporary realities has become impossible to ignore.

A rules-based international order anchored in international law and sovereign equality has helped create decades of relative stability and development. Yet today's challenges of climate change, industrial transformation, supply-chain disruptions and energy transition, require a renewed spirit of practical and inclusive cooperation.

Few challenges are as universal or consequential as climate change. It affects societies and economies across all regions, whether in India, Sweden or elsewhere. But climate action cannot be divorced from development aspirations. Billions of people continue to seek better living standards, jobs, modern infrastructure and energy access. Delivering growth and opportunity while advancing sustainability is, therefore, not a contradiction, it is the defining economic and political task of our times.

India has emerged as one of the world's fastest-growing major economies while pursuing one of the world's largest renewable energy transitions. The approach is guided by a clear objective: to bridge climate ambition with development realities.

Narendra Modi

Ulf Kristersson

As a major growth engine, and a responsible voice of the Global South, India's two defining milestones for the near future are to achieve developed country status by 2047 and Net Zero emissions by 2070. These domestic goals are deeply intertwined.

Thanks to global cooperation, including Lead It and other global platforms that India has formed with the United Nations and international partners — including the International Solar Alliance, the Global Biofuels Alliance, and Mission LiFE, India is a responsible voice of the Global South.

Simultaneously, Sweden leads the way in European climate action. Thanks to bold decisions taken decades ago, the electric grid is 98% fossil-free. The contribution of the private sector in innovation and exports of climate-friendly solutions cannot be overstated. All in all, emissions have decreased by more than a third since 1990 — and during this time, the size of Sweden's economy has almost doubled.

The approaches of India and Sweden reflect a broader belief that climate action can create jobs, expand opportunity, strengthen energy security and improve lives. The aim is not only to decarbonise domestic development pathways, but to help build partnerships that make clean industrialisation at scale possible.

It is in this spirit that India and Sweden met in Gothenburg on May 17. Our partnership reflects a shared conviction that industrial transformation can be driven through collaboration between governments, industry, innovators and financial institutions.

The green transition is not only an environmental imperative, it is also central to competitiveness, economic resilience and long-term growth.

India and Sweden have demonstrated the value of such cooperation through the Leadership Group for Industry Transition (LeadIT), launched jointly by both countries in 2019 with the support of the United Nations. LeadIT has helped place industrial decarbonisation and hard-to-abate sectors at the centre of the global climate discussion. More importantly, it has shown that developed and developing economies can co-create solutions through trust, innovation and shared responsibility.

Green transition is not only an environmental imperative, it is also central to competitiveness, economic resilience and long-term growth. REUTERS

Today, however, the scale and urgency of the challenge demand that we move further and faster. The next phase of Lead IT should move from words to action, meaning implementation at scale. It has proved to be a useful platform for action by accelerating technology partnerships, enabling industrial pilot projects, mobilizing sustainable finance, strengthening resilient clean-energy supply chains and building globally competitive low-carbon industries.

The next phase should aim to support workforce transitions, skills development and financial architecture that reduce risk and lower the cost of capital for industrial transformation.

Not every country needs to invent every solution, but every country should have the opportunity to adapt, deploy and scale technologies suited to its developmental circumstances and priorities. Emissions do not recognise borders, and neither can the solutions.

We, therefore, call for a broadening and deepening of this coalition through 2030. We invite more countries, including Nordic partners with strong innovation ecosystems and clean technology leadership, to join and actively contribute to this effort. The industrial transition can succeed only if it can deliver tangible economic value and social progress.

Solar, wind, hydropower, nuclear energy, storage technologies and low-carbon industrial solutions will all have important roles to play depending on national circumstances and priorities.

No country can secure every critical technology, mineral or industrial input alone. Nor can any nation address climate change in isolation. Emissions do not recognise borders — which is why solutions must be international.

The opportunity before us extends far beyond climate policy. It is about shaping a new era of industrial cooperation.

India and Sweden remain committed. At a moment of global uncertainty, our message is clear: cooperation, rather than fragmentation, will define the pathway to shared prosperity and a sustainable future.

Narendra Modi is Prime Minister of India and Ulf Kristersson is Prime Minister of Sweden

- **Key Terms and Explanations**

- **Multilateralism** refers to the practice of coordinating relations among three or more states according to shared principles and rules, typically through institutions like the United Nations. For example, climate negotiations under the UNFCCC bring nearly 200 countries together to decide collective action. The discourse emphasises that global challenges like climate change cannot be solved by any one country alone, making multilateralism indispensable.

- **Rules-based International Order** signifies a global system anchored in international law, treaties, and norms rather than unilateral force. It rests on sovereign equality, where every nation, big or small, has the same legal standing. The argument holds that decades of stability and development have flowed from this order, but it now requires reform to reflect contemporary power shifts and developmental realities.

- **Geopolitical Uncertainty, Energy Insecurity, Economic Fragmentation** describe a world facing great power rivalries, volatile energy markets (often weaponised), and the splintering of global trade into competing blocs. These conditions tempt nations to adopt narrow, protectionist responses, yet the narrative insists that cooperation remains the wiser path.

- **Net Zero Emissions** means reducing greenhouse gas emissions to as close to zero as possible, with any residual emissions balanced by removal from the atmosphere. India has set a target year of 2070; Sweden aims earlier. The concept is central to stabilising global temperatures.

- **Hard-to-abate Sectors** are industries where emission cuts are technically difficult and costly, such as steel, cement, chemicals, aviation, and heavy transport. LeadIT (Leadership Group for Industry Transition) was created precisely to target these sectors, bringing together governments, companies, and financiers to co-develop and scale low-carbon solutions.

- **International Solar Alliance (ISA)**, launched by India and France, is a treaty-based intergovernmental organisation aiming to mobilise solar energy investments, especially in sun-rich developing countries. Similarly, the **Global Biofuels Alliance** promotes sustainable biofuels, and **Mission LiFE** (Lifestyle for Environment) advocates mindful consumption to reduce environmental footprint—all examples of India's institutional innovation in global climate cooperation.

- **Fossil-free Grid** describes Sweden's electricity system, where 98 per cent of power comes from non-fossil sources like hydro, nuclear, and wind. This was achieved through long-term policy consistency, carbon pricing, and private sector innovation, demonstrating the feasibility of decoupling economic growth from emissions.

- **Sustainable Finance** involves channeling capital toward investments that yield environmental and social benefits alongside financial returns. Reducing the cost of capital for green industrial projects in developing countries is a key ask in the next phase of industrial transition.

- **Critical Minerals** such as lithium, cobalt, and rare earths are essential for batteries, wind turbines, and other clean technologies. Their concentrated supply chains pose a new geopolitical risk, making diversified, resilient supply chains a priority.

- **Main Arguments and Substantive Parts**

- **Core thesis:** At a time of global turbulence, the world must choose between isolationist nationalism and strengthened international partnerships. Only cooperative frameworks can simultaneously deliver economic growth, energy security, and climate sustainability.

- **Key points advanced include:**

- Climate change is universal; its effects spill across borders, making it the ultimate collective action problem.

- Development aspirations of billions cannot be put on hold. Poverty eradication, job creation, and energy access remain moral and political imperatives.

- India's twin goals — developed country status by 2047 and Net Zero by 2070 — illustrate how climate ambition and development can be integrated, not traded off.

- Sweden's experience proves that a fossil-free grid and substantial emission cuts can coexist with robust economic expansion.

- The Leadership Group for Industry Transition (LeadIT), launched jointly by India and Sweden in 2019 with UN support, exemplifies practical North-South collaboration. It has moved industrial decarbonisation to the centre of global climate discourse.

- The next phase must shift from dialogue to implementation at scale, covering technology partnerships, industrial pilot projects, sustainable finance, clean energy supply chains, and workforce transition.

- Not every nation needs to invent every solution, but every nation must be able to adapt, deploy, and scale technologies suited to its circumstances.

- The narrative calls for broadening the coalition through 2030, inviting Nordic countries and others to join, because the industrial transition must produce tangible economic value and social progress.

- **Supporting evidence:** India's emergence as a fast-growing economy pursuing a massive renewable energy expansion; LeadIT's track record in agenda-setting; Sweden's one-third emission drop while doubling its economy.

- **Historical Evolution of the Issue**

- The interplay between development, energy, and environment has a long lineage, shaping the current global discourse.

- **Pre-independence era:** Colonial economies were extractive, with resources drained to fuel industrialisation in Europe. Traditional Indian practices often embodied sustainable living, but colonial rule disrupted these systems without introducing modern environmental safeguards.

- **Post-World War II (1945–1970):** The Bretton Woods institutions prioritised reconstruction and industrial growth. Environmental concerns were peripheral. India's early Five-Year Plans focused on heavy industry and infrastructure, mirroring the global development model.

- **1972 Stockholm Conference:** A turning point. Indira Gandhi, the only foreign head of state besides the host to attend, famously linked poverty to environmental degradation, asserting that "poverty is the worst polluter." This planted the seed for differentiated responsibilities.

- **1987 Brundtland Report:** Introduced "sustainable development" as meeting present needs without compromising future generations. It bridged the perceived conflict between growth and environment.

- **1992 Rio Earth Summit:** Produced the UNFCCC, recognising Common but Differentiated Responsibilities and Respective Capabilities (CBDR-RC). Agenda 21 and the Convention on Biological Diversity also emerged.

- **1997 Kyoto Protocol:** Set binding emission reduction targets only for developed countries, reflecting CBDR. However, it excluded major emerging emitters, leading to eventual U.S. non-ratification and limited effectiveness.

- **2009 Copenhagen Accord:** A near-collapse of multilateral climate diplomacy, as top-down targets gave way to voluntary pledges. It exposed deep North-South mistrust.

- **2015 Paris Agreement:** A landmark shift to a bottom-up architecture where every country submits Nationally Determined Contributions (NDCs). It introduced a global stocktake mechanism and emphasised climate finance, technology transfer, and capacity building.

- **2019 onwards:** India and Sweden launched LeadIT at the UN Climate Action Summit, focusing on hard-to-abate sectors. India also spearheaded the International Solar Alliance (2015) and later the Global Biofuels Alliance (2023), signalling proactive coalition-building.

- **2020s:** COVID-19 disrupted supply chains, followed by the Ukraine war triggering energy insecurity. Countries began rethinking energy dependence, accelerating renewables but also reviving some fossil fuel investments. The discourse on "friend-shoring" and economic fragmentation gained prominence.

- **Present context:** The UN approaches its 80th anniversary amid calls to reform the Security Council, multilateral development banks, and global governance architecture. India's G20 presidency (2023) pushed for green development, climate finance, and LiFE. The argument for cooperative industrial transition is a direct response to these accumulated historical trends.

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Current Global Uncertainty

VS

The Defining Choice: Cooperation

UN

Multilateralism & UN 80th Anniversary

INDIA's PLEDGE

- EU Climate Action Leader
- 98% Fossil-Free Grid
- Decoupled GDP & Emissions (2x GDP, -1/3 Emissions since 1990)
- Private Sector Innovation

INDIA's PLEDGE

- Fastest-Growing Major Economy
- Largest Renewable Transition
- Responsible Global South Voice
- Targets: 2047 Developed Country, 2070 Net Zero

SWEDEN's LEAD

- EU Climate Action Leader
- 98% Fossil-Free Grid
- Decoupled GDP & Emissions (2x GDP, -1/3 Emissions since 1990)
- Private Sector Innovation

LeadIT: Industry Transition

- Launched 2019
- Focus on Hard-to-Abate Sectors (Steel, Cement)
- Co-creation Platform

LeadIT 2.0: IMPLEMENTATION AT SCALE

Minimal emissions

Pilot plants

- Tech Partnerships
- Industrial Pilots
- Sustainable Finance
- Workforce Skilling

Solar

Wind

Hydro

Nuclear

Storage

Universal Solutions Suited to National Circumstances

A Call for a Broadened Coalition through 2030. Emissions don't recognize borders; neither should the solutions.

- **Logical and Philosophical Base**

- **Underlying Logic:**

The argument rests on the recognition of deep interdependence. Greenhouse gases mix globally, so no nation can insulate itself from climate impacts through purely domestic action. This creates a classic "public goods" problem that demands collective management. The economic logic is that green industries—renewables, batteries, hydrogen—represent the next frontier of global competitiveness. Cooperating to build these sectors can create shared prosperity rather than a zero-sum race.

- **Assumptions:**

- Nations are rational actors that will choose long-term collective gain over short-term nationalistic impulses if proper institutional frameworks exist.
- Trust can be rebuilt through demonstrable, pragmatic partnerships that deliver tangible outcomes.
- Technology and finance, if properly mobilised, can decouple development from environmental harm.
- The Global South can leapfrog to clean industrialisation if given access to affordable capital and technology.

- **Philosophical Foundations:**

- **Cosmopolitanism:** Kant's idea that individuals belong to a single moral community, and states must cooperate to achieve perpetual peace. Extending this to ecology, we are all planetary citizens.
- **Utilitarianism:** Maximising overall welfare justifies transitioning to low-carbon pathways, as the costs of inaction (extreme weather, displacement) outweigh transition costs.
- **Gandhian Trusteeship and Sustainability:** Gandhi's notion that the world has enough for everyone's need but not for greed resonates with Mission LiFE's emphasis on mindful consumption and intergenerational justice.
- **Intergenerational Equity:** The Brundtland principle that future generations must inherit a livable planet is a fundamental ethical premise.
- **Sovereign Equality and International Law:** The rules-based order is philosophically rooted in the idea that all states, irrespective of power, have equal legal standing. The article reaffirms this while acknowledging that institutions must adapt to reflect current realities.
- **Capabilities Approach:** Amartya Sen's framework implies that development is about expanding people's freedoms and capabilities. Clean energy access, health, and decent work in green industries directly enhance human capabilities.

- **Multidimensional analysis**

- **Social dimension**
  - Green transition can improve public health (less air pollution), create new jobs and reduce energy poverty through decentralised renewables.
  - But abrupt transitions can deepen regional inequalities, urban-rural divides and social unrest if vulnerable groups are not protected.
- **Political dimension**
  - Multilateral climate-industrial coalitions can enhance a country's diplomatic profile and bargaining power, especially for middle powers like India.
  - Domestically, climate-aligned industrial policy can become a political narrative of national pride, but may also be politicised along partisan lines.
- **Legal dimension**
  - International law (UNFCCC, Paris Agreement) and trade rules shape what is permissible in terms of subsidies, carbon border measures and technology transfer.
  - National legal frameworks must clarify regulatory authority over emissions, land use, environmental clearances and labour protections during transition.
- **Ethical dimension**
  - Questions of fairness—who pays, who benefits, whose livelihoods are affected—are central; climate justice demands that the burdens not fall disproportionately on the poor.
  - Ethically, there is a duty to future generations to avoid catastrophic climate change while ensuring current generations have dignified lives.
- **International dimension**
  - Green transition recasts geopolitics around clean technologies, critical minerals, green finance and climate-related migration.
  - Cooperative frameworks like LeadIT, ISA and green clubs can either mitigate or amplify power asymmetries depending on governance design.
- **Economic dimension**
  - Low-carbon sectors (renewables, storage, green hydrogen, electric mobility) can become major engines of growth, exports and employment.
  - At the same time, transition costs, carbon leakages, structural change in labour markets and fiscal implications of subsidies must be managed carefully.

- **Linkages with NCERTs**

- **Class 9–10 (Social Science)**
  - Democratic Politics and Contemporary India textbooks discuss democracy, globalisation, development and environmental challenges, which relate directly to climate justice and global governance.
  - These chapters help students understand why collective action and institutions matter for global issues.
- **Class 11 (Political Science – “Indian Constitution at Work”, “Political Theory”)**
  - Topics like sovereignty, rights, justice, equality and globalisation provide conceptual tools to analyse sovereign equality, climate justice and multilateralism.
  - Chapters on “India in the World” and “Peace and Development” link India’s foreign policy to global climate and development debates.
- **Class 11 (Geography – “Fundamentals of Physical Geography”, “India: Physical Environment”)**
  - Climatic regions, monsoon dynamics and environmental hazards connect to the physical basis of climate vulnerability in India.
  - This helps visualise why a country like India is simultaneously a major emitter and highly vulnerable.
- **Class 12 (Geography – “Fundamentals of Human Geography”, “India: People and Economy”)**
  - Chapters on resources, energy, industry, transport and human development mirror the growth–sustainability–equity nexus.
  - Industrial location, resource distribution and energy mixes link directly to industrial decarbonisation and energy transition.
- **Class 12 (Economics – Macroeconomics, Indian Economic Development)**
  - Growth, structural change, infrastructure, poverty and globalisation discussions help situate green industrial policy within broader development strategy.
  - Post-1991 economic reforms, external sector and role of international institutions connect with global financial architecture debates.
- **Class 12 (Political Science – “Contemporary World Politics”)**
  - Chapters on the UN, US hegemony, alternative centres of power, globalisation and environmental movements are almost tailor-made for this theme.
  - They provide historical and conceptual context to multilateralism, emerging powers and global environmental politics.

- **Linkages with UPSC CSE syllabus**

- **GS Paper 2 (Polity and IR)**
  - "Important international institutions, agencies and fora—their structure, mandate" covers UN, WTO, climate regimes and issue-specific coalitions.
  - "Effect of policies and politics of developed and developing countries on India's interests" and "India and its neighbourhood, relations" apply to climate diplomacy, coalitions like LeadIT and India's role as voice of Global South.
- **GS Paper 3 (Economy, Environment, S&T)**
  - "Environmental conservation; climate change; environmental impact assessment" includes green transition and decarbonisation strategies.
  - "Infrastructure, investment models, industrial growth, energy, science and technology" covers industrial policy, sustainable finance and technology partnerships.
- **GS Paper 1 (Society, History, Geography)**
  - Society: impact of development and globalisation on social structure, regional inequalities and workforce transitions.
  - Geography: distribution of key natural resources, industrial location and climate-related disasters.
- **GS Paper 4 (Ethics, Integrity and Aptitude)**
  - Themes of climate justice, inter-generational equity, responsibilities of public officials in handling long-term risks and policy trade-offs.
  - Case-study potential: balancing jobs versus environment, local livelihoods versus green projects.

- **Way forward**

- **Reforming global institutions for the green era**
  - Update representation and decision-making (e.g., UNSC, IMF) to reflect contemporary economic and demographic realities, enhancing legitimacy.
  - Strengthen mandates on climate, technology and finance coordination to bridge gaps between environment, trade and development regimes.
- **Scaling climate-aligned industrial policy**
  - Countries should design sector-specific roadmaps (steel, cement, transport) that integrate decarbonisation, jobs and competitiveness.
  - Use standard-setting, public procurement, subsidies and carbon pricing carefully to push industries towards low-carbon technologies while avoiding sudden shocks.
- **Deepening technology and finance partnerships**
  - Promote joint R&D, open innovation platforms and flexible IP arrangements to accelerate diffusion of critical green technologies.
  - Expand climate finance through concessional funds, blended finance vehicles, guarantees and risk-sharing instruments to lower cost of capital in the Global South.
- **Ensuring just and inclusive transitions**
  - Develop comprehensive just-transition frameworks: mapping vulnerable workers, designing reskilling programmes, social protection and regional diversification plans.
  - Engage communities, labour unions and local governments early to build trust and legitimacy.
- **Strengthening national governance capacity**
  - Build capable regulatory institutions, climate-related data systems and inter-ministerial coordination mechanisms.
  - Mainstream climate and sustainability considerations into budgeting, infrastructure planning and industrial policy.
- **Nurturing a culture of sustainable lifestyles**
  - Initiatives like Mission LiFE can be used to encourage behavioural change in consumption, mobility and energy use, supporting structural reforms.
  - Education, media and civil society can help embed environmental ethics and shared responsibility in social values.

- **UPSC GS 2 (IR and institutions)**
  - 2023 GS 2: “Do you think multilateralism is in crisis? Discuss with reference to recent events in global politics.”
  - 2020 GS 2: “Critically examine India’s position on climate negotiations and its role in global climate governance.”
  - 2017 GS 2: “Globalisation and multilateral trade regimes are under stress. Discuss the implications for India.”
- **UPSC GS 3 (Environment, economy, technology)**
  - 2023 GS 3: “Discuss the concept of just transition in the context of climate change and India’s energy policy.”
  - 2021 GS 3: “Explain how India can achieve high economic growth while fulfilling its commitments under the Paris Agreement.”
  - 2016 GS 3: “How do international climate agreements affect India’s industrial and energy policies?”
- **UPSC Essay**
  - 2021 Essay: “The process of self-discovery is now technologically outsourced.” (Can be linked to technology and globalisation debates.)
  - 2016 Essay: “Near jobless growth: in India and elsewhere.” (Relevant to green growth and employment in transition.)
- **UPSC Ethics (GS 4)**
  - Several case studies over the years on environmental conservation versus development, rights of tribal communities versus infrastructure projects, etc., relate to climate–development trade-offs and justice.

livemint

India needs to look beyond cost optimization in its tryst with AI

What gets the work done cheaply has its appeal but will not place the country in the technological position we must aim for

V. ANANTHA NAGESWARAN
& AKASH PODDAR
are, respectively, chief economic advisor to the Government of India, and consultant, ministry of finance.

When DeepSeek released the preview of its V4 model on 24 April 2026, the contrast with the rest of the AI industry could not have been starker (bit.ly/4tMBaxw). The Pro variant is priced below Claude Opus 4.7, GPT-5.5 and Gemini 3.1 Pro, and the Flash variant undercuts every smaller frontier model. Further, it is open-source and runs on domestic Chinese chips from Huawei and Cambricon, showing the world that Nvidia's chokehold on the AI hardware space is not absolute.

In the same week, Anthropic unveiled Claude Code usage caps faster than expected. OpenAI scaled back Sora to redirect compute towards core services and Deutsche reported nearly 60% of AI failures in production were since back to capacity limits (bit.ly/4vJcb5d). A Chinese competitor is offering something almost as good, fully open-source and open-weight, and cheaper by an order of magnitude. The rest of us should be worried.

Costs have always been the ground on which newcomers or firms compete, and that matters more in AI than their capability on benchmark tests. For the enterprise buyer trying to capitalize on latent demand for its services and boost profits (bit.ly/4vJcb5d), raw frontier capability is not the binding consideration. It is the price per token. Most firms do not need 'Opus-grade' reasoning to summarize a meeting, schedule executive meetings, handle customer service or run a basic agentic workflow. What they need is a 'good-enough' tool that makes cheaper than hiring labour for those tasks.

This was China's playbook in manufacturing: it has been brought to AI. Chinese manufacturers scaled up by supplying 'good-enough' products at floor prices, eventually pushing competitors out of the market. Now, they are releasing capable models for free, setting the price floor and letting the market do the rest. Even those who won't deploy Chinese models for security reasons will use Deepseek's pricing to negotiate with Western providers. The pricing pressure will do its work.

There are developments native to India as ways to the price tag are found. AI services don't capture. India keeps its markets relatively open and does not ban services from any particular country, giving buyers a wide range of choice. With Chinese models getting cost-effective, it is likely that India's private firms will reach for the most cost-effective option, making 'indigenous' options unattractive. The incentive for Indian firms to invest in foundational AI research, already thin given the stiff competition they face from Western model providers with deep pockets, fades further with each release. If the world's cheapest capable model is open-weight and Chinese, the business case for an Indian foundation model falls even before it can be made.

Few venture investors will fund a first-building a domestic frontier model when an almost frontier alternative can be downloaded free. The talent that might have done that work will leave for firms abroad that are still investing in pre-training, or will get redirected to building application wrap of someone else's model. Neither produces the foundational expertise that could turn a country from a customer into an AI leader.

The deeper cost is harder to see on a profit-and-loss statement. Free trade and the pursuit of cheap goods delivered enormous benefits, but they also concentrated 'depth' knowledge—in the places that did the work. This is the kind of know-how that most don't appreciate. It is the engineer who can tell by feel how many millimetres the drill needs to be adjusted, the team that has debugged software at scale enough times to predict where it will fail, the operator who has maintained a fab clean-room long enough to know which procedures cannot be cut. You acquire this by doing the work repeatedly at scale, not by reading about it.

Manufacturing knew: how has not worked in China by accident, and today there is barely a domain of modern manufacturing where China does not command both underlying knowledge and a cost advantage. Reducing out of strategic necessity is not impossible, but it takes far longer than the timelines that policy incentives assume because a knowledge base has to be built by people who have never done such work. In that gap, the lead only widens. The same logic now applies to AI.

There is also an ecosystem effect for the importer. In complex systems, one capability seeds another. A country with foundation model labs develops a dense relevant pipeline of fine-tuning specialists, evaluation researchers, agent infrastructure firms, safety teams and inference optimization startups, because each of these depends on engineers close to the actual work. If we skip out the foundation, the chain does not emerge to form. We end up with the integration layer alone, forever a customer. The economics of that position has been kind to no one in the past. It is unlikely to be so kind to users of shifting geopolitics, though.

AI differs as an arena from manufacturing, which is why we should act now. Manufacturing shifted hands over decades. The AI stack is still being built, applications are being defined and implicit knowledge is being formed. The window in which a country can take a strategic stance, before dependence becomes permanent, is our now. Tooling, agent frameworks, evaluation suites, fine-tuning pipelines and research infrastructure get built around what hyper models become the default. Once Chinese open-weight models run inside India's enterprises, the surrounding ecosystem will grow around them and switching costs will become structural rather than financial.

It is time to let go of the notion that everything must be optimized solely on the basis of costs, and short-term profitability. It may be 'cheap' in the short run, but can get very costly in the long run. Intangibles such as implicit knowledge and strategic independability don't show up in quarterly reports, but their benefits to firms and the country create long-term dividends. The private sector needs to recognize this. Firms foraying into AI need to raise their research and development budgets and focus on building foundational AI capabilities rather than relying on imported solutions. Such investments need to be measured not against profit statements but rather against everything India may not be able to do in 20 years if we optimize only for what we monetarily save today.

These are the authors' personal views.

- **Key Terms and Explanations**
- **Frontier AI Models**
- These represent the most advanced, highly capable, and large-scale artificial intelligence systems available at any given point in time. They possess multi-modal capabilities and deep reasoning skills that push the boundaries of what machine intelligence can achieve.
- **Example:** Contemporary foundational systems such as OpenAI's GPT-5.5, Anthropic's Claude 4.7, or Gemini 3.1 Pro, which handle complex cognitive tasks.
- **Open-Weight vs. Closed-Source Models**
- Closed-source models are proprietary systems where the underlying code, architecture, and trained parameters (weights) are kept hidden by the developer and accessed only via APIs. Open-weight models expose these trained parameters to the public, allowing organizations to download, modify, host, and run the model locally.
- **Example:** Running a model like DeepSeek V4 on local, private data centers without needing to send data to external third-party servers.
- **Price per Token / Token Pricing**
- In generative AI, text is broken down into "tokens" (chunks of characters or words). Token pricing is the cost structure used by AI providers to charge users for processing input queries and generating output text.
- **Example:** If an enterprise is billed $0.10 per million tokens processed, its operational expenses scale directly with the volume of text analyzed during automated tasks.
- **Implicit (Tacit) Knowledge**
- This refers to deep, unwritten, and highly contextual knowledge acquired exclusively through hands-on practice, scaling, and operational repetition. Unlike explicit knowledge, it cannot be effectively documented in a manual or transferred via blueprints; it must be lived.
- **Example:** The precise intuition an engineering team develops while debugging massive distributed GPU clusters that are experiencing rare, emergent synchronization failures.
- **Hardware Chokehold**
- A strategic vulnerability where a critical step in a global supply chain is dominated by a single entity or nation, allowing them to restrict access, dictate terms, or halt progress for competitors.
- **Example:** The global AI ecosystem's near-total reliance on Nvidia's advanced hardware and proprietary CUDA software ecosystem for training complex models.
- **Integration Layer**
- The superficial tier of the technological value chain focused on building consumer applications, user interfaces, or wrappers on top of core, foundational technologies developed by external entities.
- **Example:** A domestic tech startup that designs a customer service chatbot app by simply linking an external, foreign-hosted API to a local database.

- **Main Arguments and Substantive Parts**
- **Core Thesis**
- The global artificial intelligence landscape is undergoing a structural shift driven by hyper-aggressive price optimization and the democratization of open-weight frontier models. This dynamic mirrors historical manufacturing displacements. For a developing digital economy like India, relying entirely on cheap, imported AI models to fuel short-term enterprise productivity risks long-term technological subordination, irreversible domestic brain drain, and the permanent loss of foundational "implicit knowledge."
- **The New Economics of AI: Cost Over Benchmarks**
- **Pragmatic Enterprise Shift:** For the vast majority of real-world corporate deployments, absolute peak cognitive performance on theoretical benchmarks is secondary to the cost per token.
- **The "Good Enough" Standard:** Basic tasks like summarizing corporate records, scheduling, or basic workflow management do not require highly expensive, premium reasoning models. They require cost-effective, dependable systems that can scale cheaply.
- **Capacity Failures as the Bottleneck:** Global enterprise adoption is increasingly bottlenecked by infrastructure capacity limits and usage caps rather than model intelligence limits, shifting the competitive battleground from pure capability to affordable availability.
- **China’s Manufacturing Playbook Replicating in Software**
- **The Floor-Price Disruption:** By offering high-capability, open-weight models at a fraction of Western costs, alternative providers are establishing an aggressive price floor for intelligence.
- **Breaking the Hardware Monopoly:** Deploying these systems effectively on non-Western hardware architectures (such as Huawei and Cambricon) demonstrates that the global reliance on a single hardware ecosystem can be bypassed through targeted engineering.
- **The Leverage Mechanism:** Even enterprises that refuse to deploy these specific open-weight models due to domestic security protocols will actively use their pricing structures as leverage to beat down the licensing costs of Western providers, reshaping global market economics.
- **The Strategic Threat to India’s AI Sovereignty**
- **Erosion of R&D Incentives:** Because India maintains highly open tech markets, local private firms naturally gravitate toward the most cost-effective foreign options. This completely undercuts the business case for domestic venture capitalists to fund expensive, indigenous foundational AI research.
- **The Trap of the Integration Layer:** If domestic capabilities are confined exclusively to building applications on top of foreign models, the broader technology ecosystem collapses into a permanent consumer state.
- **Ecosystem Disconnection:** Without domestic foundational labs, a nation fails to develop a robust, specialized downstream pipeline of fine-tuning experts, evaluation researchers, hardware optimization startups, and safety engineers.

- **Historical Evolution of the Issue**
- **Pre-Independence to 1980s: The Industrial and Early Computing Lag**
- **The Industrial Deficit:** India missed the early waves of the industrial revolution, leaving the nation structurally dependent on foreign heavy machinery, precision tools, and manufacturing frameworks during the early post-independence era.
- **Early Tech Policy:** In the 1970s and 1980s, protectionist economic policies and rigid import controls restricted the inflow of computing hardware. While this fostered a self-reliant mindset, it delayed the large-scale diffusion of computing infrastructure across domestic industries.
- **1990s to 2010s: The IT Service Boom and the Integration Layer Bias**
- **The 1991 Liberalization:** The opening of the economy coincided with the global internet boom, positioning India as a global hub for software services and business process outsourcing (BPO).
- **Service vs. Product Paradigm:** While India became a global giant in IT services (via companies like TCS, Infosys, and Wipro), the ecosystem primarily optimized for software maintenance, execution, and external systems integration. It rarely focused on creating foundational intellectual property, operating systems, or core hardware.
- **The Smartphone and App Waves:** In the 2010s, deep internet penetration (fueled by telecom revolutions) transformed India into one of the world's largest consumers of digital applications, yet the underlying operating systems (Android, iOS) and cloud backbones remained entirely foreign.
- **2020 to 2025: The Generative AI Explosion and Sovereign Rhetoric**
- **The Compute Crisis:** As large language models emerged as critical infrastructure, India found itself facing a acute shortage of advanced GPU compute clusters, making the pre-training of native foundational models prohibitively expensive.
- **Policy Intervention:** The Indian government launched initiatives like the IndiaAI Mission with financial outlays to procure sovereign compute infrastructure, recognizing that relying on foreign cloud ecosystems poses severe data sovereignty risks.
- **2026 and Beyond: The Open-Weight Price Floor Era**
- **The Current Paradigm Shift:** Highly capable, hyper-cheap open-weight models have disrupted market pricing. The core strategic challenge has evolved: it is no longer just about whether a nation can build a model, but whether its domestic industries can justify doing so when foreign alternatives are readily available for free.

AI GEOPOLITICS: DEEPSEEK'S V4 AND INDIA'S SOVEREIGNTY DILEMMA

A TALE OF TWO AI FUTURES: APRIL 2026

REST OF INDUSTRY STRUGGLES

Anthropic Servers

Sora

Scale-back

DATADOG

60% FAILURES DUE TO CAPACITY

DEEPSEEK'S DISRUPTION

V4

V4 Pro/Flash

- Pro variant below Claude Opus, GPT-5.5, Gemini Pro
- Flash variant undercuts every smaller model
- Open-source & Open-weight

Runs on Huawei & Cambricon Chips

Nvidia Chokehold Broken

THE NEW AI ECONOMICS: A PLAYBOOK FOR DISRUPTION

COST > CAPABILITY

Enterprise Decision Point

Low Token price

Good Enough Summary, Scheduling, Customer Service

Opus-grade Reasoning

High price

Price per Token is the binding consideration for enterprise productivity.

THE FLOOR PRICE STRATEGY

Chinese Manufacturing Redux

Capable Model Release → Free/Low Price → Sets Price Floor → Market Adopts → Competitors Exit

Setting the price floor and letting market forces do the rest.

INDIA'S VULNERABILITY IN THE OPEN MARKET

Indian businesses select Foreign Open-Weight Models

PRICE NEGOTIATION

Use as Pricing Leverage

Incentives for Indigenous Foundational Research Fade

Business case for Indian foundation model fails

Talent & Capital Dislocation

VCs won't fund pre-training

Talent leaves or builds only application wrappers

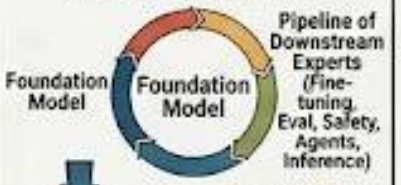
THE DEEPER COST & THE CALL TO ACTION

LOSS OF IMPLICIT KNOWLEDGE

- Software debugged at scale
- Fabs maintained
- Implicit know-how gained by *doing work repeatedly at scale*

Cannot be imported, must be built

ECOSYSTEM EFFECT & STRATEGIC LOCK-IN



Strip out Foundation

Chain does not form Forever a customer

THE PRIVATE SECTOR MUST PRIORITIZE FOUNDATIONAL CAPABILITIES.

Raise R&D budgets. Long-term dividends over short-term savings.

- **Logical and Philosophical Base**
- **Techno-Nationalism vs. Global Free-Market Capitalism**
- **The Market Efficiency Fallacy:** Classic free-market capitalism argues that nations should optimize for short-term cost efficiencies and comparative advantage. If Country A can provide digital intelligence at near-zero cost, Country B should simply consume it and reallocate capital elsewhere.
- **The Techno-Nationalist Corrective:** This framework counters that digital intelligence is not a mere commodity like agricultural surplus; it is an foundational meta-technology. Relying on foreign core intelligence models compromises strategic autonomy, as the provider nation retains the ultimate power to alter terms of service, implement ideological alignments, or restrict access during geopolitical friction.
- **Epistemology and Polanyi's Concept of Tacit Knowledge**
- **The Illusion of Information Transfer:** Philosophically, this issue interfaces with Michael Polanyi's epistemology: *"We can know more than we can tell."*
- **The Crux of "Doing":** Downloading an open-weight model gives a nation access to *explicit* outputs, but it yields zero *implicit* knowledge regarding how that model was successfully trained, stabilized, and optimized. The actual capacity to innovate is an experiential asset that cannot be imported; it must be forged through the iterative failures of building technologies from scratch.
- **Path Dependency and Structural Lock-in**
- **The Ecosystem Trap:** Software ecosystems exhibit intense path dependency. Once an entire generation of developers, enterprise data pipelines, and security protocols are optimized around a specific architectural standard, the switching costs transition from financial calculations to structural barriers. The consumer nation becomes effectively locked into an external innovation orbit.

- **Multidimensional Analysis**
  - **Social Dimension**

- **Linguistic Democratization vs. Marginalization:** Highly capable models must accurately capture regional languages and idioms. If external models overlook minor dialects, they create digital inequities.
- **Asymmetric Skill Polarization:** This shift widens the gap between basic application users and the elite class of foundational researchers, concentrating advanced technological wealth in a tiny fraction of the global population.

  - **Political Dimension**

- **Sovereignty in the Digital Age:** State sovereignty is no longer defined solely by physical borders; it depends directly on digital infrastructure control. A state that relies entirely on foreign digital brains compromises its long-term policy independence.
- **Algorithmic Governance:** Governments increasingly use AI tools to draft policies, screen public welfare applications, and moderate content. Allowing external models to guide these processes presents a serious challenge to autonomous self-governance.

  - **Legal Dimension**

- **Cross-Border Data Flows:** Using external proprietary APIs often requires routing user data across international borders, creating friction with strict data localization laws.
- **Regulatory Enforcement Cracks:** When an open-weight model is modified and deployed locally by a private actor, assigning strict legal liability for algorithmic harms or misinformation becomes an incredibly complex task for the judiciary.

  - **Ethical Dimension**

- **The Value Alignment Asymmetry:** Foundational alignment techniques reflect the ethical priorities of the model's creators. This can lead to a mismatch when a model with foreign ethical guardrails is integrated into a society with entirely different cultural, social, and philosophical values.
- **Lack of Development Transparency:** The data curation process behind low-cost models is rarely transparent, raising ethical red flags regarding fair labor practices for data labeling and respect for intellectual property rights.

  - **International Dimension**

- **The Tech Cold War:** AI technology has become a central battleground for global dominance. Neutral developing nations face intense geopolitical pressure to choose sides in hardware, software, and cloud infrastructure ecosystems.
- **Digital Neo-Colonialism:** The global south risks being cast as a mere provider of raw data and consumer revenue, while the core intellectual property and structural control remain concentrated within a few technological superpowers.

  - **Economic Dimension**

- **Premature Deindustrialization of Value:** If domestic tech ecosystems are confined entirely to the application layer, the high-margin revenues generated by foundational IP flow straight out of the country. This traps the domestic labor force in low-margin maintenance roles.
- **Disruption of the Service Sector Base:** The economic engine of India's middle class—the massive IT services sector—is highly vulnerable to hyper-cheap automation, necessitating an urgent structural shift toward advanced R&D.

- **Linkages with NCERTs**
- **Class 11 Economics: Indian Economic Development**
- **Chapter 3: Liberalisation, Privatisation and Globalisation (LPG): An Appraisal**
    - *Connection:* Helps analyze whether the complete openness to international digital services, which delivered immense gains during the 1991 IT revolution, remains an optimal strategy when navigating modern, highly strategic deep technologies like AI.
- **Class 12 Political Science: Contemporary World Politics**
- **Relevant Chapters on New Centres of Power and Global Hegemony**
    - *Connection:* Connects directly to discussions on how global power is transitioning away from purely military capabilities toward technological supremacy, data control, and microchip supply chains.
- **Class 10 & 12 Geography: Contemporary India & Human Geography**
- **Chapters on Manufacturing Industries**
    - *Connection:* Explains the concept of industrial agglomeration and infrastructure clusters. It helps students understand how China's historical dominance in physical manufacturing is being strategically adapted to dominate the digital software and AI stacks.

Linkages with UPSC CSE Syllabus

GS Paper 2: Governance, Constitution, Polity, Social Justice, and International Relations

Bilateral, regional and global groupings and agreements involving India and/or affecting India's interests.

Effect of policies and politics of developed and developing countries on India's interests, Indian diaspora.

- *Focus:* Analyzing how foreign low-cost technology strategies impact India's strategic autonomy and tech policy frameworks.

GS Paper 3: Technology, Economic Development, Bio-diversity, Environment, Security and Disaster Management

Science and Technology- developments and their applications and effects in everyday life.

Indigenization of technology and developing new technology.

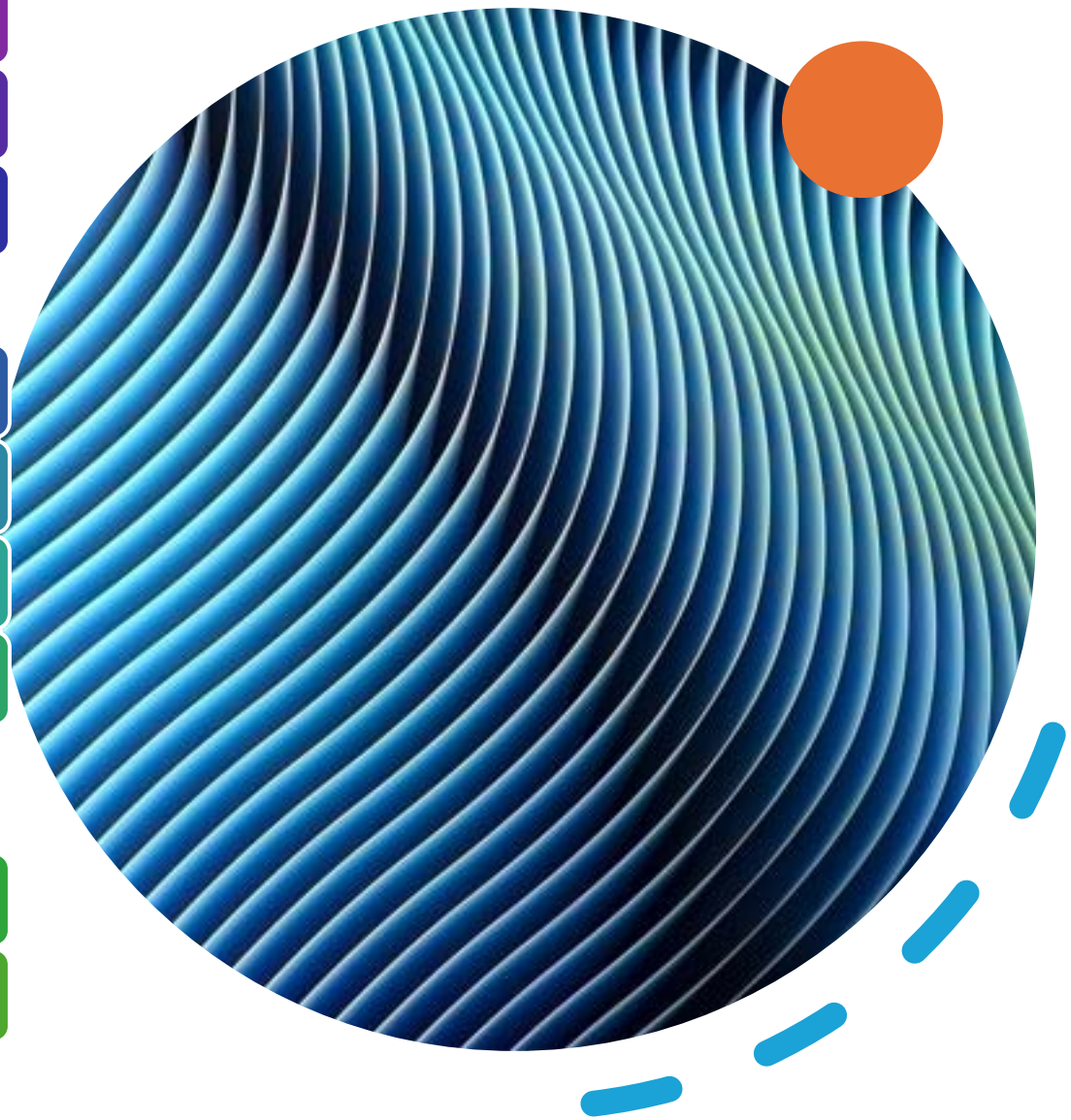
Growth, development and employment.

- *Focus:* The core debate between importing cheap technological solutions to boost immediate enterprise productivity versus making long-term capital investments to build sovereign, indigenous foundational systems.

Essay Paper

Themes on Technology, Geopolitics, and Self-Reliance

- *Focus:* Fostering critical analysis of prompts such as: *"The cost of cheap solutions can be prohibitively expensive in the long run,"* or *"True strategic independence in the 21st century is forged in silicon and software, not just on physical borders."*

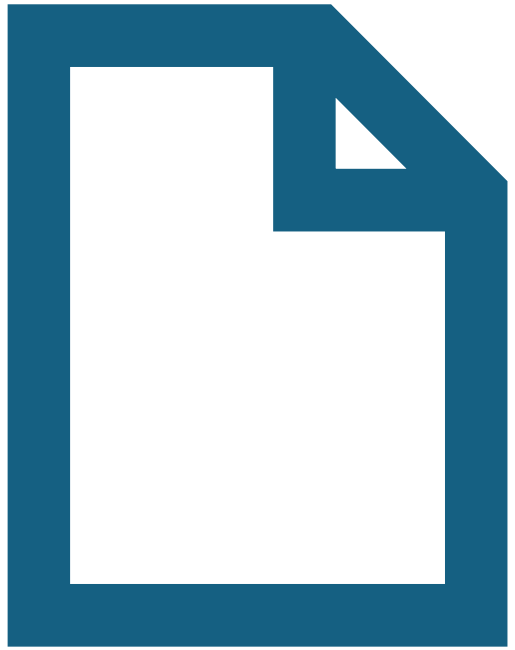


- **Way Forward**
- **Strategic Sovereign Upgrades: The IndiaAI Mission**
- **Accelerated Compute Procurement:** The state must rapidly expand its capital commitments to build out public compute infrastructure, providing domestic startups and research universities with subsidized access to high-performance GPU clusters.
- **National Data Wealth Repositories:** Create a unified, secure, anonymized data trust that aggregates India's vast public sector, linguistic, and healthcare data, giving domestic developers a unique data advantage that foreign entities cannot easily replicate.

- **Targeted Fiscal Incentives for Foundational R&D**
- **Deep-Tech Tax Credits:** Introduce aggressive tax credits and R&D write-offs for domestic enterprises that commit capital to pre-training native foundational models, shifting corporate focus from short-term software integration to long-term innovation.
- **Sovereign Venture Capital Funds:** Establish dedicated, state-backed venture vehicles designed to absorb early-stage risks, specifically funding domestic deep-tech hardware and software startups with extended maturation timelines.

- **Building Public-Private Research Consortia**
- **Collaborative Foundational Initiatives:** Form an alliance between premier academic institutions (like the IITs), major public sector undertakings, and forward-thinking private tech firms to co-develop open-weight, highly localized multilingual models (such as an expanded Bhashini ecosystem).
- **Fostering Downstream Ecosystems:** Ensure that domestic foundational models are designed to catalyze an entire localized pipeline of fine-tuning specialists, security evaluation firms, and hardware-efficiency startups, anchoring the full technology stack within the country.

- **UPSC CSE Mains (GS Paper 3)**
- **2023:** "What is the Al Triad? Why have certain countries gained an advantage over others in this regard? Discuss its significance for India."
- **2022:** "What are the main socio-economic implications of the deployment of Artificial Intelligence in India? How can India leverage AI to achieve inclusive growth?"
- **2019:** "What do you understand by 'Digital Economy'? Discuss how it has transformed traditional economic activities and what challenges India faces in securing its digital infrastructure."
- **2018:** "What is India's stand on the global discourse regarding Intellectual Property Rights (IPR)? Discuss the challenges and opportunities India faces in the indigenization of high-end technologies."



India-New Zealand trade pact: Beyond a small market

TRADE PUSH. The FTA can boost Indian pharma and services, while New Zealand can gain in agri exports

VS SESHADRI

India and New Zealand signed their bilateral Free Trade Agreement on April 27, adding another partner to India's steadily expanding FTA network, which now covers all RCEP countries except China.

By itself, New Zealand may not appear a large market. With a population of just 5.3 million and annual imports from India of only around $700 million — barely 1.6 per cent of New Zealand's imports — the commercial gains may seem modest.

Yet, at a time when India urgently needs to diversify and expand exports — merchandise exports in 2025-26 financing only about 37 per cent of imports — every additional market matters. The presence of a 3,00,000-strong Indian diaspora in New Zealand and the scope for expanding services exports further strengthen the case for the agreement.

The FTA grants duty-free access from day one for all Indian products entering New Zealand. While New Zealand's average MFN tariff is low at around 2 per cent, and nearly two-thirds of its tariff lines are already duty-free, some labour-intensive sectors important for India face significantly higher tariffs.

SECTORS TO BENEFIT

Garments, for instance, attract average duties of nearly 10 per cent, while several footwear and textile items also face higher rates. Indian exporters in these sectors will now obtain parity with competitors from China and ASEAN countries that already enjoy preferential access to the New Zealand market. Penetrating that market will still require sustained export promotion, but tariff-free access certainly helps.

Indian generic pharmaceuticals, currently accounting for exports of around $60 million, stand to benefit as well. Side letters accompanying the FTA confirm that New Zealand recognises approvals granted by regulators in Australia, the EU, Canada, Singapore, the UK, Switzerland and the US as comparable to their own. This could significantly expedite regulatory approvals for Indian prescription medicines, including generics and biosimilars, as well as medical devices already cleared by those regulators.

Other important Indian exports to New Zealand include shrimps, spices, tea, coffee, rice, gold jewellery, electrical machinery, auto components and refined petroleum products. Tariffs on these products vary, particularly for processed agricultural items such as spices. The move to zero-tariffs across the board should therefore improve competitiveness for Indian exporters.

On the import side, New Zealand exports mainly primary products to India — wood and wood pulp, steel and aluminium scrap, coal and wool — many of which serve as industrial inputs. New Zealand is also a major agricultural exporter. Fresh fruits are among its leading exports to India, and the FTA provides limited tariff-rate quota access for apples, kiwifruit, albumins and Manuka honey.

Interestingly, the agreement incorporates seasonal safeguards reflecting New Zealand's geographical advantage. Apple imports under the tariff quota will be permitted only from April to August, and kiwifruit from April to mid-October — periods that largely do not coincide with the Indian harvest season. Minimum import price conditions will also apply.

Fresh fruits are among New Zealand's leading exports to India, and the FTA provides limited tariff-rate quota access for apples, kiwifruit, albumins and Manuka honey

As in India's recent FTAs with other partners, wine tariffs will be reduced gradually depending on price bands. Dairy products, however, remain fully excluded. Overall, around 29 per cent of tariff lines have been kept outside tariff liberalisation, broadly similar to the exclusion levels under India's ECTA with Australia.

SERVICES POTENTIAL

Services trade presents another important dimension. According to New Zealand's figures available at disaggregated levels, its services exports to India amounted to NZ$1.14 billion in 2025 (1 US$ equals around 1.68 NZ$) somewhat exceeding its merchandise exports. Nearly 95 per cent of this comes from travel services, especially education-related travel spending by Indian students.

India's own services exports to New Zealand are considerably smaller at around NZ$470 million, and computer and business services account for around only NZ$110 million. This area offers substantial growth potential. The FTA provides greater certainty regarding visas for intra-corporate transferees, installers and servicers, independent professionals, and accompanying dependants.

Additionally, the agreement creates a new Temporary Employment Entry visa pathway with an annual quota of 5,000 visas for skilled Indian professionals for stays of up to three years. Covered sectors include IT, engineering, healthcare, education and construction, while professionals such as AYUSH practitioners, yoga instructors, Indian chefs and music teachers are also eligible. There is also an Annex on student mobility and post study work visa and a separate understanding on holiday work visas.

One particularly noteworthy provision is New Zealand's commitment to facilitate $20 billion in FDI inflows into India over a 15-year period, echoing a similar feature in India's FTA with the EFTA countries. Achieving this target, however, will not be easy. New Zealand's cumulative FDI into India since 2000 amounts to only around $88 million. Considerable effort from both governments and industry bodies will be required to generate investor interest.

Two additional provisions could nevertheless create useful opportunities. First, the agreement provides for economic and technical cooperation in sectors such as horticulture, apiculture, livestock, fisheries, wines and organics — areas where New Zealand possesses significant expertise.

Second, India has committed to a fast-track arrangement allowing duty-free imports from New Zealand for products used exclusively for further processing and re-export. This facility could potentially extend even to dairy inputs otherwise excluded from the FTA.

The dedicated New Zealand investment desk that India is required to establish under the agreement should therefore work proactively to integrate these various provisions into concrete investment initiatives. There may be significant opportunities, for instance, for New Zealand investors and Indian partners to collaborate in export-oriented agro-processing ventures using duty-free New Zealand inputs for value-added exports from India.

Ultimately, FTAs are only enabling frameworks. Their success depends on the quality of follow-up — export promotion, investment facilitation and business-to-business engagement. India's mission in New Zealand can also play an important role in ensuring that this agreement evolves from a modest bilateral arrangement into a meaningful economic partnership. New Zealand's leaders have already termed it a 'once-in-a-generation pact'.

The author is former Ambassador and Senior Fellow, Delhi Policy Group

- **Key Terms and Explanations**

- **Free Trade Agreement (FTA):** A pact between two or more countries to reduce or eliminate barriers to trade, such as tariffs and quotas, on goods and services. Unlike a customs union, member countries maintain independent external tariffs against non-members. For example, an FTA allows Indian textiles to enter partner markets without custom duties while India retains its specific tariff rates for countries outside the agreement.
- **Regional Comprehensive Economic Partnership (RCEP):** A mega-regional free trade agreement among Asia-Pacific nations. India was an original negotiating partner but chose to withdraw due to concerns regarding asymmetric trade balances and market flooding. The current framework of bilateral pacts allows India to engage with RCEP members individually while excluding specific nations.
- **Most Favoured Nation (MFN) Tariff:** The standard tariff rate that a World Trade Organization (WTO) member country charges on imports from other WTO members, ensuring non-discrimination. Under an FTA, countries agree to waive this standard rate and offer preferential (lower or zero) tariffs exclusively to each other.
- **Tariff-Rate Quota (TRQ):** A two-tiered tariff system where a specified quantity of a product can be imported at a lower or zero tariff rate. Once this quota is exceeded, a significantly higher tariff applies to any additional imports. For example, a country might allow up to 10,000 tonnes of apples to enter duty-free annually, but any imports beyond that volume will face a 50% duty.
- **Seasonal Safeguards:** Temporary trade measures designed to protect domestic producers from import surges during specific times of the year. In agricultural trade, this means allowing imports only during the domestic off-season, ensuring that foreign goods do not depress prices when local farmers are harvesting their crops.
- **Foreign Direct Investment (FDI) Commitment:** A binding or facilitative policy pledge within a trade agreement where one nation commits to driving a specific volume of capital investment into the partner country over a designated timeline. This links trade liberalization directly with long-term industrial investment.
- **Biosimilars and Generics:** Generic medicines are chemical copies of brand-name drugs with expired patents, while biosimilars are highly similar, subsequent versions of complex biological medicines. Regulatory recognition agreements allow these lower-cost therapies to enter foreign medical systems without undergoing repetitive clinical trials.
- **Exclusion List / Negative List:** A defined set of sensitive goods and services that are entirely exempt from tariff reductions or liberalisation commitments under a trade agreement. This tool is heavily utilized to safeguard vulnerable domestic sectors like small-scale farming or dairy production.

- **Main Arguments and Substantive Parts**

- The economic dynamics of bilateral trade agreements with advanced, smaller economies revolve around a central thesis: market size alone does not determine the strategic value of a trade pact. Instead, the focus shifts to export diversification, regulatory harmonisation, and investment linkages.
- **The Imperative of Export Diversification**
- A primary justification for pursuing trade pacts with smaller markets is the urgent need to address structural trade imbalances. When a nation's merchandise exports finance only a limited portion of its imports (such as covering roughly 57% of import bills), expanding into every available market becomes a macro-economic necessity. Smaller partner nations provide a stable, high-value consumer base that helps cushion broader global trade volatility.
- **Leveling the Playing Field for Labor-Intensive Sectors**
- While a partner nation’s average MFN tariffs might seem low (often averaging around 2%), specific labor-intensive sectors frequently face disproportionately high tariff walls. For instance:
- **Garments and Textiles:** Often face tariffs closer to 10%, pricing out competitive exporters.
- **Footwear:** Experiences selective protectionism in developed markets.
- Eliminating these tariffs immediately grants parity to exporters against regional competitors—such as China or ASEAN nations—who already enjoy duty-free access through existing regional trade networks.
- **Regulatory Convergence in High-Value Sectors**
- A major breakthrough in modern bilateral agreements is the use of "side letters" to fast-track regulatory clearances. By formally recognizing approvals granted by trusted international regulators (such as those of the US, UK, EU, or Australia), a partner nation can dramatically reduce compliance timelines for pharmaceutical exports. This allows high-quality generic drugs, biosimilars, and medical devices to enter foreign public healthcare systems without enduring redundant, expensive local trial procedures.
- **Calibrated Agricultural Integration**
- Agricultural trade requires a delicate balance between market opening and domestic food security. To prevent distress among local farmers, agreements utilize a combination of specific mechanisms:
- **Exclusion Lists:** Leaving highly sensitive sectors, like domestic dairy, completely untouched by tariff cuts.
- **Seasonal Windows:** Restricting imports of fresh produce (like apples or kiwifruit) strictly to the domestic off-season so they do not overlap with the local harvest.
- **Minimum Import Prices (MIP):** Preventing the dumping of cheap primary goods below a baseline cost floor.
- **Bridging the Services and Mobility Gap**
- Services trade frequently exhibits an asymmetric pattern, where one nation dominates in travel and education spending while the other excels in professional and digital services. To correct this, modern pacts introduce dedicated professional mobility pathways:
- **Guaranteed Quotas:** Establishing fixed annual visa allocations (e.g., 5,000 visas) for skilled professionals.
- **Diversified Sector Coverage:** Moving beyond traditional IT roles to include healthcare, engineering, education, construction, and traditional vocations like AYUSH practitioners, yoga instructors, and chefs.
- **Corporate Flexibility:** Securing clear legal frameworks for intra-corporate transferees, independent consultants, and accompanying dependents.
- **Investment-Trade Linkages**
- A novel pillar of new-age agreements is the formal coupling of market access with long-term investment targets. For example, a developed partner may commit to facilitating substantial long-term capital inflows (such as $20 billion over 15 years). This transforms the agreement from a simple border-tariff negotiation into a structural investment framework, driving foreign capital into domestic industrial and infrastructure sectors.

- **Historical Evolution of the Issue**
- The structural transformation of trade policy highlights a shift from early protectionism to a strategic embrace of calibrated bilateralism.
- **Pre-1991: The Era of Inward-Looking Protectionism:** Prior to economic reforms, trade policy was dictated by import substitution and high tariff walls. Foreign trade was viewed with skepticism, and bilateral economic agreements were limited, focusing primarily on rupee-ruble trade with the Soviet bloc.
- **Post-1991: Liberalization and the Look East Policy:** The economic crisis of 1991 triggered structural changes. India lowered average tariffs and initiated the "Look East Policy," which led to early comprehensive economic cooperation agreements with ASEAN, South Korea, and Japan in the 2000s. However, these early pacts often resulted in widening trade deficits, as domestic manufacturing struggled to compete with cheaper East Asian imports.
- **2019: The RCEP Exit as a Strategic Turning Point:** After years of intense negotiations, India walked away from the Regional Comprehensive Economic Partnership (RCEP) in November 2019. The decision was driven by the fear of unrestricted Chinese manufacturing imports and structural threats to the domestic dairy and agricultural sectors from major oceanian exporters. This exit signaled a clear refusal to join mega-blocs that offered insufficient protection for local livelihoods.
- **2021–Present: The Rise of "New-Age" Bilateralism:** Having rejected large multilateral frameworks, trade policy pivoted toward negotiated, trusted bilateral agreements. This strategy focuses on developed partners with strong regulatory systems and complementary economic structures, yielding swift agreements with the UAE (CEPA), Australia (ECTA), the EFTA bloc, and now New Zealand. These modern pacts combine targeted market access with strict rules of origin and investment guarantees.

A COMPREHENSIVE REVIEW: THE INDIA-NEW ZEALAND FREE TRADE AGREEMENT

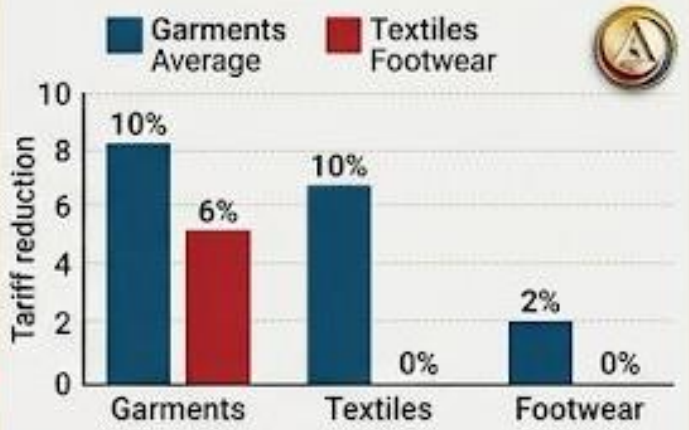
KEY TERMS & CONCEPTS

- **FTA** - Brieffy condude / India-New Zearland Free trade Agreement
- **RCEP** - Indo-Pacific, demoral RCEP government tai Free trade agreement
- **MFN Tariff** - Average nalaf tariff tariff conner social exdode roles
- **TRQ** - Three tariff reductions reating from among induonersuit risks
- **Seasonal Safeguards** - Coole sensatons of seasonal safeguards
- **FDI** - Meaning gfow into relation consiruout mooverition

STRATEGIC CONTEXT & SIGNIFICANCE

- Current trade **$700M** India exports
- **$700M** India exports e.g., $2.000M
- Diaspora **300,000**
- Diversification is urgent - Diversification of surgary

LABOR-INTENSIVE SECTOR GAINS



- Immediate parity with regional competitors - unbooneregioyed competitors

PHARMA & REGULATORY ALIGNMENT

- Generic Drugs exports $1.037 billion
- Expedited approvals via Side-letters' approvals via side letters

USA FDA | UK MHRA are recognized | EU regulators

- Medical devices

AGRI IMPORTS & SEASONAL SAFEGUARDS

- Primary products (lsts; wood, scrap, coal)
- Fruits
- Limited TRQ
  - Apples
  - Kiwifruit
  - Honey
- Non-overlapping with domestic harvest
- Minimum prices

Seasonal calendar

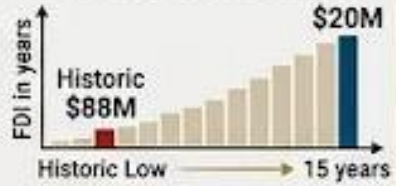
	Apr	May	May	Jun	Jul	Aug	Sep	Oct
Apples	April-August							
Kiwifruit			April-mid-October					

SERVICES, MOBILITY & THE $20B FDI COMMITMENT

New Visa Pathway

5,000 Annual Quota

$20 BILLION FDI COMMITMENT



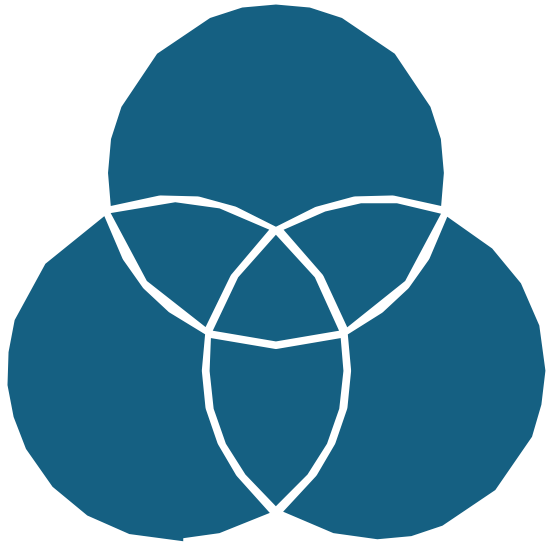
- Covered sectors: Intorantial to studentt across (IT, AYUSH, etc.)
- Dedicated Investment Desk

THE WAY FORWARD

- Export promotion
- Investment facilitation
- B2B engagement

- **Logical and Philosophical Base**
- The architecture of modern bilateral trade policy rests on a blend of economic realism, pragmatism, and strategic autonomy.
- **Economic Realism vs. Unfettered Neoliberalism**
- The philosophical core of this approach rejects pure free-market neoliberalism, which argues that all trade barriers should be eliminated regardless of domestic consequences. Instead, it embraces an **Economic Realist** paradigm: state survival and domestic stability override theoretical market efficiencies.
- By excluding dairy and implementing strict seasonal windows for agriculture, the state acknowledges that protecting the socio-economic security of small farmers takes precedence over maximizing cheap import volumes.
- **The Strategy of Calibrated Globalization**
- Rather than completely retreating into autarky (absolute self-sufficiency), the current policy path chooses **calibrated globalization**. This model acknowledges that domestic manufacturing requires external inputs and export markets to grow, but structures this integration through trusted, manageable channels. Bypassing mega-blocs like RCEP while signing targeted bilateral pacts allows a nation to pick its trading partners based on strategic trust and economic alignment.
- **Mercantilist Balancing and Services-Led Leverage**
- There is a clear logical attempt to offset structural weaknesses in merchandise manufacturing by leveraging strengths in the services sector. The strategy accepts short-term concessions on primary inputs or selective industrial goods in exchange for secured legal commitments on professional immigration quotas, intellectual mobility, and investment capital inflows.

- **Multidimensional Analysis**
- **Social Dimension**
- The presence of a sizable diaspora (such as the 300,000-strong Indian community in New Zealand) acts as a cultural and economic bridge. Expanding educational travel and securing structured post-study work visas helps integrate soft power with knowledge-based service exports, turning migration into a well-regulated economic asset.
- **Political Dimension**
- By signing bilateral trade agreements with key democratic partners, a nation strengthens its geopolitical standing. These agreements demonstrate that a country can build strong, binding economic ties through mutual consent and democratic frameworks, offering an alternative to coercive, state-directed economic models.
- **Economic Dimension**
- With domestic merchandise exports financing only a modest portion of total imports, these agreements offer vital diversification. Gaining immediate tariff parity with China and ASEAN in key sectors like garments and footwear helps revitalize labor-intensive domestic manufacturing hubs, boosting job creation and earning valuable foreign exchange.
- **Legal Dimension**
- The use of side letters for mutual regulatory recognition marks a shift toward regulatory convergence. Accepting clearances from trusted international bodies reduces administrative duplication for pharmaceutical companies, creating a streamlined legal pathway for biosimilars and medical devices.
- **Ethical Dimension**
- The core ethical challenge of trade policy is balancing consumer access to cheap goods with the protection of local livelihoods. Retaining an exclusion list for sensitive sectors like dairy ensures that trade policy remains aligned with social justice, shielding small, marginal producers from volatile global market forces.
- **International Dimension**
- Securing individual agreements with advanced Asia-Pacific economies allows a nation to build an alternative trade network that effectively covers the RCEP region while excluding problematic supply chains. This deepens economic cooperation across the Indo-Pacific and builds more resilient, secure, and reliable value chains.



- **Linkages with NCERTs**
- **Class 11 Economics: *Indian Economic Development***
- **Chapter 3: Liberalisation, Privatisation and Globalisation - An Appraisal:** This chapter tracks the historic shift from import substitution to global integration. The study of modern bilateral agreements provides an excellent real-world look at how the country navigates globalization today, balancing open markets with targeted protections.
- **Class 12 Geography: *Fundamentals of Human Geography***
- **Chapter 9: International Trade:** This chapter covers foundational trade concepts, including the roles of bilateral vs. multilateral trade, MFN status, and how trade deficits impact national economies. Modern trade pacts serve as an ideal case study for understanding how countries use selective market access to address structural trade deficits.
- **Class 12 Political Science: *Contemporary World Politics***
- **Chapter on Globalisation:** This text examines the economic, political, and cultural dimensions of global integration. Modern bilateral trade frameworks illustrate how a state can maintain its strategic autonomy and protect domestic interests while engaging deeply with the global economy.

- **GS Paper 2: International Relations & Governance**
- Bilateral, regional, and global groupings and agreements involving India and/or affecting India's interests.
- Effect of policies and politics of developed and developing countries on India's interests, and the role of the Indian diaspora.
- **GS Paper 3: Economic Development**
- Indian Economy and issues relating to planning, mobilization of resources, growth, development, and employment.
- Effects of liberalization on the economy; changes in industrial policy and their effects on industrial growth.
- Infrastructure, supply chains, and trade-related institutions.
- **UPSC Civil Services Essay & Optional Subjects**
- **Essay Themes:** Globalisation vs. Economic Nationalism; Strategic Autonomy in a Multipolar World; Balancing Agrarian Security with Industrial Growth.
- **Optional Linkages:** Highly relevant for **Political Science & International Relations (PSIR)** (Paper 2: India and the World), **Economics Optional** (International Economics and Indian Economy), and **Commerce & Management**.

- **Way Forward**
- **Activating the Investment Promotion Infrastructure**
- **Action:** Establish a dedicated, single-window investment desk tailored specifically for the partner nation.
- **Mechanism:** This desk must move beyond simple bureaucratic assistance to actively map foreign capital directly to key domestic infrastructure projects, clean-energy initiatives, and food-processing hubs. It should work closely with major investment funds to ensure the long-term investment targets are met.
- **Enhancing Quality Standards and Reducing Non-Tariff Barriers**
- **Action:** Upgrade domestic testing laboratories and export certification systems.
- **Mechanism:** To fully capitalize on lower tariffs for sensitive exports like spices, tea, and seafood, export promotion councils must implement strict farm-to-fork tracking systems. Aligning local production standards directly with international benchmarks will minimize rejections at foreign customs entry points.
- **Scaling Up Domestic Value-Added Re-Export Processing**
- **Action:** Build dedicated processing zones integrated with major shipping ports.
- **Mechanism:** Leverage the provisions that allow duty-free import of raw inputs for immediate re-export. By setting up specialized agro-processing and industrial hubs, local enterprises can import raw inputs, add value through processing, and re-export finished products to global markets without facing domestic tariff burdens.
- **Leveraging the Diaspora and Niche Service Pathways**
- **Action:** Institutionalize professional pathways through targeted certification programs.
- **Mechanism:** The ministries of Skill Development and External Affairs should collaborate to create standardized certification programs for professionals in high-demand fields, including traditional medical practices (AYUSH) and culinary arts. This ensures that the annual visa quotas are fully utilized by highly qualified professionals, boosting services exports.

- **UPSC CSE Mains Questions**
- **2023 (GS Paper 2):** "The term 'West Asia' has become a focus of attention in recent years, but India's trade and strategic alignment with advanced Asia-Pacific and Oceanian economies represents a quiet re-balancing." Analyze the strategic and economic dimensions of India's recent bilateral trade engagements. (15 Marks, 250 Words)
- **2021 (GS Paper 3):** "Explain the rationale behind India's decision to remain outside the Regional Comprehensive Economic Partnership (RCEP). How does India intend to protect its domestic manufacturing and dairy sectors while expanding its export footprints globally?" (15 Marks, 250 Words)
- **2020 (GS Paper 3):** "Account for the failure of multilateral trade negotiations under the World Trade Organization (WTO) framework. In this context, assess whether bilateral Free Trade Agreements (FTAs) serve as effective alternatives for developing economies." (10 Marks, 150 Words)
- **2018 (GS Paper 2):** "Evaluate the role of the Indian diaspora in the socio-economic and political development of destination countries. How can India leverage this diaspora asset to secure better terms in bilateral economic partnerships?" (15 Marks, 250 Words)

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RBI must not become a fiscal stabilizer for the Centre

AJIT RANADE

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India's central bank has quietly become a key pillar of macroeconomic stability. It is not just a monetary authority, but increasingly playing a role as a fiscal shock absorber. This deserves appreciation and caution.

The Reserve Bank of India (RBI) has managed an extraordinarily hard decade. It navigated demonetization, the IL&FS collapse, covid, global supply-chain disruptions, volatile oil prices, geopolitical shocks and sharp capital-flow swings. India avoided a banking collapse, runaway inflation and sovereign instability. That is no small achievement.

RBI has also been far more restrained than many advanced-economy central banks in expanding its balance sheet. After the Global Financial Crisis and the pandemic, the US Federal Reserve, European Central Bank, Bank of England and Bank of Japan massively expanded their balance sheets, even exceeding 80-100% of GDP.

Meanwhile, RBI's balance sheet expanded at a pace commensurate with that of nominal GDP and money supply. Even today, it is barely 25% of GDP. So India's monetary expansion has largely been organic and reserve-backed, not reckless 'money printing' disconnected from economic growth. It is driven primarily by foreign-exchange reserves and gold holdings rather than monetized sovereign debt. Nearly three-fourths of RBI's assets are linked to forex and gold reserves. This makes India's experience quite different from the post-2008 Western model of central banking.

But also note the extraordinary rise in RBI's surplus transfers to the Union government. In 2023-24, it transferred ₹2.11 trillion, which was 7.6% of the Centre's overall revenue receipts. The transfer for 2025-26 may be even larger than last year's record ₹2.69 trillion. These are no longer routine bookkeeping remittances, but macro-economically significant fiscal flows.

Technically, these are not 'dividends.' Under Section 47 of the RBI Act, the central bank transfers its surplus income to the government after maintaining provisions and reserves. This income is earned through interest on government securities, returns on forex reserves, liquidity operations and forex-market intervention.

Several recent developments have boosted RBI's profitability. India's forex reserves have surged to about $700 billion. Higher global interest rates generate larger returns on dollar assets. RBI has actively intervened in currency markets, booking gains through dollar sales while stabilizing the rupee. Gold prices have surged, with the value of RBI's holdings reportedly rising 57% in 2024-25 alone. RBI has thus become highly profitable and increasingly important to the government's fiscal arithmetic.

Routine reliance on RBI surpluses to reduce fiscal deficits could work against the central bank's credibility

This raises an uncomfortable question: has RBI started functioning as a quasi-fiscal stabilizer? A research paper by the IMF warned of precisely this danger. It pointed to the difference between the "pure monetary" functions of a central bank—inflation management, lender-of-last-resort operations, reserve management, banking supervision and currency issuance—and "quasi-fiscal" functions that effectively support government finances. If governments lean on central banks through seigniorage, exchange-rate operations and deficit financing, then the line between fiscal and monetary policy blurs. Fiscal stabilization migrates to the central bank's balance sheet. India is not monetizing deficits recklessly, but a lot of incremental bond issuances have landed on RBI's balance sheet.

The Indian fiscal system already has built-in mechanisms that channel savings to government borrowing. The statutory liquidity ratio effectively requires banks to hold a significant portion of deposits in government securities. In practice, Indian depositors already provide substantial captive financing to the sovereign. Public sector banks continue to dominate financial intermediation. Now, the central bank balance sheet is also becoming part of the fiscal-support architecture.

This slippage matters because monetary institutions derive credibility from restraint. Monetary policy needs insulation from political compulsions. Central bank independence is important even though it is also responsible for financial stability and crisis management. Elected governments naturally prefer higher spending and lower borrowing costs. But central banks are expected to preserve monetary credibility even when it is politically inconvenient.

Once governments start depending on central bank transfers, subtle pressures arise: to maintain lower risk contingency buffers; to maximize profits via forex gains; to support government borrowing; and to optimize central bank profitability. This weakens monetary credibility.

The Bimal Jalan Committee created an economic capital framework to impose rules-based discipline on surplus transfers and reserve adequacy. The framework distinguishes realized profits from unrealized revaluation gains on gold and forex assets. That discipline is essential and must be preserved. RBI has multiple responsibilities, as a monetary authority, exchange-rate manager, debt manager to the government, custodian of reserves and guardian of financial stability. But RBI prudence must not evolve into the Centre's dependence on it as a fiscal tap. The strength of a central bank lies not in its balance sheet or magnitude of profits, but in the credibility of its restraint. RBI must remain India's monetary anchor and not quietly become the government's most reliable fiscal stabilizer.

- **Key Terms and Explanations**
- **Monetary Policy vs. Fiscal Policy:** Monetary policy is managed by the central bank (RBI) and controls money supply and interest rates to ensure price stability. Fiscal policy is managed by the Union Government and handles taxation, public spending, and borrowing to stimulate growth.
- **Surplus Transfer (Section 47, RBI Act):** Unlike commercial corporations that pay dividends from commercial profits, the RBI transfers its "surplus" income to the central government after meeting its operational expenses, provisioning for bad assets, and maintaining necessary reserves.
- **Economic Capital Framework (ECF):** Institutionalized based on the recommendations of the Bimal Jalan Committee in 2019, this framework provides a rules-based formula to determine how much capital the RBI needs to retain for stability, and how much can be safely transferred to the government. It mandates keeping the Contingent Risk Buffer (CRB) within a band of 5.5% to 6.5% of the RBI's total balance sheet.
- **Quasi-Fiscal Operations:** Financial activities undertaken by a central bank that are essentially fiscal in nature—meaning they look like government spending, subsidization, or revenue-raising actions. When a central bank absorbs massive government debt or steps in to stabilize state-linked financial entities, it acts as a quasi-fiscal stabilizer.
- **Seigniorage:** The net revenue or profit generated by a government or central bank from the issuance of currency. It represents the difference between the face value of a currency note and the actual cost of printing and distributing it.
- **Statutory Liquidity Ratio (SLR):** A regulatory mandate requiring commercial banks to maintain a specific percentage of their Net Demand and Time Liabilities (NDTL) in safe, liquid assets—primarily government securities (G-Secs). This ensures a guaranteed, captive pool of domestic savings flowing directly into government borrowing.

- **Main Arguments and Substantive Parts**
- The evolving structural relationship between the Reserve Bank of India and the Union Government highlights a unique model of macroeconomic management, balancing resilience against institutional strain.
- **Core Thesis**
- The central bank has successfully anchored India's macroeconomic stability through a highly disruptive decade. However, its burgeoning balance sheet profitability—driven by global interest rate variations and forex interventions—risks turning the monetary authority into an essential fiscal buffer for the Union Government, potentially blurring the boundaries of institutional independence.
- **Key Analytical Points**
- **A Decade of Resilient Stewardship:** Over the past ten years, India successfully navigated a sequence of severe shocks: demonetization, the non-banking financial company (NBFC) crisis triggered by the IL&FS collapse, the pandemic, supply chain disruptions, and intense capital-flow volatility. The avoidance of a systemic banking collapse or runaway inflation stands out globally.
- **Prudence vs. Western Expansionism:** Unlike Western peers (such as the US Federal Reserve or the European Central Bank) that aggressively inflated their balance sheets to 80–100% of their respective GDPs through quantitative easing, the central bank maintained strict restraint. Its balance sheet remains organic and backed by tangible reserves (foreign exchange and gold), hovering around 25% of national GDP.
- **The Scale of Fiscal Inflows:** The financial remittances transferred from the central bank to the government have grown from routine bookkeeping adjustments into macro-economically significant capital inflows. These transfers provide substantial non-tax revenue cushions to the central budget, easing the government’s fiscal deficit management.
- **The Shifting Source of Profitability:** This surge in central bank profitability is driven by external economic factors rather than domestic printing. High global interest rates have increased yields on foreign assets (like US Treasuries), while active interventions to stabilize the rupee and soaring global gold prices have expanded the value of national reserves.
- **The Emerging Counter-Argument**
- The core risk is the creeping institutionalization of a "quasi-fiscal stabilizer" role. If the sovereign budget becomes structurally dependent on these multi-trillion rupee windfalls, subtle institutional pressures may emerge. The state might encourage the central bank to keep its risk contingency buffers at the bare minimum or structure its market operations to maximize short-term trading profits, compromising its primary mandate of price and financial stability.

- **Historical Evolution of the Issue**
- The relationship between India's fiscal authority and its monetary manager has evolved through distinct phases, shifting from deep colonial control to absolute post-independence dominance, followed by institutional reform and modern structural challenges.
- **Private Shareholders' Roots and Nationalization (1935–1951):** Established under the Reserve Bank of India Act, 1934, the bank initially began operations as a private shareholders' institution. Post-independence, recognizing the need for coordinated economic development, the government nationalized it via the Transfer of Public Ownership Act, 1948, solidifying its role as a state-owned monetary partner.
- **The Era of Fiscal Dominance (1950s–1997):** During the decades of planned economic development, monetary policy became subordinated to the government's fiscal choices. This phase was defined by the automatic monetization of fiscal deficits through the issuance of ad-hoc Treasury Bills. The government spent money, and the central bank was legally obligated to print currency to back it, a cycle that created structural, double-digit inflation.
- **The Separation Era and the FRBM Milestone (1997–2015):** The structural break from fiscal dominance occurred in 1997, when a landmark agreement between Governor C. Rangarajan and the Ministry of Finance ended ad-hoc Treasury Bills, replacing them with the Ways and Means Advances (WMA) system—a temporary liquidity facility with strict ceilings. This decoupling was codified by the Fiscal Responsibility and Budget Management (FRBM) Act, 2003, which explicitly barred the central bank from purchasing government debt in the primary market.
- **Rule-Based Governance and Capital Disputes (2015–Present):** In 2016, the adoption of the Flexible Inflation Targeting (FIT) framework formally prioritized price stability. However, a major debate regarding the appropriate size of the central bank's capital reserves culminated in the 2019 Bimal Jalan Committee report. This framework introduced an objective, formulaic approach to surplus allocation, designed to insulate capital transfers from ad-hoc political demands.

RBI: INDIA'S MACROECONOMIC ANCHOR & EMERGING FISCAL SHOCK ABSORBER

BALANCING A DECADE OF PRUDENCE WITH FUTURE RISKS

I. APPRECIATION: A DECADE OF SUCCESS NAVIGATED

Milestones, avoided collapse & runaway inflation

MILESTONES

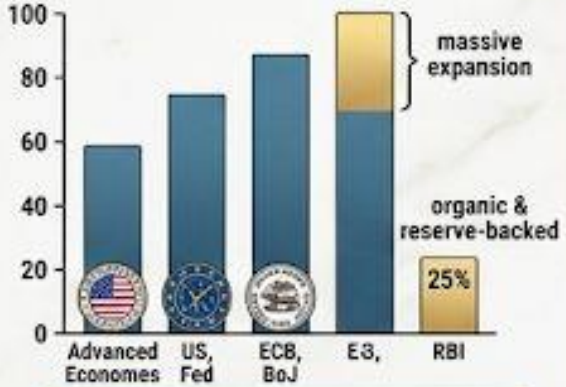
- **Demonetization**
  - nomano of currency stack
- **IL&FS Collapse**
  - eroided managemen ol cracked buildings
- **COVID-19**
  - virus rnt rellapses nl runaway inflation
- **Supply Chain Disruptions**
  - broken chain tansition
- **Volatile Oil Prices**
  - stabilize oil atittatatent of volatile oil prices
- **Geopolitical Shocks**
  - tension-tow worth tension in tension
- **Capital Flow Swings**
  - large money rowings ange runaway inflation

Macroeconomic Anchor (Resilience)

II. PRUDENCE: RESERVED BALANCE SHEET

RBI BALANCE SHEET COMPOSITION

BALANCE SHEET AS % OF GDP



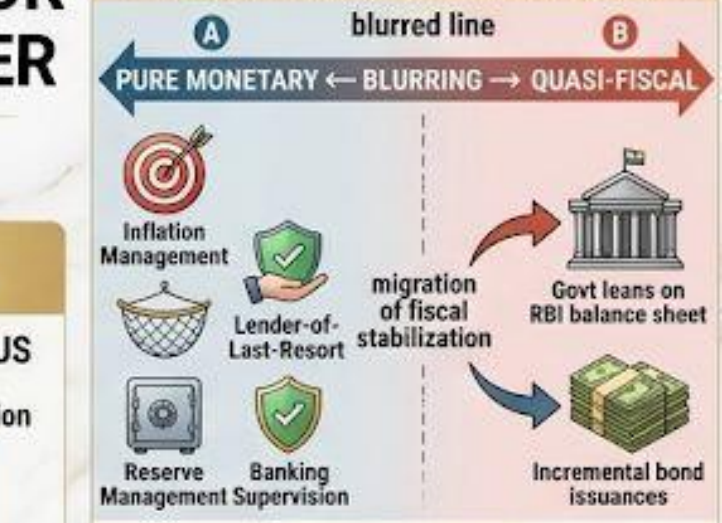
Organic Growth vs Quantitative Easing

III. THE FACTS: RISING FISCAL TRANSFERS

EXTRAORDINARY RISE IN SURPLUS TRANSFERS

DRIVER OF PROFIT

IV. CAUTION: QUASI-FISCAL ROLE?



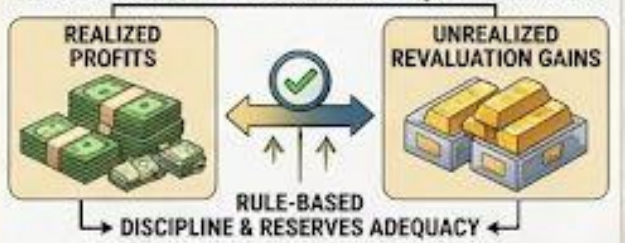
Existing Indian context

SLR creating captive financing → Public Sector Bominance → RBI

V. MAINTAINING INSTITUTIONAL STRENGTH

The way forward

Bimal Jalan Committee Economic Capital Framework



- Strength is **RESTRAINT**, not profit magnitude
- Maintain clear distinction
- **Monetary credibility insulated from political pressure**

Summary Box:
RBI must remain India's Monetary Anchor, not a Fiscal Tap.

- **Logical and Philosophical Base**
- The intersection of monetary management and sovereign fiscal responsibility involves balancing competing institutional designs and economic philosophies.
- **The Principle of Institutional Separation of Powers:** This argument rests on the classical macroeconomic premise that the power to create money must be structurally insulated from the power to spend money. Elected governments face short-term electoral cycles and are naturally inclined to boost spending and lower interest rates to stimulate growth. The central bank acts as an institutional counterweight, prioritizing long-term price stability over short-term political gains.
- **The Time-Inconsistency Problem:** Philosophically, this relates to the Nobel Prize-winning economic theory developed by Kydland and Prescott. If a government promises low inflation today but has direct control over the central bank's printing press, it will face structural incentives to break that promise tomorrow to inflate away its public debt or fund populist expenditures. Central bank autonomy solves this dilemma by locking in credibility.
- **The Consolidated Sovereign Balance Sheet Philosophy:** A alternative economic viewpoint argues that separating the central bank from the central government is an analytical fiction. Because the sovereign state is the sole owner of the monetary authority, all assets, liabilities, and profits ultimately belong to the public treasury. From this perspective, leaving massive excess capital idle within the central bank during times of fiscal stress creates an economic opportunity cost, withholding funds that could otherwise build productive public infrastructure.
- **Rules vs. Discretion:** This core conflict shapes modern institutional design. A strict rules-based approach (like the Economic Capital Framework) prioritizes institutional safety buffers. On the other hand, a discretionary approach allows the state to deploy its national balance sheet flexibly to absorb sudden global economic shocks.

- **Multidimensional Analysis**
- **Social:** Inflation acts as an regressive tax that disproportionately hurts lower-income households. When the central bank prioritizes price stability over fiscal convenience, it protects the purchasing power of vulnerable populations. Conversely, if surplus transfers fund well-targeted public infrastructure or social welfare programs, they can drive equitable human development.
- **Political:** The political economy of fiscal deficits often incentivizes maximizing non-tax revenues over unpopular structural reforms, such as widening the direct tax base or cutting inefficient subsidies. Access to large central bank transfers can reduce the political urgency needed to implement deep fiscal corrections.
- **Legal:** This issue tests the statutory limits of the Reserve Bank of India Act, 1934. It highlights the need to maintain clear boundaries between the state's sovereign right to seigniorage and the central bank's legal mandate to safeguard the financial system's solvency.
- **Ethical:** A moral hazard arises if the fiscal authority assumes the central bank will always step in to absorb institutional shocks or provide financial backstops. This expectation can inadvertently encourage less disciplined public accounting and debt management.
- **International:** Compared to Western central banks that engaged in extensive asset purchases, India’s reserve-backed balance sheet enhances its global standing. However, aggressive extraction of central bank profits can lower India’s position on international governance indices that measure institutional independence.
- **Economic:** The interaction of these factors directly shapes market liquidity. Large surplus transfers inject liquidity into the banking system when the government spends those funds. If this occurs during an inflationary cycle, it can complicate the central bank's efforts to tighten monetary policy, creating competing economic cross-currents.

- **Linkages with NCERTs**
- **Class XII Macroeconomics – Chapter 3: "Money and Banking":** This chapter outlines the foundational roles of a central bank, including currency issuance, acting as a banker to the government, and managing credit control through tools like the Statutory Liquidity Ratio (SLR) and Repo Rate. The current debate expands on these basics by showing how the "banker to the government" role can shift toward becoming a quasi-fiscal stabilizer.
- **Class XII Macroeconomics – Chapter 5: "Government Budget and the Economy":** This section defines the components of the government budget, distinguishing between tax revenue and non-tax revenue. The surplus transfers from the central bank fall under non-tax revenue receipts, illustrating how central bank profitability directly affects the nation's fiscal deficit math.
- **Class XI Indian Economic Development – Chapter 3: "Liberalisation, Privatisation and Globalisation: An Appraisal":** This chapter details the financial sector reforms introduced after 1991, which shifted the central bank's role from a rigid regulator to a market facilitator. Understanding this historical shift helps explain modern efforts to maintain rule-based institutional independence.

- **Linkages with UPSC CSE Syllabus**
- **General Studies Paper III**
- *Indian Economy and issues relating to planning, mobilization of resources, growth, development, and employment:* This covers how central bank surpluses serve as a non-tax resource for the national budget.
- *Banking Sector and Monetary Policy:* This includes the operational balance between inflation targeting, liquidity management, and government debt management.
- **General Studies Paper II**
- *Statutory, regulatory, and various quasi-judicial bodies:* This involves analyzing the institutional autonomy, governance structure, and statutory limits of the central bank under the RBI Act.
- **Essay Paper**
- *Themes on Institutional Integrity and Long-Term Vision:* Suitable for essays exploring the balance between short-term public demands and long-term institutional stability, or debates around economic governance and fiscal discipline.
- **Economic Optional (Papers I and II)**
- *Monetary-Fiscal Nexus and Central Bank Independence:* Covers the evolution of public finance in India, the history of deficit monetization, and the operational dynamics of rule-based macroeconomic frameworks.

- **Way Forward**
- To maintain a balanced relationship between India's monetary and fiscal authorities, policy frameworks can focus on structural discipline, transparency, and clear operational boundaries.
- **Protecting Rule-Based Insulation:** The discipline of the Bimal Jalan Economic Capital Framework must be maintained. The Contingent Risk Buffer (CRB) should ideally be kept well above the statutory floor of 5.5% during periods of global geopolitical tension and volatile commodity markets, ensuring national insurance reserves remain intact.
- **Introducing Smoothing Mechanisms:** To prevent sudden revenue shocks to the Union Budget, the government and the central bank could design a multi-year smoothing formula. Instead of transferring large, volatile annual windfalls directly into current revenues, transfers could be structured based on a rolling three-to-five-year moving average, making non-tax revenues more predictable.
- **Enhancing Fiscal Transparency:** The central bank and the Ministry of Finance could jointly publish an annual *Fiscal-Monetary Interdependence Report*. This document would outline the sources of central bank profits, the scale of government bond absorption, and the long-term impact on systemic liquidity, providing clear communication to global financial markets.
- **Prioritizing Domestic Revenue Reforms:** The long-term solution to fiscal sustainability remains structural domestic revenue generation. By deepening Goods and Services Tax (GST) compliance, widening the direct tax base, and advancing strategic asset disinvestment, the government can reduce its structural reliance on central bank profit transfers.

- **UPSC Mains Civil Services Examination**
- **2023 (GS III):** "Distinguish between Capital Budget and Revenue Budget. Explain the components of both these Budgets." *(Relevance: Central bank surplus transfers represent an important element of non-tax revenue receipts within the Revenue Budget).*
- **2020 (GS III):** "Define meaningful fiscal responsibility. How can the institutional autonomy of the central bank be balanced with the executive's developmental priorities? Discuss in the context of recent debates." *(Relevance: Directly addresses the core tension between fiscal needs and monetary independence).*
- **2019 (GS III):** "Do you agree with the view that steady GDP growth and low inflation have left the Indian economy in good shape? Give reasons in support of your arguments." *(Relevance: Covers the central bank's performance in stabilizing macroeconomic indicators over the past decade).*
- **2015 (GS III):** "The concept of the Monetary Policy Committee (MPC) aims to institutionalize rule-based decision-making. Assess how this transforms the historical relationship between the Ministry of Finance and the Reserve Bank of India." *(Relevance: Examines the transition from fiscal dominance to rule-based monetary governance).*
- **UPSC Prelims Civil Services Examination**
- **2021:** "With reference to India, consider the following statements: (1) The Governor of the Reserve Bank of India (RBI) is appointed by the Central Government. (2) Certain provisions in the Constitution of India give the Central Government the right to issue directions to the RBI in public interest. (3) The Governor of the RBI draws his power from the RBI Act. Which of the statements given above are correct?" *(Answer: 1 and 3 are correct; the Constitution does not contain explicit provisions to direct the RBI, which is a statutory body under the RBI Act).*
- **2020:** "In India, which of the following reviews the independent regulators in sectors like banking, insurance, electricity, etc.? (1) Ad Hoc Committees Parliament. (2) Parliamentary Standing Committees. (3) Finance Commission. (4) Financial Sector Legislative Reforms Commission." *(Answer: 1 and 2).*

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