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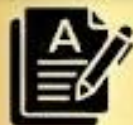
# AXIA IAS ACADEMY

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# Just war, power balance and modern conflict

Alexander Pope's famous line, "New Europe balance'd, neither side prevails: For nothing's left in either of the scales", reminds us that peace without war is perhaps best achieved when there is a balance of power. Hugo Grotius's concept of a just war was swallowed by the ambiguities of international law and the realpolitik of national self interest. Special treaties of 1815 and 1839 guaranteed Switzerland and Belgium protection from attack but provided less protection for the latter. The Hague Convention III of 1907 established procedures requiring a formal declaration of war or an ultimatum before hostilities could begin. The Covenant of the League of Nations (Article 121) believed that antecedent arbitration or judicial settlement and a three month cooling period would obviate war. The Kellogg Briand Pact (1928) condemned recourse to war and to settle controversies which were prescribed to be achieved by pacific means.

## The issue of 'self defence'

There are ambiguities in Article 2(4) of the United Nations Charter which, in one interpretation, insulate the "threat or use of force (not war)" against the territorial integrity or political independence of a state. Was this too limited? Certainly, 'self defence' finds a prominent place in Article 51 of the UN Charter to recognise an "inherent right of individual or collective self defence .... (against) armed attack".

There are textual differences on anticipatory self defence against any imminent danger of attack. The words of the French text invokes this using the word "dans le cas où un Membre est l'objet d'une agression armée" to support the right to self defence before the attack, unlike the Spanish: "en caso de ataque armado", suggesting, as in the English, self defence if the armed attack occurs. This has direct relevance to the U.S. aggression against Iran and Tehran's right of self defence. Article 51 should not be seen as an exception to Article 2(4) seeking to abolish war.

No doubt, collective defence treaties such as the North Atlantic Treaty Organisation (NATO) are permitted under Article 51, which, in turn, allows NATO to trigger collective self defence under Article 5 if a member is attacked. This fully explains the remonstrance of NATO countries not to join U.S. President Donald Trump: "This is not our war". However, the United Kingdom provided support to America through the use of its bases, while Spain denied the U.S. the use of its airspace.

This bilateral attack by the U.S. and Israel on Iran was justified by claims that Iran was developing a nuclear bomb, even though its nuclear facilities had been open to international



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inspection. But the U.S. and Israel want Iran to become defenceless and surrender all its missiles and weaponry as well. If any country should do this, it should be Israel.

The realities of just wars have been diluted out of any respectable meaning with the fall of the Soviet Union. The balance of power protections outlined in Pope's poem have disappeared. The nub of all this is the concept of anticipatory self defence which the U.S. unswervingly has used in its attack on Vietnam, Libya, Afghanistan, Iraq, Venezuela, and now Iran. Under the doctrine of state responsibility, the U.S. used any excuse to retaliate against the Latin American states in the 19th century if its citizens were threatened claiming that international law sanctioned these because it had the 'responsibility' to protect its citizens.

In the famous Caroline incident of 1837, where an American ship was smashed over the Niagara Falls, the British claimed self defence. America's Daniel Webster lawyer and diplomat contemporarily warned against its unchecked disproportionate uses. For Mr. Trump, no law has any meaning. America can no longer claim its role as the peacemaker of the world.

## The West Asia war

But let us turn to the West Asia war. Israel's pretence of self-defence against the state of Iran is thin. Its responses in Gaza, Iran, Lebanon and Syria involve territorial aggression and are illegal and genocidal. Mr. Trump's imperialism is guided by Israel. One recalls seeing a T-shirt in Jerusalem with the legend: "Don't worry America, Israel is behind you". It is difficult to understand how survivors of the Holocaust can inflict such inhumane violence.

At the root of the conflict are three important aspects. The first, the Gulf countries have never had the military prowess to defend their oil interests, property and the excessive lifestyle of governing elites. West Asia was broken into a number of nations whose military defence came from imperial nations - earlier from England, and now America. In this helpless situation, they are unlikely to give up their defence arrangements with the U.S. even though its leaders or even populace do not want adverse relations with neighbouring Iran. They are cautious. Eventually, they will side with the U.S. after Iran's counterattack on their military and energy installations and on the opening of the Strait of Hormuz.

Second, the U.S. wants to control, with the Strait firmly under its control. This is the third phase objective of the 'undeclared' war after the first and second phases of the war targeted military and then energy resources. Mr. Trump

wants a negotiated unilateral surrender though his objectives change by the day. If the Strait is to be released from Iran's control, a limited aerial and a ground attack on Kharg Island and southern Iran will alter the war irretrievably.

The third question concerns who will be responsible for the reconstruction of Iran after the conflict ends, and whether reparations will be provided by the U.S., or by China and Russia, to restore the country and the balance of power.

The talks in Islamabad/Pakistan were bound to fail. The conditionalities of both parties were incompatible. The only issue that should have been discussed was the limited logistics of ceasefire. Other issues did not have a 'yes' or 'no' answer. Each issue needed to be discussed, step by step in later meetings. Nuclear energy is resolvable by oversight. Iran was open to inspection but this was defeated in Mr. Trump's first term. Giving up missiles altogether is unreasonable for either side.

Reducing America's military presence in the Gulf and West Asia will take time and require a multi-lateral meeting of the Gulf states. The answer to the Strait of Hormuz is neither Mr. Trump's impending war, nor a negotiation between America and Iran. It requires a multilateral discussion initiated by the United Nations or a consortium of nations, including all affected countries, including China, not just Pakistan as a proxy. They have to join the peace initiative anew. Otherwise it is Munich of 1938 all over again. Pakistan has played its part. A wider initiative is needed to look for a solution not thwarted by conditionalities, promises, or Mr. Trump's mood and zeal for war.

## People and a moral voice

The UN has become meaningless as a peace keeper. Perhaps Mr. Trump wants to lead a U.S.-aligned international council that includes participation from some Gulf countries. We are also witnessing the WTO, which was created to defend America's imperial economic interest, descending into chaos along with climate change treaties.

The post-World War II which envisaged a human rights-based democratic order has been exposed as a moral façade for global predation and has failed to protect people humanely, while providing moral excuses for imperial actors. Too many sins are created in the name of democracy and human rights.

But to return to the concept of a just war, unsupported by a balance of power to preserve world peace: the concept of a just war has become meaningless except as a much needed moral voice. This moral voice rests with the people of the world - all of us, not our rulers.

Modern geopolitics challenges traditional notions of lawful and just wars

## • Key Terms and Explanations

- **Balance of Power:** A concept in international relations where states form alliances and build capabilities to prevent any single nation from dominating the system. Alexander Pope's poetic line about empty scales illustrates that when power is perfectly balanced, neither side has the advantage to win a war, thereby preserving a tense but stable peace. Think of a seesaw: if both sides are equally weighted, no one falls.
- **Just War Theory:** A doctrine of military ethics with roots in philosophy (Cicero, Augustine, Aquinas) and law (Hugo Grotius). It outlines when it is just to go to war (*jus ad bellum*) and how to conduct war justly (*jus in bello*). Key conditions include just cause, legitimate authority, right intention, last resort, proportionality, and reasonable chance of success. The article argues this concept has been hollowed out by state interests.
- **Realpolitik:** A political approach based on practical and material factors, power, and national self-interest, rather than moral, ideological, or ethical premises. The article suggests that realpolitik and legal ambiguities have swallowed the principled idea of a just war.
- **Anticipatory Self-Defence:** The claim that a state can use force to prevent an attack that is imminent, even if an armed attack hasn't occurred yet. This is distinct from *pre-emptive* (against a threat that will materialize at some point) and *preventive* (against a distant, emerging threat) war. The textual difference in Article 51's French ("agression armée" – an attack being suffered) versus English/Spanish ("armed attack occurs") is the legal battleground for this concept.
- **Caroline Incident (1837):** A diplomatic crisis where British forces attacked an American steamboat, the *Caroline*, being used by Canadian rebels. Britain claimed self-defence. The ensuing correspondence between US Secretary of State Daniel Webster and his counterpart established the *Caroline test*: self-defence must be instant, overwhelming, leaving no choice of means and no moment for deliberation. Crucially, the act must not be "unreasonable or excessive." This is the bedrock for the modern customary law requirements of necessity and proportionality in self-defence.
- **Kellogg-Briand Pact (1928):** An international agreement in which signatory states condemned recourse to war for the solution of international controversies and renounced it as an instrument of national policy. It was a noble failure—it outlawed war but provided no enforcement mechanism, and World War II broke out just over a decade later. It laid the groundwork for the UN Charter's prohibition on the use of force.
- **UN Charter Article 2(4) and Article 51:** Article 2(4) prohibits the "threat or use of force against the territorial integrity or political independence of any state." Article 51 preserves the "inherent right of individual or collective self-defence if an armed attack occurs." The article highlights a debated interpretation: does the narrow phrasing of 2(4) ("against territorial integrity") inadvertently allow uses of force that stop short of those goals, and does 51 require an actual attack or allow a response to an imminent one? NATO's Article 5 is a collective self-defence pact built on Article 51.

- **Main Arguments and Substantive Parts**

- **Central Thesis:** A stable international order, where peace is maintained without actual war, is best achieved through a genuine balance of power. The post-Cold War unipolar moment has destroyed this equilibrium, making the concept of a “just war” a cynical tool for imperial powers rather than a genuine moral restraint.
- **Erosion of Just War Principles:** The ethical framework of just war has been systematically diluted. The League of Nations’ cooling-off period, the Hague Convention’s formal declaration requirement, and the Kellogg-Briand Pact’s outright ban on war all aimed to proceduralise and limit conflict. These mechanisms were bypassed by the ambiguities of international law and the raw pursuit of national self-interest, leaving the principles empty.
- **Ambiguity and Abuse of ‘Self-Defence’:** The heart of the argument is that the inherent right of self-defence in Article 51 has been stretched beyond recognition. The textual ambiguity between the French and English versions of the Charter regarding “armed attack” versus “aggression” provides a fragile legal cover for the doctrine of anticipatory self-defence. The article posits that the US has weaponised this ambiguity, applying it unilaterally to justify interventions in Vietnam, Libya, Afghanistan, Iraq, Venezuela, and now Iran.
- **The Caroline Standard Betrayed:** Daniel Webster’s 19th-century warning against disproportionate and unchecked self-defence is still the correct legal standard. The article argues that modern US and Israeli actions, particularly the attacks on Iran and in Gaza, flagrantly violate the *Caroline* principles of necessity, imminence, and proportionality, morphing self-defence into territorial aggression and acts of genocide.
- **West Asia as a Geopolitical Chessboard:** The conflict is not simply a US-Iran or Israel-Iran bilateral issue. It’s rooted in three structural realities:
  - Gulf states are militarily weak, dependent on the US for security, and thus unable to chart independent foreign policies, especially towards Iran.
  - The US’s phased objective is ultimate control of the Strait of Hormuz, with the targeting of military and energy sites as preliminary phases.
  - The reconstruction question is a geopolitical battleground: will the US oversee it to cement dominance, or will China and Russia step in to restore Iran and thereby the global balance of power?
- **Failure of the Multilateral System:** The United Nations is “meaningless as a peace keeper.” The WTO and climate treaties are seen as instruments of an imperial economic order. Pakistan’s mediation attempt failed because it addressed incompatible conditionalities for a grand bargain rather than first nailing down a limited ceasefire. A wider, unconditional, multilateral initiative is the only answer, otherwise we face a “Munich of 1938” moment.
- **Moral Agency Rests with the People:** The ultimate counter to a corrupted concept of just war is a global “moral voice” that rests not with statesmen or rulers, but with the people of the world. The post-WWII human rights order is a moral façade; genuine ethical pressure must come from a transnational public conscience that recognizes and condemns the “inhumane violence” inflicted by those, including Israel, who should know better from their own history.

- **Historical Evolution of the Issue**

- **Ancient to Medieval Roots:** The philosophical foundations of “just war” were laid by Cicero’s Roman law notions, and later Christianised by St. Augustine and St. Thomas Aquinas, who sought to reconcile warfare with Christian pacifism by establishing strict criteria for a just cause and right intention.
- **Early Modern Codification (17th-18th Century):** Hugo Grotius, in *On the Law of War and Peace* (1625), secularised just war, grounding it in natural law and the law of nations. Alexander Pope’s 18th-century poetic observation captured the realist balance-of-power logic that governed Europe’s state system after the Peace of Westphalia and the Treaty of Utrecht.
- **19th Century: Legalisation and Neutrality:** The Concert of Europe system used special treaties (like 1815 for Switzerland and 1839 for Belgium) to guarantee neutrality, creating zones of peace by international agreement. The 1837 *Caroline* incident established the enduring customary law test for anticipatory self-defence, focusing on imminence, necessity, and proportionality. The US subsequently used a distorted “responsibility to protect” doctrine to intervene in Latin America.
- **Pre-WWI to Interwar Period:** The Hague Convention III of 1907 proceduralised the start of hostilities, requiring a formal declaration. The League of Nations Covenant (1919) introduced antecedent arbitration and a three-month cooling-off period, treating war as a procedural problem. The 1928 Kellogg-Briand Pact was the high-water mark of interwar idealism, outlawing war as an instrument of national policy, but with no enforcement mechanism.
- **The UN Charter Era (1945 Onwards):** The Charter created a new architecture: Article 2(4) universally prohibited the threat or use of force, and Article 51 enshrined the inherent right of self-defence only until the Security Council could act. The textual difference in Article 51 between “agression armée” and “armed attack” sowed the seed for the modern anticipatory self-defence debate.
- **Cold War and Post-Cold War Unipolarity:** During the Cold War, balance of power (MAD) prevented direct superpower war. The fall of the Soviet Union removed the balance, leading to unipolar US dominance. The doctrine of anticipatory self-defence was expanded drastically, most notably in the 2003 Iraq War (the “Bush Doctrine” of pre-emptive war), and used to justify interventions in Libya, Afghanistan, and now the campaign against Iran, shifting from a limited exception to a default tool of foreign policy.

## BALANCE OF POWER



POPE'S LINE: For Nothing's Left

### Just War

Grotius




VS

### Realpolitik

- Hague
- Kellogg-Briand



## UN CHARTER & SELF-DEFENCE




### ARTICLE 2(4)

**PROHIBITS THREAT OR USE OF FORCE**

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VS



### ARTICLE 51

**INHERENT RIGHT OF INDIVIDUAL OR COLLECTIVE SELF-DEFENCE (against ARMED ATTACK)**

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## ANTICIPATORY SELF-DEFENCE

French : dans le cas où...

### CAROLINE TEST

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VS

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## U.S./ISRAEL ATTACK AGAINST IRAN

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- VS
- Iran: Right of Self-Defence
  - Right of Self-Defence
  - Nuclear Facilities Inspection to oi oil interest



## PHASES OF CONFLICT

-  Military military bases
  -  Energy control
  -  Strait of Hormuz control
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- **Logical and Philosophical Base**

- **Realist Logic vs. Liberal Idealism:** The article operates within the tension between realism (power, national interest, balance of power) and liberalism (international law, institutions, moral norms). It implicitly argues that pure realism without balance leads to imperial overreach, while liberal structures (UN, WTO) can become tools for that overreach. The ideal synthesis is a realism restrained by a balance of power and genuinely multilateral institutions.
  - **Just War as Deontological vs. Consequentialist Ethics:** The original just war theory blends deontology (inherently right rules, like discrimination of combatants) with consequentialism (proportionality, reasonable chance of success). The article claims this has been hollowed out into pure consequentialism for the powerful, where any outcome they desire justifies the means, even genocide. The moral voice of people reintroduces a universal, deontological claim—certain acts are inherently wrong, regardless of the actor’s power.
  - **The Epistemology of Threat Construction:** The debate over anticipatory self-defence is essentially epistemological: how do we *know* an attack is imminent? The Caroline test set a high bar (instant, overwhelming, no moment for deliberation). Modern doctrine lowers this bar, allowing a state to construct a “reality” of an imminent threat (like a nuclear program under international inspection) based on suspicion and future intent, not evidence of an immediate physical attack. This makes “just war” a matter of perception controlled by the powerful.
  - **Sovereignty and Responsibility:** The philosophy of state sovereignty grants a state the right to self-defence. The “doctrine of state responsibility” mentioned in the article has been inverted. Originally, it meant a state is responsible for acts against another state and must make reparations. It was twisted in the 19th century by the US to mean a *right* to intervene in weaker states to protect its citizens, a logic that prefigures modern interventions.
  - **Hegelian Dialectic and a People’s Synthesis:** The “moral voice of the people” can be seen as a synthesis. The thesis is the state’s claim to monopoly on legitimate violence (just war). The antithesis is the failure and corruption of that claim by imperial states. The synthesis is the emergence of a global civil society that holds a moral mirror to states, redeeming the concept of justice from the hands of rulers and grounding it in universal human conscience.
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- **Multidimensional Analysis**

- **Social:** War leads to mass displacement, the breakdown of the "human rights-based order," and deep-seated generational trauma (e.g., in Gaza or Iran).
- **Political:** The erosion of the UN's authority signals a return to a "might is right" era, undermining the political independence of smaller nations.
- **Legal:** The conflict between Article 2(4) and Article 51 represents a constitutional crisis for international law. The "Caroline Incident" remains the only, albeit weak, legal anchor.
- **Ethical:** The paradox of "Holocaust survivors" or "Democracies" inflicting inhumane violence challenges the moral foundations of Western liberal thought.
- **International:** The shift from Atlantic-centered power to an Asia-centric involvement (China/Russia's role in West Asia) redefines global alliances.
- **Economic:** The "weaponization of the dollar" and sanctions regimes serve as a precursor to kinetic war, affecting global oil prices and trade stability.

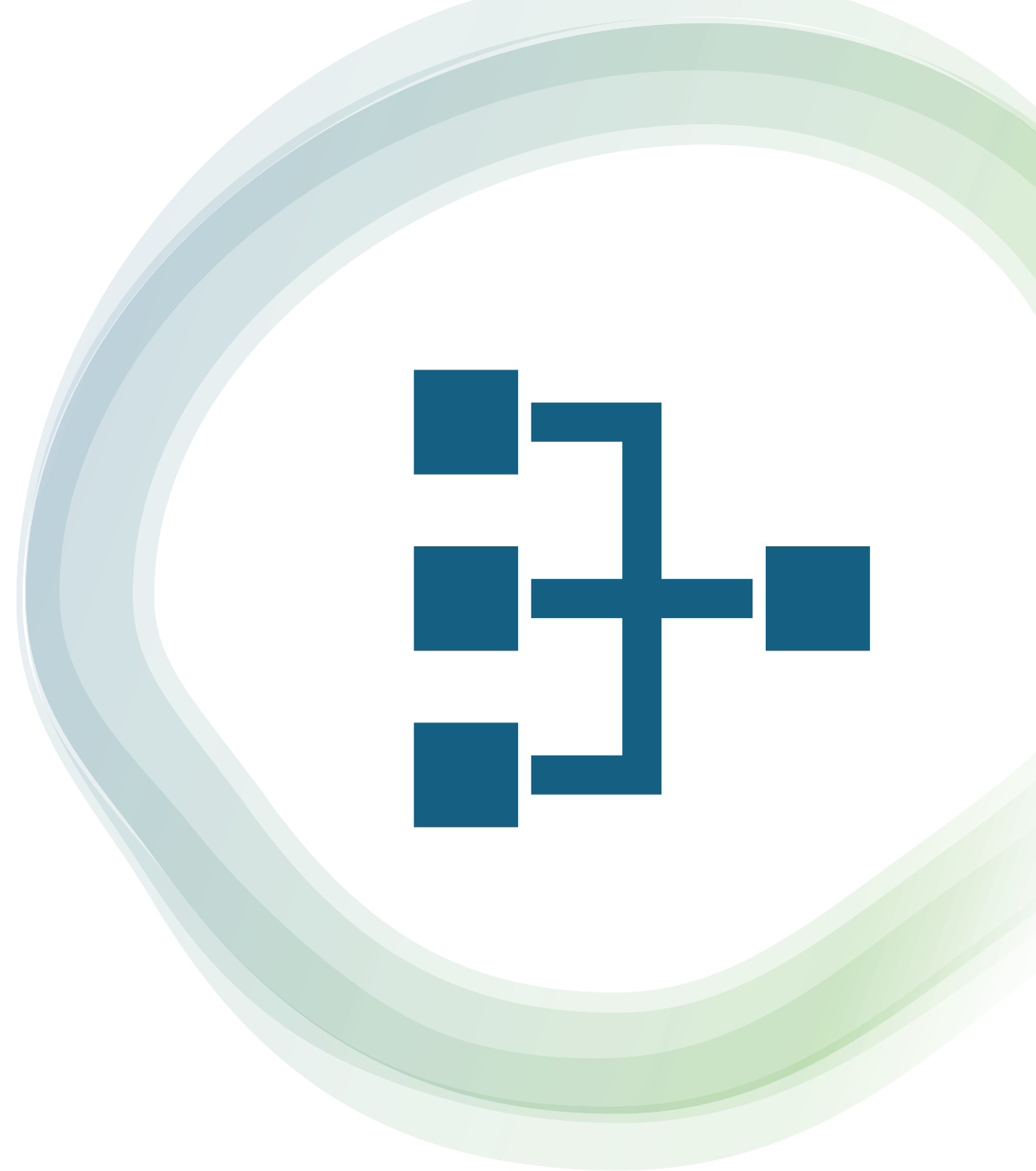
- **Linkages with NCERTs**

- **Political Theory, Class 11, Chapter 10: Peace:** This chapter directly discusses the meaning of peace, the distinction between negative peace (absence of war) and positive peace (absence of structural violence). The article's argument that a balance of power creates a negative peace without war is a core theme. The idea that a people's moral voice is essential for a just and positive peace adds depth to the textbook's discussion on non-violent approaches.

- **Political Science, Class 12, Contemporary World Politics, Chapter 1: US Hegemony in World Politics:** This chapter examines the nature of US power as hard, structural, and soft hegemony. The article provides a concrete case study of US hard and structural power in West Asia, and its critique is that US soft power (moral leadership) has collapsed, replacing it with a naked "might is right" approach.

- **Political Science, Class 12, Contemporary World Politics, Chapter 6: International Organisations:** The reading here focuses on the structure and role of the UN. The article's critique of the UN as a "meaningless" peacekeeper due to Security Council veto paralysis is a direct application of the chapter's discussion on the need for UN reform and its democratic deficit. The reference to the WTO adds another dimension.

- **History, Class 10, The Making of a Global World (Chapter 3) and The Age of Industrialisation (Chapter 4):** These chapters provide the historical context for the economic roots. The post-war Bretton Woods institutions and the global oil economy are essential background for understanding why the Strait of Hormuz matters and how control over energy became a key driver of 20th and 21st-century conflict.



## GS Paper II

- International Relations:
  - “Important international institutions, agencies and fora – their structure, mandate.”
  - “Effect of policies and politics of developed and developing countries on India’s interests.”
  - “Bilateral, regional and global groupings and agreements involving India and/or affecting India’s interests.”
- Polity and Governance:
  - “Structure, organisation and functioning of the Executive and the Judiciary... in relation to international obligations.”

## GS Paper I

- World History:
  - “World wars, redrawing of national boundaries, colonisation, decolonisation.”
  - Inter-war experiments (League, Kellogg–Briand) and post-war order formation.

## GS Paper III

- Security:
  - “Role of external state and non-state actors in creating challenges to internal security.”
  - “Challenges to internal security through communication networks, linkages of organised crime with terrorism.”
- Economy:
  - Energy security and strategic chokepoints (Strait of Hormuz) impacting India’s economic and security interests.

## GS Paper IV (Ethics)

- Ethics in international relations; “ethical concerns and dilemmas in government and private institutions.”
- Case studies on just war, humanitarian intervention, and the ethics of anticipatory self-defence.

## Essay paper

- Themes on war and peace, role of international law, moral claims of democracy and human rights, people vs rulers.

- **Way forward**

- **Clarifying and tightening self-defence standards**

- Reaffirm Caroline test criteria (instant, overwhelming necessity; strict proportionality) as the minimum for any anticipatory self-defence claim in UN practice.
- Encourage states to give detailed, public legal justifications when invoking Article 51, enabling peer scrutiny and ICJ advisory opinions.

- **Revitalising collective security and multilateral diplomacy**

- Reform UNSC working methods (greater use of restraint pledges on veto in mass atrocity situations; more open debates) to reduce paralysis.
- Expand regional security dialogues in West Asia and the Gulf, with participation of all littoral states plus key external actors, to manage Strait of Hormuz and similar chokepoints.

- **Sequenced, modular negotiations in conflict zones**

- Prioritise limited ceasefire arrangements and humanitarian corridors before attempting grand bargains on missiles, nuclear programmes, or regional alignments.
- Use confidence-building measures (incident-avoidance mechanisms at sea, notification of exercises) to gradually lower mistrust.

- **Strengthening accountability and reconstruction frameworks**

- Develop clearer norms on post-conflict responsibilities: who pays for reconstruction when unlawful force or disproportionate actions are established.
- Support international investigative mechanisms and hybrid tribunals to address serious violations, thereby reinforcing deterrence.

- **Empowering the “moral voice” of people**

- Enhance transparency around use-of-force decisions through parliamentary oversight, media access, and whistle-blower protections.
- Encourage cross-border civil society networks, academic collaborations, and people-to-people exchanges focused on peace and conflict resolution.

- **Integrating human rights consistently, not selectively**

- Apply human rights standards uniformly, including towards allies, to avoid perceptions of double standards.
- Align arms exports, security cooperation, and sanctions policies with clear human rights benchmarks and review mechanisms.

## UPSC CSE Mains – GS II

- Questions on:
  - Role and effectiveness of UN in maintaining international peace and security.
  - Legality of humanitarian intervention and responsibility to protect.
  - Impact of US policy and West Asian instability on India's interests and energy security.
  - Changing nature of global order (unipolar → multipolar) and implications for collective security.

## UPSC CSE Mains – GS I

- World history questions on:
  - Causes and consequences of World Wars.
  - League of Nations' failure and creation of United Nations.
  - Inter-war efforts at peace (Kellogg–Briand, disarmament conferences).

## UPSC CSE Mains – GS III

- Questions linking energy security, Strait of Hormuz, and India's vulnerability to Gulf crises.
- Issues of terrorism, non-state actors, and cross-border sanctuaries impacting India's security; implicit relevance of self-defence doctrine.

## UPSC CSE Mains – GS IV

- Ethics case studies on targeting terrorist groups in foreign territory, drone strikes, collateral damage, and just war criteria.

# Why India must curb gold buys, outward remittances

Prime Minister Narendra Modi's recent call for conserving foreign exchange reserves – through measures such as avoiding gold purchases, reducing fuel consumption by working from home and deferring foreign travel – came against the backdrop of the fragility marking the current global economic order. Before we discuss that further, let's look at a few indicators of India's economic health over the past few years. For the three-year period ended financial year 2023-2026 (FY26), the economy expanded by 7.3% on average, average inflation was 4%, the banking system's average net profit stood at ₹3.8 lakh crore, average growth rate of exports of goods and services was 3.5%, unemployment clocked 3.7%, and foreign exchange reserves stood at \$694 billion. Petroleum and gold imports were 33% of overall imports during this period.

In contrast to this macroeconomic robustness, the rupee has depreciated by 11.2% against the dollar between April 2023 and now. Southeast Asian currencies, on the other hand, appreciated by an average of 5.3%. Brazilian and South African currencies appreciated by an average of 13.1%. The Dollar Index depreciated by 5.6% over the same period. It's also a fact that portfolio capital outflow has been accelerating – the highest since 1996. (Portfolio capital outflows stood at \$21.3 billion in the calendar-year-to-date.) It is thus clear that the large depreciation in the rupee's value is not in sync with India's robust macro fundamentals. The Reserve Bank of India (RBI) took note of this in its latest monetary policy statement. So, what is the reason behind the rupee's depreciation?

One possible reason is that, for a considerable time, the rupee was allowed to function as a shock absorber to spur exports. However, while it did serve this purpose initially, exports became insensitive to this beyond a point and imports also started to rise. With the rupee supposedly acting as a shock absorber, the markets joined in and a self-fulfilling prophecy may have played out with the market participants betting on a weaker rupee against the dollar, even though macro fundamentals clearly suggest otherwise. Even as we begin to appreciate the hard fact that the decline in the rupee's value is likely beyond what India's macro fundamentals can explain, we must look at the options before us.

In principle, we need a comprehensive policy to address the balance of payments question and ensure that the rupee's value is in sync with India's macro fundamentals. For every one rupee appreciation of the dollar's value, the GDP decline for India is estimated to be around \$60 billion (nominal dollar terms).

Now, let us contextualise the PM's suggestions. First, let's look at gold. India imports approximately 750-800 tonnes of the metal per year. Domestic gold supply is only a fraction of India's overall supply; imports contributed around 80% in 2024, resulting in a significant forex outflow. The



Sourya Kanti Ghosh

discovery of new gold mines in districts of Odisha, Madhya Pradesh, and Andhra Pradesh could help ease the import pressure and is a positive for our current account balance, but that will take some time. So, there is no harm in reducing gold purchases in the interim to reduce imports. The Union government has just raised the customs duties on imports of precious metals, including gold, from 6% to 13%. Beyond this, the comprehensive gold monetisation policy announced by the Centre roughly a decade ago needs to be expanded into a national policy on gold (RBI recommended a national policy as far back as 1992). The expanded policy must cover trading, bullion import, jewellery export, investment, refining, etc.

The good thing about gold prices rising is the surge in gold loans. Loans against gold jewellery hovered around ₹7.5 lakh crore at the end of FY26. Gold-backed loans serve as a major source of short-term agricultural credit, especially for small and marginal farmers, tenant cultivators, and those engaged in allied activities.

Next, let us look at outward remittances. During FY22-26, \$136 billion was remitted outwards by Indians under the Liberalised Remittance Scheme, of which 73% included the purchase of immovable property, investment in debt/equity, gifts, and foreign-travel expenses. In FY23, RBI temporarily reduced the LRS limit from \$200,000 to \$75,000. There is no harm in reassessing the LRS limit now.

On the issue of NRE bonds, there needs to be an informed discussion, as the current costs of offering such a scheme may be quite high. There is also a genuine need to look at the tax structure for foreign investors, which changed after 2023.

Last but not the least, the current spike in yuan-based transactions may have caught the attention of those seeking to explain the rupee's depreciation, but data suggests otherwise. National currency market figures show as much as ~97.6% of spot yuan transactions were settled in dollars as of March 2026.

The broken cog in the currency wheel remains the Chinese central bank's hard-wired interventions on the dollar-yuan exchange rate. The pair has strengthened, even as most major currency pairs have been at the receiving end of a resilient dollar over the past two months. There is thus a genuine need to develop a Brics+ currency in sync with Brics+ Pay. The technical prowess and financial re-engineering driven by the human capital of Brics+ nations make this a worthy proposition. Interestingly, Brics+ share in the Global South's trade exceeds 40%, indicating the need for a collaborative ecosystem led by Brics+ that could structurally alter how global currency markets have behaved since the Bretton Woods system.

Sourya Kanti Ghosh is a member of the 16th Finance Commission, a member of PMRAC, and group chief economist, State Bank of India.

The views expressed are personal.

- **Key Terms and Explanations**

- **Foreign Exchange Reserves** are external assets held by RBI in foreign currencies, gold, SDRs and IMF reserve position. They act like a national safety cushion during global shocks, oil price spikes, capital outflows or rupee instability.
- **Rupee Depreciation** means fall in rupee value against another currency, mainly the US dollar. Example: if \$1 rises from ₹83 to ₹90, India must pay more rupees for the same imported oil, electronics or defence equipment.
- **Balance of Payments** records all economic transactions between India and the world. It has two major parts: current account and capital account.
- **Current Account Deficit** occurs when imports of goods, services and income payments exceed exports and receipts. High oil and gold imports often widen India's current account deficit.
- **Portfolio Capital Outflow** means foreign investors selling Indian stocks or bonds and moving funds abroad. Such outflows create demand for dollars and pressure the rupee.
- **Dollar Index** measures the strength of the US dollar against major global currencies. If the Dollar Index falls but rupee still depreciates, it suggests India-specific pressures or market expectations.
- **Liberalised Remittance Scheme** allows resident Indians to remit money abroad for education, travel, investment, gifts and property purchase, subject to RBI limits.
- **NRI Bonds** are foreign currency deposit instruments used to attract funds from non-resident Indians during external sector stress.
- **BRICS Pay / BRICS+ Currency** refers to proposed alternative payment and currency systems among BRICS and partner countries to reduce excessive dependence on the dollar.

## Main Arguments and Substantive Parts

The core concern is that India's rupee depreciation appears sharper than what its macroeconomic fundamentals justify. India's growth, inflation, banking profitability, exports, employment and forex reserves indicate reasonable macroeconomic stability. Yet the rupee has weakened significantly.

The central argument is that currency value is not shaped by fundamentals alone. Market psychology, capital flows, import composition, speculative positioning and global monetary structures also matter. When markets begin to believe that the rupee will weaken, that expectation itself can create further pressure.

A second major point is that India's import structure remains vulnerable. Petroleum and gold together form a large share of imports. Oil is essential, but gold is partly discretionary. Therefore, reducing non-essential gold imports can conserve forex without harming productive capacity.

A third argument concerns outward remittances. Liberalised outward flows for foreign property, investment, gifts and travel may need reassessment during external pressure. This does not mean capital control in a harsh sense, but calibrated prudence.

The final argument is structural. Dollar dominance continues to shape global currency behaviour. Hence, emerging economies like BRICS+ may need alternative settlement systems to reduce vulnerability to dollar-led financial cycles.

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- **Historical Evolution of the Issue**

- India's external sector vulnerability has deep historical roots. In the colonial period, India's trade and monetary system was linked to imperial needs. The colonial economy exported raw materials and imported finished goods, creating structural dependence.
- After independence, India adopted import substitution to conserve scarce foreign exchange. The 1950s-70s saw strict exchange controls, licensing, and limited foreign trade. The idea was to protect domestic industry and avoid external dependence.
- The 1991 Balance of Payments crisis marked a turning point. India's forex reserves fell to critically low levels, forcing economic reforms, rupee devaluation, trade liberalisation and IMF-supported adjustment. This created a more open economy.
- In the 2000s, capital inflows rose due to globalisation, services exports and foreign investment. Forex reserves expanded, but dependence on oil imports continued.
- After the 2008 financial crisis and later the 2013 taper tantrum, India learnt that global liquidity changes can rapidly affect the rupee. RBI intervention, inflation targeting and external buffers became important.
- In the 2020s, geopolitical shocks, oil volatility, supply chain disruptions, dollar weaponisation, and changing US-China relations created a fragile global order. India now faces the challenge of preserving openness while building external resilience.



# AXIA IAS ACADEMY

AXIA COMPETITIVE EXAM CENTRE

## UPSC CSE PREPARATION - CURRENT AFFAIRS ALUBS ANALYSIS DECODING THE RUPEE: MACROECONOMICS, FOREX, & STRATEGIC SHIFTS

### INDIA'S MACROECONOMIC ROBUSTNESS (FY26): A SOLID FOUNDATION.

- Average Economy Expansion: 7.3%
- Average Inflation: 4%
- Banking Net Profit: ₹3.8 lakh crore
- Export Growth: 3.5%
- Unemployment Rate: 3.1%
- Forex Reserves: \$691 billion

**THE PARADOX:** Rupee depreciated by 11.2% (April 2025-Now), contrary to domestic strength.

### ALERTS PORTOITMON OF ECOLIMES OF (FY26): A SOLID ES FOUNDATION.

- GOLD CHALLENGE:** High imports (86% of supply), significant forex outflow.
- CURB PURCHASES:** Raise duties (15%).
- Expanded NATIONAL GOLD POLICY:** Cover trading, refining, investment, etc. major agricultural credit for small farmers.



### CAUSES OF RUPEE DEPRECIATION: BEYOND FUNDAMENTALS.

- The Shock Absorber Theory:** Failed beyond initial spur for exports, imports rose.
- Speculative Markets:** Market participants bet on a weaker rupee despite fundamentals.
- Portfolio Capital Outflow:** Unrelenting ('Hot Money' flight \$21.3B YTD, highest since 1991).
- Dollar Index Strength:** 'Resilient Dollar' against major pairs (Yen, Euro) over the last two months.
- Yuan settlement stickiness** creates a broken cog in currency flow; global reliance on Dollar.

### 'The Currency Wheel'



### STRATEGIC MOVES FOR STABILITY: ADDRESSING THE BOP CRISIS.

- GOLD CHALLENGE:** High imports (86% of supply), significant forex outflow.
- CURB PURCHASES:** Raise duties (15%).
- Expanded NATIONAL GOLD POLICY:** Cover trading, refining, investment, etc.
- GOLD LOANS (₹7.5 Lakh Cr FY26):** major agricultural credit for small farmers.



### OUTWARD REMITTANCE REVIEW (LRS).

- LIBERALISED REMITTANCE SCHEME:** Temporary limit reduction (from \$200k to \$75k) may be reassessed.
- LARGE CAPITAL OUTFLOW:** ~\$136B FY22-26 for properties, travel, gifts, debt/equity.



### INTERNATIONAL FINANCIAL RE-ENGINEERING: BRICS+ & DE-DOLLARIZATION.

- Counter global distortions (Chinese interventions, resilient dollar).
- Build BRICS+ Currency & BRICS Pay ecosystem for local currency trade.
- BRICS share >40% of Global South trade. Alter Bretton Woods dominance.

### WAY FORWARD & यूपीएससी परीक्षा हेतु प्रासंगिकता (UPSC CSE Relevance).

- A BALANCED STRATEGY:** Import Substitution, Currency Diversification (Bilateral LCS), Deepening Bond Market.
- यूपी एससी प्रासंगिकता:** Indian Economy (BoP, Exchange Rates), International Relations (BRICS), GS Paper 3, Ethics (Consumption dilemmas), & Essay.

- **Logical and Philosophical Base**

- **Logic of the “Shock Absorber” Argument:** The article argues that the rupee was permitted to depreciate deliberately to boost exports. This is based on the standard economic logic that a weaker currency makes exports cheaper and imports costlier, improving trade balance (the “expenditure-switching” effect). However, it assumes that export demand is price-elastic. The article contends that beyond a point, exports became insensitive to the exchange rate (demand inelasticity), and imports rose due to essential import needs (oil, gold), neutralising the benefit. This reveals a flaw in the original assumption.

- **Self-Fulfilling Prophecy and Reflexivity:** Inspired by George Soros’ theory of reflexivity, market expectations about the rupee’s weakness shaped the actual outcome. If investors collectively believe the rupee will fall, they sell rupee assets, causing it to fall. This creates a feedback loop that decouples the exchange rate from fundamentals. The philosophical underpinning is that financial markets are not always efficient; they can generate self-sustaining trends detached from real economic variables.

- **Philosophical Foundations of Austerity and National Interest:** The PM’s call to reduce gold purchases and foreign travel rests on a moral economy perspective – that in times of external vulnerability, citizens should prioritise national economic strength over personal consumption. This echoes Gandhian ideals of simple living and swadeshi, appealing to collective sacrifice for the larger good. It also aligns with the “Prudent Man” principle in economic governance: conserving reserves and avoiding wasteful expenditure.

- **Trilemma (Impossible Trinity):** The Mundell-Fleming trilemma posits that a country cannot simultaneously maintain free capital flows, a fixed exchange rate, and an independent monetary policy. India’s managed float and partial capital controls attempt to balance all three. The article hints at tightening the capital account (LRS limits) and reducing import drains to gain more policy space, acknowledging the trilemma’s constraints.

- **Philosophy of De-dollarisation:** The call for a BRICS+ currency reflects a broader challenge to the dollar’s exorbitant privilege. This is rooted in a post-colonial critique of the global financial architecture – that the Bretton Woods system, and its successor, gives the US undue advantages while forcing developing countries to hold dollar reserves. The proposal to create a multipolar currency system is as much philosophical as economic, seeking to restructure global power relations through currency design.

- **Economic Nationalism vs Globalisation:** The article navigates the tension between protecting national forex reserves and remaining integrated with global capital markets. While advocating domestic gold mining and reduced imports, it does not reject globalisation outright but calls for strategic autonomy in currency matters.

- **Multidimensional analysis**

- **Social dimension**

- Gold is deeply embedded in social customs; any attempt to curb gold demand must be sensitive to cultural practices and gender dynamics (women's asset security).
- Gold loans have become a key source of credit for small and marginal farmers and informal workers; their design and regulation directly affect rural livelihoods.

- **Political dimension**

- Public appeals by the PM turn macro policy into a mass political issue, opening space for both support and criticism.
- Opposition may question whether the government is shifting responsibility onto citizens instead of improving structural policies (taxation, subsidies, energy strategy).

- **Legal dimension**

- Changes to customs duties, LRS limits, or capital controls must follow due process and be consistent with WTO commitments and bilateral investment treaties.
- Any Brics+ currency arrangement would involve new legal frameworks on exchange management, dispute settlement, and capital-flow rules among members.

- **Ethical dimension**

- Issues of distributive justice: who bears the cost of external adjustment—consumers, taxpayers, or large capital owners?
- Transparency and informed consent become ethical imperatives when citizens are asked to alter behaviour for macro reasons.

- **International dimension**

- India's external policies (gold imports, oil purchases, currency management) affect global commodity prices and regional financial stability.
- De-dollarisation initiatives and Brics+ currency could reconfigure geopolitical alignments, impacting India's relations with both Western and non-Western partners.

- **Economic dimension**

- Rupee depreciation affects inflation (via imported inputs), corporate balance sheets (external debt), and India's attractiveness as an investment destination.
- Rationalising gold imports and outward remittances can free foreign exchange for productive uses (infrastructure, technology imports), raising long-term growth potential.

## Linkages with NCERTs

### Economics – Class 12 (Macroeconomics)

- Chapters on “Balance of Payments” and “Open Economy Macroeconomics” directly relate to exchange rates, capital flows, and reserves.
- Concepts like current account, capital account, and managed float provide the theoretical base for understanding rupee depreciation and BoP management.

### Economics – Class 11

- “Indian Economy since Independence” touches on the 1991 crisis, macro reforms, and external sector liberalisation, which form the historical context for today’s external-sector debates.

### Political Science – Class 12 (Contemporary World Politics)

- Chapters on “Globalisation” and “International Organisations” help understand Bretton Woods, IMF, World Bank, and the politics of global monetary governance.
- De-dollarisation and Brics currency can be linked to the theme of emerging multipolarity.

### Political Science – Class 11 (Indian Constitution at Work)

- Chapters on “Executive,” “Parliament,” and “Federalism” show how macroeconomic and external policies are shaped within the constitutional structure—roles of Union government, RBI, and Parliament.

### Sociology – Class 12

- “Cultural Change” and “Change and Development in Rural Society” help in analysing social patterns of gold ownership, informal finance, and how macro policies impact rural communities.

## GS Paper 3 – Economy

- Indian Economy and issues relating to planning, mobilisation of resources, growth, development and employment.
- Inclusive growth and issues arising from it (gold loans and rural credit).
- Government Budgeting (fiscal-external linkages).
- Effects of liberalisation on the economy, changes in industrial policy and their effects on industrial growth (LRS, capital flows).
- Infrastructure: energy and ports (oil import dependence).
- Investment models; foreign investment, FDI vs FPI.
- Indian economy and issues relating to external sector, BoP, and currency.

## GS Paper 2 – Polity and International Relations

- Functions and responsibilities of the Union and the States in economic and financial matters.
- Important international institutions, agencies and fora—their structure and mandate (IMF, World Bank, Brics).
- India and its neighbourhood; bilateral and multilateral groupings (Brics, Brics+ currency).

## GS Paper 1 – Society

- Salient features of Indian society, diversity, and social empowerment (gold as social security, gendered ownership of assets).
- Globalisation and its social impact, including consumption patterns and outward travel.

## GS Paper 4 – Ethics

- Ethics in public administration: responsibility, accountability, and transparency in macro-economic decision-making.
- Moral dimensions of public appeals, distributive justice in economic policy.

## Way forward

### Rebalancing exchange-rate policy

- Maintain a flexible but not indifferent stance: RBI can lean against excessive, expectation-driven depreciation without committing to rigid targets, using reserves prudently and improving communication.
- Develop and publish clear frameworks for intervention to anchor expectations without revealing specific levels.

### Strategic external-sector management

- Gradually evolve a comprehensive national gold policy integrating mining, refining, trading, and monetisation, with strong consumer protection and attractive returns to build trust.
- Rationalise fuel subsidies and taxes while scaling up public transport, EV infrastructure, and urban planning to make lower fuel use feasible, not just exhortational.

### Smart management of capital flows

- Re-examine LRS limits and categories in a rule-bound, transparent way—e.g., distinguishing essential (education, health) from non-essential (luxury travel, speculative investment) outflows.
- Simplify and stabilise the tax regime for foreign investors; prioritise predictability over short-term revenue gains to attract stable capital.

### Strengthening domestic financial deepening

- Expand regulated gold-linked financial products (Sovereign Gold Bonds, gold ETF-like instruments) and ensure last-mile access, especially for rural savers.
- Encourage formalisation of gold loans with fair interest caps, transparent contracts, and robust grievance redress to protect vulnerable borrowers.

### Brics and global monetary reform

- Approach Brics+ currency as a long-term, phased project: start with increasing local-currency settlements, interoperable payment systems, and common standards before a full-fledged currency.
- Ensure that any Brics+ monetary arrangement has robust governance, representation, and crisis-management tools to avoid simply replacing one domination with another.

### Communication and public trust

- Combine public appeals with clear disclosure of macro data and policy rationale so citizens see the bigger picture and are more willing to cooperate.
- Engage civil society, industry bodies, and state governments in designing campaigns on fuel conservation and gold rationalisation.

## UPSC CSE Mains – GS 3

- 2023: “Discuss the challenges and opportunities of India’s external sector in the context of global economic uncertainty.”
- 2022: “How do foreign portfolio investments (FPIs) affect the Indian economy? What steps have been taken by the government to manage their volatility?”
- 2020: “Explain the meaning of Current Account Deficit. What are the implications of CAD for a developing economy like India?”
- 2019: “Do you agree with the view that steady GDP growth and low inflation are not sufficient indicators of a healthy economy? Substantiate.”
- 2018: “Examine the role of gold in India’s external sector and discuss the effectiveness of measures taken to reduce gold imports.”
- 2013: “What were the causes of the 1991 Balance of Payments crisis in India? How did the government respond?”

## UPSC CSE Prelims (Economy)

- Questions on:
  - Components of BoP, meaning of current and capital account.
  - Effects of rupee depreciation/appreciation.
  - Features of Liberalised Remittance Scheme.
  - Sovereign Gold Bonds, Gold Monetisation Scheme, and their benefits.

## UPSC Essay

- 2021: “The process of economic liberalisation in India has been a mixed blessing.”
- 2019: “Rise of artificial intelligence: the threat of jobless future or better job opportunities through reskilling and upskilling.” (For linking technology with financial systems, though indirectly.)

# Quad, Where Art Thou?

## With US now increasingly disinterested in the quadrilateral grouping, does it serve India's interests to hang on? As Trump & Xi summit today, New Delhi must take a hard call

Vijay Gokhale



As Trump begins his highly anticipated summit with Xi today, there's one aspect of the US-China strategic calculus that comes into sharp focus. The US-India-Japan-Australia quadrilateral dialogue or Quad is, metaphorically speaking, dead in the water. It's still afloat, but just barely. India is still waiting to host the leaders-level summit due in 2025.

Although Quad – not explicitly directed at China – declares itself a partnership, united in the conviction that peace and stability in the maritime domain underpin peace and security in the region, the recent American military action in the Gulf has neither underpinned peace and security in partnership with other Quad members, nor demonstrated sensitivity to its partner, India's, interests so close to its shores.

US, the principal architect of Quad's second edition, appears to be losing interest. Since the last ministerial meeting in July 2025, there has been no talk of a summit. Quad is barely referenced in Trump's National Security Strategy. Neither Pentagon's 2026 National Defence Strategy, nor secretary of war's statement to US Congress on April 29, makes any references to Quad. As India readies to host the next foreign ministers meeting, it's pertinent to question whether US is scaling back, or entirely scuttling, Quad.

Ironically, in 2017, Quad 2.0 was resuscitated by Trump. The four summits (2021-24) pronounced wide-ranging initiatives in health security, critical and emerging technologies, quality infra, and maritime domain awareness among others. Five years later, there's general agreement that Quad was generous on promises, but meagre on action.

The health security initiative has delivered no joint outcomes on safe and effective vaccines; the Quality Infrastructure Coordination Group has not executed a single project thus far; the Clean Hydrogen partnership has made little progress; and, the working group on critical and emerging technologies has shown no tangible results in joint R&D.

Aside from progress in the important area of maritime domain awareness, Quad has been more a set of talking heads than working hands.

It was apparent from the beginning that India and US were never entirely on the same page. For India, Quad's geographical footprint spanned two oceans, from Japan till the east African shores, whereas US saw it within a more limited geography that did not extend to regions west of India. For Washington, Quad was part of the broader geopolitical containment of China, whereas for New Delhi it was more about rebalancing.

India's Indo-Pacific vision, outlined by Modi in Singapore in 2018, clearly enunciated that all nations in this geography had a stake, and none could be excluded.



Besides, US, Japan and Australia are treaty allies, but India has no formal security treaties with any. Despite these differences, both govts felt that shared interests made Quad a value proposition worth advancing.

There were rumblings during the Biden administration, questioning India's resolve to move towards a more robust response to China's growing influence in western Pacific. But it took the long-term view, because India's inclusion added gravitas and diversity to what is otherwise a Western alliance.

Since China's salience in America's future security is regularly mentioned by secretaries Rubio and Hegseth, what has changed in American policy? For one, their priorities have shifted – America is putting

itself and its interests first. Official references to Indo-Pacific now focus on western Pacific, almost to the exclusion of Indian Ocean Region.

For another, deterring China remains a key priority; but, in Hegseth's words it must be achieved 'through strength, not confrontation', and in a manner that allows all, including China, to enjoy a "decent peace in an Indo-Pacific where trade flows openly and fairly... where we can all prosper, and all interests are respected". These policy shifts suggest a diminution in the salience of Quad.

India, it appears, does not geopolitically fit into the Trump administration's evolving Indo-Pacific strategy. It has, likely, concluded that New Delhi is reluctant, and also lacks capacity to bear greater responsibility for security in western Pacific. It's readying alternatives.

Towards the end of the Biden administration, a new maritime-focused four-nation plurilateral (Squad), in which India was substituted by Philippines, was taking shape. Most recently, this has been given a fillip with the announcement that US will build a 'forward deployed industrial base' there under the Enhanced Defence Cooperation Agreement.

More significantly US and Indonesia just signed a Major Defence Cooperation Partnership last month. This means Indonesia's role will, likely, be enhanced in US plans to strengthen deterrence and promote security in the region.

So far as the northern Indian Ocean is concerned, the Trump administration is possibly betting on giving Pakistan a bigger role in helping US to maintain peace and security in the post-conflict West Asian region.

It's unlikely that Quad will be allowed to die because it still has, for Americans, a symbolic significance. The Indian strategic community, however, needs to ask the hard question of whether the reputational and other costs of adhering to such an arrangement, merely out of hope rather than because of substantive outcomes, are a price worth paying.

Perhaps, at the ministerial meeting in Delhi, the Americans might be asked to explain how continuing with Quad helps India's development and security, rather than answering Washington's doubts about India's intentions. A re-assessment of Quad is now overdue.

*The writer is a former foreign secretary*

- **Key Terms and Explanations**

- **Quadrilateral Security Dialogue (Quad):** An informal strategic forum comprising the United States, India, Japan, and Australia. It aims to promote a free, open, and inclusive Indo-Pacific region through cooperation on maritime security, infrastructure, technology, and health. *Example:* Joint naval exercises like Malabar.
- **Indo-Pacific:** A geopolitical concept encompassing the Indian and Pacific Oceans, linking the strategic interests of nations from Africa's east coast to the Americas' west coast. It emphasizes maritime connectivity and collective security. *Example:* India's SAGAR (Security and Growth for All in the Region) vision.
- **Strategic Autonomy:** India's foreign policy principle of maintaining independent decision-making based on national interests, avoiding formal military alliances that could constrain its choices. *Example:* India's refusal to join NATO-like structures while engaging with Quad.
- **Maritime Domain Awareness (MDA):** The effective understanding of activities associated with the global maritime domain that could impact security, safety, economy, or environment. *Example:* Sharing real-time ship tracking data among Quad navies.
- **Grey Zone Operations:** Actions that fall below the threshold of open warfare but aim to achieve strategic objectives through coercion, intimidation, or ambiguity (e.g., militia incursions, cyber attacks, economic coercion). *Example:* Chinese militia activities in the South China Sea.
- **Forward Deployed Industrial Base:** A strategic concept where a nation establishes or enhances industrial and logistical capabilities in a forward location to support sustained military operations and deterrence in a region. *Example:* US plans under the Enhanced Defence Cooperation Agreement with the Philippines.
- **Major Defence Cooperation Partnership (MDCP):** A high-level defense agreement signifying deepened interoperability, joint planning, technology sharing, and potential basing access between nations, falling short of a formal treaty alliance. *Example:* The recent US-Indonesia MDCP.

- **Main Arguments and Substantive Parts**

- The core argument posits that the Quad, despite its symbolic resilience, is experiencing strategic drift and declining substantive momentum, primarily due to a shift in US Indo-Pacific strategy under the Trump 2.0 administration. Key supporting points include:
  - **US Strategic Reorientation:** Washington's focus has narrowed from the broader Indo-Pacific (encompassing the Indian Ocean) to the Western Pacific, diminishing Quad's relevance as perceived by the US. This is evidenced by the near-absence of Quad mentions in key US strategy documents (National Security Strategy 2025, National Defence Strategy 2026) and the lack of summit-level engagement since July 2025.
  - **Divergent Visions:** The US views Quad primarily as a tool for containing China within a limited geographic scope (Western Pacific), while India envisions it as a vehicle for inclusive regional rebalancing spanning two oceans (Indian and Pacific), aligned with its SAGAR doctrine. This fundamental mismatch hinders deep cooperation.
  - **Lack of Substantive Outcomes:** Despite numerous initiatives announced across Quad summits (2021-2024) – health security, quality infrastructure, clean hydrogen, critical technologies – tangible joint results remain scarce. Progress is largely confined to Maritime Domain Awareness, with other working groups showing minimal concrete output.
  - **Emerging Alternatives:** The US is actively cultivating alternative partnerships better aligned with its narrowed focus, such as the proposed "Squad" (US, Japan, Australia, Philippines) gaining traction via Enhanced Defence Cooperation Agreement initiatives, and the recently signed US-Indonesia Major Defence Cooperation Partnership, signaling a strategic pivot away from reliance on India for Western Pacific deterrence.
  - **India's Quandary:** India faces a dilemma: adhering to Quad risks reputational costs and potential entanglement in US-led containment without proportional security benefits, yet abandoning it might forego valuable cooperation avenues and signal unreliability. The upcoming Indian-hosted foreign ministers meeting presents an opportunity to demand clarity on Quad's value for India's development and security.

- **Historical Evolution of the Issue**

- **Pre-Independence/Early Post-Independence Era:** India's non-aligned movement (NAM) principle explicitly avoided joining any Cold War bloc, establishing a foundational preference for strategic autonomy and multi-engagement over formal alliances. The concept of a formal Indo-Pacific security grouping involving the US, Japan, and Australia was antithetical to this ethos.
- **Quad 1.0 (2004-2006):** Originated as an informal coalition for disaster relief coordination following the 2004 Indian Ocean Tsunami (involving US, India, Japan, Australia). It faded by 2006, partly due to Chinese objections and India's reluctance to antagonize Beijing, reinforcing its non-aligned inclinations.
- **Quad 2.0 Resuscitation (2017):** Revived under the Trump administration's initial Indo-Pacific strategy, driven by growing concerns over China's assertiveness. The first official ministerial meeting occurred in 2017, marking a shift from ad-hoc cooperation to a more structured dialogue aimed at countering Chinese influence.
- **Summit Era (2021-2024):** Under Biden, Quad leaders held four summits (virtual 2021, Tokyo 2022, Hiroshima 2023, Wilmington 2024). These meetings launched ambitious initiatives spanning vaccine diplomacy, critical and emerging technology partnerships (iCET), climate action, and infrastructure quality standards, attempting to institutionalize cooperation beyond security.
- **Current Stagnation (2025-Present):** Marked by the absence of a leaders' summit (India was slated to host in 2025), minimal reference in core US strategic documents, and perceived US strategic reallocation towards Western Pacific-centric alliances (Philippines, Indonesia). Initiatives continue at working levels but lack the political impetus and funding seen during the summit phase, raising questions about its long-term viability as a leaders' level forum.



# AXIA IAS ACADEMY: STRATEGIC ANALYSIS—THE FUTURE OF THE QUAD: STRATEGIC REBALANCING OR SLOW DECLINE?

## I. THE GEOPOLITICAL SHIFT: MAP & DIAGRAM

MAP A: QUAD VISION (2021-2024)



MAP B: NEW REALITY (2025-2026)



## II. THE PROMISE vs. ACTION GAP

GENEROUS ON PROMISES, MEAGRE ON ACTION (VACCINES, INFRA, TECH)

PROMISES	ACTION
✓ Health Security Initiatives (Safe, Effective Vaccines)	✗ No Joint Outcomes on Vaccines
✓ Quality Infra Coordination (executed projects)	✗ Not executed a single project
✓ Clean Hydrogen Partnership (progress)	✗ Little progress made
✓ Critical & Emerging Tech (Tangible Joint R&D)	✗ No Tangible Results in Joint R&D

## III. CONCEPTUAL CONFLICTS: DIFFERENT DOCTRINES

US VISION (REALISM/CONTAINMENT)	INDIA'S VISION (NON-ALIGNMENT 2.0)
🎯 Pivots back to Western Pacific	📍 Wider Footprint: Japan to E. Africa
📈 Deterrence via Strength over Confrontation	🌐 Inclusive Indo-Pacific (Modi, 2018)
🗺️ Bypasses with "The Squad" & Indonesia	🎯 Focus on Rebalancing, not Containment
🏢 Strategic Containment of China	🔄 Strategic Autonomy

## IV. EMERGING US ALTERNATIVES: THE NEW ALIGNMENTS

NEW PARTNERS OVERTAKING THE QUAD



## V. UPSC ANALYSIS & WAY FORWARD

Critically Analyse Implications for India.

1. Demand Substantive Outcomes
2. Focus on IOR Leadership (SAGAR)
3. Strengthen Domestic Maritime Capacity
4. Re-assess costs vs. benefits

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MAINS NOTE-MAKING TIP: Create a 'Balance Sheet' of Quad Promises vs. Outcomes. Focus on actual progress.

- **Logical and Philosophical Base**

- **Underlying Logic (US Perspective):** Rooted in realist international relations theory, particularly offshore balancing and containment. The US seeks to maintain its primacy by preventing any single power (China) from dominating Eurasia's maritime fringes. Quad is viewed as a cost-effective mechanism to share the burden of deterrence with like-minded democracies, leveraging their geographical positions and capabilities without requiring US unilateral overextension. The shift towards Philippines/Indonesia reflects a logic of prioritizing allies with closer proximity to the primary flashpoint (South China Sea/Taiwan Strait) and greater willingness for host nation support.

- **Underlying Logic (India Perspective):** Draws from liberal internationalism and strategic autonomy. India seeks a stable, rules-based maritime order conducive to its economic growth (reliant on sea lanes) and seeks to prevent any hegemony (including potential US hegemony) that could constrain its sovereign choices. Quad is valued as a plurilateral forum to build capacity, gain access to technology/best practices, and enhance its international standing, but only insofar as it aligns with its independent assessment of national interest and does not compromise its ability to engage with rivals like China or Russia.

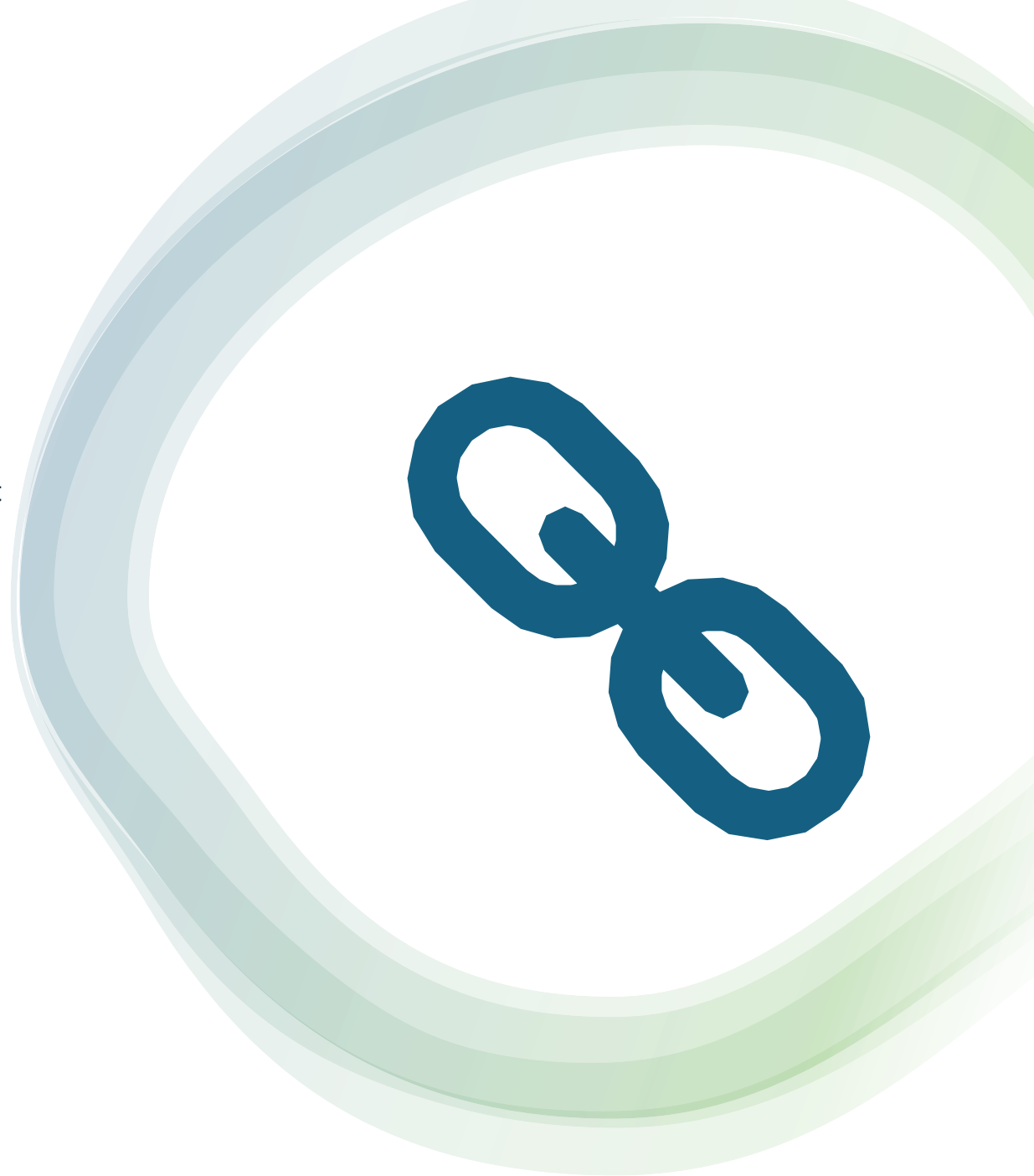
- **Philosophical Foundation:** The tension embodies a fundamental debate in global order: **Coercive vs. Cooperative Security**. The US leaning towards strengthened alliances (even if adapted) leans on deterrence through demonstrated capability and resolve (potentially coercive signaling). India's insistence on Quad as a non-alliance cooperation mechanism reflects a preference for **inclusive multilateralism** and **norm-building**, where security arises from shared rules, transparency, and mutual benefit rather than opposing blocs. The article questions whether India's continued participation, driven by hope for substantive outcomes, aligns with a realistic assessment of the partnership's current logic and philosophy.



- **Multidimensional Analysis**
- **Social Dimension**
  - Public understanding of the Quad in India is often limited to “anti-China grouping”. For students and citizens, the better understanding is that it links maritime security, technology, supply chains, disaster relief and national development. A stable Indo-Pacific protects energy flows, trade routes, digital cables and jobs.
- **Political Dimension**
  - Quad tests India’s ability to practise strategic autonomy in a polarised world. India must cooperate with the US without becoming dependent, oppose coercion without provoking unnecessary confrontation, and engage China without ignoring security threats.
- **Legal Dimension**
  - The legal foundation lies in international law, especially UNCLOS, freedom of navigation, sovereign equality and peaceful dispute settlement. India must ensure that Quad cooperation does not become legally equivalent to alliance obligations.
- **Ethical Dimension**
  - The ethical challenge is to avoid great-power hypocrisy. If Quad speaks of rules-based order, members must respect sovereignty, non-intervention, humanitarian law and fair development finance.
- **International Dimension**
  - Quad exists within a crowded Indo-Pacific architecture: ASEAN, AUKUS, I2U2, BRICS, SCO, G20, G7, East Asia Summit and Indian Ocean Rim Association. India must manage overlapping forums intelligently.
- **Economic Dimension**
  - The Quad can support supply-chain resilience, trusted technology, infrastructure, critical minerals and digital connectivity. But unless financing and market access improve, economic promises may remain underwhelming.

- **Linkages with NCERTs**

- **Class 12, Political Science II, 'Contemporary World Politics':** The chapter on **'US Hegemony in World Politics'** is directly relevant. The Quad is a manifestation of the US's attempt to maintain its primacy through coalition-building after a period of unilateralism. The chapter discusses the constraints on American power, and the Quad's struggles illustrate these constraints perfectly, as even a superpower cannot unilaterally dictate a complex partnership.
- **Class 12, Political Science II, 'Alternative Centres of Power':** The section on the **'Rise of China'** and the **'European Union'** provides a comparative case study. It explains why China's growth is a driver for the Quad. The challenges the Quad faces—diverging national interests—can be compared with the EU's own struggles with integration, showing how difficult it is to build durable multipurpose institutions.
- **Class 12, Political Science II, 'India's External Relations':** The chapter's discussions on the **'Policy of Non-alignment'** and the more recent shift towards **"multi-alignment"** are crucial. The article's point about India's inclusive Indo-Pacific vision versus the US's containment logic is a direct evolution of the same foundational debate. The entire tension of the Quad rests on India's struggle to balance its new partnerships with its historical strategic culture.
- **Class 10, Geography, 'Lifelines of National Economy':** This chapter discusses the importance of sea ports and international trade. This can be linked conceptually to why the maritime domain of the Indo-Pacific, which the Quad seeks to secure, is so vital for India's economy, as over 90% of its trade by volume is seaborne.



## Linkages with UPSC CSE Syllabus

### GS Paper 2 (Governance, International Relations):

- **India and its Neighbourhood Relations:** The Quad directly impacts the China-Pakistan dynamics in the neighbourhood.
- **Bilateral, Regional and Global Groupings involving India:** The Quad is a primary text-book example. Its efficacy, challenges, and future are core GS2 topics.
- **Effect of Policies of Developed Countries on India's Interests:** The US's shift from Quad to Squad and its bilateral pacts with Indonesia are a direct example of how a major power's strategic choices create new challenges and opportunities for India.

### GS Paper 3 (Security, Technology, Economy):

- **Maritime Security Challenges:** The Quad's raison d'être is maritime domain awareness, freedom of navigation, and securing sea lanes of communication (SLOCs) in the Indian Ocean and South China Sea.
- **Critical and Emerging Technologies:** The Quad's working group on this topic touches on supply chain resilience for semiconductors, 5G/6G, and biotechnology, directly mapping to the GS3 syllabus on indigenization of technology.

### GS Paper 4 (Ethics):

- **International Ethics:** The promises of vaccine diplomacy and infrastructure development versus the lack of delivery raises questions about moral responsibility and hypocrisy in international relations.
- **Ethical Dilemmas in Public Policy:** How should India balance its ethical commitment to strategic autonomy with the potential security and economic benefits of a closer but more dependent alliance? This is a perfect case study for an ethics paper.

- **Way Forward**

- **A “Quad-Lite” and Pragmatic Agenda:** Accept the strategic divergence as a feature, not a bug. Shift the focus entirely from lofty, unachievable goals to a concrete “deliverables” charter. Choose one or two areas—like a pan-Indian Ocean disaster response capability and a joint fund for undersea cable connectivity to trusted digital hubs—and execute them flawlessly. A single successful infrastructure project is worth a dozen summit communiqués. The motto must become “less talk, more action.”
- **Redefine India’s Role and Expectations:** India should not be expected to play a role in the Western Pacific, and the US should not be expected to secure the Western Indian Ocean. A functional “division of labour” should be formalized, with India taking the lead on the Quad’s Indian Ocean initiatives, from the Gulf of Aden to the straits of Malacca, operationalizing its SAGAR vision.
- **Institutionalize, Lightly:** To overcome the inertia between meetings, the Quad needs a permanent “Quad Secretariat” in a city like Delhi. Its mission would be modest: to be a project monitoring cell, tracking the progress of each working group, highlighting bottlenecks, and ensuring bureaucratic continuity. This minimal institution can build trust and create a permanent stakeholder.
- **Indian Ocean-Centric Multilateralism:** India must proactively build and lead Indian Ocean-focused constructs like the Indian Ocean Rim Association (IORA) and the trilateral with France and the UAE. This strengthens India’s position, provides a geopolitical hedge, and demonstrates to Washington that India has strategic options, paradoxically increasing New Delhi’s value as a partner.
- **The “India-US Strategic Question” in Delhi:** At the upcoming meeting, India must lead the agenda by respectfully but pointedly asking the United States: “What is the strategic concept for the Quad’s future, and how does it concretely support our shared interest in a stable, prosperous Indian Ocean Region, given your new policy frameworks?” This reframes the dialogue from a test of India’s loyalty to a crucial discussion on mutual relevance.

- **UPSC CSE Mains (GS2 – International Relations)**

- **2023:** “India’s maritime security strategy has evolved from a purely continental outlook to a maritime-centric vision. Explain, with examples, the factors that necessitated this shift.” (Directly relates to the logic behind India joining the Quad).
- **2022:** “The Quad has the potential to be a game-changer in the Indo-Pacific region.” Comment. (A direct question on the article's theme).
- **2021:** “Quadrilateral Security Dialogue (Quad) is transforming itself into a trade bloc from a military alliance, in present times.” Discuss. (The article provides a strong counter-argument to this very thesis).
- **2020:** “What is the significance of Indo-US defence cooperation in the changing geopolitics of the Indo-Pacific region? Examine.” (The Quad is a core component of this defence cooperation).
- **2018:** “In what ways would the ongoing US-Iran nuclear pact controversy affect India’s interests?” / “The USA is facing an increasingly assertive China in the South China Sea. Explain.” (Establishes the context from which the Quad emerged).

- **UPSC CSE Prelims (General Studies)**

- **2021:** Which one of the following is a grouping of countries that includes India, Japan, Australia and the United States? (a) ASEAN (b) QUAD (c) BRICS (d) G20. (Direct factual recall).
- **2018:** ‘Quad’ is frequently in the news. The members of this grouping are India, Japan, Australia and which one of the following? (a) USA (b) China (c) UK (d) Russia. (Direct factual recall).



C. RANGARAJAN  
R. SUBRAMANIAN

**W**hile continuing with the critical issues to be addressed by the banking system in the coming years.

Besides enhancing the ability to underwrite big ticket loans, the regulators also have a couple of Indian banks in the global top league table.

Consolidation does not by itself improve liability structure and solve the ALM (Asset-Liability mismatch) issue, an essential precondition to take up big ticket projects. Some of the amalgamated banks have attained size comparable to 500 of few years ago.

But these banks now need organisational upgrade and cannot be just an exercise in addition and subtraction of resources of amalgamated entities. Low hanging fruits of savings in tech and other operating costs are already plucked. They need to build in touch like features for better customer service and risk management.

While not discounting the value of big banks, it may be useful to note that small banks are not inherently disadvantaged. For example, a case study by NIBM points out that a relatively small bank, like Bank of Maharashtra has scored well above almost all the big banks in terms of various financial metrics consistently over period of over four years. This drives home that leadership and governance are as important as scale. This also underscores that banks of all sizes and focus have a role and place in contributing to the growth of real economy.

#### RBI CONSOLIDATION

It is also critical to analyse if in the process of consolidation, the local character of RBIs has been lost. For example, in Uttar Pradesh with a population of nearly 24 crore, 36 RBIs were merged into one RBI. Uttar Pradesh with a population of about 1.2 crore has also one RBI.

The four regions in UP are not evenly developed. The credit/deposit ratio of UP is around 60 per cent trails behind west and average of 80 per cent. In the case of Bihar which has much lower credit/deposit ratio of only 35 per cent.

Some of these States need more banks and not less. It is important to review the outcome of such mergers and corrective action taken, if the original purpose with which these banks were set up has been lost sight of.

#### WRITE-OFF OF BAD LOANS

The reduction of gross NPAs was largely achieved by write off of loans. During the last five years ending 2023, the write-offs were quite staggering at ₹1.2 lakh crore and only about ₹2.10 lakh crore was recovered from written-off accounts.

Haircuts in some of the large accounts were as high as 75-90 per cent of the claims against the borrowers. The real



# Global size via bank consolidation

**CHALLENGES AHEAD.** Big banks have the advantage of scale but small banks too perform well. NBFC model's vulnerabilities need to be addressed

test of the efficacy of the new amendments to IBC passed by legislature recently lies in faster resolution of stressed loans and lower haircuts.

The test of performance of banks therefore lies in loss accumulation of non-performing loans.

#### RISK MANAGEMENT

Probability of Default (PD) and Loss Given Default (LGD) were very high in recent years and this was mirrored in huge haircuts ranging from 75 per cent to over 90 per cent in resolution and recovery. Lenders need to revisit and upgrade their risk management practices to significantly reduce credit losses.

Lending particularly to business entails multi-layered risks. Inherent risk lies in the top layer and this is essentially base value of the risk. The default and delinquency risk are inherent as credit appraisal and decision is driven by projections and assumptions on various dimensions of business and the over all economy. Asset spillover implies opportunities and risks.

Even after mitigation of inherent risks, there is always a residue and this residual risk is embedded in the second

**The reduction of gross NPAs was largely achieved by write off of loans.**

**During the last five years ending 2023, the write-offs were quite staggering at ₹1.2 lakh crore and only about ₹2.10 lakh crore recovered**

layer. Lenders need to mitigate this risk through online and real time monitoring of business performance and effective and mandated use of funds.

Risk may be reallocated outside the banking system through securitisation and insurance products like Credit Default Swaps (CDS). These may be the building blocks for mitigation of Expected Loss provisions as mandated by latest RBI guidelines.

#### ON TAP LICENSING

It is over a decade that RBI granted licenses to new banks.

RBI may put in place a licensing system to authorize one or two new banks on an annual basis so that over a decade we have 15-20 new banks which may encourage innovation and competition and also help in deepening and widening banking access.

#### IMBALANCE IN FUNDING

Most of the NBFCs are non-deposit taking category and they depend heavily on banks and wholesale markets for deposits. As of September 2023, the aggregate loans of NBFCs stand around ₹1 lakh crore which was funded by borrowings of about ₹46 lakh crore and public deposits are a paltry ₹1.1 lakh crore.

This best illustrates vulnerability and imbalance in funding. This creates huge ALM mismatches and liquidity issues may turn to solvency issues. The collapse of three large NBFCs exposes these fault lines.

Banks account for over 80 per cent of NBFC resources directly and indirectly and this close interlinkage is another source of problem. NBFCs have huge exposure of nearly ₹1.5 lakh crore to the power sector, far exceeding commercial

banks' exposure of about ₹5 lakh crore and this sector contributed to huge NPAs of commercial banks in the earlier decade.

Between 2021-2023 September, aggregate credit of NBFCs grew much faster at 52 per cent as compared to commercial banks credit growth rate of 36 per cent and this only emphasizes the need to address imbalance in funding.

RBI's scale-based regulation (SBR) is a welcome measure, but it does not address the fundamental vulnerability of the business model of NBFC. Even DI is face this imbalance problem.

#### TECHNOLOGICAL CHANGES

The adoption of AI, including generative AI in banking is gaining momentum. Banks need to rethink the entire workflow at strategic, operational and tactical levels. Digital trade however are on the increase and it is important to further step up preventive as well as curative actions and avoid erosion of public trust in digital channels.

Bank credit is a supportive condition for growth of real economy. Growth of other sectors of finance notwithstanding, banking will continue to play a dominant role. At the current growth rate, bank credit may triple in the next 10 years or even earlier. Hence it is vital that policy makers and bankers pay heed to the opportunities, issues and concerns that may confront the banking system and we have highlighted some of them.

**(This is the second and concluding part of a two-part series).**

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## • Key Terms and Explanations

- • **Asset Liability Mismatch (ALM):** This is the risk arising when a bank's assets (like long-term infrastructure loans) have a different maturity or interest rate profile than its liabilities (like short-term deposits). For example, if a bank funds a 15-year power project with deposits that can be withdrawn in one year, it faces a liquidity crunch if depositors demand money before the loan is repaid. ALM management is a precondition for undertaking big-ticket lending safely.
  - • **Gross Non-Performing Assets (GNPA):** Loans where interest or principal remains overdue for more than 90 days. The article notes that reduction in GNPA was achieved largely through write-offs, not just recovery. A loan becomes an NPA when a borrower stops servicing debt, damaging bank profitability and capital.
  - • **Write-off:** Removing a bad loan from the bank's balance sheet, usually after provisioning fully for it. It does not mean the borrower is forgiven; recovery efforts continue. The article reveals that in five years, write-offs of Rs 9.2 lakh crore were offset by recoveries of only Rs 2.1 lakh crore, indicating poor retrieval.
  - • **Haircut:** The loss taken by lenders when a stressed loan is settled for less than the full claim. A 75% haircut means the bank recovers only 25 paise on every rupee owed. The article mentions haircuts as high as 75–90% in large accounts, pointing to severe credit loss.
  - • **Insolvency and Bankruptcy Code (IBC), 2016:** A unified law for time-bound resolution of insolvent firms. The recent legislative amendments aim to speed up resolution and reduce haircuts. Its real test, as the article says, lies in faster resolution and lower haircuts.
  - • **Probability of Default (PD) and Loss Given Default (LGD):** PD estimates how likely a borrower is to default; LGD estimates how much money the bank may lose if default occurs. High PD and LGD observed in recent years, reflected in those huge haircuts, signal flawed credit appraisal and weak recovery mechanisms.
  - • **Credit Default Swap (CDS):** A financial derivative that works like insurance against loan default. A lender buys CDS protection from a third party, transferring credit risk out of the banking system. The article suggests that securitisation and CDS can help mitigate residual risk and expected loss provisions.
  - • **Securitisation:** Pooling loans and selling them as tradable securities to investors. This redistributes risk away from banks and frees up capital for fresh lending, a building block for managing expected loss as per RBI's latest guidelines.
-

- **Main arguments and substantive parts**

- **Core thesis**

- The main argument is that Indian banking reforms must now move beyond merely increasing size and reducing headline NPAs. The next frontier is qualitative strengthening: better governance, stronger liability profile, deeper rural credit, improved risk management, and technology-led but trust-preserving banking.

- The discussion implicitly argues that scale is useful, but **scale without capability** is insufficient. Large banks must become institutionally smarter, not merely numerically bigger.

- It also warns against judging banking health only by lower gross NPAs, because much reduction can come from write-offs rather than durable improvement in underwriting quality. Recent government data reported cumulative loan write-offs of ₹9.75 lakh crore over 11 financial years, underscoring the scale of clean-up.

- **Substantive pillars of the argument**

- **Consolidation has limits**

- Mergers can improve size and perhaps some operating efficiencies, but they do not automatically solve ALM mismatch, liability weakness, or risk culture problems. After the first round of synergy gains, banks need structural modernization.

- **Leadership and governance matter as much as scale**

- The reference to relatively smaller banks doing well on financial indicators suggests that strategic clarity, management quality, and disciplined credit culture may outperform brute balance-sheet size. Bank of Maharashtra's recent financial results, for example, have shown strong profitability and improved asset quality indicators.

- **RRB consolidation must be reviewed from a development lens**

- If large-scale merger dilutes local responsiveness in rural and backward regions, then institutional efficiency may come at the cost of rural credit justice. The issue is especially relevant in states with low CD ratios and internal regional disparities.

- **Write-off-driven clean-up is not enough**

- A bank should not be seen as healthy merely because bad loans are moved out of the visible balance sheet. Real health means better appraisal, better monitoring, timely restructuring, and higher recovery.

- **Risk management must shift from static appraisal to dynamic surveillance**

- Lending risk is not a one-time decision at sanction stage. It must be tracked throughout the loan life cycle through data, monitoring, sector intelligence, and covenant enforcement.

- **On-tap licensing can improve competition and innovation**

- Periodic entry of new banks may energize the system, deepen access, and create pressure for service quality and product innovation.

- **NBFC funding structure is fragile**

- Heavy dependence on borrowings instead of stable deposits creates structural vulnerability, especially when short-term liabilities fund long-term or risky assets. RBI-reported sector data showed NBFC loans and advances around ₹52.06 lakh crore by September 2025.

- **Technology is both opportunity and risk**

- AI can improve service delivery, credit analytics, and compliance, but digital frauds can erode public trust. Therefore, workforce reskilling and cyber-resilience become central to banking reform.

## • Historical Evolution of the Issue

- Pre-1969: Banking was largely private, concentrated in urban areas, with limited rural credit. Industrial lending was cautious.
- 1969 and 1980 nationalisation: Large banks were brought under government ownership to serve the social agenda, leading to branch expansion in rural areas and priority sector lending. This phase created a culture of directed credit, sometimes compromising commercial judgement.
- Establishment of RRBs (1975–76): Based on the Narasimham Committee's recommendation, RRBs were created to combine local feel and cooperative spirit with the professionalism of commercial banks, reaching marginal farmers and rural artisans. Each RRB was district-specific, ensuring close local connection.
- 1991 reforms and NPA recognition: Financial sector reforms introduced prudential norms, income recognition, and asset classification. Accumulated hidden NPAs surfaced, leading to the first big NPA crisis in the 1990s. Several measures like DRTs, SARFAESI Act 2002, and ARC introduction attempted to speed up recovery.
- Consolidation wave in PSBs: The Narasimham Committee II (1998) proposed a three-tier banking structure with large banks. After the global financial crisis, the government began merging PSBs, culminating in the mega-mergers of 2019–20, reducing the number of PSBs to 12. The stated goal was creating globally competitive banks and realising synergies.
- IBC enactment (2016): A paradigm shift from debtor-in-possession to creditor-in-control. Initially successful, the code faced delays, high haircuts, and a clogged NCLT. Amendments in 2023–25 aimed to tighten timelines and introduce pre-packaged insolvency.
- Write-off surge post-2015: Following the Asset Quality Review by RBI, banks recognised huge NPAs, especially in infrastructure, power, and steel. Subsequent provisioning and write-offs cleaned balance sheets, but recoveries lagged. The Rs 9.2 lakh crore write-off figure over five years reflects this trend.
- NBFC growth and crisis: Post-2000, NBFCs grew rapidly, funding infrastructure and real estate. Reliance on short-term borrowings for long-term assets caused the IL&FS collapse in 2018, followed by DHFL and others. RBI introduced SBR in 2021 to tier regulations. Yet, as the article notes, fundamental funding imbalance persists.
- Digitalisation journey: From core banking solutions in early 2000s to UPI-led payment revolution, banks rapidly digitised. AI adoption is now gaining momentum, but digital frauds have multiplied, requiring continuous upgrade of security and skills.



# AXIA IAS ACADEMY: CRITICAL ISSUES IN THE INDIAN

# BANKING SYSTEM – STRATEGIES FOR THE COMING YEARS

## GLOBAL LEAGUE & UNDERWRITING

**BANK**  
**GLOBAL TOP LEAGUE**

ASPIRATION: ENHANCE ABILITY TO UNDERWRITE BIG TICKET LOANS & HAVE INDIAN BANKS IN THE GLOBAL TOP LEAGUE.

## NBFC FUNDING VULNERABILITY

**BANK SYSTEM** vs **NBFC SYSTEM**

COLLAPSE OF 3 LARGE NBFCs

## TECHNOLOGICAL ADOPTION

**AI**  
AGENTIC AI GAINING MOMENTUM

NEED TO RESKILL WORKFORCE (STRATEGIC, OPERATIONAL, TACTICAL)

DIGITAL FRAUDS ON THE INCREASE. STEP UP PREVENTIVE & CURATIVE ACTIONS

BANK CREDIT A SUPPORTIVE CONDITION FOR REAL ECONOMY GROWTH

BANK CREDIT TREBLING OVER NEXT 10 YEARS

## SCALE & ORGANIZATIONAL UPGRADE

**AMALGAMATED BANK (SBI SIZE A FEW YRS AGO)** vs **ORGANIZATIONAL UPGRADE**

- +** TECH & OPERATING COST SAVINGS (LOW HANGING FRUITS ALREADY PLUCKED)
- CHALLENGE: CONSOLIDATION ALONE DOES NOT IMPROVE LIABILITY STRUCTURE OR SOLVE ALM MISMATCH.
- +** BUILD FINTECH-LIKE FEATURES FOR CUSTOMER SERVICE & RISK MANAGEMENT.

**+** TECH & OPERATING COST SAVINGS (9% ALREADY PLUCKED)

**-** CONSOLIDATION ALONE DOES NOT IMPROVE LIABILITY STRUCTURE OR SOLVE ALM MISMATCH.

**+** BUILD FINTECH-LIKE FEATURES FOR CUSTOMER SERVICE & RISK MANAGEMENT.

**IBC** vs **NBFC**

- +** TEST: FASTER RESOLUTION & LOWER HAIRCUTE. EFFICACY OF IBC AMENDMENTS
- +** TEST OF PERFORMANCE: less accumulation of non-performing loans

## RRB CONSOLIDATION & REGIONAL CHARACTER

**UP** → 36 RRBs MERGED INTO ONE RRB (24 CR POPULATION)

**Bihar: RRB**

**Uttarakhand** → ONE RRB (1.2 CR POPULATION)

LOCAL CHARACTER LOST?

**C/D Ratio**

Region	C/D Ratio
UP	60%
Bihar	55%
National Average	80%

SOME STATES NEED MORE BANKS, NOT LESS. REVIEW MERGER OUTCOMES & CORRECTIVE ACTION

## NPA RESOLUTION & RECOVERY

**GROSS NPAs (REDUCED LARGELY BY WRITE-OFFS)**

**₹9.2 LAKH CRORE WRITE-OFFS (LAST 5 YRS to 2025)**

**75%** **90%**

HAIRCUTS IN LARGE ACCOUNTS (75-90%)

₹2.10 LAKH CRORE RECOVERED FROM WRITTEN-OFF ACCOUNTS

## EXPOSURE TO POWER SECTOR

**FUNDING IMBALANCE: VULNERABILITY & ALM MISMATCHES**

**EXPOSURE TO POWER SECTOR**

SEPT 2025: NBFC ASSET-LIAB GAP: ₹52 LAKH CRORE

FUNDED BY: ₹46 LAKH CRORE BORROWINGS

₹13 LAKH CRORE (NBFCs)

₹8 LAKH CRORE (COMMERCIAL BANKS)

₹1.2 LAKH CRORE PUBLIC DEPOSITS

CLOSE INTERLINKAGE (>40% OF RESOURCES) & FUNDING FAULT LINES

RBI'S SCALE-BASED REGULATION (SBR) WELCOME, BUT DOESN'T SOLVE FUNDAMENTAL VULNERABILITY

## LICENSING & COMPETITION

**ANNUAL AUTHORISATION (1-2 NEW BANKS)**

AUTHORISE 1-2 NEW BANKS ANNUALLY → 15-20 NEW BANKS OVER A DECADE

ENCOURAGE INNOVATION & COMPETITIVENESS

DEEPENING & WIDENING BANKING ACCESS

- **Logical and Philosophical Base**

- • Governance over scale logic: The article invokes a philosophy where institutional quality and leadership matter more than sheer size. This aligns with the New Institutional Economics view that rules, governance, and management practices determine performance, not just resources.
- • Subsidiarity principle in RRB consolidation: Implicitly, the argument that local character must be preserved rests on the idea that decisions should be taken as close as possible to the affected communities. A single RRB for a vast, diverse state violates this principle, making credit delivery impersonal and less responsive.
- • Risk management as a moral and prudential imperative: The emphasis on PD, LGD, and layered risk mitigation reflects a precautionary philosophy. In lending, animal spirits and optimism can inflate bubbles. Recognizing that residual risk always remains pushes banks to redistribute risk through markets rather than hoarding it, echoing a deontological duty to protect depositor money.
- • Competition and innovation through licencing: The call for annual licensing is rooted in classical liberal thought that entry freedom enhances efficiency, innovation, and consumer welfare. The decade-long freeze is seen as a departure from this principle.
- • Systemic interconnectedness and duty of care: The NBFC vulnerability argument is grounded in systems thinking. No financial entity exists in isolation; a collapse triggers a contagion. Hence, regulation cannot just look at individual entities but must address structural funding imbalances, a concept tied to macroprudential philosophy.
- • Epistemology of credit risk: The article accepts the limits of prediction. Despite best projections, inherent risk remains because the future is uncertain. This aligns with Knightian uncertainty—risk can be measured, but uncertainty cannot. Therefore, banks must build buffers, monitor in real time, and redistribute risk rather than assume they can perfectly forecast defaults.

## • **Multidimensional Analysis**

- • **Social:** Consolidation and RRB mergers can worsen financial exclusion in underdeveloped regions. When local bank branches disappear or lose autonomy, small borrowers, farmers, and SHGs face greater difficulty accessing credit, perpetuating income inequality. Digital frauds disproportionately affect the less tech-savvy, widening the trust gap in digital banking.
- • **Political:** Mergers and licensing are political decisions. The push for global-sized banks reflects national ambition, but it can be seen as favouring corporate India over small borrowers. Loan waivers and the narrative around write-offs become electoral tools. The demand for reviewing RRB consolidation may gain political traction in states like UP and Bihar, where regional parties champion local development.
- • **Legal:** IBC amendments must pass constitutional muster regarding creditor equality and operational creditor rights. SARFAESI and DRT laws need harmonisation with IBC. The legality of large write-offs and their impact on minority shareholders and depositor protection could be contested. Data privacy and AI regulations (Digital Personal Data Protection Act) will determine how banks use AI for credit decisions.
- • **Ethical:** High haircuts raise moral hazard—if large defaulters can settle by paying a fraction, the incentive to repay weakens. Governance failures, as evidenced by some NBFC collapses, question the integrity of rating agencies and auditors. Using AI to profile borrowers raises concerns of algorithmic bias, potentially denying credit to marginalised groups without transparent recourse.
- • **International:** The aspiration to place Indian banks in the global top league necessitates compliance with Basel III norms, strong capital adequacy, and risk management comparable to global peers. Cross-border exposures increase; a globally significant Indian bank would invite stricter oversight from international bodies like the Financial Stability Board. International bond investors will watch CDS market depth and resolution frameworks before investing.
- • **Economic:** Bank credit is projected to treble, supporting GDP growth. But the NBFC funding imbalance could amplify systemic risk, derailing growth. ALM mismatches in banks and NBFCs could trigger liquidity crises requiring RBI intervention. Risk redistribution through securitisation and CDS could deepen the corporate bond market, reducing over-dependence on banks. However, economic shocks like commodity price spikes or geopolitical tensions can quickly transform expected losses into real losses, testing the new provisioning norms.

- **Linkages with NCERTs**


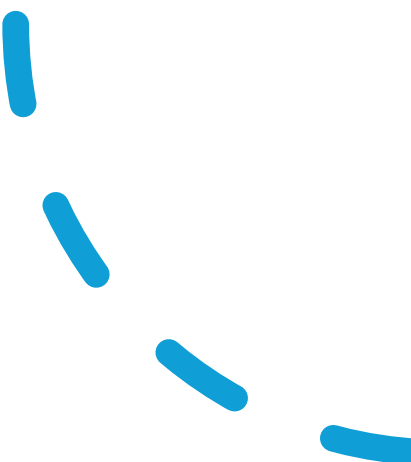
- • Class 11, Indian Economic Development, Chapter on “Rural Development”: Discusses rural credit, role of RRBs, cooperative banks, and microfinance. The issue of RRB consolidation’s impact on rural credit and low CD ratio in UP and Bihar directly connects here, highlighting challenges in rural credit delivery.
- • Class 12, Macroeconomics, Chapter “Money and Banking”: Explains functions of central bank, commercial banks, credit creation, and monetary policy. The discussion on ALM, NPAs, and the need for robust risk management flows naturally from the textbook’s coverage of bank balance sheets and credit risks.
- • Class 12, Macroeconomics, Chapter “Government Budget and the Economy”: Touches on public sector enterprises and disinvestment; the governance and performance of public sector banks (including write-offs and consolidation) relate to how government-owned entities manage public money.
- • Class 10, Economics, Chapter “Money and Credit”: Introduces formal and informal credit sources, terms of credit, and the importance of collateral. The article’s concern about financial inclusion, RRBs, and small banks links to the idea that access to affordable credit remains unequal, and consolidation might hinder it.

- **Linkages with UPSC CSE Syllabus**

- • GS Paper 3 – Indian Economy and issues relating to planning, mobilisation of resources, growth, development: Banking sector reforms, NPAs, IBC, NBFC regulation, credit growth, financial inclusion, risk management. This is the strongest linkage. The entire article fits within “Indian Economy” topics.
- • GS Paper 2 – Governance, Regulatory bodies: RBI’s role, scale-based regulation, licensing, issues of transparency and accountability in write-offs, amendments to IBC, and functioning of NCLT. Also, issues relating to the federal structure if we consider RRB consolidation impacting state-specific needs.
- • GS Paper 4 – Ethics, Integrity, and Aptitude: Ethical concerns in corporate governance, moral hazard from high haircuts, public trust in digital banking, probity in managing public sector banks, and ethical use of AI in credit decisions. A case study can be framed around a banker facing pressure to approve a risky big-ticket loan.
- • Essay Paper: Topics like “Scale vs. Governance in Indian Banking”, “Financial Inclusion: The Unfinished Agenda”, “Technology and Trust in Banking”, or “Moral Hazard in Public Finance” can draw heavily from the article.

- **Way Forward**

- • Strengthen IBC ecosystem: Fast-track NCLT appointments, digitise processes, and promote pre-packaged insolvency to deliver on lower haircuts and faster resolution. Create a secondary market for distressed assets to improve recovery.
- • Conduct a transparent review of RRB consolidation: The Ministry of Finance and NABARD should commission an independent study evaluating post-merger credit penetration, local character retention, and financial inclusion in states like UP and Bihar. Based on findings, consider de-merging some RRBs or introducing regional sub-autonomy with distinct governance.
- • Operationalise risk redistribution: RBI could issue guidelines to develop a liquid CDS market with standardised contracts and adequate margin requirements. Encourage securitisation with proper disclosure norms so that banks can transfer residual risk, aligning with expected loss provisioning frameworks.
- • Introduce annual on-tap licensing: RBI should open a regular window for banking licences, evaluating applicants on governance, financial inclusion plans, and technology adoption. This will increase competition and bring niche banks for underserved segments.
- • Address NBFC funding imbalance: Gradually allow larger, well-governed NBFCs to access a regulated proportion of public deposits, while strengthening ALM norms under SBR. Develop a deep long-term bond market with credit enhancement to reduce wholesale dependence.
- • Human capital transformation: Banks must design reskilling programmes for AI and digital roles, from board to branch level. Create a dedicated cadre of risk professionals. Incentivise performance through flexible HR policies in PSBs.
- • Fortify digital trust: Establish a national-level cyber fraud monitoring and redressal coordination agency linking banks, telecom, and law enforcement. Run public awareness campaigns in vernacular languages to protect customers, especially in rural areas.

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- UPSC CSE Mains:
  - 2023: “Digital financial inclusion has made remarkable progress in India, yet challenges remain. Discuss.” (GS3)
  - 2022: “The problem of Non-Performing Assets (NPAs) has been a major concern for the Indian banking sector. Discuss the steps taken by the government and RBI to tackle this issue.” (GS3)
  - 2021: “Critically evaluate the consolidation of public sector banks in India.” (GS3)
  - 2020: “Discuss the role of NBFCs in the Indian financial system. What are the regulatory challenges posed by their growth?” (GS3)
  - 2019: “Explain the concept of Insolvency and Bankruptcy Code. How has it impacted the resolution of stressed assets in India?” (GS3)
  - 2018: “Examine the causes and consequences of Non-Performing Assets in Indian banking sector. What measures have been taken to address it?” (GS3)
  - 2017: “What are Regional Rural Banks? Examine their role in financial inclusion and the challenges they face.” (GS3)
  - 2016: “Discuss the significance of ‘Small Banks’ and ‘Payments Banks’ in furthering financial inclusion in India.” (GS3)
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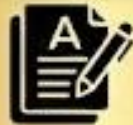
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