



AXIA IAS ACADEMY



**EDITORIAL
ANALYSIS**



JULY 10



**CONSISTENT
COMPREHENSIVE
AND CREDIBLE**



**UNIQUE AND BEST
IN QUALITY**

- 1. Building a durable India-Australia partnership (THE HINDU)**
- 2. Why India should expand its cash transfers to women (MINT)**
- 3. Mis-selling regulations need a lot more teeth (THE HINDUSTAN TIMES)**
- 4. Capitalise on What 1991 Began (THE ECONOMIC TIMES)**



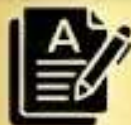
AXIA IAS ACADEMY

UPSC CSE CLASSES

RISE ABOVE THE REST



EXPERT
FACULTY &
GUIDANCE



COMPREHENSIVE
SYLLABUS
COVERAGE



STRATEGIC
TEST SERIES &
MENTORSHIP

ADMISSIONS OPEN

- Prelims + Mains + Interview
- Current Affairs Focus
- Personalized Attention
- Online & Offline Batches



WEBSITE: axiaiasacademy.com



CONTACT: +91 6002-417488



Building a durable India-Australia partnership

Prime Minister Narendra Modi's visit to Australia this week has been big on substance and high on optics. The choreography is familiar now given the warmth in the relationship: a forward-leaning leadership interaction, a massive diaspora event and a joint statement packed with deliverables and road maps. The Australian government sees India as central to its economic diversification strategy. Its new economic road map and packed ministerial calendar for India underwrite this intent. The elite consensus seems bipartisan and the convergence only growing.

Turning convergence into alignment

Yet, the harder part for most strategic relationships is drawing the line between convergence and alignment. The two might sound like synonyms, but they are not. Convergence is two countries arriving at similar conclusions about the world for their own reasons. Alignment is what happens when those separate conclusions are built into matching capabilities, institutions and habits of engagement. India and Australia have achieved a great deal of the first. The real test of this visit, and of the years after it, is whether it endures by delivering the second.

The convergence is not in doubt, and it is easy to see why it has deepened. Both countries are hedging against overdependence in a global order in transition. Australia's dependence on China, and its alliance dependence on an unpredictable Washington, have come under visible strain. This year's Lowy Institute Poll found trust in the United States at a record low of 31%, with a narrow margin of Australians saying that Canberra should distance itself from Washington under U.S. President Donald Trump. India is running its parallel diversification across energy suppliers, defence platforms and critical minerals processing, driven by a similar instinct.

New Delhi wants to limit its exposure; the Iran and Ukraine conflicts have driven home that any single-point dependency, however longstanding, is now a liability. No country can single-handedly balance China or hedge against American unpredictability. Together, and alongside partners such as Japan, they improve their odds. That is genuine convergence.

This visit has produced tangible evidence of that strategic lock-in. A Joint Declaration on Defence and Security Cooperation delivers a memorandum of understanding (MoU) between Australia's Maritime Border Command and the



Shiruti Pandalai

Inaugural India Chair
at The Lowy Institute,
Sydney, Australia

Beyond warm optics and deepening convergence, India-Australia ties face the challenge of converting trust into alignment

Indian Coast Guard and adopts an India-Australia Maritime Security Collaboration Roadmap to address shared threat perceptions. These are practical mechanisms that deepen interoperability without altering the basic character of the relationship: India remains a trusted security partner, not an ally. On energy security, Australian uranium has been legally available to India since the bilateral 2014 civil nuclear agreement, but it never actually moved commercially, largely because India's own nuclear liability law made foreign suppliers nervous about exposure.

That changed with the SHANTI Act last December, which reformed that liability regime. The agreement on uranium has operationalised a deal lying dormant for a decade. The summit also launched the Australia-India Partnership on Cyber, Critical Technologies and Supply Chains (PACTS), while reaffirming the complementarity to the Australia-Canada-India Technology and Innovation Partnership as focusing on building resilient technology partnerships through flexible multilateral arrangements. These are examples of alignment beginning to take institutional form.

There are focus areas, there are problems

But for alignment to be durable, convergence must translate into operational overlap. This is most consequential in the Indian Ocean, a region where Australian and Indian interests overlap most naturally. Both are Indian Ocean states with real stakes in the region's sea lanes. India's Information Fusion Centre-Indian Ocean Region has emerged as a key hub for maritime domain awareness, even as Australia pays closer attention to its western seaboard and Indian Ocean approaches. The two navies have converged on similar risk assessments of shadow fleets, threats to undersea cables and coercive activity below the threshold of conflict.

The new Coast Guard MoU and Maritime Security Collaboration Roadmap narrow the gap between strategic intent and operational cooperation. Yet, Australia's most consequential force-structure decisions, from AUKUS (trilateral security partnership between Australia, the United Kingdom, and the U.S.) to its broader defence posture, remain oriented towards the Western Pacific, while India's strategic planners continue to divide attention between continental threats and maritime challenges. The shared ground is real; it is simply narrower than the political convergence sometimes suggests.

Economically, the pattern is similar. Trade has

grown sharply since the Economic Cooperation and Trade Agreement came into force, but industry voices behind closed doors argue that growth sits disproportionately with large firms. Smaller exporters on both sides remain unaware of how to use it. Track 1.5 dialogues have flagged this as an operationalisation gap.

The knowledge deficit is more obvious when one looks at Australian public consciousness on India. This year's Lowy Poll found only 5% of Australians expect India to be the world's most important power a decade from now, against 54% for China, even as trust in India remains comparatively high. Convergence at the top has not yet trickled down into wider awareness of India's strategic heft.

The diaspora opportunity

The diaspora remains the biggest opportunity to change this, but with a caveat. Indian-origin Australians are now the country's largest immigrant-born community, ahead of the U.K.-born population for the first time. Political leadership has celebrated the diaspora's contribution, and a Centre for Australia-India Relations study finds that Australians broadly recognise it as skilled migrants, students and workers. But recognising the diaspora as a cultural asset, or an electoral constituency, is not alignment. Alignment would require translating that diaspora leverage into a public case for why India matters economically to the average Australian. It would require institutionalising the diaspora's comparative advantage in helping Australian Small and Medium-sized Enterprises navigate Indian regulatory and business culture, and vice versa, rather than leaving that work to individual champions. It would also mean untangling the mobility of Indian professionals from Australia's increasingly fraught migration politics.

Mr. Modi's visit has provided fresh ballast for these conversations about the future of the India-Australia partnership. His message on Australian Pension funds investing in India particularly resonated in the room when he said India would not just treat them as capital but as a marker of strategic trust imposed by Australian families in India. These statements matter because they build the broader public consciousness of India as a trusted partner for the future. Convergence got India and Australia to the table; it is these steps that institutionalise engagement incrementally that build alignment that endures.

- **Key Terms and Explanations**
- **Strategic Convergence:** This occurs when two sovereign nations independently arrive at similar conclusions about regional or global security and political architectures, driven by their respective national interests.
 - *Example:* Both India and Australia share deep concerns regarding the unilateral expansion and aggressive maritime assertions of China in the Indo-Pacific region, prompting them to cooperate without formally merging their foreign policies.
- **Strategic Alignment:** Moving a step beyond convergence, alignment is the practical institutionalization of shared worldviews. It involves translating common conclusions into matching military capabilities, synchronized institutional frameworks, and regularized habits of administrative and defense engagement.
- **Interoperability:** The operational capacity of different military forces, command structures, and tech platforms to conduct joint operations, share real-time data, and seamlessly communicate during crises or peacetime exercises.
 - *Example:* The joint naval exercise *AUSINDEX* allows the Indian and Australian navies to operate together using compatible communication protocols and logistics sharing.
- **Minilateralism:** A modern diplomatic strategy that favors small, flexible, and targeted functional groupings of countries over large, bureaucratic multilateral institutions (like the UN). Minilateralism focuses on rapid, issue-based outcomes.
 - *Example:* Groupings like the Quad (India, Australia, US, Japan) or the *Partnership on Cyber, Critical Technologies and Supply Chains (PACTS)*.
- **Diaspora Leverage:** The systematic economic, political, and cultural influence exerted by an immigrant community within their host country to strengthen ties with their nation of origin.
- **Shadow Fleets:** Networks of commercially unidentified, poorly insured, or state-masked maritime vessels used by nations to bypass international sanctions, manage clandestine energy transfers, or conduct grey-zone maritime operations.
- **AUKUS:** A trilateral security pact established between Australia, the United Kingdom, and the United States. Its primary objective is to assist Australia in acquiring conventionally armed, nuclear-powered submarines, firmly anchoring Australia's defense architecture within the Western Pacific.
- **ECTA (Economic Cooperation and Trade Agreement):** A landmark interim trade agreement signed between India and Australia to drastically reduce tariffs, open up service sectors, and smooth out regulatory bottlenecks for smoother bilateral trade.
- **SHANTI Act:** A recent, transformative legislative reform designed to restructure civil nuclear liability regimes. By addressing the financial and legal risks that foreign suppliers face under previous nuclear liability laws, it commercializes long-dormant bilateral civil nuclear agreements.

- **Main Arguments and Substantive Parts**
- The contemporary India-Australia relationship is undergoing a paradigm shift, transitioning from political warmth to institutionalized resilience. The core arguments driving this relationship include:
- **The Shift from Shared Perspectives to Hard Realities**
- The primary thesis of the current geopolitical discourse centers on the critical transition from **Strategic Convergence** to **Strategic Alignment**. While political leaders frequently celebrate shared democratic values and common regional outlooks, the true durability of the partnership rests on operationalizing these ideas into hard, everyday institutional structures.
- **Hedging Against Global Volatility and Overdependence**
- Both New Delhi and Canberra are actively navigating a global order in transition, marked by significant structural strains:
- **Australia's Strategic Dilemma:** Canberra is grappling with an overdependence on China for economic growth, alongside a growing domestic wariness regarding the predictability of its traditional security guarantor, the United States.
- **India's Diversification Drive:** Driven by vulnerabilities exposed by contemporary Eurasian conflicts, India is systematically mitigating risks associated with single-point dependencies in defense procurement, energy corridors, and critical minerals processing.
- **The Power of Collective Balancing:** Neither nation can single-handedly balance a rising regional superpower or completely insulate itself from global instability. Together, they create a formidable balancing mechanism in the Indo-Pacific.
- **The Operational Reality vs. Political Intent**
- Despite deep political warmth, structural gaps persist in security and trade architectures:
- **Geographical Focus Divergence:** Australia's long-term force structures and financial commitments (such as AUKUS) remain heavily anchored toward the Western Pacific. In contrast, India's strategic focus is split between continental border threats and the security of the Indian Ocean Region (IOR).
- **Economic Asymmetry:** While bilateral trade has expanded rapidly under ECTA, the benefits remain concentrated among large conglomerates. Small and Medium-sized Enterprises (SMEs) face a steep knowledge deficit, struggling to navigate the regulatory and business cultures of both nations.
- **Public Awareness Deficit:** Public perception has not caught up with elite strategic consensus. A vast majority of the Australian public still underestimates India's long-term global power trajectory, highlighting the need for deeper cultural and institutional engagement.
- **Transforming the Diaspora into a Strategic Asset**
- The Indian diaspora in Australia has grown to surpass other traditional immigrant communities, presenting a major strategic opportunity. However, moving forward requires viewing the diaspora as more than a cultural asset or an electoral constituency. True alignment means actively deploying their skills to help SMEs navigate regulatory systems, and untangling professional mobility from domestic migration debates.

- **Historical Evolution of the Issue**

- The trajectory of India-Australia relations has evolved from post-colonial coldness to a comprehensive strategic partnership through distinct historical phases:

- **Phase 1: Cold War Estrangement (1947–1991)**

- **Divergent Geopolitical Orbits:** Following independence, India championed the Non-Aligned Movement (NAM) and maintained close defense ties with the Soviet Union. Australia firmly anchored its security within the Western alliance through the ANZUS Treaty (Australia, New Zealand, United States).

- **The Shallow "3Cs" Framework:** For decades, the relationship was superficially sustained by the traditional pillars of **C**ricket, **C**urry, and the **C**ommonwealth, completely lacking substantial strategic, economic, or technological depth.

- **Phase 2: Post-Cold War Economic Thaw (1991–2000s)**

- **Economic Re-alignment:** The launch of India's *Look East Policy* in 1991 and the liberalization of its economy sparked initial Australian commercial interest, particularly in resources and energy.

- **The 1998 Nuclear Shock:** Relations hit a major roadblock in 1998 when Australia strongly condemned India's Pokhran-II nuclear tests, freezing high-level ministerial engagements for several years.

- **Phase 3: Strategic Re-orientation (2010–2020)**

- **The Nuclear Turning Point:** The relationship normalized rapidly when Australia reversed its policy and agreed to sell uranium to India, culminating in the **2014 Civil Nuclear Cooperation Agreement**.

- **Rise of the Indo-Pacific Paradigm:** The geopolitical shift from Asia-Pacific to Indo-Pacific provided a shared geographic and conceptual framework, elevating the relationship to a "Strategic Partnership."

- **Phase 4: Comprehensive Strategic Alignment (2020–2026)**

- **Institutionalizing Cooperation:** Facing direct geopolitical challenges, the relationship was elevated to a **Comprehensive Strategic Partnership** in 2020. Key agreements like the *Mutual Logistics Support Agreement (MLSA)* were signed.

- **Modern Deliverables (2025–2026):** The operationalization of the interim ECTA, the creation of minilateral tech frameworks like PACTS, and the passage of the **SHANTI Act** (which reformed India's nuclear liability regime) have finally unlocked commercial energy transfers and deep maritime security cooperation.

TRANSFORMING INDO-AUSTRALIAN RELATIONS: FROM CONVERGENCE TO ALIGNMENT



1 SHARED WORLD VIEWS: DEEPENING STRATEGIC CONVERGENCE

Reasons:



- Hedging against China's rise (no premonitions)
- US unpredictability
- Economic Diversification (Energy, Defense, Minerals)
- Joint Statements with Deliverables

Two countries arriving at similar conclusions.



2 OPERATIONALIZING ALIGNMENT: KEY DELIVERABLES TANGIBLE EVIDENCE OF STRATEGIC LOCK-IN



- **Defense & Security:** Joint Declaration (MoU Maritime Border Command & Indian Coast Guard, Maritime Security Collaboration Roadmap)

Key deliverables matching capabilities, institutions and habits of engagement.



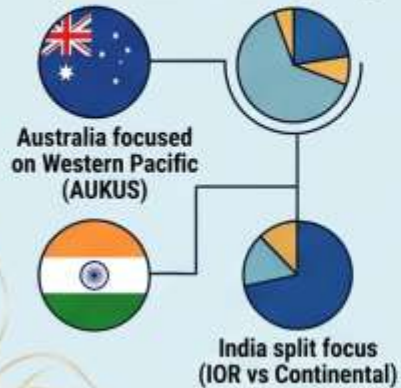
- **Energy Security:** Uranium Legal Operationalization (SHANTI Act reform)



- **Technology:** PACTS (Cyber, Critical Tech, Supply Chains)
- Australia-Canada-India Tech Partnership

3 CHALLENGES TO DURABLE ALIGNMENT

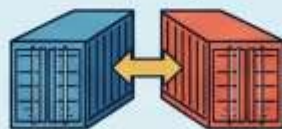
Operational Overlap Gap



Economic Gaps:

- Large Firms thrive, Small Exporters unaware of ECTA
- Operationalization Gap flag

Operationalization Gap flag



Split trade liberalization Gap flag

Public Knowledge Deficit

Infographic based on Lowy Poll



(5% of Australians see India as world's most important power vs 54% China)

Convergence at the top has not trickled down.

4 LEVERAGING THE DIASPORA OPPORTUNITY FOR ALIGNMENT



Translating diaspora leverage into a public case.

Broducting from Diaspora a Alignment

- Transform from Cultural Asset to Public Case for India's Economic Heft
- Institutionalize SME navigation of Regulatory/Business Culture
- Untangle mobility from migration politics

Strategic Trust (Australian Pension Funds investing in India)



INCREMENTAL STEPS
BUILD BUILD
DURABLE ALIGNMENT

- **Logical and Philosophical Base**

- The strategic shift in India-Australia relations is not accidental; it is anchored in established international relations theories and logical frameworks:

- **Structural Realism (Neo-realism):** At its core, the relationship is driven by the anarchic nature of the international system and the resulting balance-of-power dynamics. As a dominant power asserts itself in Asia, middle powers like Australia and rising giants like India are logically driven to pool their resources and capabilities. This minimizes their vulnerability to coercion without requiring a formal, sovereignty-limiting military alliance.

- **Strategic Autonomy and Omnidirectional Hedging:** India's foreign policy is guided by the philosophy of maintaining freedom of choice. By building strong ties with Australia, India avoids overdependence on any single partner, whether Russia for defense or Western nations for technology. Similarly, Australia uses India to hedge against its deep economic reliance on China and the shifting political landscape in Washington.

- **Neo-Liberal Institutionalism:** This framework explains the shift from mere convergence to alignment. Both nations realize that passing political goodwill is unreliable. To ensure long-term stability, they are embedding their relationship within resilient institutions, trade pacts (ECTA), joint maritime frameworks, and legislative updates (SHANTI Act).

- **Constructivist Trust Building:** International relations are also shaped by shared identities and perceptions. The deliberate use of democratic values, educational exchanges, and the growing Indian diaspora serves to build "strategic trust." This social and cultural capital helps both nations view each other as long-term partners rather than passing transactional allies.

- **Multidimensional Analysis**
- **Social Dimension**
- **Demographic Transformation:** Indian-origin individuals now form the largest immigrant-born community in Australia. This profound shift alters the multicultural fabric of Australian society and builds grass-roots familiarity with India.
- **Soft Power and Educational Exchange:** The rapidly growing population of Indian students in Australian universities serves as a vital bridge for knowledge exchange. However, this trend also demands stronger social integration measures and protection against local backlashes.
- **Political Dimension**
- **Deep Bipartisan Consensus:** A key strength of the relationship is its political resilience. In both nations, the commitment to deep strategic ties remains steady across changes in government, ensuring long-term policy continuity.
- **Domestic Migration Pressures:** The political drive to enhance professional mobility frequently collides with Australia's sensitive domestic migration debates. Managing this requires careful political communication to protect strategic goals from local electoral friction.
- **Legal Dimension**
- **Resolving Legislative Gridlocks:** The recent passage of the SHANTI Act stands as a major legal milestone. By reforming India's strict civil nuclear liability laws, it resolved a decade-long legal stalemate, allowing commercial uranium trade to finally proceed.
- **Harmonizing Trade Regulations:** The implementation of ECTA requires continuous legal alignment. Both countries must work to harmonize customs procedures, intellectual property protections, and service-sector certifications to ensure smoother trade.
- **Ethical Dimension**
- **Upholding the Rules-Based International Order:** Both nations share an ethical commitment to a regional order where might does not equal right. They advocate for international law, particularly the United Nations Convention on the Law of the Sea (UNCLOS).
- **Securing the Global Commons:** Protecting freedom of navigation, keeping sea lines of communication open, and safeguarding undersea digital infrastructure are treated as shared ethical responsibilities to support global prosperity.
- **International Dimension**
- **Reshaping the Indo-Pacific Architecture:** The partnership serves as a central pillar of the Quad, working to maintain a multipolar balance in the region. It builds a diplomatic network that prevents any single power from dominating Asia.
- **Managing Overlapping Security Postures:** Both nations must carefully balance their varying security commitments. Australia remains deeply integrated into Western structures like AUKUS, while India maintains its traditional strategic autonomy and continental defense focus.
- **Economic Dimension**
- **Securing Critical Supply Chains:** Driven by frameworks like PACTS, both countries are actively diversifying their supply chains away from restrictive single-source models. This is especially vital for critical minerals, rare earths, and clean energy technologies.
- **Unlocking Long-Term Institutional Wealth:** Encouraging Australian pension funds to invest directly in India's infrastructure projects marks a major step forward. It transforms surplus international capital into long-term strategic investments in India's growth.

- **Linkages with NCERTs**
- **Class 12 Political Science: *Contemporary World Politics***
 - **Chapter on 'Alternative Centres of Power':** This chapter explains how middle powers and regional groupings emerge to challenge unipolar or bipolar hegemony. The rise of the Indo-Pacific framework and the growth of the Quad are prime examples of alternative configurations adjusting the global balance of power.
 - **Chapter on 'Security in the Contemporary World':** The text's focus on non-traditional security threats—including energy security, supply chain vulnerabilities, and maritime piracy—directly underpins the logic behind the PACTS framework and joint maritime search-and-rescue operations.
- **Class 12 Political Science: *Politics in India since Independence***
 - **Chapter on 'India's External Relations':** This chapter traces India's historic shift from Nehruvian Non-Alignment to modern, pragmatic multi-alignment. The evolution of India's ties with Australia perfectly illustrates this transition: moving away from Cold War ideological distance toward interest-based strategic partnerships.

- **Linkages with UPSC CSE Syllabus**
- **GS Paper 2: Governance, Constitution, Polity, Social Justice, and International Relations**
- **Bilateral, Regional, and Global Groupings and Agreements:** Analyzing structural frameworks like the Quad, ECTA, and PACTS, along with their direct impact on safeguarding India's sovereign interests.
- **Effect of Policies and Politics of Developed and Developing Countries:** Examining how shifting domestic policies in Washington and Canberra influence India's defense, technological choices, and trade posture.
- **Indian Diaspora:** Evaluating the changing role of the Indian diaspora from a cultural community into a strategic economic asset that strengthens bilateral relations.
- **GS Paper 3: Technology, Economic Development, Biodiversity, Environment, Security, and Disaster Management**
- **Security Challenges and their Management:** Analyzing maritime domain awareness in the Indian Ocean Region, protecting critical undersea infrastructure, and neutralizing the gray-zone activities of shadow fleets.
- **Infrastructure and Energy:** Reviewing the commercialization of civil nuclear agreements via the SHANTI Act and mobilizing international institutional capital for national infrastructure projects.
- **Essay Paper & Optional Subjects (PSIR, Geography)**
- **Strategic Themes:** Highly applicable for essays focusing on Indo-Pacific geopolitics, middle-power diplomacy, or the economic impact of the global diaspora.
- **Political Science & International Relations (PSIR):** Directly relevant to Paper 2 (Global Centers of Power, India's Foreign Policy, and Contemporary Regional Strategic Groupings).



- **Way Forward**

- To transform strategic convergence into a lasting, resilient alignment, India and Australia should focus on targeted, practical policy reforms:

- **Bridging the Operationalization Gap for SMEs**

- While large corporations leverage free trade agreements easily, smaller businesses often lack the resources to navigate complex international markets.

- **Policy Action:** Establish dedicated *Bilateral SME Helpdesks* and joint business incubators in major industrial hubs. These centers will offer clear guidance on regulatory compliance, tax systems, and market entry strategies for both Indian and Australian small businesses.

- **Synchronizing Regional Maritime Postures**

- The differing geographic focus areas of both navies can create operational gaps that limit the effectiveness of their maritime cooperation.

- **Policy Action:** Expand the scope of India's *Information Fusion Centre-Indian Ocean Region (IFC-IOR)* by regularly embedding Australian liaison officers. This ensures seamless, real-time tracking of shadow fleets and swift coordination for protecting critical undersea digital cables.

- **De-politicizing Professional and Academic Mobility**

- Strict, unpredictable domestic immigration policies can easily disrupt economic partnerships and slow down shared technology initiatives.

- **Policy Action:** Create a stable, fast-track visa framework specifically tailored for highly skilled tech professionals, research scholars, and engineers. This insulates long-term economic and scientific cooperation from short-term domestic political shifts.

- **Operationalizing Strategic Long-Term Capital**

- India's infrastructure requires substantial investment, while Australia possesses large volumes of institutional pension funds seeking stable, long-term returns.

- **Policy Action:** Design special, sovereign-backed investment channels that shield foreign institutional investments from sudden currency swings and bureaucratic delays, making infrastructure projects highly attractive to Australian pension funds.

- **Mitigating the Public and Academic Knowledge Deficit**

- Elite strategic agreements cannot achieve their full potential if the wider public and business communities remain unaware of the partner nation's strategic value.

- **Policy Action:** Launch funded, bilateral think-tank networks, joint university research programs, and regular media exchanges. These initiatives will build deeper public awareness of India's growing economic importance and strategic weight within Australia.

UPSC CSE Prelims

1. With reference to the 'Quad Grouping', consider the following statements: (Model Question)

- 1.It was initially conceived as a strategic concept by Japanese Prime Minister Shinzo Abe.
- 2.All member nations of the Quad carry out the annual Malabar naval exercise.
- 3.It operates through a formal, centralized military command structure located in Hawaii.

Which of the statements given above are correct?

- A) 1 and 2 only
- B) 2 and 3 only
- C) 1 and 3 only
- D) 1, 2, and 3

Answer: A

2. In the context of global maritime security, the term 'Shadow Fleets' most accurately refers to: (Model Question)

- A) Submerged autonomous naval vessels deployed for deep-sea espionage.
- B) Commercial vessels with hidden ownership used to bypass sanctions and transport energy goods.
- C) Ghost ships abandoned in international waters due to environmental hazards.
- D) Specialized naval formations used exclusively for amphibious warfare operations.

Answer: B

UPSC CSE Mains

- 2023 (GS Paper 2):** "The 'Quad' is transforming itself into a trade-led economic bloc from a military alliance, in present times." Discuss the statement with reference to the changing geopolitical dynamics in the Indo-Pacific region.
- 2022 (GS Paper 2):** "The USA is facing an existential threat in the form of a rising China in the Indo-Pacific region." In this context, evaluate how the security architecture of the region is changing with special reference to AUKUS and Quad.
- 2020 (GS Paper 2):** "Quad grouping has redefined itself in recent years from a maritime security framework to a comprehensive strategic entity." Critically analyze India’s position in balancing its traditional strategic autonomy with its commitments within the Quad.
- 2017 (GS Paper 2):** "The Indian Ocean Region has become a hub of strategic competition among major global powers." Discuss the implications for India's maritime security and assess its cooperation with regional partners like Australia to counter external challenges.

Why India should expand its cash transfers to women

SOUMYA KANTI GHOSH
& SHAGISHNA K.



are, respectively, member, Economic Advisory Council to the Prime Minister, member, 16th Finance Commission and group chief economic advisor, State Bank of India (SBI); and economist, SBI.

Globally, decades of research have shown that income placed in the hands of women generates far larger household welfare gains than equivalent money given to men. India is testing this at an unprecedented scale. By 2025-26, more than 15 states had unconditional cash transfer schemes for women, costing roughly ₹1.7 trillion and reaching almost 120 million beneficiaries. Yet, rigorous evidence on what these transfers achieve beyond political optics has been scarce. We examined the Mukhyamantri Majhi Ladki Bahin Yojana in Maharashtra and Subhadra Yojana in Odisha to understand how such transfers affect household finances.

Both schemes were introduced in 2024. Odisha's Subhadra Yojana provides ₹10,000 annually in two instalments to women aged 21-60 in households earning below ₹2.5 lakh per year. Maharashtra's Ladki Bahin Yojana offers ₹1,500 monthly to women aged 21-65 under similar income criteria. Our empirical analysis employed a difference-in-differ-

ence (DiD) framework to approximate the logic of a randomized control trial in observational policy settings.

First, both schemes produced large statistically significant improvements in household savings—an 84% rise in average month-end balances in Maharashtra and 45% in Odisha, with the two estimates converging almost exactly in rupee terms, despite different transfer structures, offering us strong cross-programme validation.

Second, these transfers raised spending, though not enough to exhaust the income gain. In Maharashtra, monthly expenditure rose about 46%, implying a marginal propensity to consume of about 0.9, which means that about 90% of the ₹1,500 transfer was spent. Odisha's spending rose about 28%. These findings suggest that predictable cash transfers have strengthened household liquidity, consumption support and short-term financial stability.

Third, on average, older beneficiaries saved more, while younger ones spent more. In Maharashtra, women aged 55-59 recorded the highest savings increase (91%) while those aged 45-54 showed the largest spending rise (47%). Odisha displayed a similar pattern—women aged 45-59 had the largest balance gain (46%) while those aged

21-29 had the highest spending increase (29%). Older women appear to be building precautionary medical savings, while the middle-aged use these funds for immediate household needs.

Fourth, transfers benefited the least educated and most financially constrained women the most. In Maharashtra, savings rose 85% among illiterate beneficiaries, 95% among under-matriculates and 80% among matriculates; spending rose by 56% among under-matriculates and 33% among illiterate beneficiaries. In Odisha, illiterate beneficiaries saw a 73% savings rise, compared to 23% for matriculates.

Fifth, spending composition shifted towards welfare-improving categories. Transaction-level analysis using Merchant Category Codes shows that among Ladki Bahin beneficiaries, ATM-based education spending rose from 18% to 24% of total cash spending—the largest single shift. In UPI transactions, lifestyle spending rose from 37%

to 42%, and medical spending from 8% to 10%. *Sixth*, the schemes accelerated digital financial inclusion, with UPI adoption rising significantly among beneficiaries.

Seventh, the financial benefits extended beyond direct recipients to their male household members. In Maharashtra, relatives' month-end balances increased by about 23%. At the same time, their monthly spending declined by about 49%. Before the transfers, male relatives were partially financing women's consumption. Once women began receiving cash, this implicit

obligation ended, so men could save more. Thus, total household welfare improved for everyone.

The benefits of cash transfers stretch beyond household balance sheets. Global evidence has long established that income in women's hands does not stay in women's hands alone. It flows outward into the health, nutrition and education of the next generation. India's own research confirms this

channel: women's asset ownership improves children's nutritional outcomes, and direct income for female workers is associated with better child health. With these inter-generational effects operating alongside gains in savings and consumption, the long-term welfare dividend from India's cash transfer expansion is likely far larger than assessed.

This makes the following policy recommendations not just sensible but urgent. *First*, such programmes should evolve towards a cash-plus architecture, combining income transfers with voluntary digital literacy support, self-help group linkages and access to basic financial planning. *Second*, the transfer amounts must be reviewed periodically in line with inflation. *Third*, targeting precision should be strengthened progressively and the gains from eliminating ineligible recipients must be re-invested in enhanced benefits for deserving women, not absorbed into fiscal savings. *Fourth*, the spillover evidence from this study makes a strong case for tracking household-level outcomes, not just beneficiary-level, so that the overall welfare dividend, including the positive effect of transfers on the well-being of male relatives and children, is properly measured and reported.

These are the authors' personal views.

QUICK READ

A study of unconditional transfers in Maharashtra and Odisha shows gains that go far beyond simply providing some monetary relief. The entire family benefits in multiple ways.

Governments must combine cash transfers with digital literacy support, adjust the transfer amount periodically for inflation, tighten targeting accuracy and track household-level gains.

- **Key Terms and Explanations**

- **Unconditional Cash Transfers (UCTs):** Direct welfare payments provided to a targeted demographic without any prerequisite behavior or compliance rules (such as mandatory school attendance or clinical health checks).

- *Example:* A monthly credit of ₹1,500 direct to a beneficiary's bank account, which she is free to allocate as she sees fit, contrasts directly with Conditional Cash Transfers (CCTs) that mandate specific verification actions.

- **Difference-in-Difference (DiD) Framework:** A powerful econometric tool used to establish causal relationships in observational data. It mimics a randomized control trial by comparing the change in outcomes over time between a "treatment group" (those receiving the transfer) and a highly comparable "control group" (those not receiving it). This eliminates biases arising from time-invariant hidden differences between the groups.

- **Marginal Propensity to Consume (MPC):** An economic metric that measures the proportion of incremental income that a recipient spends on immediate consumption rather than saving. Mathematically expressed as:

- $$MPC = \frac{\Delta C}{\Delta Y}$$

- Where ΔC represents the change in consumption and ΔY represents the change in income. An MPC of 0.9 implies that out of every ₹100 received, ₹90 is instantly injected back into the local economy through consumption, while ₹10 enters formal savings.

- **Merchant Category Codes (MCC):** Standardized four-digit classification numbers assigned to businesses by payment networks (like Visa, Mastercard, or RuPay) to categorize the exact nature of a retail transaction. Examining shifts in MCCs allows researchers to track whether cash is spent on welfare-improving goods like education and medicine or non-essential items.

- **Precautionary Savings Motive:** A behavioral economic theory which suggests that individuals accumulate financial reserves as a self-insurance mechanism against future unexpected adverse shocks, such as health crises, crop failures, or sudden income drops.

- **Cash-Plus Architecture:** A contemporary social protection strategy where direct financial aid is structurally combined with complementary, non-monetary developmental interventions.

- *Example:* Pairing a monthly cash stipend with mandatory or voluntary digital literacy classes, access to formal institutional credit through Self-Help Groups (SHGs), or public health counseling.

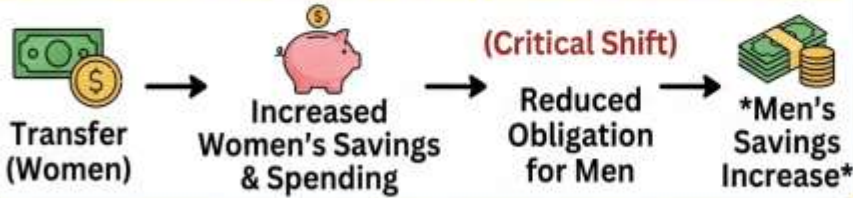
- **Main Arguments and Substantive Parts**
- **The Dual Stabilization of Household Balance Sheets**
 - Empirical evidence gathered across varying regional implementations demonstrates that unconditional cash transfers do not merely stimulate consumption; they simultaneously reinforce household financial resilience. Data indicates that even when cash transfer structures differ—such as Odisha’s bi-annual disbursement of ₹10,000 via the *Subhadra Yojana* versus Maharashtra’s monthly delivery of ₹1,500 through the *Ladki Bahin Yojana*—the net impact on average month-end bank balances converges significantly in absolute rupee terms. This represents a massive 45% to 84% expansion in household savings, providing concrete evidence that low-income families utilize these platforms for long-term financial security rather than instant dissipation.
- **The High Multiplier Effect of Marginal Consumption**
 - While savings grew, the immediate impact on consumption remains high. Beneficiaries exhibit a Marginal Propensity to Consume (MPC) hovering around 0.9 in monthly transfer setups. This implies that roughly 90% of the recurring cash injection is immediately utilized to fulfill household needs, generating a robust demand stimulus within local, rural, and semi-urban economies. The predictability of these transfers allows liquidity-constrained households to smooth out their consumption across the month, shielding them from exploitative informal credit networks.
- **Lifecycle Variations in Financial Behavior**
 - The utilization of unconditional cash transfers varies markedly based on the age of the recipient, highlighting distinct household priorities across the lifecycle:
 - **Younger Beneficiaries (Aged 21–29):** Exhibit the highest propensity to spend, channeling the incoming cash directly into immediate household consumption, nutrition, and early-childhood human capital investments.
 - **Middle-Aged Beneficiaries (Aged 45–54):** Allocate funds dynamically toward immediate domestic needs, livelihood repairs, and secondary schooling expenses for children.
 - **Older Beneficiaries (Aged 55–65):** Record the sharpest increases in month-end bank balances (upwards of 91%). These older women act as household financial managers, building dedicated precautionary pools to guard against late-stage medical shocks.
- **Progressive Equity in Wealth Redistribution**
 - The progressive nature of gender-targeted direct transfers is reflected in how effectively they serve the most marginalized demographics. The percentage growth in bank savings and essential spending is most pronounced among illiterate, under-matriculate, and severely credit-constrained women. For instance, illiterate beneficiaries frequently show double-digit expansions in active bank balances compared to their highly educated peers, proving that cash transfers operate as a powerful tool for economic equalization.
- **Structural Realignment of Consumption towards Well-being**
 - Granular analysis of digital transaction records via Merchant Category Codes indicates that cash transfers do not lead to spending on sin goods; rather, they trigger a qualitative shift in household consumption.
 - **Education:** ATM cash outlays directed toward educational expenses experience sharp upward shifts.
 - **Health and Lifestyle:** UPI-enabled transaction data reveals a rising share of funds dedicated to medical expenditures and qualitative household upgrades, reflecting long-term welfare improvements.
 - **Digital Financial Inclusion:** The necessity of accessing these funds acts as a natural catalyst for the adoption of Unified Payments Interface (UPI) ecosystems among women, systematically bridging the gender digital divide.
- **The Intra-Household "Male Spillover" Effect**
 - One of the most profound outcomes of targeted cash transfers is the positive spillover effect extended to male relatives within the beneficiary's household. Prior to these interventions, male members were under implicit obligations to partially finance the basic consumption and personal needs of the women in the family. Once direct cash transfers established an autonomous income stream for these women:
 - The informal financial strain on male relatives declined substantially, causing their individual monthly expenditures to drop by nearly half.
 - Consequently, the month-end bank balances of these male household members expanded by approximately 23%.
 - Thus, gender-targeted fiscal transfers do not create an intra-household zero-sum game; instead, they optimize the aggregate financial health of the entire family unit.

- **Historical Evolution of the Issue**
- **Pre-Independence to the 1980s (The Paternalistic, In-Kind Era):** Early Indian social protection was dominated by universal commodity subsidies and physical allocations, primarily through the Public Distribution System (PDS). State interventions viewed the household as a monolithic block, with resource management directed almost entirely through the male head of the family. Poverty alleviation schemes like the Integrated Rural Development Programme (IRDP) prioritized physical asset creation over direct income security.
- **The 1990s to 2000s (The Rise of Group Agency & Rights-Based Models):** This era saw the introduction of gender mainstreaming into macroeconomics. The National Bank for Agriculture and Rural Development (NABARD) pioneered the Self-Help Group (SHG) Bank Linkage model, proving that collectivized women were highly creditworthy. This shifted toward rights-based social safety nets, culminating in the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) of 2005. MGNREGA mandated that at least one-third of jobs be reserved for women and insisted on individual wage payments directly into bank accounts, disrupting traditional dependency models.
- **The 2010s (The Tech-Enabled Digitization Wave):** The convergence of the **JAM Trinity**—Jan Dhan accounts, Aadhaar biometric authentication, and Mobile connectivity—provided the necessary digital railway for seamless fiscal delivery. The Central Government introduced the Direct Benefit Transfer (DBT) mechanism in 2013, systematically dismantling leakage-prone intermediary layers. Targeted welfare programs such as the *Pradhan Mantri Matru Vandana Yojana* (PMMVY) utilized conditional cash architectures to promote maternal health and nutritional adjustments.
- **The 2020s to 2026 (The Era of Mass Unconditional State Welfare):** Moving past targeted, conditional, or group-based models, Indian states entered an era of universal or quasi-universal unconditional cash transfers directly geared toward women. Backed by expanding digital payment rails and evolving socio-political dynamics, competitive state-level welfare programs turned financial autonomy for women into a primary focus of state fiscal policy.



SOCIO-ECONOMIC TRANSFORMATION THROUGH GENDER-TARGETED UNCONDITIONAL CASH TRANSFERS.

INTRA-HOUSEHOLD SPILLOVER & WELFARE GAINS



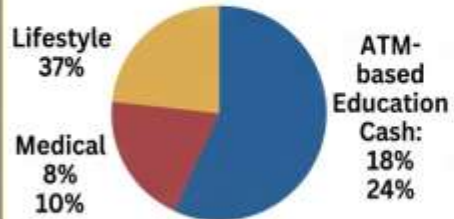
1. FINANCIAL STABILITY & MPC

- **Household Savings:** 84% Maharashtra, 45% Odisha (Averages converge)
- **Marginal Propensity to Consume (MPC ~0.9 - 90% of transfer spent)**



4. DIGITAL FINANCIAL INCLUSION

UPI TRANSACTIONS



ATM SPENDING SHIFT



Transforming Household Welfare: Lessons from Sub-national Models

INVESTMENT: UCTs IN INDIA

- **Scale:** ₹1.7 TRILLION annual cost, 120 MILLION beneficiaries
- **Target:** 15+ States, Women recipients



Mukhyamantri Majhi Ladki Bahin Yojana
(Maharashtra, ₹1,500/mo)



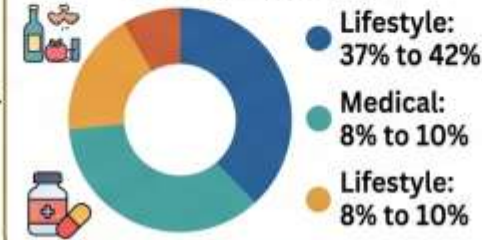
Subhadra Yojana
(Odisha, ₹10,000/yr)

PHILOSOPHICAL BASE

Amartya Sen's Capability Approach
(Enhancing Agency)
Non-Unitary Household Bargaining

2. CONSUMPTION & EDUCATION SHIFTS

UPI TRANSACTIONS



ATM SPENDING SHIFT



ATM-based Education
Cash: 18% to 24%

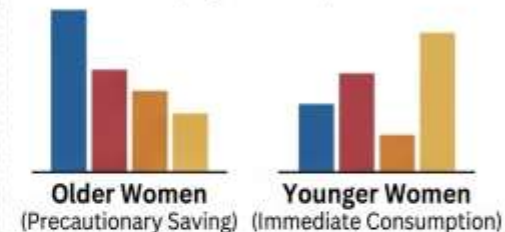
3. PROGRESSIVE EQUITY & TARGETED IMPACT

WHO BENEFITS MOST?

Least educated
(e.g., Illiterate: 85% Savings Rise)



LIFECYCLE DIFFERENCES (Age-based)



WAY FORWARD: A CALL FOR URGENT POLICY MATURATION

1. Cash-Plus Architecture (Digital Literacy, SHGs, Planning)
2. Period Review & Inflation-Indexing
3. Target Precision & Integrated Registries
4. Household-Level Outcomes Tracking



UPSC CSE SYLLABUS LINKAGES

- GS1 (Social Empowerment, Indian Society)
- GS2 (Welfare Schemes, Governance)
- GS3 (Inclusive Growth, DPI)
- GS4 (Applied Ethics, Distributive Justice)

HISTORICAL EVOLUTION (Pre-Independence to Present):



- **Logical and Philosophical Base**

- **Amartya Sen's Capability Approach**

- The logical backbone of shifting from in-kind provisions (like grains or physical assets) to unconditional cash lies within the philosophical tenets of the Capability Approach. Instead of measuring welfare purely by structural utility or commodity possession, this framework emphasizes enhancing an individual's operational freedom to choose the life they value. Unconditional cash transfers convert passive recipients into active economic agents. By extending unconstrained purchasing power to a woman, the state respects her cognitive agency, allowing her to solve her unique household trade-offs.

- **Non-Unitary Household Bargaining Models**

- Traditional microeconomics often relied on the "Unitary Household Model," which assumed that a family functions as a singular entity with a shared pool of preferences and goals. Modern behavioral and feminist economics reject this assumption, demonstrating that a household is a space of continuous intra-family negotiation. Resource allocation depends heavily on the relative bargaining power of its members.

- Placing independent, predictable income streams in the hands of women structurally alters this internal power balance. Because women globally prioritize investments in the health, nutrition, and education of children, this shift in bargaining power translates directly into enhanced long-term human capital formation.

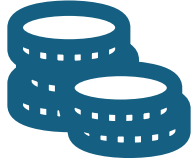
- **Multidimensional Analysis**
- **Social Dimension**
 - **Dismantling Patriarchal Dependency:** By securing an independent income source, women are relieved from total financial reliance on male counterparts for daily necessities, raising their self-worth and standing within the community.
 - **Intergenerational Welfare Dividends:** Empirical trends confirm that income held by women flows outward into the development of the next generation. Increased spending on education and medical treatment reduces infant mortality, improves child nutrition, and prevents early school dropouts.
 - **Community Cohesion and Collectivization:** Regular individual cash flows strengthen participation in village micro-credit groups, reinforcing grass-roots social capital.
- **Political Dimension**
 - **Emergence of the Autonomous Female Electorate:** The rapid expansion of these schemes highlights the consolidation of women as an independent voting bloc, often referred to as the "silent voter" phenomenon, altering traditional identity-based electoral calculations.
 - **Fiscal Populism vs. Welfare Rationalization:** Critics warn that competitive electoral promises can lead to fiscal unsustainability. However, when these schemes successfully optimize local demand and improve human development indices, they can be viewed as essential investments in social infrastructure rather than non-productive populist handouts.
- **Legal and Policy Dimension**
 - **Operationalization of Financial Inclusion Rights:** These transfer frameworks give practical meaning to financial inclusion targets, leveraging legislative backbones like the Aadhaar Act to guarantee direct, identity-verified economic support.
 - **Mitigation of Administrative Failures:** By shifting the burden of delivery from local bureaucracies to electronic clearing networks, the model minimizes corruption and extortion at the point of distribution. However, issues regarding arbitrary exclusion errors due to digital authentication failures remain a challenge.
- **Ethical Dimension**
 - **Restorative Distributive Justice:** Unconditional cash transfers function as a societal acknowledgment of the immense, uncompensated care economy and domestic labor historically sustained by women.
 - **Human Dignity vs. Bureaucratic Paternalism:** Trusting poor citizens to spend their money wisely represents an ethical shift away from state-directed paternalism (which assumes the poor cannot manage resources sensibly) toward a model that respects individual dignity.
- **International Dimension**
 - **Alignment with Sustainable Development Goals (SDGs):** These interventions directly advance multiple United Nations mandates, notably **SDG 1** (No Poverty), **SDG 5** (Gender Equality), **SDG 8** (Decent Work and Economic Growth), and **SDG 10** (Reduced Inequalities).
 - **Global South Frameworks:** India's large-scale implementations offer scalable insights for other developing economies, building upon foundational global models like Brazil's *Bolsa Família* and Mexico's *Oportunidades*.
- **Economic Dimension**
 - **Stimulating the Rural Demand Multiplier:** A high Marginal Propensity to Consume means that direct cash injections quickly recirculate through local markets, boosting micro-enterprises and stimulating rural manufacturing.
 - **Macro-Resilience Against External Shocks:** Formalized savings expansion cushions vulnerable families against unexpected shocks, preventing them from falling back into systemic poverty due to health issues or climate-induced crop failures.
 - **Formalization of the Cash Economy:** Forcing millions of new users into routine digital transaction habits accelerates the transition toward a formal, traceable, and tax-compliant financial system.

- **Linkages with NCERT Textbooks**

- **Class 11 Indian Economic Development (Chapter: Poverty & Human Capital Formation):** Directly illustrates the mechanism of state-led direct interventions. It bridges theoretical discussions on targeted poverty alleviation strategies with modern, technology-driven Direct Benefit Transfers, demonstrating how liquidity enhances human capital profiles.
- **Class 12 Macroeconomics (Chapter: Income Determination & Government Budget):** Serves as an empirical example for analyzing the Marginal Propensity to Consume (MPC) and the consumption multiplier effect within an economy. It highlights how targeted fiscal reallocations alter aggregate demand and public expenditure management.
- **Class 11 Sociology - Introducing Sociology (Chapter: Social Institutions - Family and Household):** Complements the study of structural power relations inside traditional kinship networks. It challenges the assumption of uniform family interests by showing how economic autonomy can shift intra-household decision-making power.

- **Linkages with the UPSC CSE Syllabus**
- **General Studies Paper 1 (GS1)**
- **Social Empowerment and Indian Society:** Direct relevance to topics exploring structural changes within the Indian social fabric, changes in traditional family hierarchies, and the economic empowerment of marginalized women.
- **General Studies Paper 2 (GS2)**
- **Welfare Schemes for Vulnerable Sections:** Core relevance to governance evaluation, assessing the performance, funding, and target precision of state-level interventions, as well as the digital delivery mechanisms that secure citizen entitlements.
- **General Studies Paper 3 (GS3)**
- **Inclusive Growth and Digital Public Infrastructure (DPI):** Directly linked to macro-economic planning, financial inclusion, mobilization of domestic resources, the expansion of the JAM architecture, and the broader impact of fiscal interventions on local demand and national savings.
- **General Studies Paper 4 & Essay (GS4)**
- **Applied Ethics and Distributive Justice:** Useful for exploring ethical arguments around state expenditure choices, balancing human dignity against paternalistic control, and conceptualizing governance models rooted in trust and equity.





- **Way Forward**

- **1. Transition to a "Cash-Plus" Architecture**

- To prevent cash transfers from functioning merely as short-term consumption support, state governments should evolve these programs into holistic, multidimensional platforms. Payout delivery should be coupled with voluntary access to financial planning modules, intermediate digital literacy courses, and direct operational linkages with established Self-Help Groups (SHGs) and institutional credit channels. This integration can help transform regular income streams into long-term livelihood capital.

- **2. Implementation of Dynamic Inflation-Indexing**

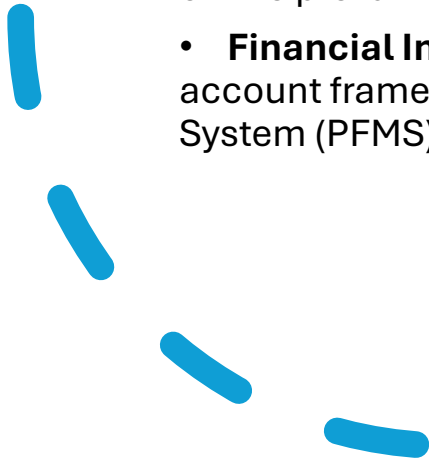
- The real purchasing power of cash transfers risks erosion over time due to retail inflation. To ensure these safety nets remain effective, transfer amounts should be periodically reviewed and indexed against local consumer price indicators (such as the Consumer Price Index for Agricultural Labourers, CPI-AL). This adjustment helps safeguard the baseline liquidity support provided to vulnerable families.

- **3. Strengthening Targeting via Integrated Data Registries**

- To balance fiscal responsibility with comprehensive coverage, administrative systems must improve targeting precision. By integrating real-time administrative datasets—such as the Socio-Economic and Caste Census (SECC), the parivar identity databases of various states, income tax records, and asset ownership registries—the state can dynamically identify and remove wealthy outliers. The fiscal gains realized from streamlining these recipient lists should be reinvested into enhancing benefit levels for the most marginalized groups, avoiding arbitrary exclusion errors.

- **4. Adopting Household-Centric Evaluation Metrics**

- Policymakers should move past narrow, beneficiary-only key performance indicators. Program evaluations need to adopt integrated, household-level monitoring frameworks. Tracking comprehensive household panel data allows the state to measure wider social benefits, including reductions in informal male debt burdens, changes in aggregate domestic health indices, shifts in child nutrition profiles, and long-term improvements in educational retention rates. This broader view captures the full intergenerational return on social safety net investments.

- 
- 
- **Civil Services Examination (Mains)**
 - **"Direct Benefit Transfer (DBT) scheme is a progressive step towards reforming the welfare delivery system in India, but it faces structural and technological challenges."** Critically analyze this statement with reference to its impact on vulnerable demographics. *(GS Paper 2, 2017)*
 - **"Performance of welfare schemes that are implemented for vulnerable sections is not so much on account of lack of funds, but due to the lack of effective institutional implementation and targeting."** Examine. *(GS Paper 2, 2019)*
 - **"Is inclusive growth possible without financial inclusion? Assess the role of the JAM (Jan Dhan-Aadhaar-Mobile) Trinity in achieving the goals of distributive justice in India."** *(GS Paper 3, 2021)*
 - **"Empowerment of women in India requires a transition from a paradigm of welfare to a paradigm of development and agency."** Discuss this perspective in light of recent sub-national fiscal interventions. *(GS Paper 1, 2023)*
 - **Civil Services Examination (Prelims Focus Areas)**
 - **Concept of Multiplier Effect:** Understanding how an initial shift in injection cascades through formal markets based on the prevailing Marginal Propensity to Consume (*MPC*). *(Conceptualized in CSE Prelims Economics)*
 - **Financial Inclusion Initiatives:** Identifying core institutional features of the Financial Inclusion Index, Jan Dhan account frameworks, and the operating rules of Direct Benefit Transfer platforms under the Public Financial Management System (PFMS). *(Core focus area in Prelims)*

Mis-selling regulations need a lot more teeth

Refunding only the amount invested in mis-sold products won't disincentivise banks. Punitive penalties must be instituted to discourage such practices

It has taken more than 20 years of bank branches mis-selling financial products to depositors for the central bank to give some teeth (though clearly not enough) to the regulations to counter this. Meanwhile, several thousand crores of rupees have been lost to mis-selling, unsuitable sales, and open cheating. This has destroyed lives, retirement corpus, and families. The Reserve Bank of India (All India Financial Institutions - Responsible Business Conduct) Second Amendment Directions, 2026 — released on June 15 and set to be implemented from January 1, 2027 — are aimed in the right direction but may prove far from effective on the ground. Bank-branches have tasted blood, and the amended rules — clearly another candidate for classification as tick-box regulations — will do nothing to keep them off depositors. When mis-selling practices reach vulnerable, first-time financialised Indians in the villages, a return to land and gold as investment options is inevitable.

Briefly, the June 15 regulations direct banks to ensure three things to curb mis-selling. One, dark patterns are not to be used in the interface with consumers. Two, sales of the branch's own products (credit cards, home loans) and

third-party products such as mutual funds and insurance must pass the "suitability" test. Selling life insurance to an 80-year-old or a small cap mutual fund to a first-time, risk-averse investor are both instances of unsuitable sales. Three, consumers should not be mis-sold products. Sales that are based on incomplete or misleading information and/or compulsory bundling are defined as "mis-selling".

What deterrents do the rules have for the bank-branches? Not many. The regulations mandate a return of the amount invested if mis-selling is established. There is no provision for even a multiple of the amount invested, which would have been punitive in effect; just the refund. The complaint-process remains clunky and difficult. While more than 50% of sales see complaints made at the point-of-sale, a John Goodman paper says that less than 5% of the people affected will escalate it to a local manager or the corporate headquarter. They absorb the loss and move on. Unless there is an app-based, easy-to-use mechanism to flag mis-selling, unsuitable sales, and poor disclosure, the efficacy of the amended regulation will be cosmetic. In the absence of a large punitive cost to the bank and a threat to senior management and the board, these regulations will remain on paper. A regulatory tick-box will make these regulations ineffective as banks' large legal teams find workarounds.

What do we need to end mis-selling? Meaningful disclosures would be great first step. Regulators need to specify the disclosure format for product features, including costs of entry, risk, lock-in

duration, cost of early exit and expected actual returns in a manner that is digestible for the consumer. For example, indicating return in relation to an amount different from the sum invested is an insurance industry practice that involves both dark pattern and mis-selling wires on which customers could trip. Elementary finance makes return a function of investment. But the Indian life insurance industry illustrates returns as the sum assured (the guaranteed pay-back in case of death or at maturity) rather than that of the amount invested. If the intent is really to inform consumers — further to the disclosures that a simple AI tool can already make — here are three concrete steps that might improve outcomes.

One, introduce commission caps. The Securities and Exchange Board of India has already done this for mutual funds. The Insurance Regulatory and Development Authority of India needs to do this for insurance — both life and health — where sales commissions remain high. Finance 101 promotes use of incentives to drive behavioural changes. Using trail commissions rather than a large upfront prize has shown impressive results in the mutual fund industry, in terms of growth and consumer adoption. Why this cannot be done for the insurance industry remains a mystery. Very high upfront incentives in life insurance has contaminated markets, ethics, and behaviour.

Two, introduce mystery shopping. The UAE government uses mystery shopping — undercover agents posing as consumers — to evaluate government services. For the financial sector,



Acknowledging that merely getting a customer to sign a form does not constitute explicit consent is a step forward by RBI.

HT ARCHIVE

third-party firms conduct checks to catch mis-selling and financial misconduct. Mystery shopping exercises can be set up using finance labs run by business schools or even the IITs. Economist Renuka Sane and I ran such an exercise that showed shocking levels of misinformation given out by 200 bank-branches in Delhi. This is documented in the 2017 peer-reviewed paper titled "Misled and mis-sold: financial misbehaviour in retail banks?". We found that 100% of all disclosures made about costs were incorrect in life insurance; this was 85% for the mutual-funds space. Ninety-nine percent of the return indicators were incorrect in life insurance and 86% in mutual funds. An update exercise would go far in nailing the extent of problem today.

Three, we need real penalties that hurt rather than the mere return of money lost by the consumer who fell prey to mis-selling. Just refunds, and that too only to those who can prove mis-selling, offers no incentive to the banks to clean up their sales processes. The UAE uses a mix of well-articulated rules, steep fines and suspension of licences for violations of rules on mis-selling. HDFC Bank was held liable for mis-selling AT1 Bonds to its clients by Dubai International Financial Centre and the bank's DIFC branch was banned from onboarding new clients or starting new businesses in 2025. The fallout was

felt here in India where an internal probe resulted in the termination of three senior executives and disciplinary penalties for 12 others. When was the last time we heard of such action being taken in India, for similar mis-selling of AT1 bonds (and other products)?

What happens now? RBI has lobbed the ball to Sebi and IRDAI for suitability rules on the products they regulate. This is an opportunity for the two regulators to act together in the interest of the consumer and put in place deeply prescriptive micro regulations on suitable sales. But a compliance-audit regulatory structure that the RBI suggests, which allows each bank to form its own version of suitability and disclosure with no penalties listed in the new regulation, has banks smirking in private. Banks already refund noisy customers or those who are well-connected. Acknowledging that merely getting a customer to sign a form does not constitute explicit consent is a step forward by RBI. But unless the regulations get more teeth, January 1, 2027, will not usher in any big change in consumer protection. We should be ready for gold and real estate featuring in greater numbers in the portfolios in the coming years.

Monika Halan is the best-selling author of the Let's Talk series of books on money. The views expressed are personal



Monika Halan

- **Key Terms and Explanations**
- **Mis-Selling**
 - The practice of deliberately, recklessly, or negligently selling a financial product that is inappropriate for the consumer's needs, or doing so by providing incomplete, distorted, or deceptive information. It often involves coercive tactics like **compulsory bundling**, where a core service (like a home loan) is withheld unless the consumer buys a secondary, unrelated product (like a specific single-premium life insurance policy).
- **Suitability Doctrine**
 - A fundamental regulatory principle dictating that a financial intermediary must only recommend products that align with the consumer's financial objectives, risk tolerance, age, and financial literacy.
 - **Example:** Selling a highly volatile, high-risk small-cap mutual fund to an elderly individual looking to park their life savings for medical emergencies violates this doctrine.
- **Dark Patterns**
 - Deceptive user-interface designs or digital choice architectures crafted to manipulate consumers into making choices that undermine their best interests while serving the financial goals of the platform provider. In banking, this manifests as pre-ticked checkboxes for insurance add-ons, hidden costs revealed only at the final step of a digital transaction, or deliberately convoluted cancellation loops.
- **Upfront vs. Trail Commission**
 - **Upfront Commission:** A large lump-sum payout given to a distributor immediately upon selling a financial product. This creates an immediate incentive to sell, regardless of how the product performs in the long run.
 - **Trail Commission:** A staggered, recurring fee paid to a distributor over the lifespan of the investment, contingent upon the consumer remaining invested. This aligns the long-term interests of the agent with the financial well-being of the client.
- **Mystery Shopping**
 - An objective, external diagnostic auditing tool where undercover agents act as ordinary retail consumers to evaluate the compliance, behavior, and disclosure integrity of front-end sales staff.
- **Additional Tier-1 (AT1) Bonds**
 - Unsecured, perpetual, non-convertible bonds issued by banks to meet Basel III capital adequacy norms. These complex institutional instruments carry a high risk of being written down or converted into equity if the bank's capital dips below a certain threshold. In retail banking spaces, they have frequently been mis-sold to risk-averse retail depositors as "high-yield fixed deposits."
- **Tick-Box Regulation / Cosmetic Compliance**
 - A superficial approach to governance where regulated entities fulfill the technical letter of the law through procedural checklists, automated sign-offs, and fine-print disclosures while systematically violating the spirit of consumer protection.

- **Main Arguments and Substantive Parts**

- **Core Thesis**

- India's structural retail banking landscape suffers from a profound enforcement asymmetry: while regulatory directives increasingly acknowledge the dangers of predatory selling, the absence of severe punitive deterrents transforms these measures into cosmetic, "tick-box" compliance exercises. This leaves retail depositors, particularly vulnerable first-time participants in rural areas, exposed to systematic exploitation.

- **The Institutional Cultivation of Predatory Selling**

- Commercial banking institutions have integrated fee-based third-party product distribution (insurance, mutual funds) into their core revenue models. Because upfront commissions on products like life insurance are high, branch networks face intense, target-driven pressure. This corporate structure incentivizes executives to exploit the trust-based relationship depositors maintain with banks, transforming custodians of capital into aggressive sales fronts.

- **The Inefficacy of Mere Principal Refunds**

- A core weakness of existing frameworks is the lack of real penalties. Mandating only a refund of the principal amount when mis-selling is proven fails to act as a financial deterrent. For a bank, a refund functions as a cost-free loan from an exploited customer. Without punitive damages (such as a multiple of the invested amount) or direct accountability for senior executives, the financial gains from aggressive sales far outweigh the occasional legal cost of a refund.

- **Grievance Redressal Friction and the Silent Majority**

- There is a stark gap between the occurrence of mis-selling and formal escalations. Behavioral evidence shows that while more than half of dissatisfied consumers express frustration at the point of sale, less than 5% escalate the matter to senior management or banking ombudsmen. The complex, bureaucratic nature of filing complaints leads the vast majority of affected citizens to absorb the financial loss and stay silent. This dynamic allows predatory sales models to remain profitable.

- **Macroeconomic Retraction to Unproductive Assets**

- When predatory financial practices spread into rural economies and affect first-time investors, it triggers a dangerous economic defense mechanism. Burned by complex financial products, everyday citizens lose faith in the formal financial system. This drives household savings out of productive financial instruments (like mutual funds and equities) and back into traditional, inert physical assets like land and gold, which directly slows national capital formation.

- **Historical Evolution of the Issue**

- **Phase 1: The Era of Fiduciary Trust (Pre-1990s)**

- **Context:** Banking in post-independence India was defined by social banking paradigms and subsequent nationalizations (1969 and 1980).

- **Dynamics:** Commercial banks operated as simple deposit-taking and credit-extending institutions. The relationship between a depositor and a bank branch was based on deep fiduciary trust, with minimal product diversity and virtually no cross-selling of third-party risk products.

- **Phase 2: Liberalization and the Fee-Income Pivot (1990s–2000s)**

- **Context:** The implementation of the 1991 Narasimham Committee recommendations opened the banking sector to private players and universal banking architectures.

- **Dynamics:** Deregulation allowed banks to seek alternative revenue streams. The concept of **Bancassurance** emerged, turning bank branches into distribution channels for insurance companies and mutual fund houses, introducing fee-based income models.

- **Phase 3: Mass Financial Inclusion and Systemic Friction (2010s–2020s)**

- **Context:** Initiatives like the Pradhan Mantri Jan Dhan Yojana (PMJDY) and rapid digitalization brought hundreds of millions of first-time, financially inexperienced citizens into the formal banking system.

- **Dynamics:** The combination of aggressive corporate sales targets and low financial literacy led to widespread mis-selling. Incidents like the retail mis-selling of complex AT1 bonds during private sector banking crises exposed the severe lack of consumer protections.

- **Phase 4: Modern Regulatory Response and Enforcement Gaps (2026–Present)**

- **Context:** The Reserve Bank of India introduced updated responsible business conduct directions targeting dark practices, mandatory product suitability, and bundling.

- **Dynamics:** While these directives clearly define structural offenses, they leave implementation details and specific penalties open to interpretation. This has sparked a broader debate about the need for sharper, more unified enforcement across different regulatory bodies.

FINANCIAL MIS-SELLING IN INDIAN BANKING: A CRITICAL ANALYSIS & THE WAY FORWARD | AN EDUCATIVE GUIDE FOR UPSC CSE ASPIRANTS

KEY TERMS & CONCEPTS

 **MIS-SELLING**
(Predatory Tactics, Bundling)

 **SUITABILITY DOCTRINE**
(Right Product, Right Client)

 **DARK PATTERNS**
(Manipulative UI Design)

 **AT 1 BONDS**
(High-Risk, Sold as FDs)

 **MYSTERY SHOPPING**
(Undercover Compliance Audits)

 **UPFRONT vs TRAIL COMMISSIONS**
(Incentive Structure)

KEY ELEMENTS and THEMATIC FLOW



THE EFFICACY GAPS OF RECENT RBI DIRECTIONS



MULTIDIMENSIONAL IMPACT



WAY FORWARD: KEY REFORMS



 **1. INTRODUCE TRAIL COMMISSIONS & CAPS**
(Align Intermediary Interests, MF Model)

 **2. DEPLOY INDEPENDENT MYSTERY SHOPPING AUDITS**
(Targeted Checks, Published Rankings)

 **3. ESTABLISH PUNITIVE DETERRENTS & SENIOR MGT ACCOUNTABILITY**
(Multiples, DIFC Precedent)

 **4. BUILD APP-BASED, EASY REDRESSAL**
mechanism for immediate flagging

LINKAGES WITH NCERTS & UPSC CSE SYLLABUS



Class 11, 12
• Rural Dev
• Liberalisation
• Money/Banking

Class sew, 2
• Governance
• Money & Banking



GS Papers 2, 3, 4
• Governance
• Regulatory Bodies
• Financial Inclusion
• Ethics

- **Logical and Philosophical Base**

- **Information Asymmetry**

- The primary economic justification for strict financial regulation is the deep imbalance of information between banks and consumers. Large financial institutions possess specialized software, actuarial data, legal teams, and complex product knowledge. The individual retail consumer, constrained by bounded rationality, cannot accurately evaluate the true risk-return profile of structured products, leaving them highly vulnerable to manipulation.

- **The Principal-Agent Dilemma**

- The structural setup of retail banking creates a fundamental conflict of interest:

- The branch executive (the agent) is supposed to act in the best interest of the depositor (the principal). However, the bank's internal incentive structures—such as upfront commission bonuses and performance targets—align the agent's rewards with corporate profits instead, causing a direct breakdown of fiduciary duty.

- **Behavioral Exploitation and Choice Architecture**

- Modern retail finance often weaponizes behavioral economics against the consumer. By using dark patterns and pre-configured default settings, financial institutions exploit human tendencies toward inertia, trust in authority, and an aversion to reading fine print. Under this setup, a signature on a standard form serves as a proxy for consent, replacing genuine, well-informed decision-making.

- **Caveat Emptor vs. Regulatory Paternalism**

- This issue challenges the classic market principle of *caveat emptor* (buyer beware). In complex, modernized financial ecosystems, the idea that a retail consumer can independently protect themselves against institutional deception is unrealistic. This necessitates a shift toward robust regulatory paternalism, where the state enforces strict boundaries on product design and sales practices to protect public savings.

- **Multidimensional Analysis**
- **Social Dimension**
 - **Erosion of Social Safety Nets:** Mis-selling frequently targets vulnerable groups, such as senior citizens, pensioners, and financially illiterate rural families. When long-term retirement savings are diverted into toxic, illiquid products, families lose their financial safety nets, driving them into economic instability during health or medical crises.
 - **Distrust in Modern Institutions:** When first-generation bank depositors experience institutional cheating, it creates deep skepticism toward state-led financial inclusion programs, alienating rural communities from the formal economy.
- **Political Dimension**
 - **Welfare Image vs. Market Realities:** Widespread financial exploitation creates a direct conflict with the state's goal of equitable development. If large segments of the population suffer losses from unregulated financial sales, it fuels public resentment, turning consumer protection into a high-stakes political issue.
 - **Demands for Populist Interventions:** When systemic mis-selling causes widespread losses, it often forces governments to implement expensive, populist bailouts or debt waivers, straining public finances.
- **Legal Dimension**
 - **Regulatory Arbitrage:** The financial landscape is split across multiple regulators: the RBI oversees banks, SEBI manages mutual funds, and IRDAI regulates insurance. Banks exploit the gaps between these jurisdictions, using their branch networks to sell products regulated by IRDAI or SEBI while operating under looser banking compliance rules.
 - **Weak Redressal Architecture:** The legal framework places a heavy burden of proof on the consumer to show they were mis-sold a product. Combined with slow, intimidating grievance processes, the legal system effectively shields large corporate institutions from accountability.
- **Ethical Dimension**
 - **Systemic Breach of Institutional Fiduciary Trust:** Banks hold a unique, trusted position within Indian society. Exploiting this trust to hit corporate sales targets represents a fundamental breakdown of institutional ethics, valuing short-term fee income over long-term client care.
 - **The Normalization of Deception:** When corporate targets force employees to use misleading disclosures and dark patterns to keep their jobs, it creates a toxic corporate culture that normalizes deceptive behavior across the wider services sector.
- **International Dimension**
 - **Contrasting Regulatory Approaches:** Global financial hubs deploy much tougher penalties for mis-selling. For instance, the UAE's Dubai Financial Services Authority (DFSA) imposes heavy fines and operational bans on institutions that violate suitability and disclosure rules.
 - **Jurisdictional Inconsistencies:** The fact that multinational financial entities face strict regulatory accountability abroad while domestic consumers in developing markets receive far lower standards of protection highlights a significant global imbalance in financial consumer safety.
- **Economic Dimension**
 - **Misallocation of National Savings:** Household savings are critical for funding national infrastructure and industrial growth. When these funds are drained by predatory financial products, it leads to a poor allocation of capital, reducing the efficiency of the entire financial system.
 - **Increased Demand for Physical Gold:** When retail investors flee the formal financial system due to predatory sales, they tend to put their money into physical gold. This surge in gold imports worsens the current account deficit (CAD) and ties up valuable domestic capital in unproductive assets.

- **Linkages with NCERT Textbooks**
- **Class 11 Indian Economic Development (Chapter: Liberalisation, Privatisation and Globalisation - An Appraisal):** Helps students analyze how opening up the financial sector post-1991 created new fee-based income streams for commercial banks, paving the way for cross-selling and modern regulatory challenges.
- **Class 11 Indian Economic Development (Chapter: Rural Development):** Explains the vital role of institutional credit and banking accessibility in rural markets, highlighting why predatory practices in rural branches can derail local development.
- **Class 12 Macroeconomics (Chapter: Money and Banking):** Provides the foundational theory on the functions of commercial banks as trusted custodians of public deposits and details the credit creation process, showing why central bank supervision is essential to maintain public trust.
- **Class 11 Political Science - Indian Constitution at Work (Chapter: Rights in the Indian Constitution & Social Justice themes):** Connects the discussion to consumer protection and economic security, which are key parts of ensuring a dignified life under the Directive Principles of State Policy (DPSP).



- **Linkages with the UPSC CSE Syllabus**
- **GS Paper 2: Governance and Polity**
- **Statutory, Regulatory, and Quasi-judicial Bodies:** Assessing the performance, jurisdiction, and coordination challenges of key financial regulators like the RBI, SEBI, and IRDAI.
- **Government Policies and Interventions:** Evaluating the design and real-world impact of consumer protection policies in digital and retail financial spaces.
- **GS Paper 3: Indian Economy**
- **Mobilization of Resources:** Analyzing how consumer trust influences the flow of household savings into productive financial assets versus physical investments like gold.
- **Banking Sector and Financial Inclusion:** Studying the evolution of universal banking, the rise of fee-based incomes, and the systemic protections needed to safeguard first-generation bank accounts.
- **GS Paper 4: Ethics and Human Interface**
- **Corporate Governance:** Examining the ethical duties of corporate boards, the conflict between target-driven bonuses and consumer welfare, and the need for high institutional integrity.
- **Fiduciary Accountability:** Understanding the ethical principles that govern relationships where there is an imbalance of power and information between an institution and an individual consumer.
- **Essay Paper**
- Directly relevant for thematic essays focused on: *"Financial Literacy as a Tool for True Empowerment," "The Balance Between Market Efficiency and Social Regulation,"* or *"Restoring Trust as the Primary Currency of Modern Economic Development."*
- **Optional Subjects**
- **Economics:** Advanced analysis of money and banking frameworks, financial sector reforms, and market imperfections caused by asymmetric information.
- **Commerce & Accountancy:** Detailed study of financial markets, financial services regulation, and corporate governance practices.



- **Way Forward**
- **1. Introduce Punitive Damages and Multiples**
 - Regulators must move past simple principal refunds. When mis-selling is proven, frameworks should mandate punitive penalties—such as forcing the bank to pay three to five times the invested amount back to the consumer. Imposing heavy financial penalties shifts the economic equation, making predatory sales practices far too costly for banks to tolerate.
- **2. Standardize Key Information Documents (KIDs)**
 - Regulatory bodies should design and enforce a mandatory, single-page **Key Information Document (KID)** for every financial product sold at a branch. This sheet must use a clear, standardized layout and font size to detail all upfront entry charges, ongoing management fees, early exit penalties, and risk ratings. It must also present expected returns based on the actual money invested, eliminating deceptive metrics like comparing returns directly to the "sum assured."
- **3. Move Entirely to Trail-Based Commissions**
 - To resolve the principal-agent conflict, upfront distribution incentives for long-term insurance and investment products sold through banks should be phased out. Transitioning fully to a trail-based commission structure ensures that branch employees are rewarded only if the client stays invested and the product performs well over time.
- **4. Deploy Continuous Independent Mystery Shopping**
 - Regulators should partner with neutral academic institutions, business schools, or independent research labs to run ongoing mystery shopping audits across banking networks. The findings from these undercover checks should be published in public transparency rankings, giving regulators the objective data they need to issue warnings or suspend business licenses for non-compliant branches.
- **5. Build a Frictionless, Tech-Driven Redressal Platform**
 - Grievance processes must be simplified by launching an independent, app-based central platform dedicated to reporting mis-selling and predatory bundling. By allowing consumers to easily upload digital evidence, text messages, or audio recordings, the platform can bypass complex branch bureaucracy, making it simple for the silent majority to voice complaints and claim compensation.
- **6. Establish a Joint Inter-Regulatory Taskforce**
 - A unified enforcement cell comprising members from the RBI, SEBI, and IRDAI should be formed to eliminate regulatory arbitrage. This taskforce must enforce a single, strict suitability standard for all financial products sold within a bank branch, ensuring that no matter which agency regulates the product, the consumer receives the same high level of protection.



Civil Services Examination (CSE) - Prelims

•Financial Stability and Development Council (FSDC) (2016):

- *Question:* Consider the following statements regarding the Financial Stability and Development Council (FSDC): (1) It is an organ of NITI Aayog. (2) It is headed by the Union Finance Minister. (3) It monitors macro-prudential supervision of the economy. Which of the statements given above is/are correct?
- *Relevance:* Focuses on inter-regulatory coordination frameworks designed to resolve jurisdictional disputes among the RBI, SEBI, and IRDAI.

•Banking Ombudsman Scheme (2010):

- *Question:* With reference to the Banking Ombudsman Scheme in India, which one of the following statements is correct?
- *Relevance:* Evaluates the structural mechanisms available to consumers for addressing grievances against commercial banking institutions.

•Additional Tier-1 (AT1) Bonds (2021):

- *Question:* With reference to 'Indian economy', consider the following statements: (1) AT1 bonds are perpetual and have no maturity date. (2) The issuer bank can call back these bonds at specified periods. (3) If a bank fails, investors in these bonds lose their principal. Which of the statements given above are correct?
- *Relevance:* Directly tests understanding of the complex, institutional instruments that are frequently mis-sold to retail investors.

Civil Services Examination (CSE) - Mains

•GS Paper 3 - Banking Reforms & Financial Inclusion (2018):

- *Question:* "Is inclusive growth possible without effective financial inclusion?" Evaluate the performance of recent financial inclusion drives in India and highlight the structural bottlenecks in protecting new market entrants.
- *Relevance:* Connects consumer protection and mis-selling risks to the long-term success of national financial inclusion campaigns.

•GS Paper 2 - Regulatory Body Governance (2019):

- *Question:* "The performance of regulatory authorities in India is often constrained by overlapping jurisdictions and statutory ambiguities." Discuss this statement in light of consumer protection disputes within the financial services sector.
- *Relevance:* Demands an analysis of the friction between banking operations (RBI) and the third-party products they distribute (SEBI and IRDAI).

•GS Paper 4 - Corporate Governance & Institutional Ethics (2022):

- *Question:* "Corporate social responsibility should not be a mere tool for cosmetic compliance; it must be backed by a strong commitment to institutional ethics and fiduciary responsibility toward the lowest stakeholder." Analyze this statement by highlighting ethical dilemmas faced by employees working under target-driven models.
- *Relevance:* Provides an open floor to address the systemic ethical issues present in commission-driven retail banking setups.

Capitalise on What 1991 Began



Srinath Sridharan & Arjun Raghavendra

Every capital control India maintains today is the descendant of a single idea: forex belongs to GoI, and citizens transact in it by permission. Fera 1973 criminalised that idea. Fema 1999 merely civilised it.

It was born of the same pre-1991 beliefs in nationalisation and licence raj, when the entrepreneur queued for licences and the wealth creator was a suspect. An economy aspiring to be the world's third-largest cannot be financed by a jurisprudence of bureaucratic approvals.

The 1991 reforms dismantled the licence but never fully dismantled the instinct. The question is no longer whether Indian capital crosses borders. The policy question is whether it does so transparently, predictably, and in ways that advance India's economic interests.

Calibrated controls served India well in the past. Through the Asian crisis, GFC and the taper tantrum, sequencing over speed preserved a stability that faster liberalisers lost. But the question before policymakers is not whether yesterday's architecture worked.

India's economic ambitions have

expanded far more rapidly than its capital account architecture. Financing a Viksit Bharat will require sustained long-term and long-gestation investments. It is whether it can finance ambitions — capital markets among the world's largest, GIFT City competing as an international financial centre, and investment needs on a scale domestic savings cannot meet. Global pension, sovereign and insurance capital must become a strategic national resource. And such capital wonders: can I read the rules in advance and will they stay consistent?

On March 27, with the rupee sliding past ₹96 to a dollar, RBI capped banks' net open positions at \$100 mn. On April 1, it barred banks from offering rupee non-deliverable forward contracts and prohibited the rebooking of cancelled contracts — 'With immediate effect, until further review'. The rupee recovered sharply within a day.

But within 12 weeks, the same regulator was dismantling adjacent

restrictions to court the capital its measures had unsettled — suspending interest-rate ceiling on FCNR(B) deposits and opening repatriable rupee accounts to foreign individual investors. No trigger for imposition was published in advance. No reason for withdrawal is published now.

The objection is not that RBI acted. The objection is that nothing in Indian law told a single investor when it would act, on what threshold, or when it must stop. That is the real boundary question in capital account policy: not where the perimeter sits, but whether it moves by rule or by fiat. Discretion is priced into every rupee asset permanently, as a discount on India's word.

The issue is not trust in RBI. That trust has been earned over decades. The issue is whether greater rule-based clarity around exceptional capital account measures can further reduce uncertainty for long-term investors without diminishing the central bank's operational flexibility.

What would a rule-based philosophy require?

► **Published destination** India's last official map of its own capital account is Fuller Capital Account Convertibility Committee of 2006 — and its final phase expired in 2011. Everything since has been administered by circular. A new committee should publish a path in which liberalisation expands steadily as stated macro-triggers — inflation, fiscal deficit, reserve adequacy, financial-sector health — are met, so that openness ceases to be an annual act of regulatory grace.

► **Use sharp tools** With Press Note 3

guarding the strategic perimeter — recalibrated in March with defined ownership thresholds — every residual sectoral cap and approval route should expire on a stated date unless the GoI publishes reasons for its survival. The burden of justification must shift from the investor to the restriction.

► **Repair static anomalies** LRS ceiling of \$2,50,000 has stood still since 2015 while GDP, in dollar terms, has doubled — and the I-T Act now collects 20% at source on remittances for overseas investment: a capital control in everything but name, administered by the tax department. Ceilings that do not move with the economy are not prudence, they are neglect wearing prudence's clothes.

► **Codified emergency brake** Crisis powers should stand within a statutory framework — bounded by a recorded trigger, a 90-day sunset unless renewed for reasons, exit criteria published at imposition, and a report to Parliament. The April measures satisfied none of these. Three months on, no law obliges anyone to say when they must stop.

India will need external capital on a scale, and it will be supplied only on the strength of promises that are structurally difficult to break. So, India's next capital account reform is about constitutional confidence in markets, institutions and citizens. The unfinished task of 1991 is to replace an architecture that manages suspicion with one that legislates trust.

Sridharan is a corporate adviser, and Raghavendra is a former IRS officer



Let go of the control freakery

- **Key Terms and Explanations**

- **Capital Account Convertibility (CAC):** The freedom to convert local financial assets into foreign financial assets (and vice versa) at market-determined exchange rates. While India has near-total convertibility on its *Current Account* (for trading goods, services, and daily expenses), it maintains calibrated restrictions on its *Capital Account* (for buying real estate, stocks, or businesses abroad) to safeguard macroeconomic stability.
- **FERA (1973) vs. FEMA (1999):** The Foreign Exchange Regulation Act (FERA), 1973, was born during an era of severe foreign exchange scarcity. It treated foreign exchange conservation with extreme rigidity, criminalizing violations and placing the burden of proof on the individual. The Foreign Exchange Management Act (FEMA), 1999, shifted the paradigm from rigid *regulation* to *management*. It decriminalized foreign exchange offenses, converting them into civil liabilities, though the underlying structural authority over foreign exchange transactions remained with the central bank.
- **Liberalised Remittance Scheme (LRS):** A discretionary mechanism introduced by the Reserve Bank of India (RBI) that allows resident individuals to freely remit a consolidated amount up to \$250,000 per financial year for permitted current or capital account transactions (such as overseas education, travel, or foreign investments).
- **Tax Collected at Source (TCS) on Remittances:** An administrative tax mechanism under the Income Tax Act where a specific percentage (up to 20%) is levied upfront on foreign remittances exceeding certain thresholds under the LRS. While technically an advance tax credit, it functions operationally as a friction point on cross-border capital movement.
- **Non-Deliverable Forward (NDF) Market:** An offshore financial derivative market where foreign exchange forward contracts are traded without the physical delivery of the underlying currencies. The parties settle the profit or loss in a freely convertible currency (typically US Dollars). It allows global investors to hedge or speculate on the value of the Indian Rupee outside the direct jurisdiction of the RBI.
- **Net Open Position (NOP):** The net difference between a commercial bank's foreign currency assets and liabilities. The regulator places caps on a bank's NOP to limit speculative currency exposure and protect the domestic banking system from sudden exchange rate shocks.
- **FCNR(B) Account:** Foreign Currency Non-Resident (Bank) accounts allow Non-Resident Indians (NRIs) to maintain fixed deposits in Indian banks in foreign currencies (like USD or GBP), insulating them from rupee exchange rate fluctuations while providing the Indian banking system with stable foreign currency inflows.
- **Press Note 3:** A strategic foreign direct investment (FDI) policy directive that mandates prior government approval for any investments originating from, or beneficially owned by citizens of, countries that share a land border with India. It acts as a targeted security perimeter for strategic sectors.

- **Main Arguments and Substantive Parts**

- The structural debate around India's capital account policies balances two competing priorities: the need for predictable frameworks to attract long-term global capital versus the central bank's requirement for operational flexibility to defend financial stability during external crises.

- **The Core Thesis**

- India's economic ambitions—such as scaling its capital markets, positioning GIFT City as a global financial hub, and financing long-gestation infrastructure projects—cannot rely on an unpredictable, ad-hoc system of bureaucratic approvals. To secure global pension, sovereign wealth, and insurance capital, India must transition away from a post-colonial mindset of managing suspicion. Instead, it must establish a rule-based capital account policy where interventions are predictable, transparent, and bound by clear institutional triggers.

- **Key Supporting Arguments**

- **The Survival of the Regulatory "Instinct":** The economic reforms of 1991 successfully dismantled the industrial "Licence Raj" for domestic business operations. However, the underlying regulatory instinct regarding foreign exchange was never fully liberalized. The system still operates on the foundational assumption that foreign currency belongs to the sovereign, and private transactors require explicit or implicit administrative permission.

- **Rule vs. Fiat in Macroeconomic Interventions:** Sudden regulatory actions—such as capping banks' Net Open Positions or abruptly restricting non-deliverable forward contracts—can stabilize the rupee during rapid depreciation. However, when these actions are taken without pre-published thresholds or transparent exit criteria, they introduce regulatory uncertainty. This makes it difficult for institutional investors to accurately price risk.

- **The Cost of Regulatory Discretion:** When long-term international investors cannot predict when or how a central bank will intervene in cross-border capital movements, they apply a structural risk premium. This discretion acts as a permanent discount on the value of Indian assets, increasing the cost of capital for domestic wealth creators.

- **Static Policy Anomalies:** Essential policy thresholds, such as the \$250,000 LRS limit, have remained unchanged for years despite substantial growth in India's nominal GDP and external economic footprint. The addition of fiscal measures like a 20% TCS effectively functions as an indirect capital control, showing a lack of coordination between tax policies and capital liberalization goals.

- **The Counter-Arguments: The Case for Strategic Flexibility**

- Defenders of India's cautious capital account architecture argue that operational flexibility is a vital policy tool, not an administrative oversight:

- **Preserving Stability in Crises:** Calibrated capital controls and sudden, decisive regulatory interventions have shielded India from severe external shocks, such as the 1997 Asian Financial Crisis, the 2008 Global Financial Crisis, and the 2013 Taper Tantrum.

- **Asymmetric Global Financial Flows:** Emerging markets face highly volatile, speculative capital flows driven by monetary policy shifts in advanced economies. Rigid, pre-announced rules could restrict a central bank's ability to act quickly against speculative attacks on the domestic currency, which could rapidly deplete foreign exchange reserves.

- **Historical Evolution of the Issue**
 - India's management of its capital account has transitioned through several distinct policy phases, moving from strict post-independence resource conservation to a system of calibrated, gradual liberalization.
- **The Pre-1991 Restrictive Era**
 - Following independence, India faced persistent foreign exchange shortages and balance-of-payments vulnerabilities. The introduction of FERA in 1973 marked the height of the state's control over foreign exchange. Foreign currency was treated as a scarce national resource. Hoarding or unauthorized dealing in foreign exchange was treated as an offense against the state, subject to criminal prosecution and a presumption of guilt. This approach matched the broader domestic policy environment of nationalization and strict industrial licensing.
- **The 1991 Watershed and the Transition to FEMA**
 - The balance-of-payments crisis of 1991 forced a major structural reassessment. As part of wider economic reforms, India accepted the obligations of Article VIII of the IMF, leading to full **Current Account Convertibility** by 1994. Recognizing that FERA's rigid framework was unsuited to an integrating economy, Parliament replaced it with **FEMA in 1999**. This legislation shifted the regulatory focus from the strict preservation of foreign exchange to facilitating external trade and payments.
- **The Tarapore Committee Reports (1997 and 2006)**
 - To chart a path toward Capital Account Convertibility, the RBI formed the Committee on Capital Account Convertibility, chaired by S.S. Tarapore.
 - **The 1997 Report** laid out strict institutional prerequisites for achieving full convertibility, including reducing the fiscal deficit, targeting low inflation, lowering non-performing assets (NPAs) in the banking sector, and maintaining adequate foreign exchange reserves.
 - **The 2006 Report** provided a multi-phase roadmap to expand capital account freedom by 2011. However, the disruption caused by the 2008 Global Financial Crisis led policymakers to pause the formal implementation of these phases, favoring a more cautious approach to capital liberalization.
- **Post-2011: Capital Account Management via Circulars**
 - Since the expiration of the 2006 Tarapore roadmap, India's capital account policy has evolved without a formal, comprehensive long-term plan. Instead, capital controls are managed dynamically through RBI circulars and regulatory notifications. This ad-hoc approach allows the regulator to calibrate capital inflows and outflows in response to shifting global financial conditions, though it lacks a singular, formalized roadmap.

INDIA'S CAPITAL ACCOUNT: FROM SUSPICION TO RULE-BASED TRUST

A Comprehensive Analysis & Future Reform Roadmap for UPSC CSE Aspirants

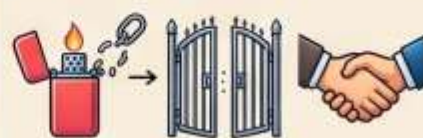
HISTORICAL EVOLUTION: THE SHIFT IN INSTINCT

[PRE-1991: LICENSE RAJ ERA]



FERA 1973: CRIMINALIZED the Idea.
Forex belonged to Govt. Permission required.
Wealth creator suspected.

[POST-1991 REFORMS: FEMA]



FEMA 1999: CIVILIZED the Idea.
Dismantled licensing, not instinct.
Decriminalized.

[KEY SUCCESSES & AMBITIONS]



Calibrated Controls Preserved Stability. Future:
Aspiring 3rd Largest Economy. Financing
Needs Scale Beyond Domestic Savings.

THE CORE PROBLEM: DISCRETION VS. RULE

RBI SUDDEN ACTIONS (e.g., RUPEE past 95)



Objection: No published triggers, exit criteria.
Unpredictability for long-term investors.
**DISCRETION IS PRICED IN PERMANENTLY
AS A DISCOUNT ON INDIA'S WORD.**

RULE-BASED PHILOSOPHY



WHAT A RULE-BASED PHILOSOPHY REQUIRES: 4 PILLARS OF REFORM

[PUBLISHED DESTINATION]



- New Committee publishes path
- Liberalization tied to **STATED MACRO-TRIGGERS**
 - List: inflation, fiscal deficit, reserve adequacy, financial health)
- Openness ceases to be annual regulatory grace

[USE SHARP TOOLS]



- Shift burden of proof to restrictions
- Sectoral caps & approval routes expire on stated date unless Govt publishes reasons of legal exigencies (e.g., "Press Note 3 guards strategic perimeter")

[REPAIR STATIC ANOMALIES]



- Dynamic Ceilings move with economy
- Eliminate implicit controls (e.g., "I-T Act collects 20% on remittances")
- Ceilings that don't move are neglect

[CODIFIED EMERGENCY BRAKE]



- Crisis powers within a **STATUTORY FRAMEWORK**
- **BOUNDARIES:** recorded trigger
 - 90-day sunset
 - exit criteria published at imposition
 - report to Parliament

FUTURE VISION: STRUCTURALLY BREAK- PROOF PROMISES



External Capital needed on a large scale,
supplied only on strength of promises
structurally difficult to break.

Next reform is about Constitutional Confidence
in markets, institutions, and citizens.
Replace architecture managing suspicion
with one legislating trust.

- **Logical and Philosophical Base**

- **Suspicion vs. Trust in Governance:** The traditional regulatory model is built on an assumption of suspicion. It assumes that if citizens and businesses are allowed unchecked cross-border mobility, it will lead to capital flight, tax evasion, and currency destabilization. In contrast, a trust-based philosophy treats capital earned by citizens as private property. Under this view, the state's primary role is to establish a stable, supportive environment that encourages capital to remain out of choice, rather than forcing it to stay through administrative barriers.

- **Rule of Law vs. Administrative Discretion:** This issue highlights a classic legal debate: the choice between clear, pre-announced rules (*ex-ante*) and flexible, retrospective administrative actions (*ex-post*). While administrative discretion gives the central bank the agility to handle financial market stress, it can conflict with the principle of predictability, which requires that laws be clear, stable, and knowable in advance.

- **The Sovereign Risk Premium:** In global finance, institutional capital acts as a judge of policy consistency. When a regulatory framework relies heavily on discretionary adjustments, foreign investors factor in this unpredictability as a structural risk. The lack of clear, predictable rules acts as an implicit tax on domestic assets, increasing borrowing costs across the economy.



- **Multidimensional Analysis**
- **Economic Dimension**
 - India faces a structural gap between its domestic savings and the long-term investment required for large-scale infrastructure and industrial growth. To bridge this gap, the country needs to attract long-term global capital, such as sovereign wealth and pension funds.
 - However, unpredictable capital controls can create structural hurdles for initiatives like GIFT City, which aims to compete with established financial hubs like Singapore and Dubai. While ad-hoc regulatory interventions help manage exchange rate volatility and curb short-term speculative capital (hot money), they can inadvertently discourage the sustained, predictable foreign inflows needed to support long-term economic expansion.
- **Political Dimension**
 - Capital account policy involves balancing two competing political goals. On one hand, there is a push for internationalization, market liberalization, and global integration to elevate India's standing in the global financial system. On the other hand, the state seeks to maintain economic sovereignty and protect the domestic economy from external financial vulnerabilities.
 - This creates a delicate balance for policymakers, who must reconcile the political objective of maintaining strong national control over macro-stability with the strategic goal of establishing India as an open, competitive global economic power.
- **Legal Dimension**
 - From a legal standpoint, managing capital controls primarily through regulatory circulars raises questions about administrative predictability and transparency. When key policy changes are implemented with immediate effect and without prior public consultation, it limits the ability of market participants to plan effectively.
 - A more robust legal framework would introduce structured statutory checks on emergency regulatory interventions. This could include mandatory sunset clauses, pre-defined economic triggers, and regular reporting requirements to Parliament, balancing central bank agility with greater institutional accountability.
- **Ethical Dimension**
 - The ethical aspect of this policy centers on economic liberty and the extent of state authority over private property. It tests whether a democratic government should have the unrestricted power to restrict its citizens' use of legally acquired, tax-paid wealth for international transactions without clear, pre-established legal criteria.
 - Furthermore, when regulatory rules shift abruptly, it can create uneven access to information, favoring sophisticated financial institutions that can adapt quickly over smaller, individual wealth creators who lack the resources to navigate sudden policy changes.
- **International Dimension**
 - As India works to integrate into global financial systems—such as its inclusion in major global bond indices—its domestic regulatory practices draw closer international attention. Inconsistent capital account policies can complicate efforts to internationalize the Indian Rupee (INR) for cross-border trade settlements.
 - To position India as a dependable anchor of global supply chains and a top destination for foreign investment, its regulatory environment must align with international standards of policy predictability and transparency.
- **Social Dimension**
 - Capital controls also have indirect social impacts, particularly on the aspirations of India's growing middle class. Restrictive remittance limits and additional compliance requirements can create hurdles for families financing overseas education or pursuing cross-border professional opportunities.
 - Additionally, by increasing the cost of foreign capital for infrastructure projects, these restrictions can indirectly slow down the expansion of public utilities, urban transport, and clean energy systems, which are vital for improving the quality of life across society.

Linkages with NCERT Textbooks

Class 11: Indian Economic Development

- *Chapter 3: Liberalisation, Privatisation and Globalisation: An Appraisal*
- *Connection:* This chapter outlines the structural crisis of 1991, the dismantling of the domestic industrial "Licence Raj," and the initial opening of India's external sector. It provides the historical context needed to analyze why foreign exchange regulations were reformed and highlights the areas where the legacy of pre-1991 administrative mindsets persisted.

Class 12: Introductory Macroeconomics

- *Chapter 6: Open Economy Macroeconomics*
- *Connection:* This chapter covers the foundational mechanics of the Balance of Payments (BoP), explaining the structural differences between the Current Account and the Capital Account. It offers the analytical framework required to understand how exchange rates are determined, why central banks intervene to manage currency volatility, and the economic implications of moving toward full capital account convertibility.

Linkages with the UPSC CSE Syllabus

Paper	Syllabus Topic	Core Connection & Analytical Focus
GS Paper 3	Indian Economy and issues relating to planning, mobilization of resources, growth, development, and employment.	The impact of discretionary capital controls on foreign capital inflows, domestic investment gaps, and the long-term financing of infrastructure projects.
GS Paper 3	Effects of liberalization on the economy, changes in industrial policy and their effects on industrial growth.	The transition from FERA to FEMA, the unresolved aspects of the 1991 economic reforms regarding capital mobility, and the global competitiveness of GIFT City.
GS Paper 2	Statutory, regulatory and various quasi-judicial bodies.	Analyzing the regulatory boundaries of the RBI, the balance between central bank autonomy and administrative transparency, and the use of delegated legislation (circulars).
GS Paper 4	Status and problems; ethical concerns and dilemmas in government and private institutions; accountability and ethical governance.	The balance between administrative discretion and the rule of law, ensuring transparency in public institutions, and protecting economic freedoms within a regulated market.
Essay	Economic Governance, Modernization of Institutions, Trust as Social Capital.	Designing essays focused on institutional design, shifting from state-led control to market-driven trust, and building regulatory frameworks for a modern economy.
Optionals	Economics (International Economics, Money-Banking); Public Administration.	Deep-dive analyses of Balance of Payments adjustments, exchange rate management policies, and the study of regulatory administration and delegated legislation.

- **Way Forward**

- **Formulating a Modern Capital Account Roadmap:** A new expert committee should be formed to design an updated roadmap for capital account convertibility, building on the foundations of the earlier Tarapore reports. This framework should establish clear, automatic expansion triggers linked to verifiable macroeconomic indicators—such as stable inflation targets, fiscal consolidation milestones, banking sector health, and foreign exchange reserve adequacy. This would shift capital liberalization from a series of ad-hoc administrative decisions to a predictable, rule-based process.

- **Establishing a Codified Emergency Framework:** To preserve the central bank's operational agility during global crises, its emergency intervention powers should be organized within a structured legal framework. Exceptional measures—such as sudden restrictions on derivative trading or liquidity caps—should require a formal, documented economic justification, be bound by an automatic 90-day sunset clause unless explicitly renewed, and include a clear exit strategy. This structure would give the central bank the tools to manage short-term instability while reassuring long-term investors that emergency interventions are temporary and rule-bound.

- **Modernizing Dynamic Policy Thresholds:** Important individual and corporate remittance boundaries, such as the LRS cap, should be indexed to India's nominal macroeconomic growth rather than left static for long periods. Additionally, upfront tax mechanisms like the TCS should be rationalized to prevent fiscal enforcement tools from acting as unintended capital controls, ensuring better alignment between tax collection and capital account liberalization.

- **Reversing the Burden of Proof for Sectoral Caps:** The regulatory approach to foreign investment should place the burden of justification on the state rather than the investor. Residual sectoral caps and administrative approval routes should include explicit sunset clauses. These restrictions should expire automatically unless the government publishes a detailed, evidence-based reason for their continuation, such as national security or strategic vulnerabilities. This change would help align India's regulatory environment with its goal of building a transparent, open, and globally competitive economy.



- **Mains Questions**

- **1.** "Most of the unemployment in India is structural in nature." Examine the methodology adopted to compute unemployment in the country and suggest improvements. (UPSC CSE GS-3 2023)
- **2.** Do you agree that the Indian economy has recently experienced V-shaped recovery? Give reasons in support of your answer. (UPSC CSE GS-3 2021)
- **3.** Assess the role of the Foreign Exchange Management Act (FEMA), 1999, in shifting India's external sector philosophy away from the restrictive legacy of FERA, 1973. To what extent does the reliance on regulatory circulars for capital account adjustments affect policy predictability for long-term global institutional investors? (Simulated GS-3 Mains Question)
- **4.** The ambition of financing a *Viksit Bharat* requires substantial integration with global financial streams and the cultivation of international financial centers like GIFT City. Discuss the structural challenges posed by discretionary capital controls on this objective, and suggest policy reforms to transition from an architecture of suspicion to one of trust. (Simulated GS-3 Mains Question)





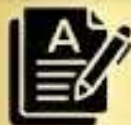
AXIA IAS ACADEMY

UPSC CSE CLASSES

RISE ABOVE THE REST



EXPERT
FACULTY &
GUIDANCE



COMPREHENSIVE
SYLLABUS
COVERAGE



STRATEGIC
TEST SERIES &
MENTORSHIP

ADMISSIONS OPEN

- Prelims + Mains + Interview
- Current Affairs Focus
- Personalized Attention
- Online & Offline Batches

 WEBSITE: axiaiasacademy.com

 CONTACT: +91 6002-417488 