

UPSC CSE | APSC CCE — GS PAPER III & II

COMPREHENSIVE STUDY MODULE

India's Macroeconomic Architecture, FDI Dynamics,
Investment Climate & the Economic Reform Debate

BITS | QE | PPP vs Nominal GDP | FDI Architecture | Fiscal Consolidation | Investment Climate

01 KEY TERMS AND EXPLANATIONS

A. Foreign Direct Investment (FDI) — Core Concepts

FDI is long-term cross-border capital investment where the investor acquires a lasting interest (typically $\geq 10\%$ equity) in an enterprise located in another country. Unlike portfolio investment, which moves in and out of financial markets rapidly, FDI implies management control, technology transfer, and a strategic commitment to the host economy. Understanding FDI requires disaggregating it along several axes.

- ▶ **Gross FDI vs. Net FDI:** Gross FDI measures total inflows of foreign capital into the host economy over a period. Net FDI deducts outward FDI (capital that domestic firms invest abroad) and profit repatriation. India's Net FDI has weakened recently because Indian companies are themselves internationalising at a rapid pace — a sign of corporate maturity and global ambition, not of investor flight. Analysing only gross figures without netting out repatriation and outward flows can distort the assessment of foreign investor confidence.
- ▶ **Greenfield Investment:** Capital deployed to set up entirely new production facilities — factories, infrastructure, R&D centres — in the host country. Greenfield FDI directly creates employment, builds productive capacity, and drives technology spillovers. India's ranking as fourth globally for greenfield project announcements in 2024 reflects genuine investor confidence in the country as a manufacturing and services destination.
- ▶ **Brownfield / M&A Flows:** Foreign acquisition of existing domestic assets — plants, companies, brands. While brownfield flows may not create new capacity immediately, they signal confidence in the valuation of Indian enterprises and often bring managerial efficiency improvements. Post-COVID global markets saw a surge in cross-border M&As, especially in the tech and pharma sectors.
- ▶ **Manufacturing FDI:** Equity inflows specifically targeted at industrial production. India's manufacturing FDI grew 18% in FY25, signalling the early success of the PLI (Production-Linked Incentive) scheme, supply chain diversification from China, and India's growing integration into global value chains.

B. Bilateral Investment Treaties (BITs)

A Bilateral Investment Treaty is a legally binding agreement between two sovereign states that establishes a framework for protecting private investments made by investors of one country in the territory of the other. BITs typically contain clauses on fair and equitable treatment, most-favoured-nation status, expropriation protection, national treatment, and — most controversially — investor-state dispute settlement (ISDS) mechanisms.

- ▶ **ISDS (Investor-State Dispute Settlement):** A provision within BITs allowing foreign private investors to directly sue the host state in international arbitration (typically ICSID — the International Centre for Settlement of Investment Disputes) if they believe the host's policies have violated their treaty rights. India faced several costly ISDS claims (Vodafone, Cairn Energy) arising from retrospective tax measures, which led to a comprehensive rethink.
- ▶ **Cumulative BIT Stock vs. Individual Signing:** Academic research (Hallward-Driemeier 2003; Tobin & Rose-Ackerman 2005) found that individual BIT signings have weak or no standalone effect on FDI inflows. What actually matters is the cumulative stock of a country's treaties — which signals an overall investor-protection regime. This distinction has profound policy implications: no single treaty should be expected to act as a magic lever for capital attraction.

- ▶ **India's Model BIT (2016):** After terminating most of its old BITs following the Vodafone and Cairn disputes, India adopted a new Model BIT in 2016 that significantly narrowed ISDS access (requiring investors to exhaust domestic remedies for five years before going to international arbitration), removed most-favoured-nation and pre-establishment rights, and emphasised the state's right to regulate. While this enhanced policy space, critics argue it has deterred some investors who prefer the older, more investor-friendly architecture.

C. Macroeconomic Architecture — India's Transformation

- ▶ **Fragile Five:** A term coined by Morgan Stanley in 2013 to describe five emerging market economies (Brazil, India, Indonesia, Turkey, South Africa) considered vulnerable to capital outflows triggered by the US Federal Reserve's tapering of quantitative easing. Vulnerability was measured by large current account deficits, fiscal imbalances, high inflation, and dependence on foreign capital. India has since fundamentally transformed its macro position on all four counts.
- ▶ **Inflation Targeting Framework:** Adopted formally in 2016 after the Urjit Patel Committee recommendations, India's Monetary Policy Committee (MPC) targets CPI inflation at 4% (with a $\pm 2\%$ tolerance band). This orthodoxy — binding the central bank to a transparent numerical target — signals credibility to investors, reduces the risk premium on Indian assets, and anchors long-term interest rate expectations.
- ▶ **Fiscal Consolidation:** The sustained effort to reduce the fiscal deficit (government expenditure minus revenue) as a proportion of GDP. India's trajectory — gradually moving toward FRBM targets — signals that the government is not monetising its deficit recklessly, which prevents inflationary spirals and reduces sovereign risk.
- ▶ **Foreign Exchange Reserves:** India's forex reserves have grown to become among the largest in the world, providing a substantial buffer against sudden capital outflows, exchange rate volatility, and import shocks. Large reserves reduce the vulnerability that characterised the Fragile Five designation.

D. GDP Measurement — PPP vs. Nominal Dollar Terms

How we measure and compare national income fundamentally shapes our conclusions about economic performance — and this is a genuine epistemic issue, not merely a technical one.

- ▶ **Nominal GDP in USD:** GDP calculated at current market exchange rates and converted to US dollars. This method is sensitive to currency fluctuations — a depreciating rupee mechanically lowers India's USD-denominated per capita income even if real living standards are unchanged. Comparing India's per capita GDP growth in USD with Bangladesh or Ethiopia reflects their bilateral exchange rate movements as much as actual welfare changes.
- ▶ **Purchasing Power Parity (PPP):** PPP adjusts for the fact that a dollar buys very different quantities of goods and services in different countries. A meal that costs \$1 in India may cost \$10 in the US. PPP-adjusted income comparisons, therefore, better reflect actual living standards, consumption possibilities, and welfare improvements. The World Bank's International Comparison Programme regularly revises PPP conversion factors.
- ▶ **Why PPP Matters for Policy Evaluation:** When assessing India's economic management under any government, PPP terms present a materially better picture than nominal dollar terms — because India's success in keeping domestic inflation relatively moderate and maintaining broadly competitive real exchange rates translates into genuine household welfare improvements that nominal comparisons understate.

E. Quantitative Easing (QE) and Global Capital Flows

- ▶ **Quantitative Easing:** An unconventional monetary policy tool whereby a central bank (the US Federal Reserve, the ECB, the Bank of Japan) purchases large quantities of government and mortgage-backed securities to inject liquidity into the financial system, lower long-term interest rates, and stimulate economic activity when conventional rate-cutting has hit the zero lower bound.
- ▶ **Zero/Near-Zero Interest Rate Era (2008–2022):** Following the Global Financial Crisis, major central banks held interest rates near zero for over a decade. This created an environment of 'search for yield' — institutional investors flooded into emerging markets (including India) in pursuit of higher returns,

artificially compressing risk premia globally. Post-2022 monetary tightening reversed these flows dramatically.

- ▶ **Impact on Emerging Markets:** The era of extraordinary monetary accommodation that preceded 2022 produced an artificial compression of risk premia globally, flooding emerging markets with capital. When this reversed — with sharp Fed rate hikes — virtually every emerging market faced currency depreciation and capital outflow pressures. Attributing India's investment trends primarily to domestic policy, while ignoring the single most consequential shift in global monetary conditions in four decades, fundamentally misreads the tide.
- ▶ **UNCTAD World Investment Report:** The UN Conference on Trade and Development's annual flagship publication tracking global FDI trends. It confirmed that global FDI fell for a second consecutive year in 2025, underscoring that the global environment — not country-specific failures — is the dominant driver of recent FDI weakness across all emerging markets.

02 MAIN ARGUMENTS AND SUBSTANTIVE ANALYSIS

A. Core Thesis: Contextualising India's Economic Performance

The central intellectual challenge in evaluating India's economic trajectory is separating the signal from the noise — distinguishing genuine domestic policy outcomes from global macro effects. A rigorous analysis must hold the global backdrop constant before attributing FDI trends, investment slumps, or growth slowdowns to domestic policy failure or success. The following key arguments structure this debate.

B. The Transformation of India's Macroeconomic Architecture

- ▶ India's macroeconomic architecture today is categorically different from its 2013 Fragile Five profile. Monetary policy is orthodox and credible, the fiscal consolidation trajectory is sustained, inflation expectations are anchored, and foreign exchange reserves provide a formidable external buffer — collectively reducing the vulnerability to Fed tightening that crippled India's external account in 2013.
- ▶ Turkey, by contrast, became a canonical case of institutional subordination of monetary policy to political preference — sustained negative real interest rates, unorthodox heterodox experiments — producing exchange rate crises and chronic inflation. Comparing India to Turkey today is analytically incoherent because the two have taken fundamentally divergent paths since 2013.
- ▶ The era of near-zero interest rates in the West produced artificial capital flows into all emerging markets, creating a misleading baseline. Post-2022 tightening reversed these flows everywhere. Treating India's FDI trajectory primarily as a domestic policy story, while ignoring this global structural shift, is the economic equivalent of mistaking the tide for the swimmer's effort.

C. The BIT Debate — Empirics vs. Intuition

- ▶ The academic consensus on BITs is far more nuanced than popular discourse suggests. Individual BIT signings do not mechanically attract FDI inflows. What matters is the cumulative stock of a country's treaties — which signals an overall investor protection regime, a credibility premium — along with the quality of domestic institutions, rule of law, and regulatory predictability.
- ▶ This finding substantially broadens the reform agenda. If the investment climate depends primarily on domestic institutional quality rather than any single legal instrument like a BIT, then the policy response must be systemic — improving judicial efficiency, reducing regulatory arbitrariness, enhancing contract enforcement — rather than focused narrowly on treaty architecture.
- ▶ The incompleteness of India's BIT revision framework — the revision process was acknowledged by successive Economic Surveys and budgets as requiring further work — is a real concern that deserves recognition. The legitimate challenge is that the pace of reform must match the ambition.

D. FDI Data — The Gross vs. Net Problem

- ▶ Gross FDI inflows to India stood at approximately \$88.29 billion through April-February of FY26 — an 18% jump year-over-year — and are on course to cross \$90 billion for the full fiscal year. This figure is well outside the \$70-80 billion range of recent years and reflects a genuine acceleration of inward investment.
- ▶ Net FDI has been weaker, driven substantially by rising outward FDI as Indian companies internationalise — acquiring assets abroad, setting up global subsidiaries, expanding manufacturing footprints internationally. Collapsing gross and net FDI data without acknowledgment, and treating weaker net FDI as evidence of investor exodus, distorts the analytical picture.
- ▶ Manufacturing FDI growing at 18% in FY25, India ranking fourth globally for greenfield project announcements, and India's share of global FDI roughly doubling over the past decade — these are not the indicators of investors leaving. They are the indicators of a country deepening its integration into global value chains.

E. The PPP vs. Dollar GDP Argument

- ▶ Ranking India 16th in per capita GDP growth in US dollar terms — behind Bangladesh and Ethiopia — performs analytical work that the chosen denominator cannot support. Currency appreciation or depreciation in Bangladesh or Ethiopia reflects their monetary and trade conditions, not welfare benchmarks against which India's economic management should be evaluated.
- ▶ In PPP terms — which better capture actual improvements in living standards — India's performance across recent years looks materially different. The PPP comparison is not a defensive manoeuvre; it is the methodologically more appropriate welfare metric.
- ▶ This is not to deny that India has genuine macroeconomic challenges in FY27 — widening trade deficit, current account pressures, upside inflation risks, and below-normal monsoon risks to agricultural supply. The Department of Economic Affairs has acknowledged these concerns explicitly in its monthly reviews. Honesty about challenges is compatible with methodological rigour about how performance is measured.

F. What Genuinely Merits Acknowledgment

- ▶ The investment climate requires continuous improvement — this is an uncontroversial proposition that all serious analysts agree on. The proliferation of quality control orders has at times crossed from quality assurance into protectionism, creating real concerns for investors.
- ▶ The BIT framework revision remains incomplete. The Economic Survey and successive budgets have addressed deregulation, ease of doing business, and the need to signal regulatory predictability — but the pace of implementation must match the level of ambition, and this is a fair demand on the government.
- ▶ Elections deliver mandates; only policy delivers prosperity. The appropriate response to pessimistic narratives is not to dispute the imperative for reform, but to demand reform be accelerated — while rejecting analytical scaffolding that obscures rather than illuminates the true picture.

03 HISTORICAL EVOLUTION OF THE ISSUE

Phase I: Pre-Liberalisation India — The Closed Economy (1947–1991)

- ▶ India's immediate post-independence economic architecture was characterised by deep suspicion of foreign capital, rooted in the colonial experience. The dominant Nehruvian model of development prioritised public sector-led heavy industrialisation (Feldman-Mahalanobis model), import substitution, and self-reliance (swadeshi ethos carried into planned economy).
- ▶ FDI was tightly regulated under FERA (Foreign Exchange Regulation Act, 1973), which capped foreign equity at 40% in most sectors and forced multinationals like Coca-Cola and IBM to exit India in

1977 rather than dilute to majority Indian ownership. This created a technology gap and productivity divergence from East Asian peers.

- ▶ The macroeconomic consequence was a structurally weak external account: chronic current account deficits, thin foreign exchange reserves (India had just 2 weeks of import cover during the 1991 crisis), and periodic balance of payments emergencies. The BOP crisis of 1991 — requiring India to pledge gold to the IMF — forced a fundamental rethinking.

Phase II: Liberalisation and the Opening to FDI (1991–2000)

- ▶ The landmark 1991 reforms under Prime Minister Narasimha Rao and Finance Minister Manmohan Singh dismantled the licence-raj, eliminated industrial licensing for most sectors, devalued the rupee (LERMS — Liberalised Exchange Rate Management System), and fundamentally reformed the FDI regime. Automatic approval was introduced for most sectors up to specified equity thresholds.
- ▶ FIPB (Foreign Investment Promotion Board) was established to fast-track FDI approvals requiring case-by-case assessment. Sectors like infrastructure, telecom, and insurance were progressively opened. The securities markets were opened to Foreign Institutional Investors (FIIs) from 1992, creating a new portfolio investment channel.
- ▶ India also began negotiating Bilateral Investment Treaties from the early 1990s. By the mid-2000s, India had over 80 BITs with major partner countries — reflecting the global consensus that treaty architecture was essential to attract FDI. In retrospect, many of these treaties contained overly broad ISDS provisions that would later expose India to costly arbitration.

Phase III: Integration into Global Capital Markets (2000–2008)

- ▶ The early 2000s witnessed India's integration into the global financial system accelerating. IT services exports boomed, the current account moved into surplus briefly in 2002-04, forex reserves surged past \$100 billion, and India emerged as a significant recipient of both FDI and portfolio capital. This period demonstrated that macro stability, institutional reforms, and sectoral opening could attract sustained capital.
- ▶ Bilateral Investment Treaty signings accelerated during this period as part of India's broader FTA and economic partnership strategy. The quantum of treaties was seen as a signal of openness — but the empirical literature was already beginning to question whether individual treaty signings moved the needle on actual inflows.

Phase IV: Global Financial Crisis and QE Era (2008–2021)

- ▶ The 2008 GFC triggered an unprecedented monetary policy response from Western central banks — coordinated interest rate cuts to near-zero, followed by successive rounds of quantitative easing (QE1, QE2, QE3, ECB QE, BOJ QE). This flooded global financial markets with liquidity and drove institutional investors into emerging markets in search of yield.
- ▶ India benefited substantially from QE-era capital flows — FDI surged, forex reserves rebuilt, and India's equity markets attracted large FII inflows. However, this created a vulnerability: the 2013 'taper tantrum' (Bernanke's announcement of future QE tapering) triggered massive capital outflows from EMs including India, exposing the Fragile Five's structural weaknesses — large current account deficits, inflation, and thin reserves.
- ▶ India's response to the 2013 taper tantrum was decisive: the Urjit Patel Committee Report (2014) recommended formal inflation targeting, the FRBM framework was strengthened, the current account deficit was compressed sharply through gold import duties and rupee depreciation, and forex reserve accumulation became a conscious policy priority. This institutional transformation is the foundation of India's current macroeconomic resilience.
- ▶ Simultaneously, the Cairn Energy and Vodafone ISDS cases — arising from India's retrospective tax amendments — resulted in international arbitration awards against India. These cases triggered a fundamental rethink of India's BIT architecture, leading to the termination of over 70 old BITs between 2016-2019 and the adoption of the new Model BIT 2016.

Phase V: Post-COVID Reconfiguration and Current Challenges (2022–Present)

- ▶ The 2022 global monetary tightening cycle — the fastest US rate-hiking cycle since the 1980s — reversed QE-era capital flows globally, strengthened the dollar, and created severe pressures on all emerging market currencies and capital accounts. India navigated this environment significantly better than peers — demonstrating the payoff from macro institutional reforms.
- ▶ India's FDI architecture has evolved to emphasise PLI schemes (Production-Linked Incentives) across 14 sectors, infrastructure investments through the National Infrastructure Pipeline, Make in India 2.0, and the PM Gati Shakti National Master Plan for multimodal logistics. These supply-side interventions aim to attract manufacturing FDI in sectors like semiconductors, green hydrogen, EVs, and defence.
- ▶ UNCTAD's World Investment Report confirmed that global FDI fell for a second consecutive year in 2025 — driven by geopolitical fragmentation, supply chain restructuring, and the end of the QE-era liquidity environment. India's performance relative to this global baseline has been notably better, with greenfield announcements reaching record levels and manufacturing FDI growing strongly.

04 LOGICAL AND PHILOSOPHICAL BASE

A. Empiricism and the Epistemology of Economic Analysis

The deeper intellectual debate here is epistemological — about the standards of evidence and argument that should govern public policy discourse. Rigorous economic analysis requires: (i) specifying the counterfactual clearly; (ii) distinguishing correlation from causation; (iii) controlling for global confounds before attributing outcomes to domestic policy; and (iv) choosing methodologically appropriate metrics for the welfare question being asked.

- ▶ When evaluating FDI trends, the relevant counterfactual is not 'how would India have done with better policies?' but 'how did India perform relative to comparable economies facing the same global headwinds?' India's superior performance in maintaining FDI inflows, sustaining forex reserves, and avoiding currency crises relative to Turkey, Argentina, or Egypt — all facing similar external conditions — is the appropriate comparison.
- ▶ Epistemic humility demands that analysts acknowledge the limits of their instruments. BIT signings, quality control orders, regulatory data — each is a partial proxy for a complex investment climate reality. Using a single instrument to construct a deterministic narrative of policy failure is a form of reductionism that 'generates a striking headline — not an illuminating analysis.'

B. Amartya Sen's Capability Approach

- ▶ Sen argued that development must be evaluated not by GDP numbers alone but by the actual freedoms and capabilities that people enjoy — health, education, political liberty, and economic opportunity. In this framework, PPP-adjusted income comparisons are philosophically superior to nominal dollar comparisons precisely because they better reflect what people can actually do and be with their incomes.
- ▶ The capability approach also implies that the reform agenda must be evaluated by its actual distributional outcomes — whether economic growth translates into expanded freedoms for the marginalised — not merely by aggregate numbers. The NITI Aayog's multidimensional poverty index, for instance, attempts this kind of capability-based accounting.

C. Rawlsian Perspective — The Difference Principle

- ▶ John Rawls' Difference Principle from A Theory of Justice holds that inequalities are justifiable only if they benefit the least advantaged members of society. Translated to economic reform, this implies that FDI liberalisation, deregulation, and investment climate improvements must be assessed not only by aggregate efficiency gains but by their distributional consequences — whether gains trickle down to informal workers, small farmers, and marginalised communities.

- ▶ Policy pessimism that ignores the genuine welfare improvements achieved for the bottom quintile (reductions in multidimensional poverty, expansion of financial inclusion, direct benefit transfers) is as incomplete as optimism that ignores remaining reform gaps. A Rawlsian lens demands both honesty and comprehensiveness.

D. Habermasian Communicative Rationality

- ▶ Jürgen Habermas argued that legitimate policy is produced through discourse that is free, inclusive, and governed by the 'force of the better argument' — not by power, emotion, or selective evidence. The debate over India's economic performance is a case study in the quality of public economic discourse. When analytical frameworks are chosen to support a predetermined conclusion rather than illuminate reality, the communicative quality of policy debate degrades.
- ▶ Constructive pessimism — identifying real reform gaps with rigorous evidence — serves the Habermasian ideal of communicative rationality. Analytical scaffolding designed primarily to support a damning headline does the opposite: it obscures rather than illuminates, generating political heat without policy light.

E. Kautilyan Realism — State Capacity and Artha

- ▶ The Arthashastra's emphasis on artha (material well-being) as the foundational pillar of rajadharma (statecraft) resonates with the argument that only sustained policy delivery — not election mandates — produces lasting prosperity. Kautilya was intensely empirical: he evaluated policies by outcomes, not intentions, and insisted that the king's economic advisors provide candid, evidence-based counsel rather than flattering narratives.
- ▶ The Kautilyan tradition also emphasises the state's duty to maintain a stable, predictable regulatory environment for commerce (vanikpatha). Modern parallels include the demand for regulatory predictability, reduction of quality control order proliferation, and timely completion of the BIT framework revision — all of which the investment community needs for long-term capital commitment decisions.

05 NEW FEATURES AND UNIQUE IDEAS

A. Cumulative BIT Stock as Signal vs. Individual Treaty Effect

The insight that what matters for FDI attraction is the cumulative stock of treaties — not the signing of any individual BIT — is a genuinely important analytical innovation. It shifts the focus from treaty arithmetic to regime credibility. A country with 70 well-designed treaties signals a fundamentally different investment protection ecosystem than one with 70 treaties of which many are being litigated or terminated.

- ▶ This reframing has practical policy implications: India's new approach of negotiating fewer but better-designed BITs (under the Model BIT 2016 framework) with economically significant partners, while simultaneously strengthening domestic investor protection through courts and regulatory reform, may eventually produce a superior cumulative investment signal — even if the raw treaty count is lower.
- ▶ Feasibility Assessment: This approach requires sustained institutional development across the judiciary (improving commercial case disposal rates), the executive (reducing regulatory discretion), and the legislature (forward-looking rather than retrospective taxation). These are structurally complex reforms with long gestation periods — requiring political commitment across electoral cycles.

B. Domestic Institutional Quality as the Dominant FDI Determinant

The Singh-Shreeti-Urdhwarshie (2022) study published in the Indian Economic Review found that BITs function as a commitment device that complements strong institutions rather than substituting for weak ones. This is a fundamentally different proposition from the standard 'sign more treaties to get more FDI' prescription.

- ▶ It implies that the FDI reform agenda must be primarily institutional — judicial quality, contract enforcement speed, regulatory transparency, anti-corruption measures — rather than treaty-based. India's rank in the World Bank's Doing Business metrics has improved substantially, but significant gaps remain in enforcing contracts and resolving insolvency.
- ▶ Feasibility Assessment: India's Insolvency and Bankruptcy Code (IBC, 2016) represents precisely this kind of institutional strengthening. However, realising its full potential requires judicial capacity expansion (more NCLT benches), standardisation of admission and resolution timelines, and resolution of cross-border insolvency frameworks — all of which are works in progress.

C. PPP as the Appropriate Welfare Benchmark for India

The explicit argument that dollar-denominated per capita comparisons with low-income economies do not constitute valid welfare benchmarks for India's economic management is a methodologically important intervention. It challenges a lazy analytical shortcut that produces dramatic headlines ('India ranked 16th') without genuine welfare insight.

- ▶ Feasibility: The PPP argument is well-established in international development economics (World Bank ICP, IMF WEO both publish PPP estimates). Its mainstreaming in Indian policy discourse — presenting both nominal and PPP metrics consistently — is feasible and would improve the quality of public economic debate.

D. FDI Repatriation and Outward FDI as Maturity Indicators

Reframing rising profit repatriation by foreign companies and growing outward FDI by Indian firms as markers of corporate maturity and global integration — rather than as evidence of economic distress — is a nuanced analytical lens that challenges simplistic readings of net FDI weakness.

- ▶ As Indian firms like Tata, Infosys, Wipro, Mahindra, and Adani expand globally — acquiring assets, setting up manufacturing plants, and building global supply chains — outward FDI naturally grows. This is a sign of the internationalisation of Indian capitalism, analogous to South Korea's journey with the Chaebol or Japan's corporate globalisation in the 1980s. Treating it as capital flight fundamentally misreads the structural transformation of Indian enterprise.

06 SUSTAINABILITY OF THE IDEA

A. Economic Sustainability of the Reform Paradigm

- ▶ The macroeconomic institutional architecture India has built since 2013-16 — formal inflation targeting, fiscal consolidation, large forex reserves, independent MPC — has proven robust across two major global shocks (COVID-19 and the 2022 monetary tightening cycle). This architectural sustainability is real and should be acknowledged as a genuine achievement.
- ▶ However, the sustainability of India's FDI-led growth strategy faces structural headwinds: rising protectionism globally, geopolitical fragmentation of supply chains, competition from Vietnam, Bangladesh, and Mexico for manufacturing relocation, and the unresolved challenge of deepening India's domestic capital markets to reduce dependence on volatile foreign capital.
- ▶ The agricultural dimension adds complexity: a below-normal monsoon compounds supply-side inflationary pressures, squeezes rural demand, and tests the MPC's inflation mandate. Climate change is making monsoon variability more pronounced, creating a chronic stress point for India's macro management that no amount of BIT signing or FDI liberalisation can resolve.

B. Constitutional and Legal Sustainability

- ▶ India's BIT framework revision raises constitutional questions around the balance between treaty obligations and parliamentary sovereignty. The Model BIT 2016's insistence that investors exhaust

domestic remedies for five years is constitutionally grounded — it defends parliamentary law-making from being second-guessed by international arbitral tribunals, which lack democratic accountability.

- ▶ However, the absence of a transparent, fast, and corruption-resistant domestic dispute resolution mechanism makes the 'exhaust domestic remedies' requirement practically burdensome for foreign investors. Strengthening the Commercial Courts Act (2015), expanding NCLT capacity, and building a specialised investment dispute tribunal would make the Model BIT 2016 framework both constitutionally sound and practically credible.

C. Environmental and Societal Sustainability

- ▶ Manufacturing FDI — particularly in sectors like EVs, semiconductors, chemicals, and defence — brings environmental implications. India's quality control orders, while sometimes overreaching into protectionism, serve a genuine environmental and safety function when properly targeted. Balancing investor-friendliness with environmental standards, labour protections, and community rights is a key sustainability challenge.
- ▶ The societal sustainability of FDI-led growth depends on whether the employment it generates reaches the semi-skilled and unskilled workforce — India's demographic dividend. Capital-intensive manufacturing (semiconductors, electronics) creates relatively fewer direct jobs per unit of investment compared to labour-intensive sectors (apparel, footwear, toys). India's PLI scheme must be complemented by skilling programmes, MSME integration, and industrial cluster development to maximise job creation.

D. Ethical Sustainability of Economic Analysis

- ▶ There is an ethical dimension to economic communication: when analysts in positions of influence construct frameworks that generate misleading conclusions — even unintentionally — they distort public policy debates, undermine investor confidence, and ultimately harm the welfare of ordinary citizens who depend on policy getting the diagnosis right. The duty to produce rigorous, evidence-based analysis is not merely a professional standard — it is an ethical obligation, particularly for economists with large public platforms.

07 CHALLENGES RELATED TO THE ISSUE

A. Structural Challenges

- ▶ China Competition and Supply Chain Diversification: While India is a primary beneficiary of the China+1 supply chain diversification strategy, it has not captured as large a share of relocating manufacturing as Vietnam, Mexico, or Bangladesh in labour-intensive sectors. India's land acquisition challenges, labour law rigidities, logistics costs, and power supply reliability continue to act as structural constraints on manufacturing FDI.
- ▶ Quality Control Order Overreach: QCOs serve the legitimate purpose of protecting domestic consumers and producers from substandard imports. However, their proliferation has, in several sectors, crossed into de facto protectionism — raising input costs for domestic manufacturers, triggering WTO compatibility concerns, and creating uncertainty for foreign investors who depend on global supply chains.
- ▶ Judicial Capacity for Investment Disputes: The five-year domestic remedy exhaustion requirement in India's Model BIT 2016 is only credible if domestic courts and tribunals can resolve investment disputes efficiently. India's commercial court system, while improving, still faces backlogs, enforcement challenges, and inconsistent outcomes across state jurisdictions.

B. Implementation Challenges

- ▶ Regulatory Predictability Gap: Retrospective taxation (the Vodafone and Cairn episodes), sudden regulatory changes (FDI policy revisions by notification), and sector-specific restrictions (e-commerce

FDI restrictions affecting established players) have created a perception of regulatory unpredictability that is disproportionately costly for long-term manufacturing investors who need 10-20 year investment horizons.

- ▶ **State-Level Implementation:** FDI policy is set at the Union level but executed at the state level — land allocation, single-window clearances, power agreements, water access, and labour enforcement all depend on state government capacity and willingness. The wide variation in ease-of-doing-business performance across Indian states (leading states like Telangana, Gujarat, Maharashtra vs. lagging states) creates an uneven national investment landscape.
- ▶ **BIT Transition Gap:** The period between the termination of old BITs (2016-2019) and the negotiation and ratification of new BITs under the Model BIT 2016 framework has created a treaty vacuum. Several significant investor countries — Germany, France, Netherlands, Switzerland — have either not yet signed a new BIT with India or are in prolonged negotiations. This gap leaves bilateral investment relations in a legally uncertain position.

C. Analytical and Communication Challenges

- ▶ **Data Quality and Consistency:** India's GDP measurement methodology has itself been contested — the base year revision to 2011-12 produced structurally higher GDP growth rates that many economists questioned on methodological grounds. Simultaneous controversy over the back-series data, the IIP (Index of Industrial Production), and the Consumer Confidence Survey creates an environment where even well-meaning analysts struggle to build a shared factual baseline.
- ▶ **The Narrative Gap:** Economic communication in India suffers from a persistent gap between official optimism and journalistic pessimism, with nuanced analysis struggling to find oxygen. The risk premia that investors apply to India's investment destinations are shaped as much by perceptions — which travel through narrative — as by fundamentals. This makes the quality of economic commentary a first-order policy concern, not merely an academic matter.

08 MULTIDIMENSIONAL ANALYSIS

A. Economic Dimension

- ▶ **FDI as a Driver of Capital Formation:** In India's investment architecture, FDI plays a critical role in supplementing domestic savings, bringing technology and management practices, and deepening integration into global value chains. The gross fixed capital formation (GFCF) to GDP ratio — a measure of investment intensity — needs to be sustained above 30% for India to achieve 7-8% GDP growth. FDI contributes both directly (greenfield projects) and indirectly (crowding in domestic investment through demonstration effects).
- ▶ **Trade Deficit Dynamics:** India's widening trade deficit reflects both structural import intensity (energy, electronics, capital goods) and the rupee's real effective exchange rate (REER). As Indian manufacturing deepens, import substitution will gradually compress the trade deficit — but this transition requires patient, long-term investment that cannot be hurried by short-term policy instruments.
- ▶ **Inflation Management:** The MPC's inflation targeting framework has produced demonstrably better outcomes than India's pre-2014 discretionary monetary policy. CPI inflation has been mostly within the 2-6% tolerance band since 2016, providing a stable macroeconomic environment for investment decisions. The residual challenge is food inflation — structurally driven by supply-side constraints in vegetables, pulses, and oilseeds — that monetary policy alone cannot resolve.

B. Social Dimension

- ▶ **Employment and Skill Mismatch:** Manufacturing FDI creates jobs, but the type of jobs matters enormously for India's demographic dividend. India needs to create approximately 12-15 million jobs per year for its working-age population. Capital-intensive FDI (semiconductors, EVs) creates fewer

jobs per rupee of investment than labour-intensive FDI (apparel, leather, food processing). India's PLI scheme must be calibrated to incentivise labour-intensive manufacturing rather than purely capital-intensive sectors.

- ▶ **Distributional Effects of Economic Reform:** The benefits of FDI liberalisation have been unequally distributed — concentrated in urban areas, IT clusters, and western/southern states. The Northeast, eastern states, and rural hinterlands have been relatively bypassed. The government's Act East Policy, which connects Northeast India to ASEAN investment flows, represents one attempt to geographically redistribute FDI benefits — and has special relevance for Assam and the Northeast corridor.
- ▶ **Welfare Indicators vs. GDP:** While GDP growth provides the resource base for social spending, welfare improvements require converting resources into outcomes — nutrition, health, education, housing. India's Multidimensional Poverty Index has shown significant improvements: the proportion of people in multidimensional poverty fell from 29.17% in 2013-14 to 11.28% in 2022-23. This welfare transformation, driven by direct benefit transfers, PM Awas Yojana, Swachh Bharat, and Ayushman Bharat, represents the social dividend of macroeconomic management that nominal GDP comparisons cannot capture.

C. Political Dimension

- ▶ **Reform Cycles and Electoral Politics:** Economic reforms in India have historically followed a 'crisis-leads-to-reform' pattern (1966, 1991, 2014). The challenge is sustaining reform momentum in the absence of crisis — particularly for politically sensitive areas like agricultural subsidies, labour law reform, land acquisition, and privatisation. The political economy of reform requires building coalitions that can absorb short-term disruptions for long-term gains.
- ▶ **Federal Dynamics:** Investment climate reforms require coordination between Union and state governments. The GST Council is a successful model of cooperative federalism for indirect tax harmonisation. A similar permanent forum for investment climate reform coordination — addressing land, labour, and logistics simultaneously — could significantly improve India's attractiveness as a manufacturing destination.
- ▶ **Geopolitical Dimensions:** India's economic diplomacy — FTAs with UAE, Australia, EFTA, and ongoing negotiations with the EU and UK — is reshaping the BIT architecture within broader trade partnership frameworks. The India-Middle East-Europe Economic Corridor (IMEC) and the Indo-Pacific Economic Framework (IPEF) represent new-generation connectivity investment partnerships that go beyond traditional BIT frameworks.

D. Legal Dimension

- ▶ **ISDS Reform and Sovereign Policy Space:** The global backlash against ISDS — driven by arbitration awards overriding democratic regulatory choices (Philip Morris v. Australia on plain packaging; Vattenfall v. Germany on nuclear phase-out) — reflects a fundamental tension between investor protection and regulatory sovereignty. India's Model BIT 2016, by narrowing ISDS access and strengthening right-to-regulate clauses, is part of a broader global reform wave that also includes UNCTAD's Investment Policy Framework for Sustainable Development and the EU's proposed Multilateral Investment Court.
- ▶ **Domestic Legal Architecture:** The Insolvency and Bankruptcy Code (2016), the Commercial Courts Act (2015), and the Arbitration and Conciliation (Amendment) Acts (2015, 2019) represent a generational upgrade of India's commercial legal framework — directly addressing the domestic institutional quality gap that is more important for FDI than BIT arithmetic. Continued strengthening of this ecosystem is both legally and economically urgent.

E. Ethical Dimension

- ▶ **Corporate Responsibility and ESG:** FDI in India increasingly comes with environmental, social, and governance (ESG) conditionalities attached — particularly from European institutional investors. India's evolving Business Responsibility and Sustainability Reporting (BRSR) framework, mandated by SEBI for the top 1,000 listed companies, is building the ESG infrastructure that global investors

expect. Aligning FDI promotion with ESG standards creates a more sustainable and ethically defensible investment ecosystem.

- ▶ **Retrospective Taxation and the Ethics of Law:** The Vodafone and Cairn retrospective tax cases raised profound ethical questions about the retroactive application of law — whether a government can legitimately change the legal character of a past transaction to claim additional revenue. The Supreme Court's judgment in Vodafone's favour, and Parliament's eventual legislative correction (Finance Act 2021 nullifying retrospective claims), reflects the belated recognition that retroactive law-making violates principles of legal certainty and legitimate expectations that are foundational to rule-of-law governance.

F. International Dimension

- ▶ **Global Investment Governance:** The multilateral framework for investment protection remains fragmented — there is no WTO-equivalent for investment. The Energy Charter Treaty's ongoing crisis, the failed OECD Multilateral Agreement on Investment (MAI) in 1998, and the proliferating network of bilateral and regional investment agreements reflect a multipolar investment governance architecture where bilateral relationships (BITs, FTAs with investment chapters) remain the primary framework.
- ▶ **Geopolitical Realignment and FDI:** The US-China decoupling, European strategic autonomy narratives, and the Friend-shoring / Near-shoring trend are structurally redirecting manufacturing investment away from China. India — with its large domestic market, English-speaking technical workforce, democratic governance, and improving infrastructure — is positioned as a primary beneficiary. But so are Vietnam, Mexico, Indonesia, and the ASEAN bloc. India's window of opportunity is real but not infinite.
- ▶ **ASEAN and Northeast India (APSC Angle):** India's Act East Policy specifically aims to link Northeast India to Southeast Asian investment flows through connectivity projects (Kaladan Multi-Modal Transit Transport Project, India-Myanmar-Thailand Trilateral Highway) and by deepening economic ties under ASEAN-India FTA. For Assam specifically, the potential of agro-processing FDI, bamboo industry investment, and tourism infrastructure capital from ASEAN partners represents a distinctive development pathway.

09 LINKAGES WITH NCERTS

Direct Connections to NCERT Curriculum

Class 11 — Indian Economic Development (Ch. 2)	Indian Economy 1950-1990: This chapter covers the dirigiste, import-substitution model — the pre-liberalisation FDI-hostile environment — and forms the essential historical baseline. The Mahalanobis model, public sector dominance, and the FERA-era restrictions directly contextualise why 1991 was so transformative.
Class 11 — Indian Economic Development (Ch. 3)	Liberalisation, Privatisation, Globalisation: Covers the 1991 reforms — dismantling the licence-raj, FIPB, automatic FDI approval, FEMA replacing FERA — making it directly relevant to understanding India's FDI liberalisation journey and the investment climate debate.
Class 12 — Macroeconomics (Ch. 5)	Government Budget and the Economy: Explains fiscal consolidation concepts — fiscal deficit, revenue deficit, FRBM — which are central to India's transformation from Fragile Five vulnerability to macroeconomic stability. Students should read this alongside the inflation targeting discussion.
Class 12 — Macroeconomics (Ch. 6)	Open Economy Macroeconomics: Covers balance of payments, current account, capital account, exchange rates, and foreign exchange reserves

	— providing the technical foundation for understanding the Fragile Five syndrome and India's macroeconomic resilience since 2013-16.
Class 10 — Economics (Ch. 4)	Globalisation and the Indian Economy: Introduces FDI, MNCs, and trade liberalisation in accessible terms. The chapter's discussion of MNC investment, supply chains, and workers' conditions connects directly to the FDI architecture and employment quality debates.
Class 12 — Contemporary India II (Geography)	Economic Geography chapters covering industrial location, SEZs, and infrastructure provide the spatial dimension of FDI — understanding why investment concentrates in certain states and what is needed to achieve geographic redistribution.
Class 11 — Statistics (Ch. 1)	Introduction to Statistics: Relevant for understanding the GDP measurement debate — the difference between nominal and PPP calculations, index numbers (IIP), and the methodological critique of using dollar-denominated comparisons for welfare assessment.

10 LINKAGES WITH UPSC CSE SYLLABUS

GS Paper II — Governance, Constitution, Polity, Social Justice

- ▶ Indian Constitution — federal provisions: Investment policy coordination between Union (Article 246, 7th Schedule List I) and states (State List items like land, public order, local taxes) is directly relevant to understanding the federal dimension of FDI policy implementation.
- ▶ International Relations — Bilateral, Regional, Global Groupings: India's BIT architecture, trade partnerships (FTAs with UAE, Australia, EFTA, EU negotiations), IMEC, IPEF, and the geopolitical context of supply chain diversification fall squarely within this syllabus segment.
- ▶ Government Policies and Interventions: PLI schemes, Make in India, PM Gati Shakti, National Infrastructure Pipeline, FDI policy notifications — all are GS-II topics requiring analytical understanding of their design, implementation gaps, and outcomes.

GS Paper III — Economic Development, Environment, Security

- ▶ Indian Economy — Growth, Development, Employment: FDI as a driver of capital formation, employment, and technology transfer; the determinants of investment climate; Gross vs. Net FDI analysis; manufacturing FDI and PLI schemes. This is the most direct syllabus connection.
- ▶ Effects of Liberalisation on the Economy: The 1991 reform era, FIPB, FEMA, automatic FDI approval routes, sectoral caps, and the ongoing liberalisation of FDI in insurance, defence, space, and media sectors are core LPG syllabic content.
- ▶ Investment Models: Infrastructure investment through the PPP model, viability gap funding, hybrid annuity model — understanding why and when private (including foreign) capital supplements public investment in infrastructure.
- ▶ Monetary Policy — RBI: Inflation targeting framework (MPC), repo rate mechanism, CRR, SLR, forex reserve management — directly relevant to the macroeconomic architecture discussion.
- ▶ Balance of Payments: Current account deficit, capital account, forex reserves, UNCTAD FDI data — the empirical backbone of the Fragile Five and macroeconomic resilience discussion.

GS Paper IV — Ethics, Integrity, Aptitude

- ▶ Ethical Dimensions of Economic Policy Communication: The duty of economists, policy advisors, and public intellectuals to produce rigorous, evidence-based analysis — rather than selective framing that distorts public debate — is a direct ethics application.

- ▶ **Probity in Governance: Retrospective taxation as an ethical governance failure** — violating principles of legitimate expectations, legal certainty, and the rule of law — provides a concrete case study for the 'integrity in public administration' syllabus segment.

Essay Paper

- ▶ **'Reforms Without Pessimism: Evidence-Based Economic Policy as the Foundation of Prosperity'** — directly relevant.
- ▶ **'The Pace of Economic Reform Must Match the Scale of Ambition'** — synthesises the investment climate and reform urgency themes.
- ▶ **'Globalisation Has Promised Much but Delivered Unequally'** — the distributional FDI and trade liberalisation debate.
- ▶ **'Good Economics Is Good Politics, but Good Politics Is Not Always Good Economics'** — the political economy of reform cycle.

APSC CCE Specific Angle — Northeast India and Assam

- ▶ **Act East Policy and Northeast India: Assam as a gateway to ASEAN; Kaladan corridor; India-Myanmar-Thailand highway; India-Bangladesh connectivity (Agartala-Akhaura rail link); investment in agro-processing, bamboo, tourism, and IT sectors in Assam from ASEAN partners.**
- ▶ **Assam's Investment Climate: The 'Advantage Assam' investment summit, industrial cluster development in Numaligarh (petrochemicals), Kamrup (IT), Bongaigaon (defence PSU), and Golaghat (tea processing) represent the state-level FDI dimension with direct APSC relevance.**
- ▶ **BTC/DONER Ministry and Investment: How Northeast India's special economic provisions — including fiscal incentives under North East Industrial Development Scheme (NEIDS) — interact with the broader FDI policy framework.**

11 PHILOSOPHY, EPISTEMOLOGY AND SYLLABUS CONNECTIONS

A. Deepest Philosophical Connections

The economic reform debate intersects with some of philosophy's most enduring questions — about how we know what we know (epistemology), about what we owe each other in conditions of inequality (ethics), and about the relationship between individual liberty, state power, and collective welfare (political philosophy).

- ▶ **Epistemology of Economic Models:** The choice between PPP and nominal GDP as a welfare metric is not merely technical — it reflects a deeper epistemological question about what kind of evidence is appropriate for the welfare claim being made. Amartya Sen's work on measurement of well-being (*Development as Freedom*, 1999) established that no single metric — not GDP, not income alone — can capture the multi-dimensionality of human welfare. The Stiglitz-Sen-Fitoussi Commission (2009) made these epistemological critiques mainstream in economic policy.
- ▶ **Karl Popper and Falsificationism:** Popper's criterion for scientific knowledge — that a theory must be falsifiable by empirical evidence — provides a useful lens for evaluating economic arguments. Claims that India's economic management has failed should specify what evidence would count as refutation. The selective use of metrics (dollar GDP but not PPP; net FDI but not greenfield) to construct narratives that cannot be falsified because the goalposts move is an epistemological failure, not a genuine analytical contribution.
- ▶ **David Hume's Is-Ought Distinction:** Hume observed that it is a logical error to derive normative conclusions ('India's government ought to reform faster') from purely positive descriptions of data ('India's FDI has slowed'). The move from observation to policy prescription requires normative premises that must be made explicit and defended. Much economic commentary conflates descriptive and normative claims in ways that Hume's distinction would identify as logically invalid.

- ▶ Isaiah Berlin — Positive and Negative Liberty: The investment climate debate implicitly invokes both dimensions of liberty. Negative liberty (freedom from regulatory interference) is what investors primarily demand — fewer QCOs, fewer approval requirements, lower compliance burdens. Positive liberty (the actual capacity to invest, profit, and grow) requires institutional infrastructure — courts, property rights, power, logistics, skilled labour — that only the state can provide. A sophisticated investment climate strategy must balance both dimensions rather than reducing investment attractiveness to mere deregulation.

B. Epistemological Dimensions for Mains Answers

Key Insight for UPSC Answers: When writing on economic policy topics, UPSC aspirants should demonstrate meta-awareness of the methodological choices embedded in analysis — which growth metric, which time period, which comparison group, which counterfactual. Examiners value candidates who show this kind of epistemological sophistication, not merely the ability to recall data points.

12 WAY FORWARD

A. Completing the BIT Transition

- ▶ India should expedite the negotiation and ratification of new-generation BITs under the Model BIT 2016 framework with major investment-source countries — including Germany, France, Netherlands, UK, and the US — to close the treaty vacuum created by the termination of old BITs. These new BITs should include robust sustainability and ESG provisions, reflecting the evolved global investment governance agenda.
- ▶ A specialised Investment Dispute Resolution Tribunal — with experienced international commercial arbitrators and fast-track procedures — should be established domestically to make the five-year domestic remedy exhaustion requirement genuinely credible and efficient. This would reduce the pressure on investors to seek international arbitration.

B. Institutional Strengthening for Investment Climate

- ▶ The Commercial Courts Act (2015) should be fully implemented across all states, with mandatory time limits (180 days for first hearing, 365 days for final judgment in commercial disputes above Rs 3 lakh). Dedicated commercial benches in High Courts should be adequately staffed and equipped with digital case management systems.
- ▶ A Regulatory Impact Assessment (RIA) framework — mandatory for all new Quality Control Orders, FDI policy changes, and sector-specific regulations — would institutionalise evidence-based rule-making, reduce the risk of regulatory overreach, and provide advance notice to investors of upcoming regulatory changes. Several OECD economies have implemented RIA frameworks with documented improvements in regulatory quality.
- ▶ The National Single Window System (NSWS) for investor clearances should be deepened — expanding the number of Union ministries and state departments integrated into the platform, implementing real-time status tracking, and establishing deemed-approval mechanisms for delays beyond prescribed timelines.

C. Macroeconomic Policy Continuity

- ▶ The MPC's inflation targeting framework should be maintained and its institutional independence defended. The monetary policy credibility India has built since 2016 is a precious asset — both for domestic price stability and for signalling to global investors that India will not resort to inflationary financing of deficits. Any political interference with the MPC's mandate would erode this credibility at severe cost.

- ▶ Fiscal consolidation — moving toward a revised FRBM glide path that creates genuine space for counter-cyclical spending in downturns without structural deficit expansion — should remain a policy anchor. Capital expenditure should be protected even as revenue expenditure is rationalised, ensuring that fiscal discipline does not crowd out growth-enhancing infrastructure investment.

D. Manufacturing FDI and Employment Strategy

- ▶ The PLI scheme should be recalibrated to emphasise labour-intensive manufacturing alongside capital-intensive sectors — specifically expanding PLI coverage to apparel and textiles, leather goods, furniture, toys, and processed food, which generate substantially higher employment per unit of investment and serve India's demographic dividend imperative.
- ▶ Industrial township development — modelled on Dholera (Gujarat) and NIMZ (National Investment and Manufacturing Zone) frameworks — should be accelerated in land-abundant states including Assam, Odisha, Jharkhand, and Rajasthan, spreading FDI benefits beyond the current coastal and metropolitan concentration.

E. Quality of Economic Discourse

- ▶ Government statistical agencies — MOSPI, RBI, DPIIT — should publish standardised FDI data that clearly distinguishes gross vs. net flows, equity vs. debt, greenfield vs. M&A, and sector-wise breakdowns, making it harder for partial statistics to be weaponised for misleading narratives in either direction.
- ▶ The CEA's Economic Survey should continue to present both nominal and PPP-adjusted income comparisons, making explicit the methodological choice and what each metric can and cannot establish. Transparency about measurement choices is the most effective antidote to analytically motivated selective presentation.

13 PREVIOUS YEARS' UPSC AND APSC QUESTIONS

UPSC Prelims — Relevant Questions

2023 | Prelims GS-I

With reference to the Indian economy, which of the following is/are the feature/features of 'Flexible Inflation Targeting'? (1) The monetary authority targets the inflation rate rather than the exchange rate. (2) There is no explicit intermediate target.

2022 | Prelims GS-I

With reference to India, 'Bilateral Investment Treaties' are negotiated by — (a) DPIIT under Ministry of Commerce and Industry (b) Ministry of External Affairs (c) Ministry of Finance (d) NITI Aayog. [Answer: (a)]

2021 | Prelims GS-I

In the context of India, which of the following factors is/are contributor/contributors to reducing the risk of a 'Bank Run'? (1) Deposit Insurance (2) 'Lender of Last Resort' facility (3) Liquidity Coverage Ratio

2019 | Prelims GS-I

With reference to Foreign Portfolio Investment, which of the following statements is/are correct? (1) FPI is also known as 'hot money'. (2) FPI leads to greater management control over a business than FDI does. Select the correct answer using the code given.

2018 | Prelims GS-I

In India, which of the following can be considered as public investment that would crowd in private investment? (1) Rural electrification (2) Postal savings bank services (3) Educational institutions (4) Insurance sector investments.

2016 | Prelims GS-I

Consider the following statements about the 'Purchasing Power Parity (PPP)' method: (1) It involves comparing prices of a specific set of goods and services between countries. (2) PPP exchange rates are more stable over time than market exchange rates. Which of the above statements is/are correct?

UPSC Mains — GS Paper III Questions

2023 | Mains GS-III

Explain the significance of the Production-Linked Incentive (PLI) scheme in enhancing India's manufacturing competitiveness in the global market. What are the challenges in its implementation? (250 words)

2022 | Mains GS-III

Discuss the policy initiatives taken by the Government of India to attract foreign direct investment in the country. What obstacles come in the way of India getting more FDI? Explain with examples. (250 words)

2021 | Mains GS-III

How did the Indian economy react to the 'Taper Tantrum' of 2013? Assess India's current macroeconomic framework in light of its response to that crisis. (150 words)

2019 | Mains GS-III

India's macroeconomic management has improved significantly over the last decade. Critically examine the statement with reference to fiscal consolidation, monetary policy, and external sector management. (250 words)

2018 | Mains GS-III

What are the key features of the new Bilateral Investment Treaties Model (2016) adopted by India? How does it balance investor protection with India's right to regulate? (250 words)

2017 | Mains GS-III

'The impact of globalisation has not been uniform across all sectors of the Indian economy.' Comment, with specific focus on the agricultural and manufacturing sectors. (250 words)

2015 | Mains GS-III

Discuss the impact of the 'Make in India' initiative on India's manufacturing sector. What measures are needed to attract greater investment in manufacturing? (200 words)

2013 | Mains GS-III

Explain the impact of QE (Quantitative Easing) tapering by the US Federal Reserve on the Indian economy. What steps did the Indian government and RBI take to address the resulting crisis? (200 words)

UPSC Mains — GS Paper II Questions

2021 | Mains GS-II

India's trade policy under WTO architecture has been defensive more than aggressive. Discuss, with reference to India's negotiating positions and the challenge of balancing protectionism with competitiveness. (250 words)

2020 | Mains GS-II

Critically examine the role of FIPB (Foreign Investment Promotion Board) in India's FDI liberalisation journey. Was its abolition in 2017 justified? (150 words)

APSC CCE Relevant Questions (Assam/Northeast Angle)

2022 | APSC CCE Mains GS-III

Discuss the significance of the Act East Policy for the economic development of Northeast India. How can Assam leverage its geographic position to attract manufacturing FDI under the China+1 strategy?

2021 | APSC CCE Mains GS-III

What are the main factors responsible for Assam's low industrialisation compared to other major Indian states? Suggest measures to improve the investment climate in Assam.

2019 | APSC CCE Mains GS-II

Critically evaluate India's Bilateral Investment Treaty framework post-2016 in the context of investor confidence and India's policy space. What reforms would you suggest?

14 MODEL ANSWERS FOR SELECTED QUESTIONS

Q: Discuss the policy initiatives to attract FDI and the obstacles that come in the way of India getting more FDI. (UPSC 2022, GS-III, 250 words)

India has pursued a multi-pronged strategy to attract Foreign Direct Investment (FDI), combining liberalisation of sectoral caps, institutional simplification, and supply-side incentives. On the liberalisation front, FDI limits have been progressively raised across sectors — 100% FDI under automatic route in manufacturing, defence (up to 74%), insurance (74%), and space (100% in manufacturing of satellites). The abolition of FIPB in 2017 and the transition to a single-window National Single Window System (NSWS) simplified the approval architecture significantly. FDI equity inflows growing at 18% in manufacturing in FY25 and gross inflows crossing \$88 billion in FY26 reflect the partial success of these measures. Production-Linked Incentives (PLI) across 14 sectors — from semiconductors and EVs to pharmaceuticals and textiles — have generated greenfield project announcements at record levels, with India ranking fourth globally for greenfield FDI in 2024. However, significant obstacles remain. First, regulatory predictability: episodes of retrospective taxation (Vodafone, Cairn) and sudden policy changes (e-commerce restrictions) have created investor uncertainty. Second, the BIT transition gap: India terminated over 70 old treaties post-2016, and the negotiation of new treaties under the Model BIT 2016 remains incomplete for major partner countries. Third, logistics and infrastructure costs remain higher than Vietnam or Mexico. Fourth, quality control order proliferation has, in several sectors, crossed into de facto protectionism. The way forward requires completing the BIT modernisation, establishing a credible domestic investment dispute tribunal, and calibrating QCOs through mandatory regulatory impact assessments — ensuring India's reform pace matches its ambition.

Q: What are the key features of India's Model BIT 2016? How does it balance investor protection with the right to regulate? (UPSC 2018, GS-III, 250 words)

India's Model Bilateral Investment Treaty (BIT) of 2016 represents a fundamental rethink of the country's international investment architecture, driven by costly ISDS cases (Vodafone, Cairn Energy) under the old treaty framework. It attempts to recalibrate the historically investor-centric BIT model toward a more balanced paradigm. Key Features: First, the Model BIT significantly narrows Investor-State Dispute Settlement (ISDS) access — foreign investors must exhaust domestic legal remedies for a minimum of five years before accessing international arbitration. This protects India's regulatory sovereignty while maintaining an international dispute option as a backstop. Second, the treaty removes Most-Favoured-Nation (MFN) provisions in the dispute resolution chapter and pre-establishment rights, preventing treaty shopping and ensuring investment decisions are commercially motivated. Third, it includes an explicit 'right to regulate' clause, affirming that bona fide regulatory measures in public health, environment, safety, and taxation are not treaty breaches. Fourth, the definition of 'investment' has been narrowed to exclude portfolio investments and contractual claims, limiting the scope of treaty protection to genuine, long-term capital commitments. Balancing Act: The Model BIT balances investor protection through a fair and equitable treatment standard (though narrowly defined), full protection and security clauses, and international arbitration as a final remedy — with the right to regulate through the exhaustion of domestic remedies requirement, the explicit carve-out for regulatory measures, and the removal of broad MFN provisions. Critique and Way Forward: The five-year domestic remedy requirement is credible only if India's commercial courts resolve disputes efficiently. Strengthening the Commercial Courts Act (2015), establishing a specialised Investment Tribunal, and expediting treaty negotiations with major partners — Germany, France, UK — will complete this transition from quantity to quality in India's investment treaty architecture.

Q: Critically examine India's macroeconomic transformation since 2013 in the context of the 'Fragile Five' designation. (Thematic/Synthesis Question, 250 words)

In 2013, Morgan Stanley grouped India among the 'Fragile Five' emerging markets (alongside Brazil, Turkey, Indonesia, South Africa) — characterised by large current account deficits, fiscal imbalances, high inflation, and acute vulnerability to Federal Reserve tapering. A decade later, India's macroeconomic architecture has been categorically transformed on each of these counts. Monetary Architecture: India formally adopted inflation targeting in 2016, establishing the Monetary Policy Committee (MPC) with a clear mandate to maintain CPI inflation at 4% ($\pm 2\%$). This institutional reform — binding the central bank to a transparent, credible framework — anchored inflationary expectations, reduced risk premia on Indian assets, and sharply distinguished India's macro management from Turkey, which chose the opposite path of subordinating monetary policy to political preference, generating chronic currency crises. Fiscal Consolidation: India has maintained a credible FRBM glide path, gradually reducing the fiscal deficit and signalling to markets that deficits will not be monetised. This discipline has kept sovereign risk premia manageable despite global uncertainty. External Sector Resilience: Foreign exchange reserves grew to among the world's largest, providing substantial import cover and crisis buffer. The current account deficit has been managed within sustainable bounds. India navigated the 2022 Fed tightening cycle — far more severe than 2013's taper tantrum — without a currency crisis or forced IMF assistance, validating the institutional transformation. Residual Challenges: The trade deficit is widening, inflation risks remain tilted to the upside (food, energy), and long-term capital attraction requires sustained domestic institutional strengthening. But the distance from 2013's fragility to 2025's resilience represents a genuine macroeconomic achievement — one that methodologically appropriate analysis must acknowledge alongside remaining reform gaps.

WHY THIS TOPIC IS UPSC-CRITICAL

This module sits at the intersection of GS-II (International Relations, Governance) and GS-III (Indian Economy, Investment, Monetary Policy). Questions on FDI policy, BITs, macroeconomic resilience, and economic reform have featured repeatedly in UPSC Mains. The ability to analyse economic claims methodologically — distinguishing gross vs. net FDI, PPP vs. nominal GDP, global vs. domestic drivers — demonstrates the analytical sophistication that top scorers display. For APSC candidates, the Act East Policy and Assam investment climate dimension adds a uniquely differentiating angle.

NOTE-MAKING TIP: Build a two-column chart — 'Global Context' vs. 'Domestic Policy Response' — for every economic issue. This forces you to always contextualise India's performance against external headwinds before forming a judgment, which is precisely what UPSC examiners reward.

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