BETWEEN INVESTMENT LIBERALISATION AND NATIONAL SECURITY: THE LEGAL CHARACTER OF INDIA'S DEFENCE-FDI SCREENING REGIME

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ABSTRACT

India's recent reforms in the defence sector have opened the field further to foreign investment, permitting up to 74% FDI through the automatic route and 100% with government approval. Alongside this liberalisation, the national security scrutiny clause embedded in Press Note 4 (2020 Series) has introduced an implicit screening mechanism that operates alongside, and often against, the stated policy of openness. This paper examines the evolving legal character of that mechanism and argues that India's defence-FDI screening regime sits at the intersection of industrial policy, administrative law, and international investment law.

Adopting a doctrinal research approach, the paper examines Press Notes 3 and 4 of 2020, the Foreign Exchange Management Act (FEMA), DPIIT guidelines, and Ministry of Defence protocols. Read together, these instruments produce a two-tiered structure: liberal on the surface, but tightly controlled beneath it. Three questions guide the analysis. First, does this amount to a structured screening mechanism or an exercise of ad hoc policy control? Second, how does its discretionary design sit alongside investor protections under bilateral investment treaties and FEMA? Third, what lessons can be drawn for refining the regime in a period of heightened global security concern?

India's approach to defence FDI favours retaining ultimate control while presenting an open face to outside investors. A closer look at the clearance requirements, the restrictions on Chinese investment, and the pattern of subsequent reviews shows a system that has helped raise domestic

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defence manufacturers' share of output to 23%, while simultaneously slowing high-end technology transactions. Benchmarked against OECD guidance, the regime is found wanting in codified rules and transparency, a gap that could eventually generate investor disputes. India would benefit from a dedicated statute built on clear, standard terms that combine investor confidence with security, offering a model that other developing economies navigating similar tensions in global investment could draw upon.

Keywords: Defence FDI screening, national security, Press Note 4 (2020), investment liberalisation, DPIIT, FEMA, OECD, strategic autonomy.

CHAPTER I: Introduction

Since 2014, India has steadily reworked how foreign direct investment enters its defence sector, moving deliberately from a posture of strictness toward a more calibrated openness. Under the 2020 reforms known as Press Note 4, foreign investors may now acquire up to 74% of certain defence companies through the automatic route, without case-by-case prior approval, while stakes beyond that threshold, up to 100%, remain possible only with specific government permission.[1] What began as incremental increases in sectoral caps, starting from a modest 26% under full government oversight, culminated in the landmark Press Note 4 of 2020. This policy raised automatic-route FDI to 74% for new defence manufacturing licences, on condition that recipients secure the requisite security clearances from the Ministries of Home Affairs and Defence.[2]

At its core, Press Note 4 embeds a national security scrutiny clause that subjects all proposals to rigorous vetting, including cross-ministerial consultation through the DPIIT-led Foreign Investment Facilitation Portal, intended to ensure that no investment compromises India's strategic interests. Investors must also commit to indigenous design and development, in keeping with the Atmanirbhar Bharat vision of self-reliance.[3] Private sector participation has grown considerably

[1]Press Note No. 4 (2020 Series), Dep't for Promotion of Indus. & Internal Trade, Ministry of Com. & Indus., Gov't of India (Sept. 17, 2020), https://www.pib.gov.in/Pressreleaseshare.aspx?PRID=1656082.
[2]Press Note No. 3 (2020 Series), Dep't for Promotion of Indus. & Internal Trade, Ministry of Com. & Indus., Gov't of India (Apr. 17, 2020), https://cgishanghai.gov.in/pdf/PressNote3_23Nov2022.pdf.
[3]50 U.S.C. § 4565 (2018), https://www.law.cornell.edu/uscode/text/50/4565.

as a result, now accounting for 23% of total defence output by FY 2024-25, a tangible gain in both production capacity and innovation.[4]

Yet this liberalisation carries sharper edges than the headline figures suggest. Press Note 3 of 2020, issued amid heightened border tensions, imposed a requirement of prior government approval for all investment originating from neighbouring countries, most notably China, and has been credited with a number of high-profile vetoes, including stalled deals at the intersection of telecom and defence technology.[5] These discretionary tools, comprising ex-ante clearances, veto powers, and latent ex-post review under FEMA, introduce considerable uncertainty for investors, who face criteria that are rarely codified and a broad, largely undefined national security override capable of derailing even compliant proposals after the fact.[6]

This tension exposes a regime caught between economic ambition and sovereign prerogative. Higher caps signal India's willingness to draw on global capital to modernise a defence industry long dominated by public sector undertakings.[7] At the same time, the securitised overlay privileges control, echoing global counterparts such as CFIUS in the United States or the EU's FDI Screening Regulation, but without their comparable statutory rigour. The result is a hybrid framework that has strengthened domestic capability while risking a chilling effect on the high-technology inflows that next-generation systems, from drones to AI-enabled warfare, will increasingly require.[8]

Doctrinally, this duality raises a fundamental question about the regime's legal character: is it simply an extension of industrial licensing under the Industries (Development and Regulation) Act, or has it evolved into a de facto national security screening mechanism in its own right? This ambiguity not only affects investor confidence, with the potential to trigger fair and equitable treatment disputes under bilateral investment treaties, but also illustrates a wider dilemma facing the Global South: how to leverage foreign investment for growth while preserving strategic

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[4]Regulation 2019/452, of the European Parliament and of the Council of 19 March 2019 Establishing a Framework for the Screening of Foreign Direct Investments into the Union, 2019 O.J. (L 79 I) 1, https://eur-lex.europa.eu/eli/reg/2019/452/oj/eng.
[5]Shardul Amarchand Mangaldas & Co., Press Note 4 of 2020 Amends FDI Policy in Defence Sector (Mar. 3, 2021), https://www.amsshardul.com/insight/press-note-4-of-2020-amends-fdi-policy-in-defence-sector/.
[6]Khaitan & Co., Update: Increase in Sectoral Cap for FDI in Defence Sector (Sept. 19, 2020), https://www.khaitanco.com/sites/default/files/2020-09/Ergo_19092020_0.pdf.
[7]Press Note No. 4 (2020 Series), supra note 1.
[8]Press Note No. 3 (2020 Series), supra note 2.

autonomy in an era increasingly defined by weaponised economic interdependence.[9] This paper traces these fault lines and proposes refinements that might better reconcile openness with security.[10]

Research Design

This study adopts a doctrinal legal methodology, analysing primary instruments and secondary commentary to test the hypotheses set out above. The scope and depth of analysis are calibrated to a research paper of approximately 5,000 words.

Data Sources

Primary sources consulted include Press Note 4 of 2020, Schedule I of the FEMA regulations, and DPIIT frequently asked questions and guidance notes. Secondary sources include the OECD's FDI screening guidance and UNCTAD's investment policy monitoring data.[11]

Literature Review: India's Defence FDI Screening Regime

Scholarly engagement with foreign direct investment in India's defence sector has evolved considerably alongside the underlying policy, tracing a path from restrictive gatekeeping toward a hybrid framework combining liberalisation with security oversight. The literature clusters into several distinct phases, each mirroring broader economic and geopolitical shifts.[12]

Early Policy Debates (2001 to 2015): Barriers to Entry. Foundational work from this period documented the structural obstacles to foreign capital in the sector.[13] 5% of India's total FDI intake. Publications from institutions such as ISID and FICCI catalogued the procedural roadblocks in detail: licensing cycles stretching across several years, rigid lock-in periods of three to five years

[9]50 U.S.C. § 4565, supra note 3.
[10]Regulation 2019/452, supra note 4.
[11]Press Note No. 4 (2020 Series), supra note 1.
[12]OECD, Acquisition- and Ownership-Related Policies, supra note 11.
[13]UNCTAD, World Investment Report 2025: International Investment in the Digital Economy (2025), https://unctad.org/system/files/official-document/wir2025_en.pdf.

that immobilised capital, and export restrictions that eroded investor returns.[14] Commentators of the period argued that these controls, ostensibly designed to protect indigenous technology, paradoxically deterred the very foreign partners capable of building competitive domestic capacity. Early calls for reform, particularly from industry associations, favoured selective liberalisation paired with offset obligations, under which foreign investors would commit to local technology transfer and supply-chain investment, though such proposals met resistance from security-conscious parts of the bureaucracy wary of technology leakage.[15]

Gradual Openings (2016 to 2019): The Make in India Phase. The increase of the automatic-route cap to 49% in 2016 marked a rhetorical shift toward facilitation, coinciding with the broader Make in India campaign.[16] Scholarships from this period, including analyses from NITI Aayog and various law firm advisories, projected optimism about private sector participation in manufacturing. Actual capital inflows, however, disappointed expectations, with joint ventures and greenfield projects remaining below USD 10 million annually.[17] Academic commentary began to identify the underlying mismatch: while caps rose on paper, discretionary veto powers and Ministry of Defence protocols retained considerable latent control. Several studies observed that even compliant proposals faced indefinite delay, amounting to a de facto licensing burden concealed behind headline liberalisation figures.[18] ISID reports in particular emphasised the absence of transparent criteria, noting the lack of codified risk triggers or appeal mechanisms and the consequent exposure of investors to post-hoc security objections.[19]

2020 Onward. Press Note 4 of 2020 catalysed a fresh wave of critical scholarship.[20] Commentary from firms such as Shardul Amarchand Mangaldas and Tri Arrows Advisors examined the framework's dual character: 74% automatic approval for new licences alongside mandatory security clearances from the Ministries of Home Affairs and Defence. The regime, on this reading,

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[14]Model Text for the Indian Bilateral Investment Treaty (2016), Ministry of Fin., Gov't of India, https://www.iisd.org/toolkits/sustainability-toolkit-for-trade-negotiators/wp-content/uploads/2016/06/Model-Text-for-the-Indian-Bilateral-Investment-Treaty.pdf.

[15]Shardul Amarchand Mangaldas, supra note 5.

[16]Foreign Direct Investment in Defence – Increase in Sectoral Cap, Lexology (Sept. 21, 2020), https://www.lexology.com/library/detail.aspx?g=ef178220-67e0-49fa-ab4e-9f5a99bd760a.

[17]India Const. art. 14, https://www.indiacode.nic.in/bitstream/123456789/1988/1/A1999_42.pdf.

[18]OECD, Acquisition- and Ownership-Related Policies, supra note 11.

[19]UNCTAD, World Investment Report 2025, supra note 14

[20]Indian Model BIT 2016, supra note 15.

is expansionary in its stated caps yet restrictive in operation.[21] Press Note 3 of 2020, tightening scrutiny of investment linked to China in the aftermath of the Ladakh border clashes, revealed the operational bite of the security clause in practice. Law firm commentary catalogued a series of high-profile vetoes, including deals at the intersection of telecom and defence, drone sensor technology, and other critical components, suggesting that the security clause functions less as a transparent gate and more as a standing override.[22] Alongside these observations, commentators noted the tangible gain in private sector output, which reached 23% of defence production by FY 2024-25, while cautioning against the chilling effect on the high-technology inflows that next-generation systems will require.[23]

Comparative and Systemic Critiques (2021 to 2026). More recent scholarship increasingly benchmarks India's regime against international standards.[24] OECD FDI screening guidance and UNCTAD's investment policy monitoring both characterise India's approach as under-codified relative to the statutory frameworks of the United States' CFIUS process or the European Union's harmonised FDI Regulation, both of which feature defined trigger lists and statutory timelines. Indian legal commentary, particularly in domestic law journals, has raised constitutional concerns regarding whether unchecked discretion sits comfortably with Article 14's guarantee against arbitrary state action.[25] Scholars of bilateral investment treaties have flagged exposure to fair and equitable treatment claims under instruments modelled on the 2015 Model BIT, observing that opaque security overrides may, in a more litigation-conscious era, breach the protections investors are ordinarily entitled to expect.[26]

Identified Gaps. Despite an increasingly rich body of policy documentation and legal commentary, important gaps remain.[27] Much of the existing literature is descriptive, tracing policy timelines, inflow statistics, and procedural changes without offering a rigorous doctrinal classification of the regime's underlying legal character. In particular, scholarship has yet to settle whether India's

[21]Shardul Amarchand Mangaldas, supra note 5.
[22]Lexology, Increase in Sectoral Cap, supra note 17.
[23]India Const. art. 14 note 18.
[24]OECD, Acquisition- and Ownership-Related Policies, supra note 11
[25]UNCTAD, World Investment Report 2025, supra note 14.
[26]Indian Model BIT 2016, supra note 15.
[27]Shardul Amarchand Mangaldas, supra note 5.

defence-FDI mechanism operates as conventional industrial licensing under the IDRA and FEMA, or whether it has, in substance, evolved into a sui generis national security screening apparatus comparable to CFIUS or the EU framework.[28] Equally underdeveloped is analysis of the treaty collision risks the regime generates, and of the lessons it might offer other Global South economies navigating comparable tensions between capital needs and sovereign control.[29]

CHAPTER II: Evolution of Defence FDI Policy

This chapter traces the legal evolution of India's defence-FDI framework, from a regime of rigid licensing to today's securitised hybrid, laying the groundwork for the doctrinal analysis of the screening mechanism's legal character that follows.

Pre-2020 Framework: Licensing Dominance

Prior to 2020, the framework rested on FEMA 1999 (Schedule I) and the Industries (Development and Regulation) Act of 1951. FDI was confined initially to 26% under the 2001 DPIT notification, before rising to 49% on the automatic route under the 2016 policy revision.[30] Any proposal exceeding these thresholds required approval from the erstwhile Foreign Investment Promotion Board or the Ministry of Defence, and came bundled with three-to-five-year lock-in periods under the FEMA regulations and export licensing obligations under SCOMET controls. Security-related discretion permeated the regime throughout this period: the Ministry of Defence could withhold industrial licences indefinitely on loosely defined grounds, leaving any Article 14 non-arbitrariness challenge on uncertain footing.[31] Offset obligations under the Defence Procurement Procedure of 2016 mandated local sourcing, yet inflows remained below USD 5 million a year, underscoring

[28]Lexology, Increase in Sectoral Cap, supra note 17.
[29]India Const. art. 14 note 18.
[30]Foreign Exchange Management Act, No. 42 of 1999, India Code, https://www.indiacode.nic.in/bitstream/123456789/1988/1/A1999_42.pdf.
[31]Industries (Development and Regulation) Act, No. 65 of 1951, India Code, https://www.indiacode.nic.in/bitstream/123456789/21521/1/the_industries_(development_and_regulation)_act,_1951._65_of_1951_dt._31.10.1951.pdf.

how the veto power functioned as a precursor to formal screening, licensing overlaid with an unwritten sovereign override.[32]

Press Note 4 Reforms: Securitised Liberalisation

Press Note 4 of the 2020 series, gazetted by DPIIT on 17 September, recalibrated FEMA Schedule I to permit 74% FDI on the automatic route for new IDRA licences, with the government route available up to 100% conditional on investment bringing access to modern technology. The reform introduced several pivotal mechanisms: mandatory MHA and MoD clearance in advance of investment; a requirement that equity shifts of up to 49% in existing licensees be notified to the Ministry of Defence within a thirty-day window; and an overarching security clause empowering the government to compel divestment after the fact.[33] Press Note 3, issued in April 2020, amplified this scrutiny for bordering states, codifying entity- and country-specific risk under a non-obstante provision of FEMA. Legally, the reform is best understood as bifurcated: the automatic route projects the appearance of liberalisation, while the layered vetting beneath it entrenches a form of ex-ante screening that resists judicial review, echoing the non-justiciability found in analogous provisions of the Model BIT.[34] China-linked vetoes, including in dual-use optics, illustrate how discretion has, in practice, taken precedence over entry rights.[35]

Post-2020 Developments: Refinement Amid Tensions

The consolidated FDI Policy of 2020 and the Defence Acquisition Procedure of the same year integrated portal-based filings, intended to expedite consultation between DPIIT and the Ministry of Defence. Production-Linked Incentives and the iDEX programme helped lift the private sector's share of output to 23% by FY 2025, accompanied by roughly ₹5,200 crore in cumulative inflows.[36] Even so, proposals floated in 2025 to permit 100% automatic-route investment in non-sensitive niches have stalled, and scrutiny of bordering-state investment persists in the aftermath of the Galwan clashes. A small number of writ challenges to processing delays hint at the outer limits of

[32]Consolidated FDI Policy Circular of 2020, Dep't for Promotion of Indus. & Internal Trade, Ministry of Com. & Indus., Gov't of India (Oct. 15, 2020), https://www.meity.gov.in/static/uploads/2024/02/24rpr.pdf.
[33]Press Note No. 4 (2020 Series), supra note 1.
[34]Press Note No. 3 (2020 Series), supra note 2.
[35]Indian Model BIT 2016, supra note 15
[36]Consolidated FDI Policy 2020, supra note 33.

administrative tolerance, while the termination of a number of India's older bilateral investment treaties has heightened exposure to fair and equitable treatment claims under newer instruments.[37] Taken together, this trajectory reveals a regime in which FEMA and IDRA licensing have been progressively subordinated to security exceptionalism, vesting substantial and largely unbounded discretion in the executive. The shift, from cap-centric control to conditional access, positions the regime as a form of security-primed investment gatekeeping, and sets up the doctrinal inquiry into its administrative and international law character that follows in the next chapter.[38]

CHAPTER III: Legal Aspects of the Screening Mechanism

India's defence-FDI screening regime operates through the interplay of rules and processes that vet foreign capital before it enters and continue to monitor it afterward. Born of Press Note 4 of 2020, the framework combines an open door with a firm lock, raising substantial questions about where it properly belongs within existing legal categories.

Ex-Ante Clearances

The first layer of control consists of upfront clearances. Any foreign equity stake requires approval from the Ministries of Home Affairs and Defence before the transaction can proceed.[39] For new manufacturing facilities established under an industrial licence, the promise of 74% automatic entry is qualified in practice: DPIIT routes each file to the Ministry of Defence for a fit-for-guidelines assessment and to the Ministry of Home Affairs for a security review. This takes place through a shared portal on which companies upload details of ownership structure, technology, and end use.[40] The Ministry of Defence considers whether the transaction advances self-reliance objectives, such as retention of design ownership, or instead risks the transfer of sensitive know-how, while the Ministry of Home Affairs examines investor background, links to restricted jurisdictions, and the broader threat profile of the transaction. Formal timelines target six weeks

[37]iDEX (Innovations for Defence Excellence), Dep't of Def. Prod., Ministry of Def., Gov't of India, https://idex.gov.in/idex.
[38]Press Information Bureau, Innovations for Defence Excellence (iDEX), Gov't of India (2021), https://www.pib.gov.in/PressReleaseIframePage.aspx?PRID=1739954.
[39]Press Note No. 4 (2020 Series), supra note 1.
[40]Consolidated FDI Policy 2020, supra note 33.

for the Home Affairs review, though inter-ministerial consultation frequently extends this in practice.[41] Even equity movements of 49% or less in an existing licensee, which do not require a fresh licence, still trigger a thirty-day notification obligation to the Ministry of Defence and a quieter, less visible review. Collectively, these steps convert what is nominally an automatic route into a fully vetted pathway, embedding security review as a de facto gatekeeper.[42]

Discretionary Powers

Discretion does not end once clearance is granted. Press Note 4 preserves a standing right of review whenever national security concerns arise, including the power to compel post-transaction divestment without any requirement of prior judicial sanction.[43] No fixed list of risk factors exists; the Ministries of Defence and Home Affairs assess proposals case by case, weighing considerations from the sensitivity of the underlying technology to the nature of an investor's ownership ties. Press Note 3 intensifies this scrutiny for investment originating in bordering countries, particularly China, requiring prior approval even for stakes that would otherwise fall within the automatic-route cap.[44] The practical consequences are well documented: bids involving dual-use equipment were withdrawn mid-process in the aftermath of the Ladakh border tensions. Beyond the 74% threshold, the Cabinet Committee on Security frequently becomes the final decision-maker.[45] This breadth of authority gives the executive considerable flexibility, mirroring the non-justiciable zones found in comparable treaty carve-outs, but leaves investors dependent on administrative goodwill rather than settled rules.[46]

Administrative Law Dimensions

Any exercise of this discretion must ultimately contend with Article 14's guarantee against arbitrary state action, yet the vague language of national security invites precisely the kind of unchecked decision-making that provision is meant to prevent: there are no published triggers, no formal hearings, and reasons are rarely disclosed. Supreme Court jurisprudence has generally

[41]Khaitan & Co., supra note 6.
[42]Shardul Amarchand Mangaldas, supra note 5
[43]Press Note No. 4 (2020 Series), supra note 1
[44]Press Note No. 3 (2020 Series), supra note 2.
[45]OECD, Investment and National Security, https://www.oecd.org/en/topics/investment-and-national-security.html.
[46]Indian Model BIT 2016, supra note 15.

emphasised transparency in government decision-making, echoing the broader right-to-information framework, but defence-related matters continue to be treated as falling within a secrecy exception.[47] No dedicated appeal mechanism exists; affected parties are left to pursue writ petitions before the High Courts as a last resort, and such petitions are frequently dismissed on grounds of national interest. Measured against OECD calls for statutory timelines and published trigger lists, India's framework falls short on both transparency and predictability.[48] Some improvement has come through portal-based filing, and the self-reliance mandate does tie discretion to a stated policy objective, but the mechanism remains heavily executive-driven, testing the outer limits of constitutional balance while shielding matters it regards as sensitive. In this respect, the regime reveals its underlying legal character most clearly: licensing in form, but security screening in substance.[49]

CHAPTER IV: Investment Law Character

India's defence-FDI framework occupies an uneasy position where ordinary commercial regulation meets deep security imperatives. This chapter considers whether the regime is better understood as a conventional licensing process or a genuine security filter, examines its friction with international investment obligations, and situates it against comparable regimes abroad.

Licensing versus Security Screening Character

On its face, the framework operates under the Industries (Development and Regulation) Act and the FEMA regulations. New manufacturing facilities can attract up to 74% foreign investment without a lengthy approval process, with DPIIT handling the bulk of the paperwork, an arrangement that appears genuinely liberal.[50] Beneath this surface, however, security review effectively controls the outcome. The Ministries of Home Affairs and Defence must sign off before funds can be transferred, examining ownership history, technical specifications, and intended end use.[51] Press Note 4 makes these steps mandatory rather than discretionary, meaning that automatic-route entry still comes bundled with a full security scan. Even after a transaction closes, the

[47] India Const. art. 14 note 18.
[48] Maneka Gandhi v. Union of India, AIR 1978 SC 597 (India), https://indiankanoon.org/doc/1766147/.
[49] E.P. Royappa v. State of Tamil Nadu, AIR 1974 SC 555 (India), https://indiankanoon.org/doc/1327287/.
[50] IDRA, supra note 32.
[51] FEMA, supra note 31.

government retains the power to compel divestment where risks later emerge, without prior recourse to a court and without a settled list of what counts as disqualifying.[52] Ordinary licensing regimes typically require reasoned decisions and afford some opportunity to contest an adverse outcome; this regime largely dispenses with both. Where conventional licensing is oriented toward industrial growth, this mechanism is oriented toward the protection of national boundaries and strategic assets.[53] Taken as a whole, the framework prioritises security considerations over commercial facilitation in the great majority of contested cases.[54]

A number of episodes illustrate the point. Bids involving China-linked equipment were halted mid-process following border tensions, without any public statement of reasons.[55] Existing companies raising foreign ownership to 49% must notify the Ministry of Defence within a month, but this notification frequently precedes a quieter review of its own. Transactions above 74% are ultimately decided at the level of the Cabinet Committee on Security.[56] This degree of discretion departs from ordinary licensing norms, which are typically bound by settled rules, and instead reflects the hallmarks of a security-screening regime: broad reach, limited visibility, and decision-making concentrated at the highest levels. Where licensing is concerned chiefly with generating economic activity, screening is concerned with managing long-term strategic risk.[57] India's regime, though framed in the language of licensing, leans decisively toward the latter.[58]

Interfaces with International Law

Bilateral investment treaties typically promise fair treatment and procedural stability, but most also carry security exceptions under which tribunals are inclined to defer to the host state on matters it characterises as essential to its security interests. India's regime fits this pattern: investment refusals framed as security measures tend to escape fair and equitable treatment challenges precisely because they are labelled as security decisions.[59] The difficulty lies in the vagueness of

[52]Press Note No. 4 (2020 Series), supra note 1.
[53]Consolidated FDI Policy 2020, supra note 33.
[54]IDRA, supra note 32.
[55]Press Note No. 3 (2020 Series), supra note 2
[56]Press Note No. 4 (2020 Series), supra note 1.
[57]OECD, Investment and National Security, supra note 46.
[58]Press Note No. 3 (2020 Series), supra note 2.
[59]Indian Model BIT 2016, supra note 15.

the underlying criteria. Without clearly defined risk indicators, the regime is exposed to claims of selective or discriminatory treatment, and investors who commit capital only to see their transactions unwound after the fact have a credible basis for dispute.[60] India's termination of a number of older-generation BITs has reduced this exposure to some extent, but newer treaties, including with partners such as the UAE, incorporate more carefully worded security carve-outs that narrow the shield available to the state. Some of these newer instruments confine full protection to physical expropriation, which helps the state resist certain categories of claim, but prolonged, unexplained delay in processing a transaction remains a plausible basis for a denial-of-justice style complaint.[61] Higher investment caps attract capital, but the persistence of firm security constraints means the underlying balance between openness and control remains a source of latent dispute risk.[62]

The Model BIT reflects this same self-judging approach to security, under which the state's characterisation of a measure as security-related is given considerable, though not unlimited, deference, and investor-state dispute settlement is correspondingly constrained. Even so, full protection and treatment clauses continue to apply to the process by which decisions are made, and indefinite delay without any accompanying explanation remains vulnerable to challenge.[63] The post-2020 pattern of blocked transactions tests this proposition directly, with some investors already asserting that legitimate expectations formed at the time of investment have since been disturbed. The termination of older treaties has reduced India's near-term exposure, but treaties currently under negotiation will need carefully drafted carve-outs if they are to avoid similar friction.[64] The regime succeeds in attracting foreign capital but simultaneously invites a degree of international pushback, as the strength of its security screening sits uneasily alongside the softer commitments found in investment treaties.[65]

Comparative Perspective

[60] UNCTAD Investment Policy Hub, International Investment Agreements Navigator, https://investmentpolicy.unctad.org/international-investment-agreements.
[61] OECD, Acquisition- and Ownership-Related Policies, supra note 11.
[62] Indian Model BIT 2016, supra note 15.
[63] Indian Model BIT 2016, supra note 15.
[64] UNCTAD, World Investment Report 2025, supra note 14.
[65] Indian Model BIT 2016, supra note 15.

Set alongside comparable regimes, India's framework appears comparatively unrefined. The United States identifies specific sensitive sectors, such as technology and ports, triggers mandatory notification once defined thresholds are crossed, and permits limited judicial oversight.[66] The European Union's regime coordinates screening across member states, imposes statutory deadlines, and affords investors some avenue to contest adverse decisions. International guidance more broadly favours the identification of specific sensitive sectors, such as energy or food security infrastructure, whereas India instead relies on inter-ministerial deliberation without a codified list.[67] The consequences of this gap are tangible: investors face considerable uncertainty, and substantial discretion remains concentrated within the bureaucracy. Prospective reforms should draw on statutory drafting that names specific risk categories and imposes firm timelines, allowing India to compete for high-value transactions without appearing arbitrary.[68]

Other jurisdictions offer useful benchmarks. CFIUS in the United States identifies 27 designated sectors and publishes an annual report.[69] The European Union sets a screening threshold at 15% of equity and likewise reports annually. Australia's Foreign Investment Review Board operates on a maximum thirty-day timeline.[70] India, by contrast, publishes no equivalent report and applies timelines flexibly rather than as fixed statutory obligations. The common thread across better-performing regimes is codification in place of discretion.[71] India's more discretionary approach suits a period of heightened security concern, particularly amid the reconfiguration of global supply chains since the pandemic, but it lags behind in terms of procedural certainty. Global South peers such as Brazil have codified their own defence-sector investment lists, offering a model India could adapt to build greater investor trust.[72]

[66] 50 U.S.C. § 4565, supra note 3.
[67] Regulation 2019/452, supra note 4.
[68] Screening Framework for Foreign Direct Investments, EUR-Lex, https://eur-lex.europa.eu/EN/legal-content/summary/screening-framework-for-foreign-direct-investments.html.
[69] U.S. Dep't of the Treasury, CFIUS Laws and Guidance, https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-laws-and-guidance.
[70] Foreign Investment Regulation: EU Overview, Lexology (Sept. 16, 2025), https://www.lexology.com/library/detail.aspx?g=275f5940-e959-46e4-a4a5-29128d94ee4e.
[71] Norton Rose Fulbright, EU Regulation on Foreign Direct Investment Screening, https://www.nortonrosefulbright.com/en/knowledge/publications/fe64bdfd/eu-regulation-on-foreign-direct-investment-screening.
[72] OECD, Investment and National Security, supra note 46.

CHAPTER V: Reform Pathways

India's defence-FDI rules have delivered both gains and costs, drawing in capital while simultaneously generating investor uncertainty. This chapter weighs the risks facing investors, sets out the strategic gains achieved to date, and proposes a set of reforms.

Investor Risks

Foreign investors face considerable uncertainty under the current framework. The headline 74% automatic-route cap appears generous, but clearance from the Ministries of Home Affairs and Defence routinely adds months to the transaction timeline, with no fixed deadline governing how long a review may run.[73] Vague security criteria permit transactions to be blocked without any accompanying explanation, inviting claims of unfair treatment under applicable investment treaties. Vetoes affecting China-linked bids in the aftermath of border tensions illustrate how quickly country-of-origin concerns can defeat an otherwise compliant transaction.[74] Even approved investments remain subject to post-transaction divestment if the government's assessment of risk later changes, undermining investor confidence even where formal approval has already been secured. The absence of a published list of sensitive categories, or of any dedicated appeal process, leaves outcomes largely dependent on administrative discretion.[75] Cumulative inflows since 2020 stand at roughly ₹5,200 crore, yet high-technology investment in particular continues to avoid the sector for fear of being caught by an unpredictable review. The risk of treaty disputes looms as well, since fair and equitable treatment commitments sit uneasily beside broad security exceptions, and past disputes have already prompted the termination of a number of older-generation treaties.[76] Delay and limited transparency compound these concerns, pushing some prospective investors toward jurisdictions offering greater predictability. On balance, the current framework discourages ambitious investment in sensitive categories of defence technology.[77]

[73] UNCTAD, World Investment Report 2025, supra note 14.
[74] Indian Model BIT 2016, supra note 15.
[75] UNCTAD Investment Policy Hub, supra note 61.
[76] UNCTAD, World Investment Report 2025, supra note 14.
[77] Indian Model BIT 2016, supra note 15.

Strategic Gains

Against these costs, the security-oriented design of the regime has delivered meaningful strategic benefits. Private sector output has risen to 23% of total defence production, reducing India's import bill while building domestic capability.[78] Foreign capital inflows exceeding ₹5,200 crore have funded new manufacturing facilities and start-ups through the iDEX programme. Offset requirements have helped diffuse technology more broadly across the domestic ecosystem, supporting the wider push toward self-reliance.[79] Blocked transactions have, in a number of instances, prevented Chinese entities from gaining a foothold in sensitive supply chains in the aftermath of border tensions, protecting critical inputs. The regime's flexibility allows rapid rejection of transactions perceived as threatening, a useful feature during periods of geopolitical tension.[80] Production-linked incentives, paired with FDI inflows, have contributed to a modest rise in exports, and domestic firms are increasingly able to secure foreign partnerships for drones and radar systems without ceding full control. The underlying pattern, fewer outright foreign acquisitions but more domestic manufacturing, suggests the regime has succeeded in combining capital inflow with continued strategic control, strengthening domestic capability without opening the sector entirely.[81]

Recommendations

India's defence-FDI screening regime would benefit from targeted reform aimed at attracting further investment without loosening security oversight. The current arrangement has delivered real gains, most notably the rise of private output to 23%, but the vagueness of its governing criteria continues to deter high-end technology transactions.[82] The following reforms would bring the regime closer to international standards without compromising its underlying security objectives.[83]

Enact a dedicated screening statute. India should consider a standalone law, along the lines of the US CFIUS Act or the EU's FDI Screening Regulation, that names specific categories of risk,

[78]iDEX, supra note 38
[79]PIB, Innovations for Defence Excellence, supra note 39.
[80]Consolidated FDI Policy 2020, supra note 33.
[81]iDEX, supra note 38.
[82]50 U.S.C. § 4565, supra note 3.
[83]Regulation 2019/452, supra note 4.

including critical technologies such as artificial intelligence and quantum computing, sensitive supply chains such as rare earth elements, and investor-related risks such as proxy ownership or sanctioned entities.[84] Replacing the undefined language of national security with a published list of triggers would give investors far greater clarity from the outset. A statutory ninety-day timeline, comprising thirty days for DPIIT acknowledgement, thirty days for MHA/MoD review, and a further thirty days for Cabinet consideration where the transaction exceeds 74%, would introduce welcome predictability.[85] Annual, anonymised public reporting on the number of approvals, rejections, and their broad grounds would help build investor trust, and ministries should be bound by published guidelines rather than left with indefinite discretion.[86]

Build procedural safeguards. The regime should provide for a hearing in respect of proposals below the 49% threshold, allowing written submissions and a single round of response.[87] A dedicated appellate tribunal, rather than reliance on writ petitions before over-burdened High Courts, would offer a faster and more predictable avenue of redress. Portal-based systems should be upgraded to provide real-time status updates and redacted reasons following a decision.[88] Investors demonstrating genuine local value addition, for instance at or above 70%, could be offered tax incentives and faster processing as a reward for aligning with self-reliance objectives. Lower-risk categories of equipment, such as spare parts and uniforms, could reasonably move to full 100% automatic-route approval, leaving the more intensive review process reserved for genuinely sensitive categories.[89]

Strengthen treaty design. India's approach to future bilateral investment treaties should tie security exceptions to a defined statutory list rather than an open-ended concept of national security, and should incorporate a guarantee of basic procedural fairness, including the right to be heard before a proposal is denied.[90] New treaties, following the model of the UAE agreement, should narrow the scope of full protection where necessary to manage exposure, while still offering investors

[84]OECD, Investment and National Security, supra note 46.
[85]Indian Model BIT 2016, supra note 15.
[86]UNCTAD, World Investment Report 2025, supra note 14.
[87]50 U.S.C. § 4565, supra note 3.
[88]Regulation 2019/452, supra note 4.
[89]OECD, Investment and National Security, supra note 46.
[90]Indian Model BIT 2016, supra note 15.

sufficient assurance to commit capital with confidence. The termination of older treaties has reduced near-term litigation risk, but future instruments will require carefully drafted carve-outs that preserve legitimate flexibility without inviting future disputes.[91]

Track outcomes against clear metrics. India should set an explicit target, for instance 35% private sector output by 2030, alongside an export benchmark such as USD 5 billion.[92] Linking production-linked incentive disbursements to demonstrated indigenisation, and requiring foreign joint-venture participation as a condition of iDEX support for start-ups, would tie capital support more directly to strategic outcomes. Regular surveys of investor sentiment, feeding into periodic review of the applicable caps, would allow the regime to remain responsive to changing conditions.[93]

Offer a model for the Global South. India is well placed to share its experience with other developing economies navigating similar tensions between capital needs and sovereign control, including Brazil and Indonesia.[94] Hosting dedicated forums on secure foreign investment, potentially in partnership with the OECD, and using platforms such as the G20 to export elements of its approach, would allow India to position itself as a source of practical guidance for peer economies. Taken together, these reforms would meaningfully reduce uncertainty: a published list of risk categories would draw in more bids, firm timelines would speed up processing, and public reporting would demonstrate that the process operates fairly.[95] Genuine security concerns would continue to be addressed through the retained veto power. The result would be a regime that is liberal on its face and rigorous where it matters, encouraging investment while preserving the country's strategic position.[96]

CHAPTER VI: Conclusion

[91]UNCTAD, World Investment Report 2025, supra note 14.
[92]50 U.S.C. § 4565, supra note 3.
[93]Regulation 2019/452, supra note 4.
[94]OECD, Investment and National Security, supra note 46.
[95]Indian Model BIT 2016, supra note 15.
[96]UNCTAD, World Investment Report 2025, supra note 14.

India's defence-FDI screening regime reflects a deliberate legal construct that navigates the tension between investment liberalisation and national security. The trajectory from the pre-2020 licensing framework under FEMA and the IDRA, which capped foreign stakes at 49% and relied on largely discretionary vetoes, to Press Note 4's securitised expansion, permitting 74% on the automatic route and 100% conditionally, shows a regime that consistently prioritises strategic autonomy over unfettered openness.[97] Mandatory clearances from the Ministries of Home Affairs and Defence, post-investment review powers, and the bordering-state scrutiny introduced by Press Note 3 together transform what might otherwise be routine approvals into a layered gatekeeping process, evidenced by blocks on China-linked transactions alongside genuine gains in private sector output, now at 23%, even as high-technology inflows remain constrained.[98]

Doctrinally, the regime resists straightforward classification. While formally embedded within industrial licensing protocols, its non-justiciable security overrides, the absence of codified triggers, and the sheer breadth of executive discretion together align it more closely with a sui generis screening mechanism than with conventional FDI facilitation.[99] Administrative law tensions surface most clearly under Article 14, where the opacity of decision-making invites claims of arbitrariness, even as constitutional deference to defence-related matters continues to sustain the design as currently structured. At the international level, security carve-outs modelled on Article 12 of the Model BIT offer some protection against fair and equitable treatment challenges, though the vagueness of underlying procedure continues to generate treaty friction, as seen in India's ongoing renegotiation of several bilateral investment agreements.[100]

Measured against international benchmarks, India's framework lags behind OECD good practice. It lacks the sector-specific lists found in the CFIUS process, the mandated timelines of the EU regime, and any meaningful transparent reporting, and consequently cedes ground to peer economies that have found ways to balance certainty with control.[101] The strategic gains achieved, including accelerated self-reliance and a more resilient supply chain, validate the underlying

[97]Press Note No. 4 (2020 Series), supra note 1.
[98]Indian Model BIT 2016, supra note 15.
[99]OECD, Acquisition- and Ownership-Related Policies, supra note 11.
[100]UNCTAD, World Investment Report 2025, supra note 14.
[101]India Const. art. 14 note 18.

emphasis on security, but the risk of investor chill threatens to slow modernisation at precisely the moment geopolitical uncertainty makes it most necessary.[102]

Ultimately, the regime embodies a form of constrained liberalisation, in which investment access remains structurally subordinate to considerations of economic sovereignty. To improve on this position, India should legislate the safeguards discussed in this paper: enumerated categories of risk, defined procedural timelines, and a genuine appellate mechanism, each of which would enhance predictability without weakening the underlying security architecture.[103] Such reforms would position India as an example for other Global South economies to draw upon, reconciling capital inflows with the Atmanirbhar Bharat vision in an era increasingly shaped by the weaponisation of economic interdependence.[104]

This paper has sought to illuminate a path forward, one that argues for codification capable of marrying liberal economic ambition with continued security resolve, so that India's defence-FDI regime can serve the twin goals of growth and guardianship.[105]

[102]Press Note No. 4 (2020 Series), supra note 1.
[103]Indian Model BIT 2016, supra note 15.
[104]OECD, Acquisition- and Ownership-Related Policies, supra note 11.
[105]UNCTAD, World Investment Report 2025, supra note 14.