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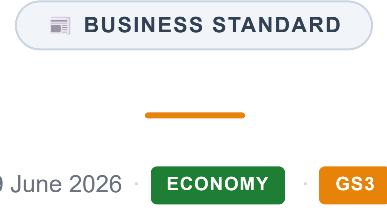
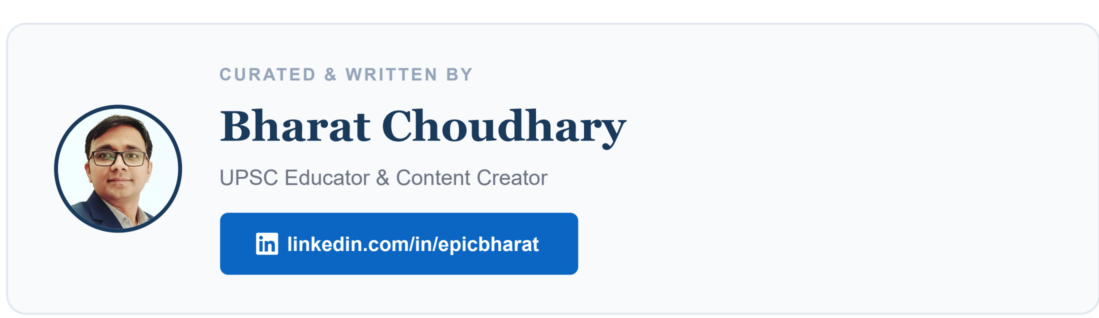
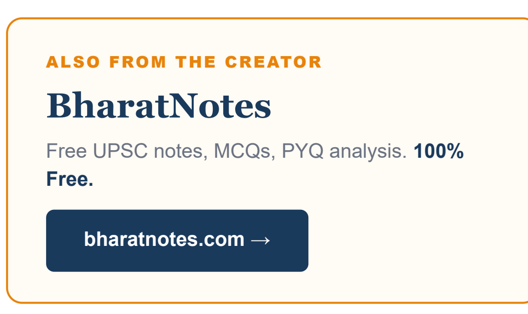
Opening the Bond Market: On Foreign Capital and Its Risks







Opening the Bond Market: On Foreign Capital and Its Risks

Business Standard 9 June 2026 **GS3**

Source: ujiyari.com — Free UPSC & State PCS Current Affairs

INTERVIEW ANGLE

"Foreign money deepens the bond market but can flee in a crisis. How does India attract long-term capital while insulating itself from sudden reversals?"

Source: Original editorial ↗ Business Standard

Every fact web-verified against primary sources

WHY THIS MATTERS NOW

India has exempted foreign investors from tax on government securities and widened their access, a calculated move to **deepen the bond market** and capitalise on global bond-index inclusion. But opening a debt market to foreign capital is a classic double-edged sword. For an aspirant, this is a GS3 case on **capital markets, government borrowing and financial stability**, and the perennial trade-off between depth and volatility.

THE CRUX IN 60 WORDS

India's **tax breaks and expanded Fully Accessible Route** aim to draw foreign investors into **government securities**, deepening the market, lowering borrowing costs and aiding **bond-index inclusion**. But foreign debt holdings can **flee in a crisis**, pressuring the rupee and yields. The fix is in the **design**: target long-tenor, patient capital; keep reserves and macroprudential tools; open **gradually**.

THE ISSUE, DECODED

CONCEPT	WHAT IT MEANS	WHY IT MATTERS
Fully Accessible Route	Uncapped FPI access to specified G-Secs	The channel being widened
Bond-index inclusion	Joining global indices like JPMorgan GBI-EM	Brings large passive inflows
Sudden stop	Abrupt reversal of foreign capital	The core volatility risk
Crowding out	Government borrowing squeezing private credit	What deeper foreign demand can ease

THE ANALYSIS: DEPTH VERSUS VOLATILITY

1. **Depth is the benefit.** A broader investor base lowers borrowing costs, adds liquidity, and frees domestic credit for private borrowers.
2. **Index inclusion amplifies inflows.** Global bond-index membership channels large, passive foreign money into eligible G-Secs.
3. **Volatility is the cost.** Foreign debt holdings are rate- and risk-sensitive and can reverse sharply in a global shock.
4. **Design decides the balance.** Long-tenor instruments attract patient capital; buffers and sequencing manage the risk.

DATA AND INSTITUTIONS VAULT

FPI tax exemption on G-Sec interest and capital gains; **Fully Accessible Route (FAR)** *(RBI, 2020) expanded to 15, 30 and 40-year G-Secs and Sovereign Green Bonds.* **Index:** *inclusion in the* **JPMorgan GBI-EM** *and other global bond indices brings passive inflows.* **Buffers: foreign-exchange reserves**, *macroprudential measures, and a* **managed-float** *rupee.* **Concept:** *the* **"sudden stop"** *and "hot money" risks; the* **impossible trinity** *constraining open economies.* **Issuer: G-Secs** *are issued by the* **RBI** *on behalf of the Government of India.*

THE DEBATE

Argument to preserve caution: India's low foreign ownership of debt has been a stabilising strength; opening up trades long-term stability for short-term inflows.

Argument to open up: A deeper, index-included bond market lowers borrowing costs and matures India's financial system, a necessary step for a large economy.

The balanced verdict: Open, but by design. Attract **long-term, patient capital**, keep **reserves and macroprudential tools**, sequence the opening **gradually**, and retain the ability to manage flows in a crisis, so depth does not become fragility.

HOW TO THINK ABOUT THIS (TRANSFERABLE SKILL)

> *Many reforms deliver a clear benefit (depth, inflows, growth) that carries an inseparable risk (volatility, dependence). The strong answer does not just praise or condemn; it identifies the trade-off and asks how design can keep the benefit while containing the risk. This "benefit-with-embedded-risk" lens applies to capital flows, FDI and trade liberalisation alike.*

DIAGRAM-IN-WORDS

`Tax breaks + FAR expansion -> foreign inflows into G-Secs -> deeper market + lower borrowing costs + index inclusion` carries `rate/risk sensitivity -> sudden-stop risk -> rupee and yield volatility`. The design fix: `long-tenor patient capital + reserves + macroprudential tools + gradual sequencing`.

THE WAY FORWARD

1. **Target long-tenor instruments** to attract patient, stable capital.
2. **Maintain adequate reserves and macroprudential tools** to manage volatility.
3. **Sequence the opening gradually**, monitoring foreign-ownership levels.
4. **Retain the ability to manage flows** during global shocks.

THE TAKEAWAY BOX

"Opening India's government-bond market to foreign investors deepens it but imports volatility." Critically examine the trade-off. (250 words)

"Foreign capital deepens a bond market in good times and tests it in bad ones; the art is to attract the patient and prepare for the panicked."

Fully Accessible Route (RBI 2020) · JPMorgan GBI-EM index inclusion · G-Secs issued by the RBI · sudden stop / hot money · impossible trinity · Sovereign Green Bonds.

Is India right to trade some financial stability for the depth and lower borrowing costs that foreign capital brings?

Connects to GS3 PYQs on capital flows, FPI and financial markets; probable forward question is the depth-versus-volatility framing above.

today's FPI/G-Secs article; static GS3 on financial markets, capital flows and the external sector.

Sources: Business Standard, RBI, Ministry of Finance

Source: Opening the Bond Market: On Foreign Capital and Its Risks — Ujiyari.com | Free UPSC & State PCS Editorial Analysis

KEY ARGUMENTS AT A GLANCE

India's tax exemptions and expanded Fully Accessible Route to draw Foreign Portfolio Investors into government securities can usefully deepen the bond market and lower borrowing costs, but the inflows bring capital-flow volatility and currency risk that must be deliberately managed.

✓ SUPPORTING

- A broader foreign-investor base deepens and adds liquidity to the bond market, supports global bond-index inclusion, and reduces the crowding-out of private borrowers.
- Foreign holdings of debt are sensitive to global interest rates and risk sentiment, so they can reverse sharply in a crisis, pressuring the rupee and yields.

- Targeting long-tenor bonds aims to attract patient capital (pension and sovereign-wealth funds) rather than volatile short-term flows.

COUNTER

Some argue India's relatively low foreign ownership of debt is a strength that should be preserved, and that opening up trades long-term stability for short-term inflows.

WAY FORWARD

Attract stable, long-term capital through long-tenor instruments, maintain adequate foreign-exchange reserves and macroprudential tools, sequence the opening gradually, and retain the ability to manage flows during shocks.

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MAINS ANSWER FRAMEWORK

QUESTION

"Opening India's government-bond market to foreign investors deepens it but imports volatility." Critically examine the trade-off. (250 words)

INTRODUCTION

India has long kept foreign ownership of its government debt low, a deliberate caution. Its new tax breaks and expanded access for foreign investors mark a calculated bet that the benefits of opening up now outweigh the risks.

BODY

The reforms exempt Foreign Portfolio Investors from tax on the interest and capital gains from specified Government Securities and expand the Fully Accessible Route to long-tenor (15, 30 and 40-year) bonds and Sovereign Green Bonds. The logic is sound: a deeper, more liquid and more diverse bond market lowers the government's borrowing costs, supports India's inclusion in global bond indices (which channels large passive inflows), and reduces the crowding-out of private borrowers competing for domestic savings.

But the risk is equally real. Foreign holdings of debt are sensitive to global interest-rate differentials and risk sentiment; in a global shock, they can exit quickly, pushing up yields, weakening the rupee and importing inflation, the classic “sudden stop” that has destabilised emerging markets before.

India’s historically low foreign ownership of debt has been a genuine source of stability. The way to reconcile this is in the design: target long-tenor instruments that attract patient capital such as pension and sovereign-wealth funds rather than hot money; maintain adequate foreign-exchange reserves and macroprudential tools to manage volatility; sequence the opening gradually; and retain the ability to respond during shocks.

Opening the bond market is not wrong, but it must be done with eyes open to the volatility it imports.

CONCLUSION

India should welcome foreign capital into its bonds for the depth it brings, while building the buffers and design safeguards that keep the openness from becoming a vulnerability.

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