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AN ANALYSIS OF THE IMPACT OF THE MODEL INDIAN BILATERAL INVESTMENT TREATY ON FOREIGN DIRECT INVESTMENT IN INDIA

UMA ANÁLISE DO IMPACTO DO MODELO DE TRATADO DE INVESTIMENTO BILATERAL INDIANO SOBRE O INVESTIMENTO ESTRANGEIRO DIRETO NA ÍNDIA*

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Abstract: Foreign Direct Investment is considered the primary source of non-debt finance for the Country, which can help in enabling the generation of employment, capital inflow, access to improved technology, and human resource development. The Crisis of Balance of Payment, which highlighted the inherent weaknesses in the Indian Financial System, has been the catalyst in enabling the government to develop policies promoting the liberalization and privatization era in India. Foreign investors have been wary of their investment in the host country. The BITs ensure the protection of the investment of foreign investors. The Researcher in the present paper analyzes the relationship between foreign investment and the number of bilateral investment treaties that India has entered into, after adopting the Model BIT, in 2016.

Keywords: Bilateral Investment Treaty. Foreign Direct Investment. Liberalization. Balance of Payment. Indian Financial System.

Resumo: O Investimento Estrangeiro Direto é considerado a principal fonte de financiamento não-dívida para o País, o que pode ajudar a viabilizar a geração de empregos, entrada de capital, acesso a tecnologia aprimorada e desenvolvimento de recursos humanos. A Crise do Balanço de Pagamentos, que destacou as fraquezas inerentes ao Sistema Financeiro Indiano, tem sido o catalisador para permitir que o governo desenvolva políticas que promovam a era da liberalização e privatização na Índia. Os investidores estrangeiros têm sido cautelosos com seus investimentos no país anfitrião. Os BITs garantem a proteção do investimento de investidores estrangeiros. O pesquisador do presente artigo analisa a relação entre o investimento estrangeiro e o número de tratados bilaterais de investimento que a Índia celebrou, após a adoção do Modelo BIT, em 2016.

Palavras-chave: Tratado de Investimento Bilateral. Investimento Direto Estrangeiro. Liberalização. Balança de Pagamentos. Sistema Financeiro Indiano.

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Introduction

The Model of the Bilateral Investment Treaty is one of the important factors determining the inflow of foreign investment in the host countries across the world. There has been the proliferation of the BITs from the last decade of the twentieth century[1].

Entering into the bilateral investment treaties is an indication that the state is prepared to protect the investments made by foreign investors. There has been evolution of the standards of treatment under the bilateral investment treaties. The protection afforded through the provisions of the BITs has backfired at times, when the host state has failed to protect its sovereign actions in the arbitral tribunals The structure of the initial BITs aims to attract investors, overlooking the state's regulatory powers. The clauses like national treatment and most favored nation have tried to extend the protection afforded to the local nationals and the investors from the third nation.

The MFN clause has been one of the most contentious clauses, which, at times, seems to compromise on the interests of the host state. India has lost its first arbitral dispute due to the expansive and wide interpretation of the MFN clause. It was one of the reasons which led India to restructure the Model BIT. Emerging Economies consider foreign investment the most significant contributor to the much-required capital for economic growth. The foreign investors seek support, in terms of the protection, through the standards of treatment under the BITs. The analyst has been critical of the actions of the host state when the latter tried to balance the investors' interests with the state's regulatory powers.

Bilateral Investment Treaties

The primary factor in attracting foreign investment is the assurance, which the investors get from the protection afforded under Bilateral Investment Treaties[2]. The justice delivery system and the political stability further addon to the investors' confidence in the host country. International Law expects the countries to abide by the provisions of the Treaties and treat them as sacrosanct[3]. There have been conflicting views as far as foreign

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investment is concerned[4]. The proponents of the Classical theory have been favorable to foreign investment[5]. There has been a school of thought which prefers foreign investment, as it lays the foundation for the vital macroeconomics metrics as far as the nation is concerned[6]. The developed nations' investors bring enhanced technology that may favor the sectors in the developing world.[7]. Foreign investment can be a source of more prosperity in developing countries if the investment supports employment and development in different sectors of the economy[8]. The other schools of thought are of the opposite view. They align the foreign investment with more dependence on the foreign capital[9].

There are cases of human rights violations and environmental harm closely associated with the dealings of the foreign investor[10]. There have been allegations of using the outdated or banned technology in the developing countries, which have caused severe environmental harm and caused the loss of life in the developing and underdeveloped countries[11]. The Bhopal tragedy in India was one of the worst tragedies of the twentieth century where foreign investors had been casual in their approach[12]. Due to the investor's negligence, there was a loss of life, and the environment was damaged.

Bilateral Investment Treaties intend to protect the investment made by the eligible investors in the host country[13]. The treatment standards in the BITs have a role in building investor confidence[14]. However, in the quest for investment, there has been a compromise of the national interests of the host countries[15]. There have been instances when the

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exploitative nature of foreign investors has proved to be detrimental to the host country's interests[16]. There is a need to have balanced Investment treaties to protect the investors' interests and accommodate the state's regulatory authority[17]. The investor-state dispute resolution under the BITs should also evolve with time, looking at the conflicting positions taken by the tribunals[18].

Model Bilateral Investment Treaty of India

The Indian approach towards foreign investment has been receptive after the independence[19]. However, during the 1970s, there was a shift towards protectionism, which impacted the economy's growth[20]. The Balance of Payment crisis of 1991 was an eye-opener for India[21]. Consequently, the liberalization, privatization, and globalization phase began for India[22]. India entered into the first Bilateral Investment Treaty with the United Kingdom in 1994[23]. India adopted the BIT model based on the pattern adopted by the developed countries, wherein the stress is on the protection given to the foreign investment rather than the state's regulatory powers. India has entered into Bilateral Investment Treaties with around eighty countries from 1994 to 2011[24]. The Model BIT of 2003 succeeded the 1994 model BIT of India.[25]The nature had been investor friendly in overall approach[26]. However, the spate of adverse decisions at the arbitral tribunals invited the attention of the Indian establishment to change the model BIT from investor centric to state-centric [27]. The White Industries had an impact on the approach of the Indian establishment vis-à-vis the

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Investment Treaties [28]. The review process undertaken by the working group of the central government ensured that there should be a shift in the investor dispute resolution mechanism[29]. The balance between the investors' interest and the state regulatory power is ensured in the Model BIT 2016 [30]. The BIT provisions have not been left open for broad and vague interpretation [31].

The Model BIT has tried to shrink the scope of the applicability of the provisions of the bilateral investment treaty. Under the model BIT, the definition of the investment changed from asset-based to enterprise-based [32]. There are detailed exceptions, laid down under the definition of the investment. Article 2 of the Model treaty broadly lays down the exclusions where the treaty will not be applied. The cases of Vodafone and Cairn Energy impacted the provisions of the Model BIT[33]. Article 2.4(ii) of the model treaty explicitly lays down that the measures taken by the state regarding the taxation shall be out of purview for the review of the Arbitral Tribunal[34]. The Most Favored Nation clause does not find a place in the Model Indian BIT due to its expansive interpretation in the cases like White Industries, where the Arbitral Tribunal has ruled against India. Investors have invoked the MFN clause to derive more favorable treatment present in the Bilateral Investment treaties of other nations. The White Industries has invoked the MFN to avail the effective means for asserting claims of the investment. The provisions regarding the same were available under Article 4(5) of India-Kuwait BIT.

The Model BIT of India has also introduced the Investors Obligations, which were not in the previous Models[35]. The Provisions under Chapter III of the treaty require that investors comply with the laws of the host state. The investors have also been refrained and barred from offering bribes to public officials. Investors should adhere to corporate social responsibility provisions under the Model BIT.

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FDI Policy of India

The Government has been promoting foreign investment by making policy measures that promote ease of doing business in India[36]. The FDI policy aims to cope with the challenges that the investors face and also balances them with the national interests. FDI is the primary non-debt source of finance for the economic development in India[37]. The FDI infuses sustainable capital for the long term[38]. Foreign investment is desirable for gaining cutting-edge technology and ensuring employment for the masses[39]. In order to ensure the growth story of India, FDI policies should be stable and consistent[40].

The Department for Promotion of Industry and Internal Trade governs the FDI policy in India. There are regular reviews of the FDI policy at the department level, and updates added to the policy as per the expectation of the industry and regulatory requirements. This ensures a robust business environment in India for foreign investors. The Department under the Ministry of Commerce and Industry is instrumental in rationalizing the FDI policy in India. The Reserve Bank of India reports the inward remittances, and the DPIIT also ensures the maintenance of the data on the FDI in India.

Shifting most sectors to the automatic route ensures that investors do not need to engage in elaborate procedures[41]. The sectoral cap is raised to 100% for many sectors under the FDI policy [42].

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Data of FDI flows in India

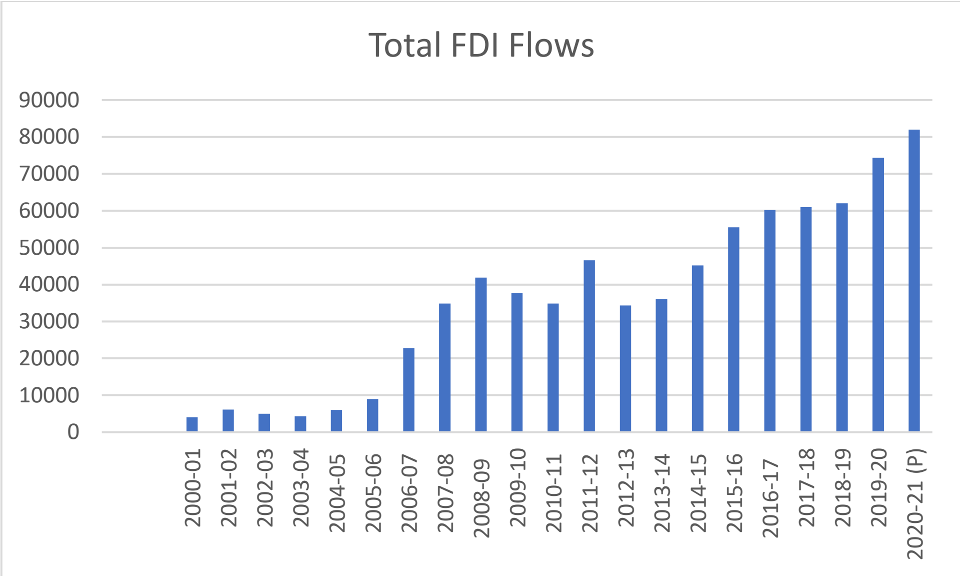
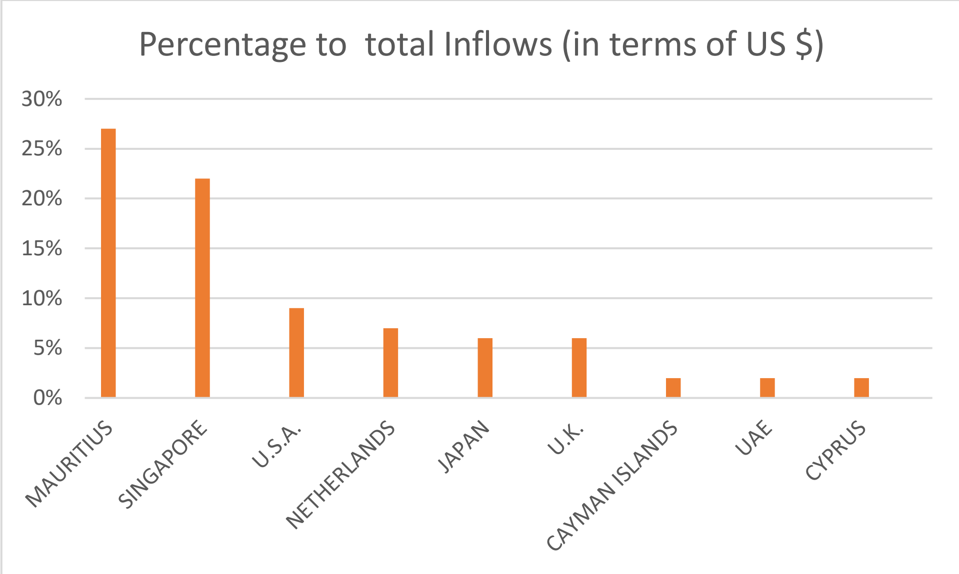


Figure 1: FDI Flow in India from 2000-2001 to 2020-21

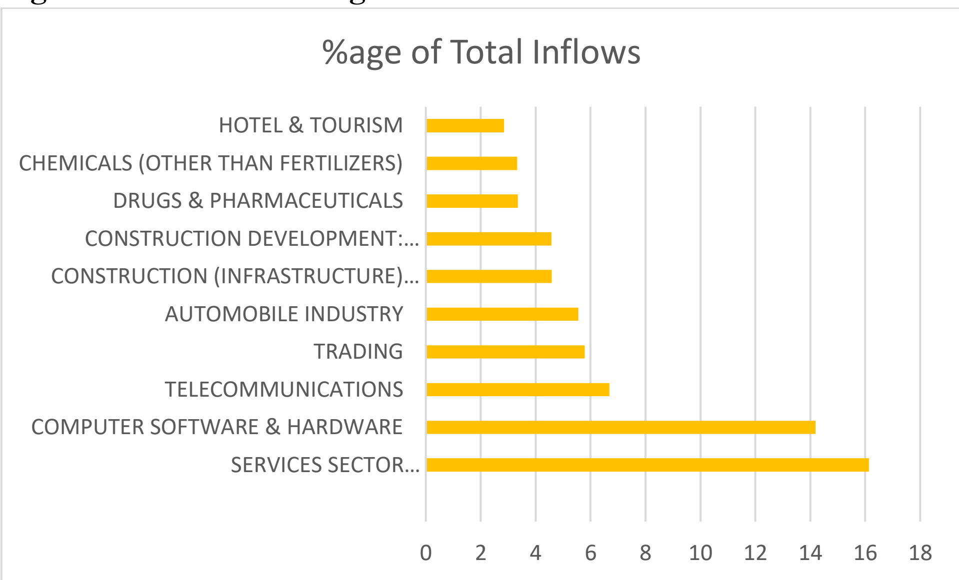
The Graph has been prepared after taking into the consideration cumulatively the Foreign Direct Investment in Equity form and Re-invested earnings and other Capital. The Data has been taken from the official website of Ministry of Commerce and Industry, Government of India. The Chart throws light on the Total FDI flows in India from the period 2000-2001 to 2020-21. As observed from the Graph in Figure 1, there has been a constant increase in the Foreign direct investment from the year 2000-2001 to 2020-21.

Figure 2: Share of Top Investing Countries in India



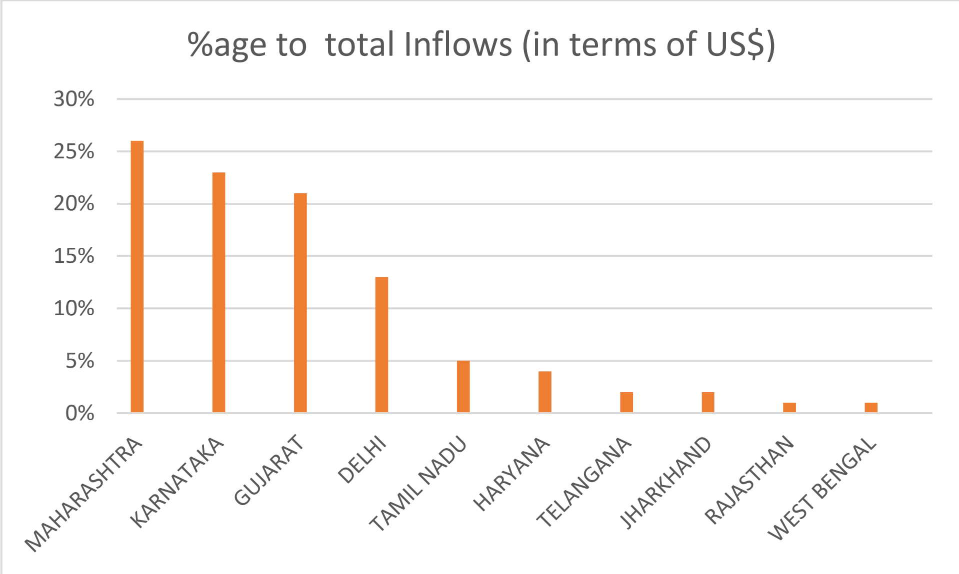
The figure depicts the share of the top investing countries in India from the Period 2019-20 to 2021-22. As per the data taken from the website of Department for Promotion of Industry and Internal Trade, India is attracting the highest investment from Mauritius. From the developed nation Unites States of America also figures at the third position in terms of the cumulative foreign investment for the said duration.

Figure 3: Sectors attracting the FDI Inflows in India



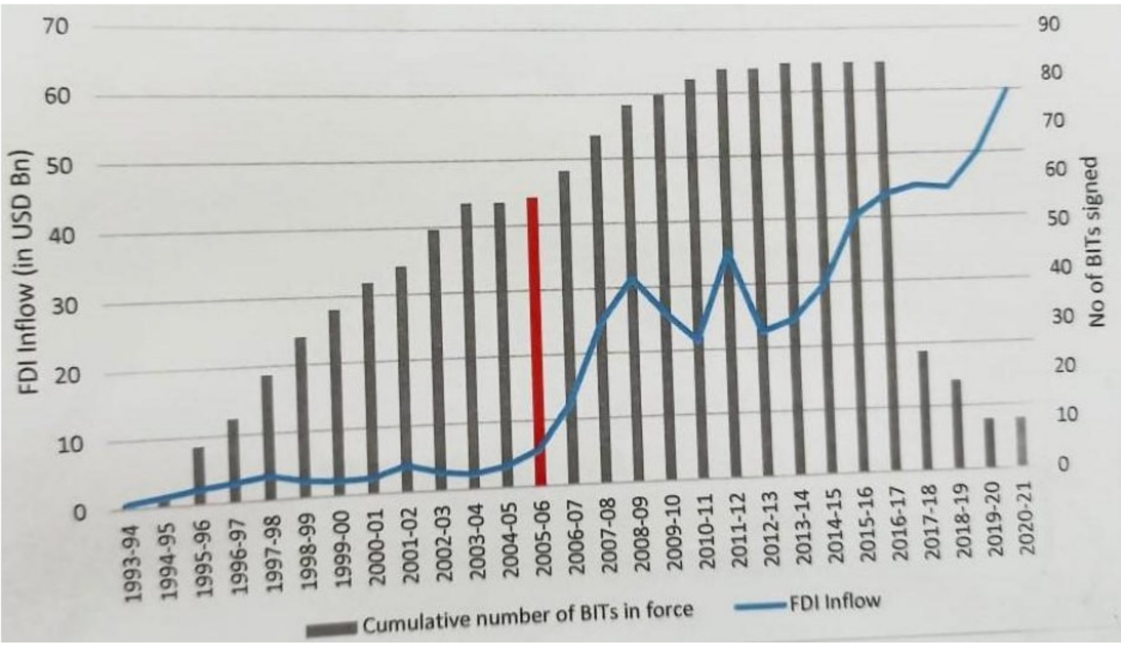
The figure 3 has been prepared after analysing the data from Financial Year 2000-2001 to December 2021. The top 10 sectors have been taken into consideration while preparing the chart provided in the Figure 3. The Graph depicts that the Services Sector in India attracts the highest Foreign Direct Investment. The Chart in Figure 3 is an indicator of the preferences in terms of the sectors of the Foreign Investors in India.

Figure 4: FDI inflows in Different States of India



The Figure shows the state wise distribution of the Foreign Investment in India from the period Oct, 2019 to December 2021. The data has been taken from the website of the Department for promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India. The Graph depicts ten states of India, that have been attracting the foreign direct investment. Among the states, Maharashtra is leading the tally with around 26% of the FDI in India is received in the State. Thereafter, Karnataka and Gujarat are second and third with 23% and 21% of the total FDI received in India.

Figure 5: Relationship between FDI Inflow and No. of BITs signed[43]



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The Chart in the Figure 5, has been taken from the tenth report of Committee on External Affairs, titled "India and Bilateral Investment Treaties". The Graph in the figure is depicting the relationship between the FDI inflows and the No. of BITs signed with India from the financial year 1993-94 onwards. The Graph shows that though the number of Bilateral Investment Treaties after adopting the new model of 2016 has dropped significantly, the inflow of the foreign direct investment in India has been steady. The Graph captures the trends from the financial year 1993-94 to 2020-21. There appears to be no direct and positive relationship between the signing of the Bilateral Investment Treaties and the Foreign Direct Investment in India.

Conclusion

The Bilateral Investment Treaties influence the decision of the prospective investors in attracting investment in the host state. The investors give due credence to the protection clauses under the BIT. The investors evaluate the BITs by the protection afforded through the clauses such as Fair and Equitable treatment, protection against expropriation, National treatment, and Most Favoured Nation. With the rising cases of broad interpretation given to the clauses in favor of the investors, there is a general tilt seen among the host states to review the existing Bilateral Investment Treaties. The developing states have consolidated their economic positions, and they favor taking positions favoring the state regulatory power. India has come out a long way since the 1991 Balance of Payment crisis. The economic reforms heralded in the wake of the 1991 crisis have strengthened India's position. The Budgetary provisions and effective long-term policies of the Reserve Bank of India ensured that the foreign reserves of India have consolidated.

The investor-friendly BITs of 1991 have given less leeway to the state regulatory power. Till 2011, India had not faced adverse arbitral awards, and it had been a usual way for the Indian establishment. However, post white industries case, India paved its way for the new investment regime era. Taking advantage of its strong position, India has given room to a model BIT that will care for investor interests but not compromise state interests. It has not been a hidden fact that the adverse awards have been an unnecessary cost to India. The reason has been the loosely worded treaty provisions, which have given room to the treaty arbitration. The Indian establishment brought specific changes that the jurists and thinkers in India have criticized. The subject experts have predicted that the measures will deter foreign investment in India. The data from the department for the promotion of industry and internal trade highlights that there has been a steady growth in foreign direct investment. Still, there is a need to update the treaty provisions. There is a need to make the investor dispute resolution mechanism more rationale. The interests of the investors cannot be compromised, especially during times when the world is facing uncertainty. With the efforts of the Indian government, the investment ecosystem in India has undergone a sea change. Since the model BIT 2016, very few nations have entered into a new agreement with India, which is hard to negate. It will do better to provide a stable dispute resolution and adopt the standard practices tailored as per the Indian requirement, not losing the focus of the prospective investors and the stakeholders in the process.

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