EVOLUTION OF PROTECTION OF FOREIGN INVESTORS IN INDEPENDENT INDIA

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Abstract

This paper traces the historical evolution of protection available to foreign investment and investors in independent India. The investment protection regime has seen three phases. First phase was post-independent socialist period when national treatment was espoused, nationalization was considered a sovereign right and restrictions were placed on foreign investment. The second phase was of liberalization from mid-nineties to around 2015 when India executed bilateral investment treaties with eighty-three countries. The third and present phase has seen termination of investment treaties. Understanding and presenting this journey of India is the key objective of this research paper.

Keywords

Investment protection, bilateral investment protection treaty, bilateral investment protection agreement, foreign investment, foreign investors, foreign direct investment, national treatment, nationalization, model investment treaty, joint interpretative statement.

Introduction

Whenever an entrepreneur or investor moves out of his / her home country to a foreign land, there are many unforeseeable risks. Investment protection treaties between countries are intended to protect investors from such risks to some extent.

India's post-independence investment protection regime can be divided into three phases as follows:

a) From independence to year 1995 when India-UK treaty came into force

b) From 1995 to around 2015

c) After year 2015

India signed her first Bilateral Investment Protection Agreement (BIPA) with United Kingdom in 1994, with the objective of attracting and incentivizing foreign investment. India's first BIPA was based on a model created by a developed country - where emphasis was on protection of foreign investment, rather than internationally recognized regulatory powers of the State. This excessively investor friendly regime remained unchanged for nearly two decades.

The objective of this paper is to study the evolution of India's investment protection regime through the three phases as outlined above.

Methodology

This research paper is based on doctrinal research on the subject of historical evolution of protection of foreign investors in independent India. The researcher looks at the mindset of Government of India and the laws as they have changed through the

past more than seven decades based on writings of historians and also based on observations of Parliamentary Committees.

From Independence to Year 1995

At the time of independence, India had large foreign investment which was mostly British. The situation at that time is well described as follows:

With independence, India became host to a large body of foreign capital. It was three-quarters British, almost entirely privately-owned, and still fairly typical of business investment in a colonial economy. Characteristically, it concentrated on extractive industries and processing for export for international trade, and on ancillary services. At the first official count, less than a year after Independence, a little over one-quarter was in tea and jute which together made up half [of] India's exports; 17 percent in trading; finance and management accounted for just 8 percent; and utilities (electricity mainly) and transport (shipping mainly) for about 6 percent each. No more than one-fifth was invested in manufacturing jute.[1]

British policy was to favour British owned businesses in India and discourage Indian businesses. After independence, there was a strong reaction to this from Indian businesses who pleaded for nationalization of all foreign businesses.

Having faced discrimination at the hands of the British Government during the colonial times, there was resentment towards foreign investment from the domestic industry. The domestic industry was insisting that all foreign investments are bought and their control from foreign hands be taken away. The existing foreign investments were mostly in natural resource extraction; therefore, they were retarding the nation's development.

[1] Books: Michael Kidron, Foreign Investment in India, 1965

The newly formed government of independent India did not accept this approach. During this time, especially in the 1950s and 1960s, the Government was receptive and welcoming towards foreign investment. The economic philosophy in this duration was to allow foreign investors to operate with the knowledge that eventually they would have to transfer technology, skill and finally control to nationals of the host state. In the Industrial Policy Resolution of 1948, the Government gave an indication to that effect. It was unequivocally stated that whenever the control of the foreigner's property would be taken, it would be subject to the fundamental rights under the Indian Constitution, and, fair and equitable compensation. At that time, right to property was a fundamental right.[2]

It may be mentioned that at the time of independence the political class that came to power strongly believed in *swadeshi* (own country) and self-reliance. The national mood was against foreigners including foreign capital and foreign companies. In addition, there was strong influence of socialist (and even communist) ideology. The slogan was to uproot all exploiters (which meant capitalists, whether Indian or foreigners, and landlords). It is with this context that we must look at the policy announcements during the initial years of independence. The following extract about policy statement made in April 1949 shows the mind of the country at that time.

Prime Minister, Jawaharlal Nehru submitted a special policy statement on foreign capital to the Parliament on 6 April 1949. It was declared that:

1. Existing foreign interests would be accorded 'national treatment': 'Government does not [sic]intend to place any restrictions or impose any conditions which are not applicable to similar Indian enterprise'.

[2] Books: Aniruddha Rajput, 2018

2- New foreign capital would be encouraged: 'Government would so frame their policy as to enable further foreign capital to be invested in India on terms and conditions that are mutually advantageous.'

3. Profits and remittances abroad would be allowed, as would capital remittances of concerns 'compulsorily acquired'.

4. Fair compensation would be paid 'if and when foreign enterprises are compulsorily acquired'.

5. Although majority ownership by Indians was preferred, 'Government will not object to foreign capital having control of a concern for a limited period, if it is found to be in the national interest, and each individual case will be dealt with on its own merits'.

6. 'Vital importance' was still attached to rapid Industrialization of personnel, but 'Government would not object to the employment of non-Indians in posts requiring technical skills and experience when Indians of requisite qualifications are not available'.

7. From the legal standpoint, two principles emerge from this policy and they remained the cornerstone of the Indian attitude towards foreign investment at the international level: national treatment (NT – no higher treatment to foreign investors than domestic investors), and the right of nationalization, subject to the payment of fair compensation.[3]

Nehru era (1947-1964) was marked by significant growth of public sector industries and restrictions on foreign investments. During this period, foreign investors were given a treatment at par with domestic investors but they faced many restrictions that domestic investors did not face. Nationalization of foreign companies was not done on a mass scale. But the threat was always there and the government made no efforts to play down the threat.

[3] Books: Ibid.

The Nehru era ended with the shocking invasion of India by China in 1962. The humiliating defeat was a wake-up call for India. It also marked the demise of romanticism that marked the Nehru era. The wars of 1965 and 1971 brought further shocks for Indian economy as well as polity. India could no longer afford to spend nominal amounts on defense. High expenditure on armed forces led to high inflation which led to increasing prices.

Seventies was also the period when the generation born after independence was joining workforce. There was high demand for jobs. With economy in a difficult phase, unemployment was rising. This led to sharp rise in youth frustration and anger. Response of the ruling party was to nationalize banks and project socialism as a cure for the problems facing the country. The situation of the period is summed up in the following extract:

The time during 1965–1981 was turbulent. This was a period of economic difficulty for India and economic disparity within India. In response, inward-looking protectionist policies were adopted, which made foreign investors lose faith in the economy. Relations with the US became difficult because India was unwilling to support the US in the Vietnam War. Food aid from the US was seen to be used as a lever to interfere in internal affairs. It was at this time that the second wave of nationalizations took place. It targeted domestic companies and excluded foreign investors. Economic inclusion was one of the planks hailed by the then Prime Minister, Mrs Gandhi.[4]

There was a change of government in 1977 with Janata Party taking over from Congress. However, the new government's attitude to foreign investment was no different. In fact,

[4] Books: Ibid.

the new government was harsher towards foreign investors compared to the previous regime. The situation under the Janata Party government is summed up as follows:

As per the Industrial Policy of 1977, foreign companies were required to dilute their equity up to 40% to get NT. Companies in many sectors, such as airline, shipping and banking, were forced to incorporate under the Indian Companies Act. Multinational corporations that did not have manufacturing plants and were in the field of services or were monitoring the economy could not dilute to less than 40% and had to leave. In 1977, Coca-Cola left the Indian market because the government insisted that it collaborate with an Indian entity.[5]

Nationalizations and restrictions on foreign investors failed to lift up the economy and Indian economy became infamous for its slow economic growth.

Post Liberalization Period

During the 1950s to 1980s India had a slow rate of GDP growth – around 3.5% per annum (often called Hindu rate of growth). Persistently low growth rate was accompanied by low per capita income. Even as the country was moving slowly on the growth path, the shock came during 1991 with the crisis in balance of payments and foreign currency.

In mid-1991, India's exchange rate was subjected to a severe adjustment. This event began with a slide in the value of the Rupee leading up to mid-1991. The authorities at the Reserve Bank of India took partial action, defending the currency by expending international reserves and slowing the decline in value. However, in mid-1991, with foreign reserves nearly depleted, the Indian government permitted a sharp depreciation that

[5] Books: Ibid.

took place in two steps within three days (July 1 and July 3, 1991) against major foreign currencies: for example, 9.5% and then another 23 percent against the U.S. dollar. With assistance from the IMF and after an initial stage of stabilization through administrative controls, the government embarked on an adjustment program featuring macroeconomic stabilization and structural reforms. Structural measures initially emphasized accelerating the process of industrial and import delicensing and then shifted to further trade liberalization, financial sector reform, and tax reform. [6]

The currency crisis of mid-1991 pushed India towards liberalization. Of course, it must be remembered that the world order had changed in the meanwhile with the collapse of USSR which was unfolding at that time (1988-91). With the dissolution of USSR, the countries that had argued for National Treatment found themselves without their leader. In the post-USSR world, India had to reassess her relations with the Western world. While India might have hesitated in doing an ideological somersault, the crisis of mid-1991 combined with events in USSR pushed India's hands. Economic reforms and liberalization post-1991 saw India welcoming foreign investment with open arms.

In April 1992, India joined the Multilateral Investment Guarantee Agreement (MIGA). On 20 December 1993, the European Union (EU) and India signed third generation Cooperation Agreement on Partnership and Development. Article 11 contemplated 'encourage[ment] and increase in mutually beneficial investment by establishing a favorable climate for private investments including better conditions for the transfer of capital and exchange of information on investment opportunities'.

[6] Working Papers: Valerie Cerra and and Sweta Chaman Saxena, IMF, 2000

After these early steps for encouraging foreign investment, India started entering into BITs with many countries. India expressed its willingness to adhere to higher standards of protection for foreign investment and gave up the insistence on NT. Writing in 2000, the legal adviser of India stated that: 'in the current context of negotiation of investment protection agreements a less ideological and more pragmatic approach to these concepts has become possible'.

It was at this point of time that India wholeheartedly joined the project of BITs. India started entering into BITs to attract foreign investment. The programme was called BIPAs. The dominant thinking within the Government was that entering into BITs would result into greater inflow of foreign investment. It first floated a model BIT and entered into the first BIT with UK in 1994. The second Model BIT was released in 2003.[7]

Committee on External Affairs, Seventeenth Lok Sabha has summed up the overall BIT scenario in India as follows:

Bilateral Investment Treaty (BIT) is an agreement for according protection to investments by nationals and companies of one State in another State. International Investment Agreements (IIAs) which include Bilateral Investment Treaties and Investment Chapters of Trade and Economic Agreements provide for a reciprocal commitment to protect the private foreign investments in each other's countries. India signed its first Bilateral Investment Treaty with the United Kingdom (UK) in 1994. Post 1991 economic reforms and up to 2015, India signed BITs with 83 countries out of which 74 were enforced. These BITs were largely negotiated on the basis of the Indian Model BIT text of 1993.

[7] Books: Aniruddha Rajput, 2018

1.2. India's approach in regard to BIT was highlighted by the Secretary (ER), Ministry of External Affairs in his opening statement during the course of briefing on the subject on 7 September 2020:

"India's approach to BITs has been aimed at providing appropriate protection to foreign investors in India and Indian investors in foreign countries in the light of the relevant international precedents and practices while maintaining a balance between the investor's rights and the Government's obligations by accommodation and cooperation. Our interests in this domain have grown with our rising stature in global affairs. We also remain conscious of the realities of negotiations with sovereign Governments while upholding our national interests and priorities" [8]During the post-liberalization phase, India had executed BITs with enormous speed covering most of the major countries in the world. At this time, BITs were seen as zero-cost means of attracting foreign investment into the country. Nobody was even thinking about claims arising out of investor-state disputes.

Post-2015 Period

The thinking in the official circles of India changed with the arbitral award in the case of White Industries[9]. It may be said that India's honeymoon with BITs ended with the arbitral award in case of White Industries. The award was seen as a challenge to India's sovereignty and also to supremacy of India's courts.

Serious rethinking of an overly liberal investment protection regime in the BITs started only when India lost the first investment case in White Industries v. Australia in 2011. There have been concerns about the expansive interpretation of investment treaties. Some

[8] Reports India: Committee on External Affairs, 2021

[9] International Tribunal Awards: White Industries v. India, 2011

states have experienced wearisome consequences of investment arbitration. This was the first time India had a first-hand experience of an investment claim. The experience was painful for various reasons. It exposed the possibility that the actions of the Supreme Court (which is the highest Court of Appeal in India and also serves as the constitutional court) could be challenged before an arbitral tribunal.[11]

Parliamentary Committee on External Affairs summed up the situation arising after the White Industries (supra) case as under:

1.7. MEA has further informed the Committee that from 1994, when India started its BIT programme, until the end of 2010, BITs in India did not attract much attention. India also had only marginal involvement with Investment Treaty Arbitration, which refers to the dispute resolution mechanism available under BITs. During this period, India was involved in only one Investment treaty dispute, and even this dispute did not result in an arbitral award. Towards the end of 2011, India received its first adverse award in relation to a BIT in the White Industries Australia Limited V. Republic of India Case. The tribunal found that India had violated its obligations to the investor under the India-Australia BIT. This Award holds significance as the first Investment Treaty Arbitration Award against India.

1.8. As a result of the adverse award in the White Industries case and the notices of dispute under different BITs, there was a renewed focus on India's BIT regime and questions were raised about balancing investment protection with India's regulatory power, compelling India to re-think its BIT programme. Over time, especially after 2010, global and Indian experience with Investment Treaties, and the substantial increase in international arbitration cases arising out of these Investment Treaties, led to a revisit of India's earlier Model BIT text.

[11] Books: Aniruddha Rajput, 2018

1.9. With the approval of the Cabinet, a new ***Model text was adopted in 2015****. The Cabinet also approved (i) to use the Model text in 2015 as the starting point for renegotiations of existing and future BITs and investment chapters of CECAs/CEPAs/FTAs with appropriate modifications, alterations or concessions as approved by the Minister of Finance, and (ii) adopting the strategy of terminating existing BITs whose initial treaty period was over and issue Joint Interpretative Statement for those BITs whose initial treaty period is still valid.*

1.10. The model BIT, unlike the earlier BITs, has an enterprise based definition for investments covered by the treaty. It also does not contain Fair and Equitable Treatment (FET) clause but rather has a treatment of investments clause that prohibits the host country from subjecting foreign investments to measures that constitute a violation of customary international law through denial of justice (judicial and administrative), breaches of due process, and targeted discrimination on manifestly unjustified grounds or manifestly abusive treatment, such as coercion, duress and harassment. While the new model BIT does not include an MFN (Most Favoured Nation) clause, it does provides for national treatment to the extent that a Party shall not apply measures that accord less favourable treatment than it accords, in like circumstances, to its own investors with respect to the management, conduct, operation, sale or other disposition of investments in its territory. The new model BIT also states what would constitute like circumstances.

1.11. In the dispute resolution provisions in the new model BIT, the focus has been on domestic remedies with investors having to exhaust local/domestic remedies including invoking the jurisdiction of the domestic courts of the host country for a minimum period of five years before being able to resort to arbitration under the treaty. This condition is however exempt if there is no domestic remedy available to the investor and the only

remedy available is under the BIT. The new model treaty also elaborates the mode and requirements for arbitrator appointments and also tries to elaborate the possible conflict of interest issues. Further, the new model BIT tries to incorporate principles of transparency by having provisions which require the proceedings under the BIT to be made available to the public, subject to applicable law on protection of confidential information.

1.12. After the approval of the new model BIT by the Cabinet, GoI has initiated the process of termination of the existing BITs whose initial duration/term as concluded and began the process of renegotiating these treaties based on the new model BIT. Based on the Cabinet decision, till date India has issued termination notice to countries with whom the initial period has expired. [12]

India terminated all BITs unilaterally during the period from March 2016 to November 2020. It is open to dispute whether unilateral notices of termination issued by India for BITs are valid under international law. However, it cannot be doubted that the BITs which were to expire due to efflux of time have certainly expired after the issue of termination notice by the Government of India.

Only two countries agreed to executing Joint Interpretative Statement (JIS) as demanded by India. BITs with these two countries and with four other countries are still in force.

Post release of Model Bilateral Investment Treaty in 2015, India has signed BITs/Investment Agreements with Belarus, Kyrgyzstan, Taiwan and Brazil.

Notably, all countries who are major exporters of capital to India have refused to either sign a JIS or negotiate a fresh BIT with India. As it stands, presently India's foreign investor

[12] Reports India: Committee on External Affairs

protection regime is in a state of suspended animation with the older BITs unilaterally suspended by India and with no major country accepting India's position on investment protection. This is surely not a good situation and needs to change sooner rather than later.

Conclusion

India's regime for protection of foreign investors was marked by commitment to national treatment (treating foreign investors at par with domestic investors), right of country's government to nationalize and strong restrictions on foreign investment. There was a reversal in policy after liberalization of nineties. India aggressively chased foreign investment and entered into Bilateral Investment Treaties (BITs) with eighty-three countries. The policy of signing BITs changed after the White Industries case which was an eye-opener. White Industries case combined with various other notices received by India on the basis of various BITs led India to terminate all BITs unilaterally during 2016-2020. India has tried to negotiate new bilateral investment treaties with all countries based on its own draft. However, no major country has so far accepted India's draft. Presently there is uncertainty and confusion in India's investment protection regime.

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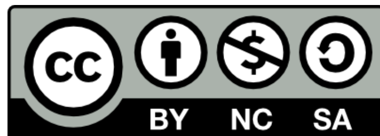

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