RECENT AMENDMENTS TO INDIA'S FDI POLICY: ARE THEY WTO COMPATIBLE?

May 23, 2020

Background

On April 17, 2020, India amended its Foreign Direct Investment Policy (**FDI Policy**) requiring all investments from countries sharing land border with India subject to approval from the government. Specifically, the notification issued by the Department for Promotion of Industry and Internal Trade (**DPIIT**) provides that "*. . . an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route*." The requirement extends to both direct and indirect investment i.e. an investment from countries sharing a land border with India if routed through entities located in other countries such as Hong Kong or Singapore will also be subject to government approval. Media reports suggest that the amendment is targeted at China as the government is wary of Chinese companies (which are mostly state-owned) taking over Indian companies at lower valuations due to loss of business on account of COVID-19. The amended policy will come in force when the same is notified by India's central bank, Reserve Bank of India (**RBI**) pursuant to its powers under the Foreign Exchange Management Act, 1999. Further, media reports also suggest that the government is rejigging rules for foreign portfolio investment to check direct investment in stock markets from China and Hong Kong.

China has alleged that India's new amendment to the FDI policy is discriminatory and inconsistent with India's obligations under the World Trade Organization (**WTO**) rules and other multilateral agreements.

The question therefore is whether foreign investment rules are covered under the WTO agreements and if so, how and to what extent.

WTO and Foreign Investment

The discussions within the WTO on a multilateral agreement on investment disciplines have been there since its inception. While there are inherent linkages between trade and investment (i.e. movement of capital), members have not reached a consensus whether a separate investment agreement within the WTO is needed. While there is no standalone agreement on investment rules, some aspects of foreign investment are regulated within the WTO. For example, the Agreement on Trade-Related Investment Measures (**TRIMs Agreement**) prohibits trade-related investment measures, such as local content requirements, that are inconsistent with basic provisions of the GATT 1994. Similarly, the General Agreement on Trade in Services (**GATS**) addresses foreign investment in services as one of four modes of supply of services. Since the obligations under the TRIMs Agreement is linked with obligations under the GATT 1994, there cannot be violation of the TRIMs Agreement unless there is a violation of specified provisions of the GATT 1994. The GATT 1994, however, does not deal with domestic investment rules.

GATS and Foreign Investment

The GATS contains rules governing international trade in services. It also defines four ways (or "modes") of trading services:

- Services supplied from one country to another (e.g. international telephone calls), officially known as "cross-border supply" (**mode 1**);
- Consumers or firms making use of a service in another country (e.g. tourism), officially "consumption abroad" (**mode 2**);
- A foreign company setting up subsidiaries or branches to provide services in another country (e.g. foreign banks setting up operations in a country), officially "commercial presence" (**mode 3**); and
- Individuals travelling from their own country to supply services in another (e.g. fashion models or consultants), officially "presence of natural persons" (**mode 4**).

Services through commercial presence (i.e. mode 3) is of particular importance in context of foreign investment rules.

The obligations under the GATS are broadly of two types:

- General obligations; and
- Sector-specific obligations (i.e. obligations with respect to service sectors which are specified by Member States in their schedule of commitments).

The general obligations apply to Members even if no specific commitment has been provided. Article II of the GATS provides for most-favoured-nation (**MFN**) treatment obligation which is one such general obligation. The MFN obligation essentially requires that if a country allows foreign competition in a service sector from any country, it must offer treatment no less favourable to like services and service supplier from all other countries. Notably, Article II allows

for certain limited temporary exemptions. India has availed exemption with respect to service sectors such as shipping and audio-visual services either against specified countries or all countries. The recent amendments in the FDI policy could be viewed inconsistent with India's MFN obligations with respect to service sectors not specified under the MFN exemption category. For example, while a Singaporean entity may invest in the food delivery service sector in India without any prior government approval and establish its commercial presence within India to deliver those services, a Chinese entity would require prior government approval to offer like services. Therefore, with respect to investment into sectors other than those notified by India under the MFN exemption, one could possibly argue that amended FDI rules do not offer equality of opportunity to like services or service supplier from China or that they modify the condition of competition to the detriment of like services and service suppliers from China.

India has also offered sector specific commitments with specific limitations under different modes of services. The obligations with respect to sector specific commitments are expressed through market access commitments and national treatment obligations. With respect to market access, Article XVI of the GATS require Members to accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions as specified in the Members' schedule of commitments. For certain service sectors such as banking and insurance, India has specified a horizontal limitation stating that the commitments are subject to entry requirements, domestic laws, rules and regulations and the terms and conditions of the RBI, Securities and Exchange Board of India and any other competent authority in India. However, this horizontal limitation has not been applied to many other service sectors within India's schedule of commitments. To the extent, India has not specified any limitation on mode 3 services with respect to identified service sector and there are no horizontal limitations, the amended FDI rules could be argued to be inconsistent with India's commitments.

The GATS recognizes a Member's right to frame regulations to meet its national policy objectives; however, such regulations must be administered in a reasonable, objective and impartial manner. Further, while the GATS also provide for certain general exceptions under Article XIV and security exceptions under Article *XIVbis*, India would need to demonstrate that the recent amendments to the FDI rules meet the requirements of these exceptions.

In the meantime, should you require any information or clarification, please do not hesitate to contact us at insights@elp-in.com