Don’t turn the clock back on investment norms

Former Prime Minister PV Narasimha Rao talking to his Cabinet colleague Manmohan Singh in 1994. (Sanjay Sharma / HT Archive)

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Exactly three decades ago, India decided to embark on an economic path that it had eschewed since Independence. The sagacious leadership of Prime Minister PV Narasimha Rao coupled with the competence of his finance minister (FM) Manmohan Singh converted the massive balance of payments crisis into an opportunity to unleash major structural economic reforms. Global developments such as the disintegration of the erstwhile Union of Soviet Socialist Republics (USSR), the collapse of communism in eastern Europe, and the rise of China and the East Asian economies knocked the bottom out of the Soviet-style planning that had long inspired Indian policymakers.

As an integral element of these structural economic reforms, India adopted measures aimed at liberalising foreign investment, both direct and institutional, to overcome the problem of over-dependence on debt.

The economic liberalisation of foreign investment sowed the seeds for India’s decisive shift towards a liberalised international law regime on foreign investment. In the first four decades after Independence, India not only had a conservative attitude towards foreign investment in economic terms but also in terms of international law. India, in the 1960s and 1970s, steadfastly opposed international law on foreign investment, advocating that domestic law should predominantly govern matters of foreign investment protection, including dispute resolution.

The adoption of a liberalised international legal regime on foreign investment came about dramatically. As journalist Shaji Vikraman has reported, towards the end of 1992, when FM Manmohan Singh, having announced the 1991 economic reforms, was in the United Kingdom (UK), he was asked about protection for foreign investments in India.

India’s treatment of foreign investors under the Foreign Exchange Regulation Act before the dawn of the 1991 reforms gave rise to these genuine concerns.

On his return to India, Singh asked his officials at the department of economic affairs of the ministry of finance to start working on an international foreign investment treaty, popularly called the bilateral investment treaty (BIT) that would provide confidence to foreign investors willing to invest in India. This became critical for India to demonstrate to the world its seriousness about the economic reform process launched in 1991. In his 1993 and 1994 budget speeches, Singh signalled the role of BITs as an important means of attracting foreign investment to India.

Finally, in 1994, India signed its first BIT with the UK. Later, India signed BITs with a large number of developed and developing countries. These BITs provided foreign investors fair and equitable treatment; just compensation for expropriation of foreign investment, that is, compensation representing the full market value of the investment affected, which was to be paid without undue delay; and recourse to international arbitration for settlement of disputes between foreign investors and host States.

Thus, India started openly embracing those very international law principles on foreign investment that it had opposed in the decades following Independence.

Now, the tide has turned. Stung by foreign investors suing India before BIT arbitration tribunals for State overreach, India made a hasty retreat from the international legal principles on foreign investment that it adopted in the 1990s. India unilaterally denounced several of its BITs and diluted investor protection features in its new model BIT.

This protectionist attitude towards international law on foreign investment has undone the reform of the 1990s. It is coming in the way of signing new investment treaties with major global players such as the European Union. The absence of investment treaties will dampen investor sentiment in India. While foreign investment inflows have increased in 2020-21, this surge is largely driven by short-term portfolio investments and a few major acquisition deals involving select corporations such as the Reliance Group. What India really needs is investment in the job-creating manufacturing sector, which is at the heart of the government’s Atmanirbhar Abhiyan, self-reliance campaign. Empirically, it is proven that the collective presence of an overall investor protection system put in place by BITs has positively influenced foreign investment inflows to India. Thus, it is time to shed the protectionist mindset and, with suitable modifications, restore the 1990s reform that liberalised the international legal regime on foreign investment.

The views expressed are personal