


How to deal with the national security risk from FDI and trade

 indianexpress.com/article/opinion/columns/how-to-deal-with-the-national-security-risk-from-fdi-and-trade-9590370

September 27, 2024



As Pratik Datta has argued, several liberal democracies like Canada, and Australia too limited Chinese FDI during the pandemic.

The debate on Chinese foreign direct investment (FDI) into India oscillates between economic benefits and security risks. But, a key fundamental question beyond that remains unanswered. Does India have a comprehensive legislative framework to deal with FDI and international trade on grounds of national security? The answer is negative, despite the high-decibel debates.

It is important to recall that in April 2020, when the world was beset with the fears of a raging pandemic, India adopted a new FDI regulation called Press Note 3 (PN3). PN3 is enforced through the Foreign Exchange Management Act (FEMA) — a law that provides the architecture for the orderly development and maintenance of the foreign exchange market in India. To curb opportunistic takeovers and acquisitions of Indian companies weakened due to the pandemic, PN3 subjects inward investments from land-bordering countries to prior approval of the central government (the so-called government route). While many countries share land borders with India, this regulation aimed to curb Chinese FDI into India. In short, it was said that India subjected Chinese FDI to greater control for national security reasons, though PN3 does not contain the words “national security”.

While India was not the only country restricting Chinese FDI then, India's method remains an aberration. As Pratik Datta has argued, several liberal democracies like Canada, and Australia too limited Chinese FDI during the pandemic. However, these countries did so under dedicated legal provisions designed to deal with risks FDI may pose to national security. For instance, Section 25 of Canada's Investment Act empowers the government not just to screen inward FDI but also to act against FDI in operation if it is "injurious to national security".

FEMA does not contain explicit provisions to deal with FDI on national security grounds. This is not surprising because national security in the military sense is not directly linked to managing foreign exchange. Since India doesn't have a specific law that deals with risks that FDI might pose for national security, FEMA — a foreign exchange control law — doubles up as a legal instrument to screen foreign investment for national security, pointing to a legal vacuum.

India's international treaty practice further provides evidence of this vacuum in India's domestic legal system. Unlike the domestic legal regime, India's past and current international investment treaties and investment chapters in free trade agreements have separate provisions to deal with issues like current and capital account transactions (things that fall within FEMA's domain) and national security. For instance, in the 2015 Model Bilateral Investment Treaty (BIT), Article 6 deals with foreign investment-related exchange control issues, while Article 33 empowers the state to take measures for the protection of national security even if such measures violate the treaty's substantive provisions. Likewise, international trade agreements such as the General Agreement on Tariffs and Trade, contain separate provisions to deal with trade restrictions arising out of foreign exchange difficulties and national security.



**Everything explained...
Every day**
with your Express Subscription

Now at just
₹1299/year

BUY NOW

The legal vacuum in India on this point is not restricted to foreign investment. It extends to international trade. Immediately after the Pulwama terror attack in February 2019, India denounced its most favoured nation obligation under the World Trade Organisation towards Pakistan and increased customs duties on all Pakistani imports to 200 per cent. While the reason to do so was national security, India relied upon section 8A(1) of the Customs Tariff Act — a law relating to customs duties. Section 8A(1) confers "emergency powers" on the government to increase tariff rates. It is typically meant for economic emergencies, not for

trepidations arising from terrorist attacks. Like FEMA, the Customs Tariff Act doubled up as a national security instrument in this case. The absence of a specified domestic law to deal with FDI and international trade on security grounds makes New Delhi vulnerable if India's measures are challenged at international courts and tribunals.

The ongoing debate on national security risks and Chinese FDI should be utilised to trigger another national debate — the need for India, according to global best practices, to have a dedicated law dealing with national security risks that FDI and international trade might pose.



Inform your opinion. Read what today's changemakers are saying. Subscribe to our Opinion & Editorial newsletter

The writer is professor, Jindal Global Law School, O P Jindal Global University. Views are personal