Rising Border Tensions with China: Effects on India’s Foreign Direct Investments

Sino-Indian relations have been under duress recently due to increasing territorial/border tensions. China’s actions towards India have not been amicable, leading to several disputes thereby raising security concerns. Consequently, India has tightened certain foreign rules concerning e-commerce and Foreign Direct Investment. This article argues that the recent changes brought by the Indian government are not in violation of any WTO norms.

The increase in tension on the India-China border is an inevitable observation of the present. The tension spiked to its highest after the Galwan Valley attack where the Chinese military killed over 20 Indian troops including the Commanding Officer. The consequent Ladakh standoff, after China massively ramped their military presence, is another blaze in the fire. Evidently, China’s recent actions are not amicable and has raised security concerns for India. As both countries are nuclear-equipped, the fluctuating relations need to be resolved at the earliest. Meanwhile, India has adopted certain precautionary measures such as banning more than 100 Chinese applications and amending the Foreign Direct Investment (FDI) norms.

Recently, the Indian government released the Consolidated Foreign Direct Investment (FDI) Policy 2020 incorporating changes in the e-commerce sector, and investment routes. The changes aim at better regulation of foreign investment in e-commerce and prohibition of opportunistic takeovers/acquisitions of Indian companies by foreign investors. The global pandemic has caused economic distress and there is concern that foreign organisations may take undue advantage of the situation by hostile takeovers or compulsive acquisitions. The change in the investment route states that “any investment by an entity of a country, which shares a 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 be made only upon seeking prior approval of the Government.”

From the outside, it would seem that mandating foreign investors from neighbouring countries to obtain prior approval of the Government for investment in Indian companies is a risky move considering the current economic decline due to the pandemic. This policy change has affected China particularly — being a major investor in Indian economy — as the government will no longer allow investment automatically, without approval. China does not seem happy with the policy change.

What Triggered the Amendment?

At the time of heightened distress due to the pandemic, economic and security concerns have increased significantly. Indian organisations have become vulnerable due to heavy losses caused by months-long lockdowns, thereby creating scope for foreign investor takeovers. Recently, the People’s Bank of China (PBOC) increased its stake to 1.01% from 0.8%, through the FPI route in India’s HDFC, whose shares have fallen nearly 41% since the beginning of the lockdown. PBOC’s action was treated as an alarm by the Indian government following which the policy was changed.

Notably, China considers the amendment as discriminatory, disregarding the fact that the amendment intends to prevent the rapacious acquisition of domestic firms weakened by the pandemic-induced economic crisis. Also, China alleges the amendment to be violative of the global trading norms under the World Trade Organisation (WTO) and G20 consensus, seeking resort to the previous mechanism. Notably, the revised FDI Policy neither restricts market access nor alters national treatment thereby ensuring the two tenets of global trade, and thus cannot be termed as discriminatory.

Revised FDI Policy and WTO Norms

Despite being a major investor in the Indian market, China cannot have the freedom to gain undue advantage. Notably, WHO has classified the COVID-19 crisis as a “public health emergency of international concern”; hence countries have the right to take necessary remedial steps. The amended FDI policy intends to protect an essential security interest which is consistent with the relevant WTO Agreements: of the four modes enumerated in the General Agreement on Trade in Services (GATS), ‘Mode 3,’ which deals with supply “by a service supplier of one member, through commercial presence (defined under Article XXVIII(d) of GATS) in the territory of any other member” is to be understood in correspondence to FDI in WTO law.

The Most Favoured Nation (MFN) status in the WTO means that countries cannot discriminate between their trading partners (under WTO law); the amended FDI policy does not violate the MFN clause (Article II) as this policy does not alter national treatment. The policy mandates neighbouring countries to follow the government route. Notably, there are certain exemptions in financial services provided under Article II, Para 1.3.2 which applies to measures affecting the supply of financial services as defined in Para 2(c) of Article 1 of the GATS. FDI being a financial conduct attracts exemption in financial services; the domestic regulation clause of the exemption states that *"a member shall not be prevented from taking measures for prudential reasons to ensure the integrity and stability of the financial system".* The stability of the financial system ensures essential security interest.

Furthermore, the agreement on Trade–Related Investment Measures (TRIMs) state that no member shall apply a measure that is prohibited by the provisions of GATS Article III, i.e., national treatment. The amended FDI policy ensures national treatment to every nation including China as none of them are denied access to Indian markets unreasonably. Moreover,Article XIV bis itself lays down security exceptions, clause 1(b)(iii) of which states that *"necessary steps taken in international relations for the protection of its essential security interests at the time of emergency shall not be violative of GATS."* Thus, the act of the Indian government taking a firm stand to protect its industries from opportunistic takeovers or acquisitions appears justified and legal.

Conclusion

The strong preying upon the weak has proved to be an international phenomenon, especially during the current pandemic. One such example is the recent increment of People's Bank of China's stake in HDFC. With such actions arise a need to protect the economy, and India's revised FDI policy should be seen against this background, to prevent opportunistic takeovers and acquisitions. Countries like Germany, Australia and Spain have also tightened their foreign investment policies to preclude hostile takeovers by overseas investors, but their changes to their FDI policies have not been labelled as a violation of WTO norms. Consequently, India's policy change should not be treated as a global trade violation as it does not contravene the WTO norms. Further, considering that recent actions of China has raised border tensions between the two countries, such precautionary steps have become indispensable for India.

India's revision of FDI Policy merely puts layered entrances for the investors to enter the Indian market. The revised policy neither tampers the MFN clause nor does it deny national treatment to China. Consequently, the revision is not violative of any rules of the World Trade Organization (WTO). Moreover, no bilateral investment treaties between India and China subsist at present. Therefore, China cannot challenge India's amendment to its FDI Policy under a bilateral investment treaties arbitration mechanism as well. However, despite the border tensions, China is a major investor in the Indian market and such measures might slow down the investments from China and, at the moment, India's Covid-hit economy needs foreign investments to revive strongly, but its's security cannot be compromised for the same.

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