JMVD LEGAL UPDATES

ON *"AMENDMENT TO INDIA'S FDI POLICY – WHETHER IN VIOLATION OF WTO PRINCIPLES?"*

MAY 07, 2020

Author: *Ms. Sheetal Agrawal, Senior Associate, Mumbai Office, JMVD Legal.*

On 18th April, 2020, the Department for Promotion of Industry and Internal Trade, ("**DPIIT**") released a press note (Press note no. 3 of 2020)[1] to announce a proposed amendment to the current Foreign Direct Investment ("**FDI**") Policy ("**Press Release**"). The proposed amendments in the Press Release have been incorporated in Rule 6 of the Foreign Exchange Management (Non-Debt) Instruments Rules, 2019 ("**Amended FEMA Rule**"). This announcement came amidst the ongoing phase of the COVID-19 pandemic. DPIIT has undertaken this step in order to curb opportunistic takeovers / acquisitions of Indian companies due to financial stress caused by the pandemic and to ensure that the Indian companies are protected and not taken advantage of by foreign entities.

There are two routes available for foreign entities to invest in India – the automatic route and the government approval route. Under the automatic route, investment in sectors specified does not require any prior approval from the Government of India. However, under the government approval route, a prior permission is required.

The Press Release and the Amended FEMA Rule suggests that Government approval will be required for any investments into India by any entity / person that is situated in any of the countries with which India shares its land border. Further, if the entity is a beneficial owner of an investment in India or is a citizen of any of the countries sharing border with India, they shall also be privy to such Government approval. Any transfer of ownership of existing / future FDI in an entity in India, directly or indirectly shall also require government approval.

The Press Release has received criticism, especially from China. China has criticized the proposed FDI norms as "discriminatory" and has made allegation

[1] https://dipp.gov.in/sites/default/files/pn3_2020.pdf

that the principles of "non-discrimination" as laid down by the World Trade Organization ("**WTO**") are being violated by India.[2]

In this paper, certain WTO agreements will be analyzed to determine the legality of the proposed amendment to the FDI Policy by DIPIIT with respect to the "non-discrimination" clause and against the overall backdrop of liberalization and facilitation of trade and investment.

This paper is divided into three parts:

a. Firstly, the paper lays down a brief history and background of the WTO and the agreements related to it.

b. Secondly, the paper specifically discusses the agreements that are related to FDI – The General Agreement on Tariffs and Trade ("**GATT**"), The General Agreement on Trade in Services ("**GATS**") and Agreement on Trade-Related Investment Measures ("**TRIMS**"). This part of the paper delves into an analysis of whether the Press Release violates any of the terms under the specified agreements.

c. Lastly, the paper provides a conclusion based on the analysis as presented other sections of this paper.

Part I: History and Background

The WTO was established in 1st January, 1995 under the Marrakesh Agreement. The Marrakesh Agreement was initially singed by 123 nations on 15th April,

[2] Joshua Abhay Patnigere, First Post, April 18, 2020, 'Changes in FDI rules necessary to ensure no Indian entity is shortchanged during COVID-19 pandemic, especially by 'opportunist' China', link at: https://www.firstpost.com/india/changes-in-fdi-rules-necessary-to-ensure-no-indian-entity-is-shortchanged-during-covid-19-pandemic-especially-by-opportunist-china-8274721.html

1994. The WTO provides a common institution framework for conducting trade relations among its members.

WTO has various agreements including the GATT, GATS, TRIMS etc which have been signed by different countries across the world. Adherence to the terms and conditions laid down by these agreements is strongly advised to ensure fair trade practices among the nations. The preamble of the Marrakesh Agreement states that the objectives of the WTO Agreements include “raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services”.

The WTO agreements are contracts that bind governments / signatory sovereign countries to keep their trade policies within agreed upon limits. The WTO agreements are broadly divided into the following categories: (i) Multilateral agreements on trade in goods; (ii) General Agreement on Trade in Services; (iii) Agreement on Trade Related Aspects of Intellectual Property Rights. There are certain other specific agreements and annexes dealing with the special requirements of specific sectors or issues. Finally, there are the detailed and lengthy schedules (or lists) of commitments made by individual countries allowing specific foreign products or service-providers access to their markets.[3]

[3] World Trade Organisation, Understanding the WTO: The Agreements, Overview: A Navigational Guide, link at: https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm

Part II: WTO agreements related to FDI

a. **The General Agreement on Trade in Services** (“**GATS”)**

The term FDI means a situation that “occurs when an investor based in one country acquires an asset in another country with the intent to manage that asset.”[4] The WTO agreements do not specifically cover the concept of FDI.

However, the integration of investment and cross border trade in the WTO is most evident in GATS.[5] Article 1(2) of the GATS defines ‘trade in services’ as the supply of services “by a service supplier of one member, through commercial presence in the territory of another member.”[6] Article 28 (d) of the GATS further defines ‘commercial presence’ as “any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a member for the purpose of supplying a service.”[7]

In accordance with GATS, each member is bound by the specific commitments as inscribed by it in its Schedule of Commitments. As per Article VII of GATS, the Schedule of Commitments can be subject to any conditions and qualifications as set out therein.[8] India provided for such Schedule of Commitments on July 28, 1995 (as supplemented from time to time), whereby the commitment in the financial services sector are subject to “entry requirements, domestic laws, rules and regulations and the terms and conditions of the Reserve Bank of India,

[4] World Trade Organisation, ‘Trade and Foreign Direct Investment’, WTO News, Press/57, 9 October 1996, pg. 4, link at https://www.wto.org/english/news_e/pres96_e/pr057_e.htm

[5] *Ibid* at pg. 33

[6] World Trade Organization, The Legal Texts, The Results of the Uruguay Round of Multilateral Trade Negotiations, pg. 287, link at https://docs.wto.org/gtd/WTOlegaltexts/Legal_texts_e.pdf

[7] *Ibid.*

[8] Supra note at pg. 292

Securities and Exchange Board of India and any other competent authority in India."[9] Therefore, by virtue of these Schedule of Commitments, India is well within its commitments as communicated under the GATS and has not violated any of the agreed commitments through the Press Release and the Amended FEMA Rule.

Further, with regard to services other than the financial services as prescribed in the current FDI Policy in India, there has been no violation of the principles laid down under GATS since there is no 'unfavourable treatment' for certain nations. It does not restrict market access but merely regulates it based on the internal policies of investment.

b. **<u>The General Agreement on Tariffs and Trade ("GATT") and Agreement on Trade-Related Investment Measures ("TRIMS")</u>**

GATT is the agreement that regulates tariffs in goods only. One of the specific agreement related to investment in goods is the TRIMS. The preamble of TRIMS states that one of the objectives of TRIMS is "to promote the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners…"[10] Thus, the terms of the preamble are wide enough to inculcate the principles of FDI under the TRIMS.

Article I of TRIMS clearly states that it is related to investment measures related to trade in goods *only.* Ad Article XVII para 2 of GATT defines the term "goods" as limited "to products as understood in commercial practice, and is not intended

9 World Trade Organisation, GATS/SC/42/Suppl. , 28 July, 1995, link at https://webcache.googleusercontent.com/search?q=cache:chgep8icpV0J:https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx%3Ffilename%3DQ:/SCHD/GATS-SC/SC42S1.pdf+&cd=1&hl=en&ct=clnk&gl=in

10 World Trade Organization, The Legal Texts, The Results of the Uruguay Round of Multilateral Trade Negotiations, pg. 143, link at https://docs.wto.org/gtd/WTOlegaltexts/Legal_texts_e.pdf

to include the purchase or sale of services."[11] The Black's Law dictionary defines 'goods' as "tangible or movable personal property other than money; esp. articles of trade or items of merchandise or as things that have value, whether tangible or not."[12] The definition of 'goods' can be inferred from the interpretation of the term in the Canada – Renewable Energy Case, wherein the Appellate body accepted that "goods" or "product" (as used interchangeably in all the WTO agreements) mean "something that is capable of being traded".[13]

The changes as suggested in the Press Release and Amended FEMA Rule is related to investment routes in specific sectors. However, it does not fall under measure related to "trade in goods" and therefore is not covered under the GATT and/or TRIMS.

Part III: Conclusion

India's proposed amendments in the FDI Policy is in compliance with its specific commitments under the GATS as well as the general commitments of not denying market access to certain nations.

The proposed amendment does not seem to violate any principles / agreed commitments under the GATT and TRIMS as these agreements are specifically related to investment measures related to 'goods'. The proposed amendments do not in any manner whatsoever effect any trade in goods. It is an investment policy change that has been suggested by the DPIIT within the purview of the existing commitments at the WTO.

[11] Supra note 6 at pg. 143

[12] Black's Law Dictionary, 9th edn., West (2009)

[13] Appellate Body Reports, Canada – Renewable Energy at pg. 5.62

The world is dealing with an unusual and unfortunate situation that has led to such crucial and difficult decisions to protect the corporations and Indian entities in the country from hostile takeovers in the hour of their financial weakness/ crisis. The proposed amendments in the Press Release are mere procedural amendments to ensure that the nation deals with the outcomes of the ongoing pandemic in an efficient way and protect its Indian entities. Many such similar measures are being adopted by various other countries such as Germany, France, Italy and Spain as well whereby they are tightening their FDI policies to prevent hostile acquisitions.

The primary objective of these internal measures is to protect the domestic industries and is not directed towards any particular nation. China, especially, already has a huge investment into various Indian entities. According to the DPIIT, India received FDI from China worth US $ 2.34 billion (approx Rs 14.846 crores) between April 2000 and December 2019.[14] The proposed amendments are not aimed at stopping the FDI from land bordering nations, including China. It is a mere regulatory measure that includes an approval process and does not automatically result in any equity cap or restriction and by extension doesn't lead to violation of the WTO principles. To conclude, prima facie the amendments proposed by the Press Release and the Amended FEMA Rule is not in violation of WTO's principles of non-discrimination and most favoured nations. However, certain clarity is still required as to how the 'beneficial owner' angle will play out and what whether a cap on the timeline for approval will be implemented. Detailed clarifications from the concerned departments and ministries must be looked out for.

[14] ET Contributors, Economic Times, 'View: Why govt's recent FDI move may not bode well for the Indian economy', April 19, 2020, link at: https://economictimes.indiatimes.com/news/economy/policy/view-why-govts-recent-fdi-move-may-not-bode-well-for-the-indian-economy/articleshow/75238956.cms

JMVD® LEGAL

Corporate, Tax, Intellectual Property & Business Advisory

Law Firm

Our Offices

Principal Office
302, Man Heritage, Opp. High Court, South Tukoganj, Indore-452001, Madhya Pradesh,
India

Mumbai Office
D-401, Surana Regency Annexe, Near Baneshwar Temple, Worli, Mumbai-400030,
Maharashtra, India

Indore- I Office
402, A D Imperial, Opp. High Court, South Tukoganj, Indore-452001, Madhya Pradesh,
India

Indore- II Office
11-d, Slice-4, Scheme-78, Vijaynagar, Indore-452010, Madhya Pradesh, India

Phone: +91 731 4947938; Email: tax@jmvdlegal.com, mumbai@jmvdlegal.com;
Website: www.jmvdlegal.com

Disclaimer: No information, contents, opinions and resources whatsoever provided in this article shall be construed as tendering of professional legal advice, source of advertising or solicitation or invitation.