Bilateral Investment Treaties

For Prelims: Bilateral Investment Treaties (BITs), Union budget 2024-25, Foreign Direct Investment (FDI).

For Mains: Bilateral Investment Treaties, Significance of FDI for Indian Economy.

Source: IE

Why in News?

While presenting the interim **Union budget 2024-25**, the Indian Finance Minister stated that India will be negotiating **Bilateral Investment Treaties (BITs)** with its trade partners to boost the inflow of **Foreign Direct Investment (FDI).**

- This announcement comes at a time when India's bilateral treaties have dried up, more so, since the adoption of the Model BIT **in 2016.**

What are the Bilateral Investment Treaties (BITs)?

- **About:**
    - BITs are **reciprocal agreements between two countries** to promote and protect foreign private investments in **each other's territories.**
    - In the mid-'90s, the Indian government initiated BITs to **offer favourable conditions and treaty-based protection** to foreign investors and investments.
- **Minimum Guarantees:**
    - BITs establish minimum guarantees between the two countries regarding the **treatment of foreign investments,** such as,
        - **National treatment** (treating foreign investors at par with domestic companies)
        - **Fair and equitable treatment** (in accordance with international law)
        - Protection from expropriation (limiting each country's ability to take over foreign investments in its territory).
- **Arbitration under BITs:**
    - BITs generally provide a mechanism for settling disputes between **investors and the country of investment.**
    - The most preferred mode of settling such disputes is arbitration, where parties agree to have their dispute decided by a **neutral person (the arbitrator) instead of going to court.**
- **History:**
    - The first BIT signed by India was with the UK in 1994.
    - The BIT regime gained attention in the **year 2010 with the settlement of the first-ever investor** treaty claim filed against India.
    - In 2011, India suffered its first adverse award in a dispute arising out of the **Australia-India BIT (*White Industries v Republic of India*)** where the Indian government was ordered to pay USD 4.1 million by the **International Chamber of Commerce.**
    - By 2015, India faced 17 known BIT claims, notably including one with **Cairn Energy Plc,** a

British oil and gas company, resulting in a USD 1.2 billion award against the Indian government.
    - Given the burden that was being levied on the public exchequer, the government was compelled to **revisit the 1993 BIT model.** This led to the adoption of the 2016 model BIT resulting in the government terminating **68 of the 74 treaties it had executed until 2015** with a request to renegotiate terms based on the revised text.
        - The adoption of the 2016 BIT model was seen more as a knee-jerk protectionist measure rather than a nuanced and calibrated approach to encouraging foreign investment.

What have been the Challenges with the 2016 Model BIT?

- **Narrowing Definition of Investment:**
    - Model BIT narrowed the definition of investment that needed to qualify for BIT protection. Model BIT indicates that India proposes a narrow 'enterprise-based' definition for investment, whereby **only direct investments are protected under the treaty.**
    - Besides this, the definition of investment in the Model BIT also contains a negative list, which precludes portfolio investments, interest in debt- securities, intangible rights, etc. **from the definition of investment.**
    - Thus, the new definition does not take into account the increased scope of foreign investments in the modern era of globalisation and liberalisation.
- **Exhaustion of Domestic Remedy Clause:**
    - Model BIT contains a **clause mandating exhaustion of domestic remedy** prior to initiating international arbitration proceedings.
    - The 2016 model BIT provided that an investor must exhaust local remedies before taking recourse to international arbitration.
        - This surely does little to increase confidence in foreign investors.
- **Impact on FDI:**
    - The difficulties in renegotiating terms with other countries have also contributed to challenges in attracting FDI.
    - FDI equity inflows in India declined 24% to USD 20.48 billion in April-September 2023.
        - The total FDI — which includes equity inflows, reinvested earnings and other capital — contracted 15.5% to USD 32.9 billion during the period under review against USD 38.94 billion in April-June 2022.
- **Wide Discretionary Powers to Host State:**
    - The treaty included a clause ensuring **fair treatment of investments,** prohibiting both parties from implementing measures that are **clearly abusive or violate due process.**
    - However, what is the **yardstick for assessment of violation of "due process"** is not defined.
    - Further, Model BIT states that if the Host State decides that the alleged breach under the BIT is a subject matter of taxation at any point in time, the decision of the Host State therein shall be non-justiciable and exempt from review by an arbitral tribunal.
        - The Model BIT simplistically assumes that a foreign investor shall have complete confidence in domestic judicial interpretations and mechanisms.
        - This could potentially give wide discretion to the Host State to unilaterally exclude any dispute from the jurisdiction of a tribunal, merely by asserting that the conduct in question relates to taxation.

Way Forward

- India can revisit its BIT regime to ensure it **aligns with global best practices while balancing the interests** of both foreign investors and the domestic economy. This may involve incorporating provisions for fair and equitable treatment, most favoured nation status, and robust dispute resolution mechanisms.
- The recommendations made by the **Parliamentary Standing Committee on External Affairs** in 2021, such as promoting pre-arbitration consultations and negotiations, should be implemented to **facilitate the timely settlement of disputes** and ensure effective representation in investor-state disputes.
- India should invest in developing local expertise in the field of investment arbitration to enhance

its capacity to handle investor-state disputes effectively. This can involve training professionals and legal experts, as well as creating specialised institutions for investment arbitration.

- India should adopt a progressive approach to BITs that balances the need for investor protection with the imperative of regulatory sovereignty. This may involve incorporating provisions that promote sustainable development, environmental protection, and social welfare alongside investor rights.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Q. Consider the following: (2021)

1. Foreign currency convertible bonds
2. Foreign institutional investment with certain conditions
3. Global depository receipts
4. Non-resident external deposits

Which of the above can be included in Foreign Direct Investments?

(a) 1, 2 and 3
(b) 3 only
(c) 2 and 4
(d) 1 and 4

Ans: (a)