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A POSSIBLE WTO AGREEMENT ON INVESTMENT- IDENTIFYING EMERGING ISSUES AND THEIR IMPLICATIONS FOR INDIA

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I. Introduction

Bilateralism to multilateralism and all that lies in between

The potential of foreign investment to inject a positive and multiplier effect on the receiving economy's national output is now universally recognised. Most developing countries are unilaterally liberalizing their capital account and actively pursuing foreign capital to finance, primarily, their infrastructure and development projects. In 2015, global FDI flows stood at US$ 1.76 trillion, increasing by more than 5.5 times in the last two decades (US $315 billion in 1995). In rhythm with the forces of globalisation, as capital began to disavow its territorial linkages and started moving freely across borders, concerns regarding the inability of States to establish the legal institutions necessary to offer protection for foreign investments and demands for an international investment protection regime heightened. The scepticism regarding host State's behaviour was founded on the assumption that, although there is initially a convergence in the interests of the foreign investor and the host State in bringing in investment, post-establishment, the aspirations of the investor and the objectives of the State are fundamentally conflictive. Whereas the investor is forever aiming to maximise its profits and exit the market without suffering a financial loss, the host State, guided by the purpose of keeping the investment steadfast, has an incentive to amend the governing laws or put in place capital controls, if not expropriate the investment without compensation[2].

It was against this background of scepticism regarding hostile host State behaviour that international legal instruments for protection of foreign investment first developed. They were concluded at the bilateral level as a set of rules that would offer a minimum standard of protection to foreign investments. Bilateral Investment Treaties (BITs) containing disciplines on non-discrimination, expropriation, fair and equitable treatment of investors and investments, prohibition of performance requirements and provisions on investor-state dispute settlement system (ISDS) were the first concrete building blocks for an international investment protection regime. It was expected that these scattered fragments of bilateral treaties would eventually pave the way to a

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[2] In economic theory this is referred to as a 'hold up' or 'dynamic inconsistency problem'. See Oliver Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985), 52; Andrew T Guzman, Why LDCs Sign Treaties that Hurt Them, *Virginia Journal of International Law* 38, no. 4 (1998): 639, 658.

multilateral investment agreement. Concerted efforts to initiate negotiations for such an agreement under the WTO framework were made at the Singapore Ministerial Conference of the WTO in 1996. However, the path towards multilateralism in international investment law has been fraught with complexities and has eluded the consensus that was visible in other areas of international economic laws (GATT and then WTO for international trade law and the IMF for international monetary law). This paper attempts to identify and evaluate the issues that need to be addressed before moving towards a multilateral agreement, specifically from the perspective of India.

This issue has gained emphasis today as the efforts to locate a multilateral investment agreement within the WTO matrix have once again gained traction. In the run up to the 10th WTO Ministerial Conference at Nairobi, certain members proposed "new issues" as an item for consideration at Nairobi. Amongst other issues, the facilitator's report that was circulated before the Nairobi Ministerial Conference mentioned 'investment' as an issue that could be pursued after Nairobi or as a recurring issue[3]. The renewal of attention towards the "Singapore new issues" forms part of a larger narrative to develop multilateral rules on competition, investment, e-commerce, government procurement so as to enhance the participation of micro, small and medium enterprises in regional and global value chains. Even as debates continue regarding the appropriateness of the WTO as a forum for negotiating multilateral investment disciplines on investment and whether multilateral disciplines would actually contribute to enhanced MSME participation in GVCs, it seems pertinent to look at some of the substantive issues surrounding the extant international investment regime so as to assess whether any of these issues can be resolved by progressing from bilateralism to multilateralism. Part II of the paper identifies the issues underlying the multilateralization of the investment regime. The issues are broadly divided into three parts. Issues that pertain to the extant bilateral treaty framework are assimilated under Part IIa. The more fundamental question of whether FDI itself has the natural quality of positively impacting the economy of the host State has been dealt with under Part IIb. Issues that are India-centric, but could very well confront policy makers in other developing countries as they enter the transitory phase and liberalise FDI, are analysed in Part IIc. Part III concludes.

[3] World Trade Organization, Report by the Facilitators, Tenth Ministerial Conference- Consultations on Ministerial Declaration ¶ 4.17, October 2015, JOB/TNC/55

II. Identification of Issues:

The implications of a multilateral investment agreement within the WTO for India can be addressed from three stand points:

a. What are the concerns with the current regulatory regime- International Investment Agreements? Here, it is extremely important to discern the true nature of the weaknesses in the extant regime, if any, because if the issues are systemic or inherent to the very make-up of investment disciplines then there remains no reason to move from IIAs to MIAs. At the same time, it is equally important to highlight the weaknesses in the current framework that can be rectified by moving from a bilateral approach to a multilateral approach.
b. What are the effects of FDI on economic development? This is a broader question on the very efficacy of FDI as an instrument in bringing benefits to the host economy and in correcting the balance of payment situation.
c. On one side, India has been progressively liberalising its FDI regime and entering into an increasing number of IIAs. On the other side, it has shown scepticism towards initiating negotiations on a multilateral investment agreement at the WTO. How can this seeming contradiction be reconciled?

a. Concerns on International Investment Agreements

The current regulatory regime for global investment flows consists of a fragmented treaty framework in the form of Bilateral Investment Treaties (BITs) and other treaties (such as FTAs and Double Taxation Avoidance Agreements) with investment provisions (BITs and other treaties are collectively referred to as "International Investment Agreements"- IIAs). These agreements, concluded at the bilateral or regional level, binds the parties to offer protection to investments and investors of the other country. A standard IIA would contain disciplines on non-discrimination, expropriation, fair and equitable treatment of investors and investments, prohibition of performance requirements and, most importantly, provisions on investor-state dispute settlement system (ISDS) which allows foreign investors to seek remedies against the host state before an international arbitral tribunal.

Over the years there has been a rapid increase in the number of BITs of BITs operating at the global stage. Today, there are 2,953 BITs of which 2,322 are in force (UNCTAD 2016). There are 362 other treaties with investment provisions of which 294 are in force. Simultaneously, there has also been a surge in investment arbitrations initiated, from a single dispute in 1993 to 70 disputes in 2015 (Figure 1).

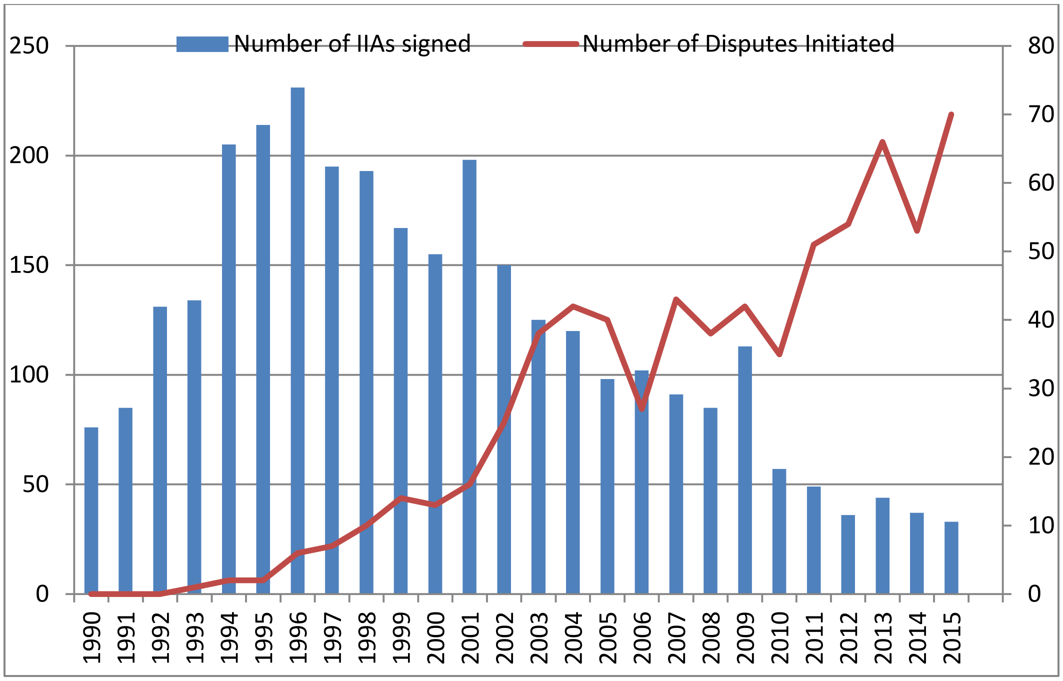

Figure 1: Number of IIAs signed and investment arbitration disputes initiated between 1990-2015

Source: UNCTAD IIA Database (www.investmentpolicyhub.unctad.org)

This exponential surge in the number of IIAs and disputes has motivated a vast breadth of literature that has examined the IIA regulatory framework to show that there are systemic issues in the present system which will invariably be reflected in a multilateral arrangement as well. The first issue relates to the inadequacy of conclusive empirical evidence that shows any direct co-relationship between signing BITs and attracting capital inflows. Secondly, investment agreements, by their very nature, are heavily loaded in favour of the investor and investor's home country (as compared to the host state) because their primary purpose is understood as seeking to encourage the inflow of investment. This inherent asymmetry in the IIA between the rights of the investor/investment and the rights of the host State's government to regulate such investment is best reflected in the rapid increase in the number of performance requirements that are prohibited by the IIA. Thirdly, the operation of the ISDS mechanism has raised significant concerns in both developing countries and developed countries. The fourth issue is directly related to the growing proliferation of IIAs and whether such a scattered and diverse policy framework has interrupted the operations of trans-national corporations (sources of FDI) who seek policy coherence at the multilateral level. As mentioned, it is critical to understand whether these four issues are systemic to the very concept of IIAs while discussing the need for a transition to a multilateral treaty framework.

1. UNCERTAIN RELATIONSHIP BETWEEN IIAS AND FOREIGN INVESTMENT

A graphic examination of FDI inflows into developing countries and the number of BITs signed between developing economies over the last two decades suggests a direct co-relation between the two (Figure 2). In 1994-95, when there were just 130 IIAs that involved developing economies, they received US$ 102,387 million in FDI inflows. By 2014, the number of IIAs rose to 2089 and the FDI received increased to US$ 681,387 million.

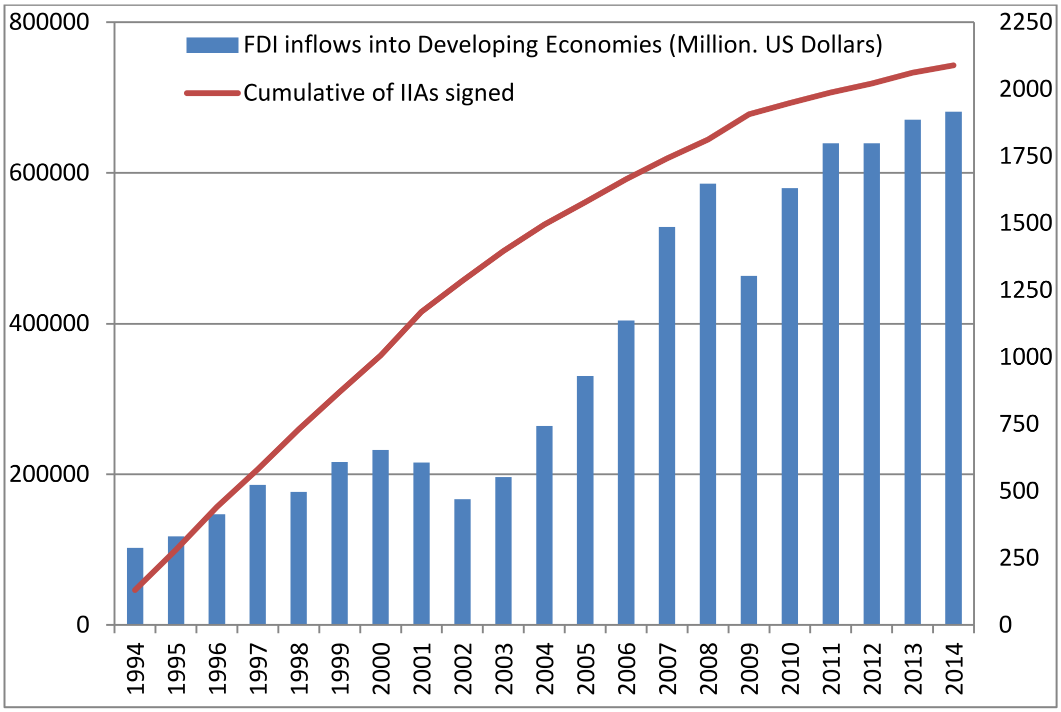

Figure 2: Growth in IIAs signed and FDI inflows into developing countries from 1994-2014

Source: UNCTADStat[4] and UNCTAD IIA Database[5]

UNCTAD (1998) conducted a study on the determinants of bilateral FDI flows that covered seventy-two host states over twenty-three years. It reported that relationship between BITs and FDI was statistically weak, both in the sense of statistical significance and in the sense of magnitude of effect, and concluded that BITs could be expected to only "marginally increase" FDI.[6] UNCTAD (2014) found that BITs appear to have no

[4] The FDI figures include all developing economies excluding the offshore financial centres in the Caribbean: Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Barbados, the British Virgin Islands, the Cayman Islands, Curaçao, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Sint Maarten (Dutch part) and Turks and Caicos Islands. It is calculated as a flow concept and is measured at current prices and current exchange rates as available on 30.08.2016.
[5] The cumulative of IIAs signed includes all IIAs to which developing economies have been a party to in the period from 1994-2014. It is to be noted that, here developing economies also includes LDCs
[6]UNCTAD, "Bilateral Investment Treaties in the Mid- 1990s,"(1998).

effect on bilateral North-South FDI flows and that the empirical results do not support the hypothesis that BITs foster bilateral FDI.[7]

The findings of Hallward-Driemeier (2003) were far more critical than the UNCTAD study with regard to the impact of BITs in promoting FDI flows. To begin with, she found that although a larger volume of FDI flowing from OECD countries to developing countries were being covered by BITs by 2000, this increase was accounted for by additional country pairs entering into agreements rather than signatory hosts gaining significant additional FDI. Secondly, an empirical analysis found that BITs are either insignificantly correlated with FDI or are significantly and, counter-intuitively, negatively associated, implying that BITs might actually harm a country's FDI prospects. In any case, BITs are not substitutes for good institutional quality and local property rights and are only complements.

Tobin and Rose-Ackerman (2004) studied the relationship between BITs and FDI flows and domestic investment environment. They found that, broadly, the relation between BITs and FDI is weak (for "riskier" countries the relation between BITs and FDI is stronger). They also found that the relation between BITs and domestic investment environment is again weak. This means that, although BITs tend to favour foreign investors over domestic investors, they do not appear to dampen domestic investment. In conclusion, although the effect of BITs on private domestic environment in the host state is neutral, they do not fulfill their primary objective of attracting FDI either.[8]

On the contrary, Neumayer and Spess (2005) came up with quantitative evidence that a higher number of BITs raises the FDI that flows to a developing country.[9] However, the authors also found some evidence that this relationship may be conditional on the strength of domestic political institutions in the host state. Host states with domestic institutions that are ineffective at protecting the property rights of foreign investors may be more likely to see a significant impact on FDI upon signing a BIT, and that positive effect may decline as domestic institutions improve. The authors concluded that BITs may be useful "substitutes" for domestic political reform.

Studying the impact of BITs on FDI outflows from capital exporting OECD countries, Egger and Pfaffermayr (2004) found that ratifying a BIT is associated with a 30% increase in outflows from the capital-exporting country to the ratifying country. They concluded that "BITs [when implemented] exert a positive

[7] UNCTAD, "Trade and Development Report," (2014): 159.
[8] Jennifer Tobin and Susan Rose-Ackerman, "Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties," *William Davidson Institute Working Paper*, no. 58 (2004).
[9] Eric Neumayer and Laura Spess, "Do Bilateral Investment Treaties increase foreign direct investment to developing countries?," *World Development* 3, no. 1 (2005): 31-49.

and significant effect on real stocks of outward FDI." They also posit that signing a BIT (as opposed to actually ratifying it) exerts a relatively lower impact on FDI stocks. [10]

Büthe and Milner (2008) carried out a statistical analysis of FDI data for 122 developing countries from 1970 to 2000 to test whether developing countries that belong to the WTO and participate in more PTAs experience greater FDI inflows than otherwise, controlling for many factors including domestic policy preferences and taking into account possible endogeneity. They concluded that joining international trade agreements allows developing countries to attract more FDI and thus increase economic growth[11]. In a similar vein, in a 2009 study, they also specifically examined the effect of BITs on inward FDI flows into least developed countries. They found a significant positive effect of BITs on FDI; in their base model, one standard deviation in the cumulative number of BITs signed resulted in a 29% increase in FDI as a percent of host country GDP.[12]

Aisbett (2007) looked at nearly 2,500 BITs that were signed since 1980 to test whether BITs stimulate investment in twenty eight low- and middle-income countries and reported that she "found no evidence for the claim that BITs signal a safe investment climate."[13] Aisbett identified a number of serious methodological challenges that existing studies largely ignored, particularly the problem of accounting for the endogeneity of BIT adoption. She note that there is potential endogeneity due to both reverse causality and omitted variables (For example, an improvement in the investment climate in the host state or an increase in FDI flows in one year may cause a BIT to be signed in the next year). Once these problems were addressed using appropriate statistical methods, significant correlations between BIT ratification and FDI inflows disappeared.

Yackee (2010) devised an alternate method of examination of the relation between investment treaties and FDI flows. First, he enquired to what extent investment treaties influenced rankings of "political risk" provided by for-profit business consultants and found that BITs are not strongly correlated with political risk rankings. Yackee also surveyed providers of political risk investment insurance and in-house counsels of large US-based corporations where he asked them whether BITs influenced their companies underwriting and investment decisions respectively. The results of these lines of inquiry provide evidence that BITs do not meaningfully influence FDI decisions. Majority of insurance providers surveyed did not view BITs as relevant to their underwriting decisions. Also there was low familiarity amongst in-house counsels of major corporations with, much less appreciation of, BITs as risk-reducing devices.

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[10] Peter Egger and Michael Pfaffermayr, "The impact of bilateral investment treaties on foreign direct investment", *Journal of Comparative Economics* 32, no. 4 (2004): 788–804.
[11] Tim Büthe and Helen V. Milner, The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements?, *American Journal of Political Science* 52, no.4 (2008):741-762.
[12] Tim Büthe and Helen V. Milner, "Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis", in *The Effects Of Treaties On Foreign Direct Investment*, eds. Karl P. Sauvant & Lisa E. Sachs (Oxford: Oxford Unity Press, 2009), 196.
[13] Emma Aisbett, "Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation," *Munich Personal RePec Archive*, 2007, http://mpra.ub.uni-muenchen.de/2255/ (accessed on 30.08.2016)

It is clear from the above that extant studies that examined the relation between BITs and FDI flows have resulted in widely disparate results- ranging from negative to insignificant to positive. This means that econometric analysis has failed to come up with consistent and established evidence that there is a statistically significant co-relation between signing a BIT (or signing more and more BITs) and increase in FDI flows. But the lack of consistency in results, whether positive or negative, is itself attributable to the lack of a verifiably supreme research method that is unanimously agreed upon as most suitable for answering the question "Do IIAs attract FDI?". This is not the same as saying that we *know* that IIAs do not work. It means that there are methodological issues that constrain econometric analysts from arriving at one certain answer to that question. The implication of this uncertainty in quantitative outcomes of a BIT is that it should at least caution a certain modesty of expectations when governments enter into BITs. Also, countries need to adjust for this lack of established evidence while calculating the opportunity cost of taking up prohibitions on performance requirements and subjecting themselves to ISDS proceedings.

The case of Brazil further amplifies the dubious connection between FDI flows and IIAs. Brazil has held itself back from implementing BIT with any country (as of August 2016, Brazil has signed 20 BITs but none of these are in force). However, this has not impeded the inflow of foreign investment into the country. During 2000-2013, it attracted $600 bn of FDI. Compared to Brazil, India's track record of attracting FDI has been modest. Despite having BITs or IIA with about 80 countries, India could attract FDI to the extent of $210 bn during the same time period. This goes on to suggest that there are other factors at play that guide investment decisions.

2. PROHIBITIONS ON PERFORMANCE REQUIREMENTS

Foreign investors lack incentives to *actively* contribute to the economic development of the host state and therefore, there has been a felt need among countries to apply certain policy interventions that shall ensure positive benefits from foreign investment. Host states tie foreign investments to certain performance requirements that investors must meet in order to establish or operate a business, or to obtain some advantage offered by the host state- such as local content or local employment requirements, transfer of technology requirement, export requirements, limitations on equity ownership, requirements to enter into joint venture with domestic partners, limitations on repatriation of profits.

States have increasingly been committing, in international investment treaties, not to impose performance requirements on foreign investors. The presence of such provisions that prohibit performance requirements in IIAs and their chilling effect on the regulatory space of host states to achieve sustainable development goals has been a persistent argument against IIAs and an MIA. In this context, it is important to understand the scope and implications of these prohibitions contained in IIAs and whether their presence dampens the case for a MIA.

To start with, there is already a multilateral agreement- WTO Trade related Investment Measures (TRIMS) Agreement- that contains a set of performance measures that WTO members are restricted from applying (Table 1).

Table 1: Scope of Prohibitions on Performance Requirements in TRIMS

PERFORMANCE REQUIREMENT	SCOPE OF PROHIBITION	PROVISION IN TRIMS
Local content requirements	The purchase/use by an enterprise of products of domestic origin or from any domestic source	Annex, Para 1 (a)
Trade balancing requirements	An enterprise's purchase/use of imported products is limited to an amount related to the volume or value of local products that it exports	Annex, Para 1 (b)
Import restrictions	General import restrictions related to a product used in local production. Import restrictions related to the enterprise's volume or value of local production that it exports	Annex, Para 2 (a)
Foreign exchange balancing requirements	Restrictions on an enterprise's access to foreign exchange for imports to an amount related to the foreign exchange inflows attributable to the enterprise	Annex, Para 2 (b)
Domestic sales requirement	The exportation of products is restricted in terms of particular products, volume or value of products or volume or value of local production	Annex, Para 2 (c)

Source: Annex to WTO Agreement on Trade Related Investment Measures

Other than the TRIMS Agreement, there are numerous IIAs that contain prohibitions on performance requirements. The scope of prohibitions contained in these IIAs has become increasingly broader than the WTO TRIMS Agreement. In light of this, the performance requirement prohibition clauses in a future MIA could take at least two shapes. It could either incorporate the TRIMS provisions *mutatis mutandis* considering that TRIMS is itself a multilateral agreement under the WTO umbrella (WTO level) or it could assimilate the broader range of prohibitions contained in IIAs and go beyond the TRIMS (WTO-plus).

What could be the implications arising from a MIA that contains provisions on performance requirements that replicate the TRIMS provisions on performance requirements (WTO level)? It is worth recalling that a large majority of developing countries feel disadvantaged by the existing prohibitions under the TRIMS Agreement and have been seeking the removal of certain elements and the operationalisation of the Special and Differential (S&D) treatment principle under the Agreement. In 2001, developing countries proposed an amendment to the TRIMS Agreement that would add an enabling provision to Article 2 and 4 of the TRIMS Agreement by way of which "developing countries shall be exempted from the disciplines on the application of domestic content requirement" and also a fresh opportunity to notify TRIMS which would then be allowed to be maintained till a new transition period.[14] In 2002, Brazil and India made a joint proposal[15] to the Committee on TRIMS that Article 4 of the TRIMS Agreement should be amended in order to incorporate specific provisions that will provide developing countries with the necessary flexibility to implement development policies. The proposal highlighted seven circumstances under which developing countries should be allowed to temporarily deviate from Article 2 of the TRIMS Agreement:

1. Promote domestic manufacturing capabilities in high value-added sectors or technology-intensive sectors;
2. Stimulate the transfer or indigenous development of technology;
3. Promote domestic competition and/or correct restrictive business practices;
4. Promote purchases from disadvantaged regions in order to reduce regional disparities within their territories;
5. Stimulate environment-friendly methods or products and contribute to sustainable development;
6. Increase export capacity in cases where structural current account deficits would cause or threaten to cause a major reduction in imports.
7. Promote small and medium-sized enterprises as they contribute to employment generation.

India's domestic policies with regard to local content requirements were successfully challenged by other WTO members on two occasions which led to India having to reframe its domestic policies. In 2002, a Panel of the WTO Dispute Settlement Body, in a dispute brought by the EC (*India-Autos*), found that India had acted inconsistently with its obligations under Article XI of the GATT 1994 by imposing on automotive manufacturers an obligation to balance any importation of certain kits and components with exports of

[14]World Trade Organization,Compilation of outstanding implementation issues raised by members, Tiret 39 and Tiret 37, 2001, JOB(01)/152/Rev.1.

[15]World Trade Organization, Communication from Brazil and India, The mandated review of TRIMS Agreement, Para 12 (b) Doha Ministerial Declaration, Implementation related issues and concerns, Tiret 40, 2002 G/TRIMS/W/25.

equivalent value. The Panel stated that this finding "appears consistent with Item 2(a) of the Illustrative List [...] which suggests that measures linking the amount of imports to a certain quantity or value of exports can constitute restrictions on importation within the meaning of Article XI:1.[16] In *India- Solar Cells* the Panel found that the domestic content requirement measures maintained by India in the initial phases of its National Solar Mission are trade-related investment measures covered by paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement and therefore inconsistent with Article 2.1 of the TRIMS Agreement (and Article III: 4 of GATT).[17]

This shows that in most WTO member-states, including India, objectives such as encouraging local sourcing and improving trade balance continue to be high priorities in their industrial policy and they are impeded from pursuing these policy goals because of WTO commitments. In light of this, it is highly unlikely that there would be any form of consensus among WTO members to replicate the performance measures that are prohibited under TRIMS in a new MIA.

Considering next the situation that the MIA will be WTO-plus, it is to be recognised that there are advantages in replacing a scattered if not overlapping framework of BIT-rules with a uniform and singular set of MIA rules. Chaisse and Hamanaka (2014) have highlighted the complications that arise from inconsistencies in overlapping treaties such as lack of clarity in determining the effective rules that restrict the state's behaviour and difficulties in determining the substantive obligations towards foreign investors.[18] Secondly, what needs to be also considered is that more and more countries are anyway progressively moving beyond TRIMS commitments in their respective BITs (Table 2). If there is an MFN provision in these BITs that would mean that these commitments are horizontally applicable to all BIT partners of a country. In light of this, it can be argued that moving towards a MIA would not significantly change the depth or breadth of existing commitments. Thirdly, replacing performance requirement prohibitions under IIAs with the same set of prohibitions under a WTO-backed MIA would mean replacing the ISDS mechanism also with the WTO dispute settlement mechanism which has its own implications (discussed below).

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[16] WT/DS/146/R, Panel Report, India – Measures Affecting The Automotive Sector

[17] WT/DS/456/R, Panel Report, India- Certain Measures Relating To Solar Cells and Solar Modules

[18] Julien Chaisse and Shintaro Hamanaka, "The investment version of the Asian noodle-bowl: The proliferation of International Investment Agreements," *ADB Working Paper Series on Regional Economic Integration*, no.128, (2014): 14.

Table 2: Scope of prohibitions on performance requirements in select IIAs

Prohibitions on:	TRIMS Agreement	NAFTA (1994)	India-Singapore (2005)	ASEAN (2009)	India-Korea (2010)	India-Japan (2011)	US-Korea (2012)	EU-Canada (2014)
Export restriction	●		●	●	●	●		●
Local content	●	●	●	●	●	●	●	●
Export-Import balance	●	●	●	●	●	●	●	●
Export requirement	●	●			●	●	●	●
Restriction on sales	●	●			●	●	●	●
Local management		●	●	●	●	●	●	●
Headquarters								●
Research and Development requirement		●						●
Technology transfer		●			●	●		●
Exclusive supply		●			●	●		●
Joint venture requirement								●
Local minimum equity requirement/ maximum foreign limit								●

PROHIBITIONS ON:	TRIMS AGREEMENT	NAFTA (1994)	INDIA-SINGAPORE (2005)	ASEAN (2009)	INDIA-KOREA (2010)	INDIA-JAPAN (2011)	US-KOREA (2012)	EU-CANADA (2014)
Monopoly company								●
Entry quotas of any kind								●
Numerical quotas in sectors of any kind								●
Minimum/maximum number of employees								●
Total number of firms or employees in a sector								●

Source: Shintaro Hamanaka (2013), Satwik Shekhar (2017, forthcoming)

Yet, there are obvious disadvantages, particularly for a developing country like India, in being party to a MIA with WTO-plus provisions. Firstly, the reason behind there being a "noodle bowl of IIAs" is that states have chosen to differentiate between their IIA partners in different treaties and tailor-make the performance requirement rules to suit specific objectives. Consequently, states ought to be wary of disentangling this noodle-bowl with a homogenous set of rules. Secondly, as Table 2 reveals, there is considerable variation, in terms of scope and the degree of prohibition between extant BITs. Although, countries are increasingly committing to WTO-plus rules on performance requirements and sometimes even allowing MFN provisions in their respective IIAs, the breadth of rules covered, for example, in EU-Canada CETA is vastly wider than those covered in India-Singapore CECA. Therefore, the magnitude of implications would depend on which IIA will be used as a model or benchmark for the MIA negotiations.

It is crucial to bear in mind that the set of performance requirement measures provided in the illustrative list of the Annex to TRIMS Agreement were prohibited on the basis of the rationale that the imposition of these measures have a trade restrictive effect and also while keeping in mind the development and financial needs of developing country members. This can be better understood from an UNCTAD survey (2014) that focused on the frequency of measures taken by investment promotion agencies to promote sustainable development goals. The survey showed that the most importance performance requirements used were the ones that are not prohibited explicitly under TRIMS (Figure 3). It can be inferred from this finding that a marginal addition to the existing list of prohibited measures can have a disproportionate effect on the policy space of countries.

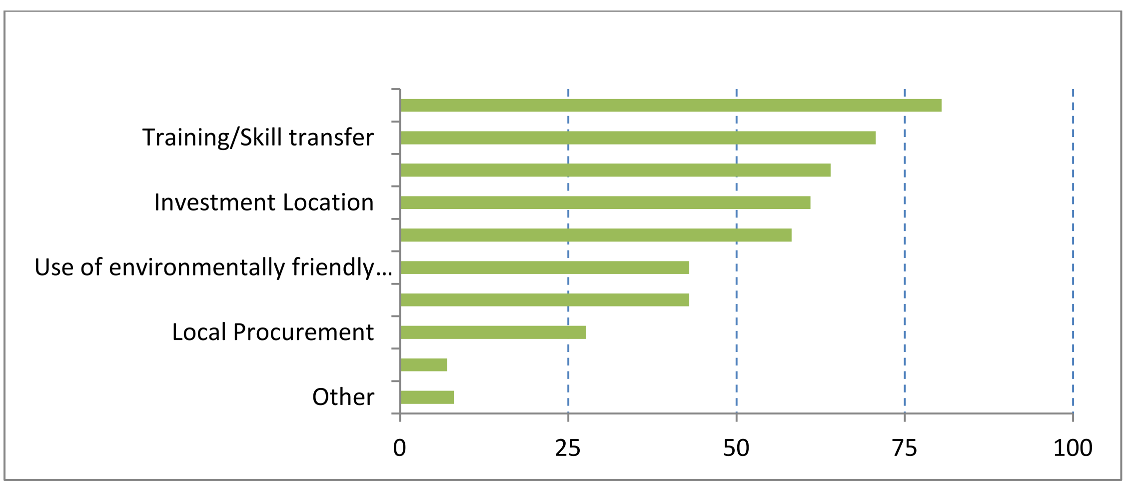

Figure 3: Most important performance requirements linked to investment incentives for foreign investors (Per cent)

Source UNCTAD, World Investment Report 2014, p112

On the other side, some studies that emerged in the early 2000s found that, firstly, the restrictiveness of the most popularly used performance requirements was rather low and secondly, that there exists no evidence to show that the more restrictive performance requirements discourage FDI in any significant manner. The first finding comes from an ERT survey (2000)[19] that examined investment conditions in 28 countries. Amongst the variables that were measured were the following three items:

1. performance requirements related to exports, local content, manufacturing, and foreign exchange neutrality (including requirements that are not codified);
2. requirements related to employment conditions (discrimination of foreign investors against comparable local employers) and work permits for international staff;
3. technology targeting, i.e., interventions into the corporate transfer of technology and insistence on R&D efforts in the host country and R&D dissipation.

The restrictiveness of these performance requirements were scored on a scale ranging from 0 (most liberal) to 6 (most restrictive) for the years 1992-1999 in all 28 countries. The results show that even in the early 1990s, the restrictiveness score of performance requirements was rather low in most countries (the average score was below 2 in 1992). Moreover, the average score declined significantly during the 1990s, indicating that performance requirements became less restrictive in almost all sample countries with some specific exceptions.

The second study draws on the findings of the ERT Survey. Nunnenkamp and Pant (2003) carried out a correlation analysis to show that even the more restrictive performance requirements (amongst those identified in the ERT Survey) do not actually discourage FDI in any significant manner. Their analysis shows that the co-efficients of co-relation between inward FDI stocks per capita and performance requirements are not negative in any significant manner and is, on the contrary, positive in at least one case (technology targeting).

In conclusion, there are obvious negative implications that arise from being party to a MIA with performance requirement prohibitions, regardless of whether this is at the WTO-level or WTO-plus level. However, considering the vast degree of variation between extant IIAs, the actual magnitude of implications would depend on which IIA, if any, serves as a model for the MIA. Also, studies show that the PR measures that are most popular amongst countries are those that are outside the purview of TRIMS, and therefore their prohibition would have a relatively larger impact. On the other side, even as countries are progressively liberalizing the restrictiveness of their PRs, there is little evidence on record that restrictive PRs actually discourage FDI inflows. This indeed calls to question the very necessity of having PR prohibitions in an investment treaty.

[19] ERT, "Improved Investment Conditions: Third Survey on Improvements in Conditions for Investment in the Developing World," *European Round Table of Industrialists*, (2000).

3. THE MALADY OF INVESTOR-STATE ARBITRATIONS:

The Investor-State Dispute Settlement (ISDS) mechanism is a recent institutional innovation (mid-twentieth century) that was designed to fill a crucial gap in international law, namely, the settlement of investor-state disputes. Before its arrival, the grievances of investors in foreign states had to be settled through diplomatic channels and have sometimes even led to the threat or use of military force.[20] To this extent ISDS has helped in reducing the causes of international tension and recourse to military force. Yet, there exists multiple issues with the operation of the ISDS mechanism that more and more countries, even developed countries like Australia and Germany, are growing visibly cautious of their inclusion in their IIAs.

There are at least six significant problems with the ISDS mechanism. First, the design of the ISDS mechanism is such that it evokes serious questions regarding the independence and impartiality of the arbitrators. Unlike in most other international judicial bodies, the compensation for the arbitrators is paid by the parties to the dispute. This creates a conflict of interest amongst the arbitrators. In certain cases, the arbitrators were not at arm's length with the private party suing the foreign government. Further, there exists a sort of revolving door between the participants of the dispute. The arbitrators in one case may be lawyers arguing for foreign investors. This is because the legal professionals who are participating in ISDS are not proscribed by any arbitral rules from engaging in concurrent career activities.

Secondly, the position of law laid down through decisions in ISDS disputes is inconsistent and often contradicting. This is attributable to the fact that the jurisdiction of ISDS is spread across dispute resolution provisions contained in close to 3000 IIAs which are themselves overlapping and often inconsistent with each other. There is no single set of harmoniously codified agreement to which the ISDS can claim its legal basis.

Thirdly, there exist minimum avenues for appeal or annulment of the ISDS awards. Review of ISDS awards under the two most commonly used international treaties of investment dispute resolution- 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") and the 1965 ICSID Convention is available only on very narrow grounds even if the awards are based on errors in law or in fact. Under the New York Convention, State parties are required to recognize and enforce arbitral awards except on very fundamental seven grounds. States' right to challenge awards under the ICSID Convention are even more restricted. Under ICSID, arbitral awards cannot be appealed before national courts. The ICSID Conventions requires every party to enforce the arbitral award as if it were a binding judgement of the highest domestic judicial body.

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[20]Andrew Paul Newcombe and Luis Paradell, "Law and Practice of Investment Treaties: Standards of Treatment, in "Historical Development of Investment Treaty Law," (Alphen aan den Rijn: Kluwer Law International, 2009), 9.

Fourth, the amount of award and financial compensation granted by some of the ISDS tribunals are also a matter of deep concern as they could exert significant pressure on the public exchequer and act as a disincentive for policy regulation. Table 3 provides a glimpse of the amounts awarded by arbitral tribunals in select cases. In some instances, governments were required to pay financial compensation despite the arbitral tribunal establishing that the foreign investor had violated the terms of its contract with the government. In *Occidental Petroleum v. Ecuador*[21], Ecuador was awarded a penalty of US$2.4 billion for annulling a contract with the investor despite the tribunal finding the investor to have violated a clause of the contract.

Table 3: Quantum of arbitral awards in ISDS

- ***Yukos v. Russia*** – USD 50 billion (3 awards for 3 former Yukos majority shareholders, 2014)
- ***Occidental v. Ecuador*** – USD 1,769,625,000 (ICSID, 2012)
- ***Al Kharafi and Sons v. Libya*** – USD 935 million (ad hoc, 2013, with interest, fixed at 4% per annum, the sums owing under the March 22, 2013 award are increasing, topping one billion US dollars at the end of 2014)
- ***Gold Reserve v. Venezuela*** – USD 713 million plus costs (ICSID, 2014)
- ***Wagih Siag v. Egypt*** – 74,550,795 USD (ICSID, 2009)
- ***Duetsche Bank v. Sri Lanka*** – USD 60,368,993 (ICSID, 2012)
- ***Bernandus Henricus v. Zimbabwe*** – USD 10,637,000 (ICSID, 2009)
- ***France Telecom v. Lebanon*** – USD 266,349,600 (UNCITRAL, 2005)
- ***Argentina*** – USD 1,140,819,547 in 15 cases

Source: Kinda Mohamediah (2015)

Fifth, another crucial aspect highlighted by experts is the regulatory chill experienced by governments on account of the threat of being sued by the foreign investor. Governments may be deterred from taking measures that may result in changes in the business environment, even if such measures are necessary for pursuing desirable economic, social and environment objectives.

Sixth, investment arbitration tribunals have shown a tendency to adopt an expansive interpretation of the standard for fair and equitable treatment (FET). FET provisions constitute a standard element of BITs wherein each party guarantees to protect investments (and, in some cases, investors) against serious instances of arbitrary, discriminatory or abusive conduct by host States. However, due to the use of broad language for FET in BITs and the uncertainty regarding what constitutes the appropriate standard for fair and equitable treatment tribunals have adopted a broad interpretation of the FET provision in BITs to the extent that it has emerged as a "catch-all clause".[22] The implication of such an overreach is that stifles government intervention to the extent of threatening the sovereign right of policy making. In *Occidental Exploration & Prod. Co. v.*

[21] ICSID Case No. ARB/06/11, available at http://www.italaw.com/cases/767 (Last visited on 28 September 2016).
[22] Cosbey, Aaron et al. 2012. "Investment Treaties & Why they matter to Sustainable Development: Questions and Answers," *International Institute for Sustainable Development.*

Republic of Ecuador[23], the FET standard was interpreted to include a "stable and predictable business and regulatory environment", allowing the investor to seek compensation for changes in tax and regulatory standards. Similarly, in a series of cases against Argentina, the arbitral tribunals found that the emergency measures undertaken by Argentina to tackle its currency crisis of 2000-02 were a breach of its FET obligation as it had "failed to provide a stable investment regime".[24] Even when BITs limit the standard of FET by linking it to "customary international law" (CIL), tribunals have found a way to resort to an expansive interpretation.[25] In *Railroad Development Corp. v. Guatemala*[26], the tribunal while identifying the standard of FET under CIL did not look at the "general and consistent practise of states" or *opinio juris*- the actual constituents of CIL- but relied on earlier arbitral awards' opinion on the contents of CIL.

If a multilateral investment agreement under the umbrella of WTO comes into being investor-state disputes could be subsumed by the dispute settlement mechanism of the WTO. If this were to happen, then not only would the multiplicity of fora for settlement of investment disputes be replaced by a more uniform WTO-backed mechanism but most of the problems underlying the ISDS would be obviated under the WTO dispute resolution mechanism. Table 4 undertakes a comparison of the two dispute resolution mechanisms- ISDS and WTO- to better understand how the issues pertaining to the ISDS mechanism are dealt with differently under both mechanisms.

[23] ICSID Case No. ARB/06/11

[24] *CMS Gas Transmission Company v.The Republic of Argentina* (ICSID Case No. ARB/01/8); *Enron v. The Republic of Argentina* (ICSID Case No. ARB/01/3).

[25] Mathew C Porterfield, "A Distinction Without a Difference? The Interpretation of Fair and Equitable Treatment Under Customary International Law by Investment Tribunals," *International Institute for Sustainable Development*, 2013, https://www.iisd.org/itn/2013/03/22/a-distinction-without-a-difference-the-interpretation-of-fair-and-equitable-treatment-under-customary-international-law-by-investment-tribunals/ ((accessed September 25, 2016))

[26] ICSID Case No. ARB/07/23

Table 4: Comparison of dispute resolution mechanisms under ISDS and WTO

ISSUE	ISDS	WTO
Independence/ impartiality of the decision makers	Arbitrators are appointed by the parties and they are ad hoc panels. Parties to the dispute compensate the arbitrators. Arbitrators are not prohibited from practising law or pursuing concurrent career activities. There are no universal special purpose rules on ethics or code of conduct for the arbitrators under the ISDS system although ICSID convention requires independence and impartiality of the arbitrators.	Panellists in each dispute are chosen from an indicative list of nominees chosen by the WTO members. The Panellists are usually chosen in consultation with the countries in dispute. The Appellate Body is a permanent decision making body composed of seven members appointed by the Dispute Settlement Body of the WTO, in which all WTO members are represented. WTO panellists and Appellate Body members receive compensation directly from the WTO budget, which is funded by the member states and may not accept compensation from the parties. The 1996 WTO Code of Conduct for the Dispute Settlement Understanding applies to all panellists and Appellate Body members of the WTO.
Inconsistency in judgements arising from the lack of a uniform legal basis	The jurisdiction of ISDS is spread across dispute resolution provisions contained in close to 3000 IIAs. Owing to this, the judgements are often inconsistent and sometimes contradictory.	There is a relatively higher level of consistency in DSU's decisions primarily because of institutional characteristics of the WTO (dispute resolution is more transparent, coherent and organised, the secretariat plays a role in assisting the Panellists and there is a healthy exchange of views between the members of the Panel).

ISSUE	ISDS	WTO
		The terms of reference to the Panel and Appellate Body are, by law, limited to examining the provisions in the covered agreements of WTO which is a set of harmoniously codified multilateral agreements. The findings of the Appellate Body carry de facto precedential value and cited as a position of law in subsequent disputes.
Appeal mechanism	Minimal and ineffective under ISDS as it is available only on narrow grounds that exclude review of errors of law.	Parties have a right to appeal legal issues under the WTO and approximately 70% of Panel reports are appealed.
Amount of pecuniary compensation claimed	Investors seek billions of dollars as compensation and are sometimes even granted which could even affect the fiscal position of the respondent State.	WTO's DSU mechanism does not provide for monetary damages. Remedy available is the withdrawal of the inconsistent measure by the erring State. However retaliatory measures are available if it is established that the failing respondent State has not complied with the decision.

It is evident that most of the issues pertaining to the ISDS system would be remedied if it is replaced by the WTO dispute resolution mechanism. *Prima facie*, it could be argued that the presence of the WTO dispute settlement mechanism makes a strong case in favour of moving from the ISDS-battered IIA regime to a DSU-backed MIA regime.

However it is worth noting that moving to the DSU forum for settling investment disputes has its own downsides. DSU opens the possibility of suspending concessions in other sectors or under other WTO agreements ('cross-retaliation") in certain circumstances if it has been found that the respondent Party has not brought its measure in compliance with the provisions of the MIA. Since BITs might remain in force even after the MIA is concluded, ISDS tribunals will have concurrent jurisdiction over investment disputes and this could lead to forum-shopping by investors with the objective of achieving the most desirable outcome. This also raises the 'possibility of conflicting factual and legal determinations, inconsistent remedies, and inefficiencies'.[27] Indeed, this was visible in the *Philip Morris* disputes[28] where Philip Morris challenged the plain packaging laws of Australia in three different forums- at the Australian Supreme Court, at ICSID under the Hong Kong- Australia BIT and at WTO DSU alleging violation of provisions in WTO Agreement on Technical Barriers to Trade (TBT Agreement) and The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The temporal nature of BITs with the option to not renew these treaties makes a strong case to continue with the ISDS platform for resolution of investment disputes as compared to the DSU platform under WTO as obligations undertaken at WTO get permanently locked in.

Another fundamental issue pertains to whether the DSU can rely on extant ISDS jurisprudence for the interpretation of provisions in WTO agreements. This directs back to the debate on what constitutes "applicable law" before WTO Panels and ABs and whether non-WTO decisions (such as those of investment arbitral tribunals) constitute applicable law while interpreting the provisions of covered agreements. Several scholars are of the opinion that there is nothing in the Agreement on the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU Agreement) that restricts WTO Panels and AB from relying on non-WTO law for the interpretation of covered agreements.[29] Although Article 7 of the DSU Agreement instructs Panels to examine the matter referred to them "in the light of the relevant provisions" of the covered agreements cited by the parties to the dispute and "to address the relevant provisions in any covered agreement(s) cited by the parties to the dispute", it is not clear that the covered agreements constitute an exhaustive list of all rules that WTO Panels and AB can possibly apply. Panels and AB, arguably, have the

[27]Brooks E Allen and Tommaso Soave, "Jurisdictional Overlap in WTO Dispute Settlement and Investment Arbitration," *The Journal of the London Court of International Arbitration* 30, no. 4 (2014): 1.
[28]*Philip Morris Asia Limited v. The Commonwealth of Australia*, (PCA Case No. 2012-12)
[29]Joost Pauwelyn, "How to Win a World Trade Organization Dispute Based on Non-World Trade Organization Law?," *Journal of World* Trade, 37, no.6 (2003), 997-1030; Joel Trachtman, "The Domain of WTO Dispute Resolution, 40, *Harvard International Law Journal* 40, (1999): 342; Brooks E Allen and Tommaso Soave, "Jurisdictional Overlap in WTO Dispute Settlement and Investment Arbitration," *The Journal of the London Court of International Arbitration* 30, no. 4 (2014): 1.

discretion to offer deference to non-WTO rules and decisions. The application of ISDS jurisprudence in WTO disputes at the DSU reduces the incentive to move from BITs to MIA for the purpose of supplanting the ISDS with DSU.

It is worth noting that the ISDS mechanism allows investors to directly bring cases for arbitration and there by seek expeditious resolution of disputes, whereas under the WTO only States can bring cases which could have ramifications on the political and economic relations between States. The flipside of this view is that the WTO arrangement ensures that sovereign discretion (whether a grievance, prima facie, exists or not) is exercised before launching a dispute. This would guard against the practise by investors of instituting disputes with malicious intentions.

4. A PROBLEM OF PLENTY- THE EFFECTS OF MULTIPLE AND OVERLAPPING IIAS ON INVESTMENT AND INVESTMENT REGULATION

As has been mentioned above, in the void that has been created by the lack of a comprehensive and multilateral investment treaty framework has spawned a scattered and fragmented regime of more than 3000 IIAs that can even be inconsistent with each other. Chaisse and Hamanaka (2014) in their paper, which mapped the provisions of Asian IIAs, observed that the proliferation of IIAs could "lead to inconsistency across IIAs and bring legal interpretation problems as well as the proliferation of unexpected investor-state disputes." They have given possible situations where multiple layers of IIAs could create difficulties for the host administration determining the substantive requirements in its treatment of foreign investors:

> "Suppose a situation where in a plurilateral IIA lists several prohibited performance requirement measures and states that there is no limitation to introduce other performance requirement measures, while a (nested) bilateral IIA includes a longer list of prohibited performance requirement measures. In such a case, it is not easy to foresee which set of rules prevails. In short, while nested agreements give traders more options, the effective rules that restrict states' behavior and policies become unclear if two or more IIAs are nested." [30]

Inconsistency could also arise if there are multiple IIAs (by means of FTA and BIT) with the same country that alternately stipulates that disputes can be instituted before national courts and international arbitration. This would lead to multiple actions and can create conflicts between the two. Intersected IIAs also cause the problem of treaty shopping agreements and unexpected use of agreements.[31]

However, as has been argued above, States choose to differentiate between the design of the provisions in different treaties and their scope keeping in mind specific domestic policy goals. The bilateral/plurilateral

[30] Julien Chaisse and Shintaro Hamanaka, "The investment version of the Asian noodle-bowl: The proliferation of International Investment Agreements," *ADB Working Paper Series on Regional Economic Integration*, no.128 (2014).
[31] Ibid., 14.

treaty framework gives states' the discretion to differentiate between partner countries and tailor make provisions, through negotiations, provisions that suit the corresponding partner country. It also leaves the possibility to not renew treaties upon their expiry.

From the perspective of the investor, an UNCTAD study (1996) has argued that "trans-national corporations are flexible and experienced enough in operating diverse policy frameworks and they can adapt to regulatory differences among countries." It argues for maintenance of status quo (IIAs) by observing that the "current arrangements are working well in providing an enabling framework that allows FDI to contribute to growth and development and in supporting high and growing volumes of FDI".[32] Drabek (1998) has rebutted this position by arguing that although transnational corporations are flexible and can adjust to national differences there is no reason to believe that they will not seek less costly alternatives such as regulatory frameworks that significantly reduce the administrative costs of implementing tailor- made regulations. It is inconceivable that trans-national corporations would accept a system in which they have to deal with hundreds of regulations. "Moreover the high administrative costs of the present system will continue to discourage many potential investors who would find the regulatory framework expensive and lacking transparency."[33]

[32] UNCTAD, "World Investment Report," (1996): 161
[33] Zdenek Drabek, "A Multilateral Agreement on Investment: Convincing the Sceptics", *World Trade Organisation, Staff Working Paper*, no. 5 (1998): 8.

b. FDI and Economic Development

Although FDI has significantly contributed to the economic growth and development of many states, particularly in East Asia, it is still a question of much debate whether FDI as an instrument has intrinsic qualities that can automatically contribute to economic development, *sans* active policy intervention by the state. Amongst the many arguments that are touted as advantages of liberalising the FDI regime there is particular emphasis on how it leads to Outward FDI (OFDI) flows which is seen as contributing towards economic development and also how it helps meeting balance of payment shortfalls. We analyse below the contribution of OFDI towards economic development and whether FDI contributes towards correcting the balance of payment situation in the particular context of India.

1. EFFECT OF OUTWARD FDI ON THE HOME ECONOMY

Proponents of a relaxed FDI regime have argued that the liberalisation of India's FDI regime is a two-way road as it will also lead to OFDI from India. OFDI, it is argued will bring benefits to the Indian economy and this makes a strong case for a multilateral investment agreement which will offer legal protection to Indian investors abroad. With the calibrated relaxation of the capital account, the cushion provided by the gradual build up of foreign exchange reserves and the improvement in macro-economic stability, India has progressively liberalised its outbound FDI policy since 2003. There has been significant growth in OFDI flows from India in the recent years as its domestic corporate sector opened up its overseas operations in pursuit of new markets, cheaper resources, or better technology (Figure 4).

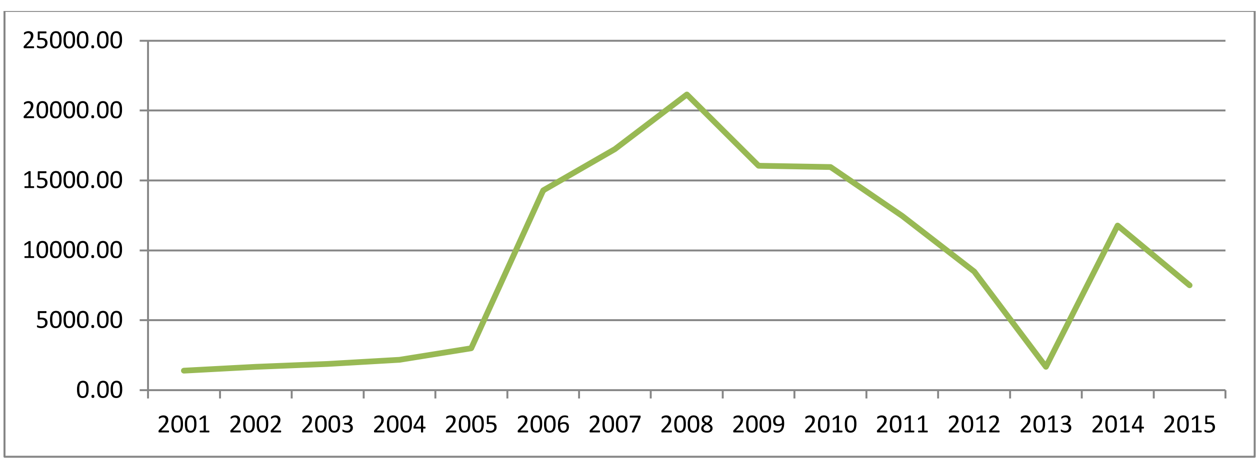

Figure 4: OFDI flows from India from 2001 to 2015 (in million US Dollar) Source: UNCTAD

Even so, before venturing to accord legal protection to OFDIs through BITs it is important to develop an objective assessment of the long term trends in the growth of OFDI, its relative volume when compared to inward FDI and the actual gains to the home economy arising from OFDI. Figure 4 tracks the trend in

OFDI flows from India in the period ranging from 2001- 2015. In the first decade of the twentieth century, OFDI increased by close to 25 times (from $677.67 million to $16,843.37 million). However, it is also noticeable that the growth in OFDI has by no means been consistent in the post-FDI liberalisation regime (between 2008-09 and 2009-10 OFDI shrunk from $18,578.70 million to $13,714.07 million). A comparison of volume of inbound flow of FDI with outbound FDI from 2001 to 2015 indicates that OFDI from developing countries, including India, has not kept pace with FDI flowing into these countries (figure 5). It is clear that most developing countries continue to be net capital importing economies and their policy initiatives to liberalise the flow of capital by opening up their capital account and entering into BITs will benefit foreign investors more than domestic investors.

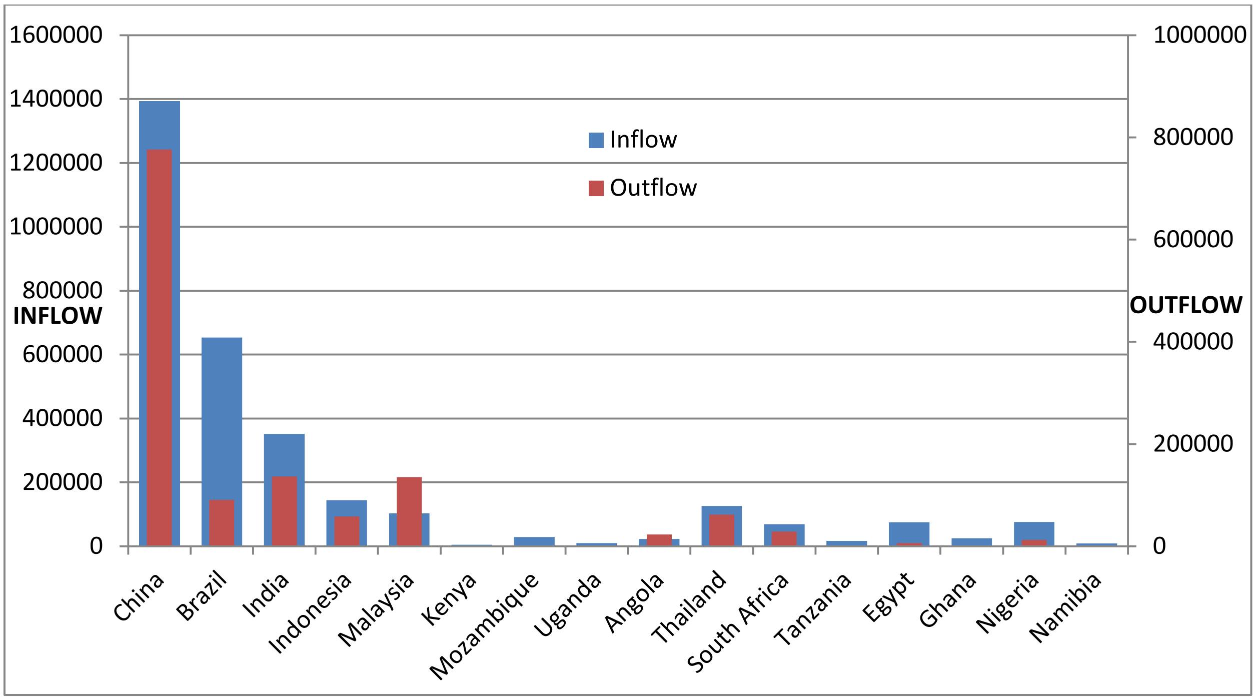

Figure 5: Amount of inward FDI to and outward FDI from developing countries from 2001-15 (in million US dollar). Source: UNCTAD

What is far more striking is that there is little evidence to show that OFDI from India has resulted in significant repatriation of profits. Mapping the foreign exchange inflows of top 100 listed Indian firms that had invested abroad during 2007-08 to 2011-12 Kallummal et al (2016) found that the cumulative inflow of foreign exchange during the period 2007-08 to 2014-15 was only around 7 per cent of the cumulative OFDI from these firms during 2007-08 to 2011-12. The results from this study unambiguously bring out that OFDI from India has not resulted in significant repatriation of profits earned from this OFDI. Also, just as there is no concrete evidence that BITs actually contribute towards FDI inflows, there exists no empirical proof that signing a BIT motivates Indian investors to invest in partner countries. Once again the FDI-BIT linkages argument becomes crucial while attributing causality to BITs for OFDI.

The impact of OFDI on domestic investment has also been examined in detail by several studies. A study on OECD countries using data from the 1980s and 1990s came to the conclusion that OFDI reduces domestic investment[34]. Al Sadig (2013) in a study that looked at outward FDI data and domestic investment from 121 countries, over the period 1990-2010 found that outward FDI in these countries had a negative effect on domestic investment.[35]

2. <u>EFFECT OF FDI ON BALANCE OF PAYMENT SITUATION:</u>

Developing countries with persistent current account deficits often prefer FDI to debt-creating inflows because it does not entail fixed obligations besides being more stable than portfolio investments. However, the effect of FDI on balance-of-payment could be much the same as debt-creating inflows when looked at from a long-term perspective. This is slowly becoming evident in the case of countries which have depended on FDI for development of manufacturing capabilities such as the East Asian economies. Over a long period of time, the stock of FDI tends to turn negative as inflow of capital diminishes and repatriation of profits and remittances of income continues to increase or stay stable.

Secondly, as Chandrasekhar and Ghosh (2010) argue, all capital that is introduced as "FDI" do not go into greenfield projects, but could simply enhance the foreign equity participation in an indigenous firm. Therefore, they further argue that it "should be expected that any increase in the equity stake of the foreign investors in existing joint ventures or purchase of a share of equity by them in domestic firms does not automatically change the orientation of the firm. As a result, in such cases FDI inflows need not be accompanied by any substantial increase in exports, whether such investment leads to the modernisation of domestic capacity or not. Moreover, if the domestic market is attractive for these firms, there is no reason to believe that when the market is expanding and diversifying rapidly, foreign investors in greenfield projects too (such as in automobiles or telecommunications) would not target the domestic market."[36]

Thirdly, in the absence of performance requirements such as foreign exchange controls, there could be greater expenditure of foreign exchange by these firms on imported inputs which could worsen the current account deficit and thereby further exacerbate the balance of payment situation. There could also be expenditure of foreign exchange on account of royalties repatriation of profits as dividends encouraged by the

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[34] M Desai, C. Foley and J. Hines, "Foreign Direct Investment and the Domestic Capital stock," *American Economic Review* 95, no.2 (2005): 33-38.

[35] Ali J. Al-Sadig, "Outward Foreign Direct Investment and Domestic Investment: the Case of Developing Countries," *International Monetary Fund Working Paper*, no.52 (2013).

[36] C.P. Chandrasekhar and Jayati Ghosh, "FDI and the Balance of Payments in the 2000s", *Network Ideas,* March 2010, http://networkideas.org/news/mar2010/FDI.pdf (accessed September 25, 2016)

more liberalised environment. Sarode (2012) through Granger causality test shows that the overall impact of FDI on the Indian current account was negative over 1997- 2011.[37]

[37] S Sarode, "Effects of FDI on Capital Account and GDP: Empirical Evidence from India," *International Journal of Business and Management* 7, no. 8 (2012): 102-107

c. The Seeming Paradox between India's Progressive Liberalization of FDI Regime and Reluctance in Negotiating an MIA

As part of the radical economic reforms that it undertook in the early 1990s, India embarked on a path of calibrated liberalization of its capital account with the view of augmenting its quickly depleting foreign exchange and averting the balance of payment crisis. The equity owned by foreign investors, as a percentage share in paid up capital of domestic companies was incrementally increased, the onerous FERA (Foreign Exchange Regulation Act) regulatory regime was replaced by the FEMA (Foreign Exchange Management Act) and more of investments were brought under the automatic approval route.

Most recently, the Government of India liberalized the FDI limit in insurance sector, pharmaceutical sector, petroleum-refining, courier services, private security agencies, animal husbandry, trade in food products manufactured in India, commodity exchanges, broadcasting carriage services, credit information companies, infrastructure companies, air transport services, and in single and multi-brand product retail trading[38]. As part of the Make-in-India campaign that was rolled out in 2014, FDI limit in defence, certain railway infrastructure activities and construction sector were also liberalised.[39]

However, India has consistently opposed the demands for negotiating a multilateral investment agreement under the WTO's mandate. India has also prepared a new blue print for bilateral investment treaties- Model Bilateral Investment Promotion Agreement with a view "to bring a better balance between the objective of investor protection and the interest of nation".[40] It modified the ISDS provision requiring investors to exhaust local remedies before commencing international arbitration, and limited the power of the tribunal to awarding only monetary compensation. The model excludes matters such as government procurement, taxation, subsidies, compulsory licenses and national security to preserve the regulatory authority for the Government.[41] The Model BIPA will not only form the template for future BIT negotiations but India also seeks to renew its existing BITs on these modified terms and have communicated the same to 47 of its BIT partners.[42] Moreover, only four RTAs to which India is a party- Japan, Korea, Malaysia and Singapore have investment chapters.

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[38]The FDI Policy of the Government of India is consolidated in the Circular on Consolidated FDI Policy and is available at http://dipp.gov.in/English/policies/FDI_Circular_2016.pdf

[39]Make in India online: New Initiatives information at http://www.makeinindia.com/policy/newinitiatives/.

[40]Press Trust of India, "India to replace BIPA with a new pact to protect investments," *Business Standard*, November 2014, http://www.business-standard.com/article/pti-stories/india-to-replace-bipa-with-a-new-pact-to-protect-investments-114111900873_1.html, (accessed September 30, 2016).

[41]Government of India, Ministry of Finance, *Model Text for the Indian Bilateral Investment Treaty*, New Delhi, December 2015.

[42]Deepshikha Sikarwar,"India seeks fresh treaties with 47 nations", *Economic Times*, May 2016, http://economictimes.indiatimes.com/news/economy/foreign-trade/india-seeks-fresh-treaties-with-47-nations/articleshow/52458524.cms (accessed October 1, 2016).

Visible here is an apparent dichotomy between India's open domestic ambitions and its guarded reluctance to make commitments at the international stage. There could be several reasons that guide India's restraint in taking multilateral and regional commitments on investment.

As is the case in several developing countries, the foreign investment protection regime in India also is still at a nascent stage. India's domestic FDI policy is subject to the necessities and imperatives of its ongoing development agenda and these are early days to "lock-in" its domestic policies at the multilateral level as there could be subsequent policy reversals. Recently, after opening up FDI in multi-brand retail trading, India rolled it back owing to domestic dissonance over the implications of this policy on domestic small scale vendors and traders. It is now left to the discretion of the State Governments/Union Territories who are free to take their own decisions in regard to implementation of this policy. There will be no scope for such policy reversals once commitments are made at the WTO level. In comparison, FTA/BIT framework provides some flexibilities to review the agreement. Such flexibilities could be used to seek amendments in the investment provisions. It is possible that some compensation may have to be given to the FTA partners for modifying some of the problematic provisions that may be experienced over the years after implementation of provisions on investment. However, once rules on new issues are negotiated at the WTO, the possibility of seeking amendments in the treaty text may be almost impossible. In the most extreme case, if implementing some of the provisions on investment in an FTA/ BIT proves to be extremely difficult, India could even consider abrogating the FTAs/ BITs. However, once investment becomes part of the WTO rules, the possibility of a country quitting the WTO on account of difficulties that may be experienced in implementing investment-related obligations may be extremely low, if not totally non-existent.[43]

It is interesting to note that India is no outlier in regard to reviewing treaty obligations contained in IIAs. The UNCTAD 2014 World Investment Report has documented the case of at least 40 countries, including developed countries that are revisiting their IIAs to modify their terms and conditions in light of the experience they gained regarding the implications of these IIAs on their domestic regulatory space. In 2008, Ecuador and Venezuela started to terminate BITs with other countries and in 2012 Bolivia terminated its BIT with the US. South Africa took a policy decision to terminate its BITs and afford protection to foreign investors through domestic legislation (*Promotion and Protection of Investment Act 2015*[44]). It unilaterally withdrew from the BITs with Germany and Australia. Italy gave official notice of its intention to withdraw from the Energy Charter Treaty. In early 2014, Indonesia announced plans to terminate more than 60 BITs and to draft a new model agreement. It has already terminated its BITs with Egypt and Netherlands. The Russia-Uzbekistan and Switzerland-Tunisia BITs were also terminated in 2014 and replaced by new agreements.

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[43] The author acknowledges the research inputs of Jayant Raghu Ram for this paragraph.

[44] Act No. 39514, Government Gazette,Vol. 606, Republic of South Africa

In the case of India, the model BIPA, that replaces India's existing investment treaty framework, mandates the exhaustion of local remedies before commencing international arbitration. This amendment to its treaty framework comes after India was taken to international arbitration 17 times by foreign investors challenging its domestic regulatory measures. In the model BIPA, India has also provided that the obligations shall not apply to any law or measure regarding taxation, including measures taken to enforce taxation obligations.[45]

A multilateral agreement on investment is likely to prohibit some of the performance requirements (PRs) that are maintained by India, but currently not prohibited by the TRIMS Agreement. A maximum limit on foreign equity is a performance requirement maintained by India in several sectors. Similarly, conditions that require local management of the investment are present in sectors such as banking and insurance. These performance requirements are already prohibited under certain IIAs such as NAFTA and EU-Canada CETA (*Table 2, above*). A multilateral investment agreement under the WTO could possibly assimilate some of these PRs prohibited under extant IIAs which would then have severe implications on India's FDI regulatory space.

It is important to bear in mind that positive benefits from FDI do not accrue automatically, because the commercial interests of companies do not always coincide with states' development goals. Specific policies, such as performance requirements, are needed to create an environment that promotes the positive impacts of FDI. Yilmaz Akyuz has argued that whether FDI crowds in or crowds out domestic investors depends on the externalities and spillovers generated by foreign firms. "They can stimulate domestic investment if they help improve overall economic performance through linkages with the domestic industry and technological and managerial spillovers. However, such benefits are not automatic. In the absence of deliberate and effective policies to generate positive spillovers, financial and technological strengths of these firms can simply crowd out domestic investors."[46] India's submission to the WTO's Working Group on the Relation between Trade and Investment, citing from the experience of "South Asian tigers", observed that "left to market forces, transfer and diffusion of technology may not materialise, especially in the case of developing countries". India argued that developing countries should "preserve their right and ability to influence FDI inflows into their territories with a view to ensuring that it is accompanied by appropriate technology and that there is a sincere effort on the part of the investors to effect technology transfer so that productivity levels are

[45] Article 2.6 of the Model Text for the Indian Bilateral Investment Treaty provides that "this treaty shall not apply to any taxation Measure. Where a Host State asserts as a defence that conduct alleged to be a breach of its obligations under this Treaty is a subject matter of taxation which is excluded by this Article from the scope under this Treaty, any decision of the Host State, whether before or after the commencement of arbitral proceedings, shall be non-justiciable and it shall not be open to any arbitration tribunal to review any such decision."

[46] Yilmaz Akyuz, "Foreign Direct Investment, Investment Agreements and Economic Development: Myths and Realities," South Centre Research Paper, no.63 (2015).

enhanced and export capabilities augmented, which alone could assist in the increased participation of developing countries in the global market place"[47]

Lastly, the strategy for economic growth and development in India has been tethered to an ambitious manufacturing policy spearheaded by the "Make in India" campaign. For such a strategy to come to fruition, it is not only important that the industrial policy is dynamic but the foreign investment protection regime has to be aligned with such an industrial policy and has to be subserve the development trajectory that the industrial policy envisions. To elaborate, the FDI policy could contain transfer of technology requirements, mandate local sourcing or fix a cap on royalty repatriation. These requirements may not essentially be WTO-consistent. In multi-brand retail trading, India's FDI policy provides that at least 30% of the value of procurement of manufactured/processed products purchased shall be sourced from Indian micro, small and medium industries (local sourcing). In single-brand retail trading, the policy requires that, in respect of proposals involving foreign investment beyond 51%, sourcing of 30% of the value of goods purchased, will be done from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors. Another area which India would seek to discipline is the repatriation of royalty. The seriousness of this issue, as India sets outs to frame a FDI-led industrial growth, can be observed from the case of the Maruti- Suzuki joint venture. In the past decade, royalty payments made by Maruti Suzuki to its parent-Suzuki (Japan) as a percentage of pre-tax profit have increased from 13% to 36%.[48] It is doubtful whether a WTO Agreement on Investment would allow the flexibility to maintain local sourcing requirements or caps on royalty repatriation.

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[47] WT/WGTI/W/105, Communication from India, "FDI Flows and Technology Transfer", World Trade Organization (2001)

[48] "Maruti's royalty payment to Suzuki rises 6.6 times in 15 years," *Business Standard*, October 2015, http://www.business-standard.com/article/companies/maruti-s-royalty-payment-to-suzuki-rises-6-6-times-in-15-years-115102001221_1.html (accessed October 3, 2016)

III. Concluding Remarks

This Paper attempts to assimilate the issues and implications of a multilateral agreement on investment under the WTO framework. The extant investment protection regime consists of a fragmented treaty framework in the form of IIAs. Although a WTO Agreement on Investment would replace this scattered framework with a harmonized set of rules that are uniformly applicable to all WTO members and also promises to replace the ISDS mechanism with the State-State dispute settlement mechanism under WTO, some of the systemic issues that confront the extant regime would manifest themselves onto the multilateral treaty as well. To begin with, the jury is still out on the relationship signing a BIT (or signing more and more BITs) and attracting FDI flows. The implication of the insufficiency of econometric evidence on quantitative outcomes of a BIT is that it should at least caution a certain modesty of expectations when governments enter into BITs and further still, entering into negotiations for a WTO Agreement on Investment.

Developing countries, including India, have voiced concerns over the stifling of regulatory space by performance requirement prohibitions contained in WTO TRIMS Agreement. In such a case, there are obvious negative implications that arise from being party to a new WTO Agreement on Investment with performance requirement prohibitions even if they are at the WTO-level, much worse if they are WTO-plus. However, considering the vast degree of variation between extant IIAs, the actual magnitude of implications would depend on which IIA, if any, serves as a model for the multilateral agreement. Also, studies show that the PR measures that are most popular amongst countries are those that are outside the purview of TRIMS, and therefore their prohibition would have a relatively larger impact. On the other side, even as countries are progressively liberalizing the restrictiveness of their PRs, there is little evidence on record that restrictive PRs actually discourage FDI inflows.

Coming to the fundamental question of impact of FDI on economic development of the host State, amongst the many arguments that are touted as advantages of liberalising the FDI regime two are particularly prominent. Firstly, it is argued that the liberalisation of India's FDI regime will also lead to outward flow of FDI (OFDI) from India. OFDI, it is argued, will bring benefits to the Indian economy and this makes a strong case for a multilateral investment agreement which will offer legal protection to Indian investors abroad In the case of India, new research has shown that OFDI has not resulted in significant repatriation of profits earned from this OFDI. Also, just as there is no concrete evidence that BITs actually contribute towards FDI inflows, there exists no empirical proof that signing a BIT motivates Indian investors to invest in partner countries. Secondly, it is argued that capital seeking developing countries with persistent current account deficits should prefer FDI to debt-creating inflows because the former does not entail fixed obligations besides being more stable than portfolio investments. The effect of FDI on BoP could be much the same as debt-creating inflows when looked at from a long-term perspective. Over a longer period of time, the stock of FDI tends to turn negative as inflow of capital diminishes and repatriation of profits and remittances of income continues to increase or stay stable.

The seeming paradox between India's open domestic FDI policy and its guarded reluctance to make commitments at the multilateral level can be reconciled if it can be acknowledged that India's foreign investment protection regime is still at a nascent stage. India's domestic FDI policy is subject to the requirements of its ongoing development agenda and these are early days to "lock-in" its domestic policies at the multilateral level as there could be subsequent policy reversals. There will be no scope for such policy reversals once commitments are made at the WTO level. In comparison, FTA/BIT framework provides some flexibilities to review the agreement. Such flexibilities could be used to seek amendments in the investment provisions. In the most extreme case, if implementing some of the provisions on investment in an FTA/ BIT proves to be extremely difficult, India could even consider abrogating the FTAs/ BITs. However, once investment becomes part of the WTO rules, the possibility of a country quitting the WTO on account of difficulties that may be experienced in implementing investment-related obligations may be extremely low, if not totally non-existent. An UNCTAD study shows that at least 50 countries have actually dismantled their existing bilateral treaty frameworks and gone back to the drawing boards to formulate new bilateral rules that would leave the States with desirable regulatory cushion[49]. India itself has drafted a new model BIPA and is seeking to renew its existing BITs on the basis of obligations as modified by the model BIPA and have communicated the same to 47 of its BIT partners. This possibility for developing countries to review existing IIA obligations or even rescind treaties is absent at the multilateral level and offers an explanation to the apparent dichotomy between buoyant domestic FDI ambitions and seeming reluctance in negotiating a multilateral investment agreement at the WTO.

[49] UNCTAD, "World Investment Report 2015: Reforming International Investment Governance," no. E.15.II.D.5, 108 (2015).This was the topic of the Tenth Annual Columbia International Investment Conference, entitled 'Investment Treaty Reform: Reshaping Economic Governance in the Era of Sustainable Development' (held at Columbia University, New York, 10–11 November 2015).

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