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India can get FDI without privileging foreign investors

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What do investors want? On the establishment of a regional office of The Hague-based Permanent Court of Arbitration (PCA) in New Delhi, chief justice D.Y. Chandrachud reflected on one crucial element for enhancing investor confidence, the "rule of law." Established under an 1889 intergovernmental treaty, the PCA provides an institutional framework for both intergovernmental and commercial arbitrations. Its New Delhi office is an important step for India's aspirations to become a global arbitration hub.

Justice Chandrachud's address noted that "rule of law is the virtual semiconductor of our digital era," and investors thrive in a system where rights are protected, contracts enforced and disputes resolved efficiently.

The rule of law is fundamental to the Constitution. The judiciary has the power to invalidate laws or government actions that are arbitrary or violative. When fairness is imbued within the legal framework, a key question that arises is whether trade and investment agreements that India concludes should provide foreign investors any special rights that are otherwise not available to domestic investors or to a domestic investee entity. 'Investor-state dispute settlement' (ISDS) is a mechanism often used in agreements to do precisely that. It affords special rights to foreign private investors to initiate dispute resolution proceedings against sovereign governments before *ad hoc* tribunals.

The origins of ISDS can be traced to a 1959 agreement between Germany and Pakistan. It proliferated to over 3,000 investment treaties worldwide, including several of India's bilateral investment treaties. India's tryst with ISDS was exemplified by recent awards in favour of foreign investors. Among these was the *White Industries* case involving an Australian supplier of machinery to Coal India and the Antrix satellite dispute that involved a French investor. In each instance, alternative remedies were available to the aggrieved investors, including through access to courts within India and through commercial arbitration proceedings.

Though the ISDS is an exclusive remedy available to foreign investors, it is problematic because of its very character. Arbitration is best suited to disputes arising from commercial matters—such as over the rights and obligations of parties where contractual terms have commercial consequences. ISDS arbitrations, however, are not always disputes of that kind, and instead, often involve matters of public policy and interpretation of national laws. Over the last few decades, ISDS has had a chequered history of fragmented and often contradictory jurisprudence that has emerged from hundreds of *ad hoc* tribunals, leading one scholar to call it the "wild wild west of international law."

Keep outdated mechanisms for investor-state dispute settlement out of investment agreements

Not surprisingly, even one of the biggest early proponents of ISDS, the US, has questioned its wisdom. President Joe Biden's sees no rationale for an ISDS mechanism that provides only some corporations exclusive access to special tribunals. The US-Mexico-Canada Agreement (USMCA), which replaced the NAFTA in 2020, phased out the availability of ISDS for US and Canadian investors. Since then, the US has not included ISDS in any of its agreements.

Proponents of ISDS have argued that it attracts investment, but this has no factual basis. Brazil exemplifies this. It has remained an attractive investment destination without using ISDS in its deals. Its model is that of investment facilitation with a focus on conflict prevention. The Brazil-India Investment Cooperation and Facilitation Treaty is an example.

Attracting investment is critical for growth. Trade and investment agreements signal to businesses that they are welcome and that their investments will be protected. Streamlined processes for foreign investment, elimination of bottlenecks, transparency of rules and procedures, and access to local infrastructure also help.

Yet, disputes are possible and effective resolution is crucial. The India-Brazil treaty provides for national-level ombudsmen dedicated to supporting each other's investors through a collaborative approach to prevent disputes. Matters that get escalated can be referred to a joint committee with representatives of both countries. If dispute prevention fails, then either country can seek arbitration.

Another model is the Investment Promotion and Cooperation chapter under the Trade and Economic Partnership Agreement that India signed with Switzerland, Iceland, Norway and Liechtenstein. Its thrust is on investment promotion and cooperation. These seemingly soft obligations are given teeth through the institutional mechanism of a sub-committee tasked with engaging the private sector to identify obstacles and opportunities. It also puts in place a consultative mechanism for governments to resolve disputes.

India also recently signed the Agreement on Clean Economy under the US-led Indo-Pacific Economic Framework (IPEF). While its text is yet to be released, fact sheets explaining the IPEF note that its objective is to facilitate investments, project finance, joint projects, workforce development and capacity building for industries.

Each of these offers valuable lessons for the design of investor protection mechanisms as India negotiates trade and investment deals with the EU, UK and others. Innovative ways to attract and retain foreign investments are important. But ISDS is not necessary to achieve this objective.

These are the author's personal views.