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IMPACT OF PANDEMIC OUTBREAK ON FOREIGN DIRECT INVESTMENT: A LEGAL ANALYSIS

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ABSTRACT
It has been expected that the Foreign Direct Investment flows will fall more than 30 per cent in the current year that is 2020 considering even the most optimistic scenario, steps taken by the government to address public issues and measures to support economic policy to handle the COVID-19 and the resulting recession. In the developing countries foreign direct investment is expected to fall even more as the primary, manufacturing, and other severely impacted sectors account for a larger share of foreign direct investment compared to the foreign countries. A significant role can be played by Foreign Direct Investment at the time of crisis and even after in supporting economies through supporting their affiliates financially and helping the government in dealing with the pandemic. A steady decline has been witnessed in the past five years in the foreign direct investment flows and if the economic support policies and the public health insurance policies do not prove to be efficient then the foreign direct investment flow would remain below the pre-crisis level in the coming year that is 2021. The author in this article has covered the impact pandemic on the economy of India and China, measures taken by the Indian government for the foreign direct investment flows in India, how the multinational enterprises and the foreign investors have been impacted by COVID-19 and lastly what has been the response of OECD Investment policy to deal with the pandemic.

Keywords: FDI, foreign direct investment, inflow, COVID-19, India, China, government policy, OECD, economy.
CHAPTER I

1. **INTRODUCTION**
   
   The COVID-19 crisis has caused a dramatic fall in Foreign Direct Investment (FDI). The pandemic has undone years of economic globalization as FDIs have never been disrupted like this ever before. FDI might decrease further by 5-10 percent in the year 2021 and by 2022 it may initiate a graduate recovery. This will depend upon the duration of the global crisis as well as upon the effectiveness of policy interventions to tackle the adverse effects of the pandemic on the economy. Uncertainty is also led by factors such as continuing trade tensions and financial and geopolitical risks.

   Developing countries are affected as it is expected that the FDI inflows will drop below the global average. As there is a prolong in the recovery from the pandemic and the FDI inflows keep on dropping, it is expected that the developing countries will lose their export revenues, that will have a consequent impact upon employment opportunities.

   The top 5,000 Multinational Enterprises (MNEs) that account for most of the global FDI have seen that the expected earnings have revised down by 40 percent for the year on average and this has resulted in many industries plunging into losses. The reinvested earnings will be affected due to the lower profits and these reinvested earnings account for more than 50 percent of FDI on average.

   The international production system will continue to play a key role in the growth and development of the economy despite the drastic decline in the global FDI due to the crisis.

2. **BACKGROUND OF THE STUDY**
   
   This article lays emphasis upon the crisis due to the COVID-19 pandemic on the Foreign Direct Investment and measures taken by the government to regulate FDI. Further, the downfall that
has been caused due to the crisis and suggestions given by different surveys and guidelines given by the OECD.

3. **RESEARCH PROBLEM**
This paper addresses how the pandemic impacted international investment, whether it has proved to be fruitful for India's foreign direct investment or has done the opposite. How countries should emphasize more healthcare sectors and how they can deal with the same in future. FDI flows to developing countries expected to drop even more as sectors that have been severely impacted by the pandemic, including the primary and manufacturing sectors, account for a larger share of their FDI than in developed economies. How FDI could play a key role in supporting economies during and after the crisis through financial support to their affiliates, assisting governments in addressing the pandemic, and through linkages with local firms.

4. **OBJECTIVE OF STUDY**
i. To focus on the changes that have been brought about in the foreign direct investment regime of India and aims to analyze the potential these changes in policy holds particularly in the wake of the global pandemic.
ii. To see the vital role played by FDI to support the economies during and after the pandemic crisis with the help of assisting governments and financial support.
iii. To study the impact of the pandemic crisis on multinational enterprises and foreign investors.
iv. To study the response to the OECD investment policy and the suggestions given by them.

**CHAPTER II**

**FOREIGN DIRECT INVESTMENT**

2.1 **WHAT IS FOREIGN DIRECT INVESTMENT (FDI)?**
An investment made by an individual or a firm in one country in business interests that are in another country. Because of FDI, the foreign companies are involved directly in day-to-day operations with another country. Therefore, they bring
technology, skills, and knowledge along with money. Usually, FDI takes place when the foreign business operations are established by an investor or the investor acquires assets of foreign business in a foreign company, this also includes controlling interest or establishing ownership in a foreign company. The portfolio investments are different from the FDIs as in the former merely equities of the foreign-based companies are purchased by the investor. Usually, the investors utilise the FDIs in open markets that have growth prospects and skilled workforce rather than closed markets.¹.

2.2 FOREIGN DIRECT INVESTMENT IN INDIA
FDI plays a key role in the economic development of India by acting as an important monetary source. In 1991, the economic liberalisation had started in India and since then growth has been seen in FDI in India. At present, India is a part of the top 100 in the club of Ease of Doing Business (EoDB).

2.2.1. THE ROUTES THROUGH WHICH FDI ENTERS INDIA
There are two routes through which FDI gets into India and they are- automatic routes and government routes.

Automatic Route: In this route approval from the government of India is not required by the Indian company or the non-resident investor for the investment.

Government Route or Approval Route: In this route the approval of the government is required prior to investment. The respective Administrative Ministry or Department considers the FDI proposals under the government route².

CHAPTER -III
IMPACT OF COVID-19 ON THE ECONOMY OF CHINA AND INDIA

3.1 EFFECT OF PANDEMIC ON CHINA’S ECONOMY
China has become one of the most hyped locations for investment in the world and an emerging market economy because of its free-market principles and promising opportunity to many companies and investors. But, due to the COVID-19 pandemic, China's economy went down. Starting two months of the year 2020 ruined the economy of China due to pandemic,
further, many foreign companies and foreign investors stepped out of China and are looking forward to investing in other Asian countries, this can prove to be a good opportunity for India.

In the manufacturing sector, China is the world leader and half of the world’s crude steel is produced by China. (In 2019- China had produced 996.3 Mt while worldwide it was 1,869.9 Mt). The pandemic outbreak has resulted in the downfall of Foreign direct investment (FDI) from 10.8 percent Year-over-Year (YOO) to $31.2 Billion (216.19 Billion Yuan), compared to first quarter of previous year 2019, FDI in China had grown by 5.8 percent from a YOY to $136.71 Billion (941.5 Billion Yuan).

Chinese companies in 62 countries had signed 6,944 newly foreign contracted projects in 2019 which included “Belt and Road Routes” which was at a value of $154.89 Billion. Further, in around 56 countries China had invested $15.04 Billion in Non-Financial Direct Investment (Non-FDI along with the “Belt and Road Routes”, a YOY fall of 3.8%, which is accountable for 13.6% in 2019. China’s global FDI outflows had increased in the recent years due to the government initiatives and policies that had encouraged the firms to “Go-Global.” But the pandemic has caused a recession in their fast-growing economy.

At present China has 24 Free Trade Agreements (FTAs) under construction, out of which 16 agreements have already been signed and implemented. 3.

3.1.1 REVIVAL OF CHINA’S ECONOMY

Chinese government among very few countries has been successful in controlling the pandemic and this is the reason that even after the downfall caused due to pandemic overall investment into the country remains at a prominent level and the country resumed its production system earlier as compared to other nations.

The Chinese government in the meantime has put effective measures in place to service operations of the multinationals that are operating in the country and to retain investment along with adopting new measures to attract investment.
The high-tech industries have attracted most of the FDI that came into China. The value of Mergers and Acquisitions transactions into China have grown up by 84 percent, mostly in the e-commerce industries and information services. Further, many multinational companies also expanded their investments into China. 

3.2 IMPACT OF COVID-19 ON INDIAN ECONOMY

The Indian economy is seeing a downfall in 2020 due to Covid-19 and the extended lockdown to combat the same. The backbone of the Indian economic structure comprises Micro, Small, and Medium Enterprises (MSMEs) sector. 97 percent of the industries in India fell under the category of MSMEs. MSMEs are also the strongest factor that led to innovation, employment, and economic development; besides these they also contribute to 31% of India’s Gross Domestic Product (GDP).

Because of the lockdown due to the COVID-19, MSMEs had been adversely affected and the contribution of 31% of Indian GDP already went down. Around 60 percent of firms are out of funds for the salary of their employees and more than 25 percent of firms are on the way to getting shut down permanently and most of these are the start-ups that have been affected the worst.

There is a need that India should focus upon trade agreements to boost bilateral trade. Trade agreements play a vital role in integrating into the global economy and strengthening economic cooperation with the other economies.

CHAPTER IV

MEASURES TAKEN BY THE INDIAN GOVERNMENT

On 17th April 2020, a press note was issued by the Department of Promotion of Industry and Internal Trade, “Press Note 2020”. The objective was to restrain the opportunistic takeovers and acquisitions of Indian companies amidst the global crisis that is going on due to the Covid 19 pandemic. A partial embargo has been proposed in Press Note 2020 on Foreign Direct Investments with the countries that share land borders with India.
4.1 A BRIEF ANALYSIS AND AMENDMENTS PROPOSED BY THE PRESS NOTE 2020
Paragraph 3.1.1(a) of the FDI Policy has been amended under this Press Note, Foreign Direct Investments in the Indian companies by an entity that is incorporated in a neighbouring nation (country sharing land border with India) or an entity whose citizen or beneficial owner is situated in the neighbouring nation will be requiring the approval of the government. Further the same paragraph states that any transfer of ownership of an already existing or a future FDI in an Indian company that results directly or indirectly in the beneficial ownership to come within the purview of the Paragraph 3.1.1(a), will also require the approval from the government.

4.2 CONCEPT OF BENEFICIAL OWNERSHIP
India shares borders with seven countries which comprise China, Pakistan, Nepal, Bhutan, Myanmar, and Afghanistan (“Neighbouring Nations”). Citizens of these neighbouring countries of FDI by the entities that have been incorporated in will require prior approval from the government.
Not only the approval of the government for the FDI from citizens and entities of the neighbouring nations into an Indian company has been made mandatory under the Press Note 2020 but it has also been proposed to extend a restriction similar in nature for an indirect foreign investment in the Indian companies by introducing the concept of beneficial ownership given in para 3.1.1(a) from the nations other than the neighbouring nations. The concept of beneficial ownership forms a part of the multi layered structure and will become applicable to FDI by an entity and has not been incorporated into any of the neighbouring nations.
Illustration- A company which is incorporated in a country whose FDI is permitted under the automatic route but if an entity incorporated in China or a Chinese national is the company's ultimate beneficial owner, the Company may require a prior approval from the government if the test of beneficial owner is satisfied.
4.3 TRANSFER OF OWNERSHIP OF EXISTING OR FUTURE FDI
The Press Note 2020 under paragraph 3.1.1(b) proposes to impose a restriction on the primary investments to be made by the citizens and entities of the neighbouring nations in India as well as the secondary direct or indirect investments in the Indian companies by acquiring shareholding from an already existing company. Hence government approval is required not only from the entity or citizen of a neighbouring nation but also if there is transfer of securities or shares of an Indian company to a citizen or an entity of a neighbouring nation. Though the Press Note 2020 puts a restriction on the FDI from neighbouring nations but the main aim was to bring the FDI flow from China to the Indian companies within the route of the Government approval.7

4.4 HISTORICAL BACKGROUND
In India, a security clearance is required from Ministry of Home Affairs for Foreign Direct Investment from Bangladesh and Pakistan as well in certain specifies sectors which comprises of telecommunication, satellites, broadcasting, operations, and establishment, defence, civil aviation, private security agencies and mining and mineral separation of titanium bearing ores and minerals, value addition and integrated activities. The investors from Pakistan cannot make an investment even through the approval route in the sectors comprising defence, atomic energy, space and other sectors or activities that have been prohibited for FDI. Certain details of the investor and the investee are required in the security clearance form which is prescribed by the government in the sectors mentioned above. The form specifically requires information regarding the investor or if its affiliates have operations or presence in China, Pakistan, or Bangladesh.
In India, therefore, in the context of foreign investment, terms such as “national security” and “sensitive” have been historically relevant for FDI from Bangladesh and Pakistan and for sectors including media, defense and telecommunications8.
CHAPTER V

IMPACT OF COVID-19 ON FOREIGN INVESTORS AND MULTINATIONAL ENTERPRISES

The COVID-19 pandemic has caused a successive and cascading effect upon the Multinational enterprises (MSNEs). A severe disruption has been caused to the Global Value Chains (GVCs), global recession has been triggered by demand and supply shocks. New rules are being considered by governments across the world affecting foreign investors. A sharp decline has been witnessed in the global flows of the FDI with an uncertain outlook.

FDI plays a key role in many developing countries as a source of finance having the potential to bolster the economic resilience of these countries at the time of crisis and help in economic transformation and support the employment growth through the phases of recovery. The World Bank Group conducts quarterly pulse surveys of the foreign investors to gauge the pandemic effect on their operations and investment plans.9.

5.1 SECOND ROUND OF THE PULSE SURVEY

In September 2020, the Second Round of the Pulse Survey10 released its result which showed that over the second quarter of 2020, the pandemic’s adverse effect had become universal for the MNE affiliates. A decline has been seen in the net income of more than 80 percent of MNEs from what they had expected without COVID-19, by an average of 37 percent, while over half reduced employment and two-thirds decreased investment in the developing countries affiliate the operations.

The responses have been drawn from around 80 MNE affiliates (companies having foreign owners) that are operating in economies with low-income and middle-income including the developing countries. In April, the results of the first round of the survey were released in which the experiences of MNEs in the first quarter of 2020, as the pandemic first took hold, was released. In the third quarter (July to September) MNEs expected that the shocks induced due to pandemic might ease as the economies have opened gradually and the companies have
adjusted to the new market conditions. An improved outlook for the supply chain reliability has been reported by the MNEs signaling resilience and adaptation of the business entities.

5.2 ADAPTATION OF NEW BUSINESS STRATEGIES
The MNEs business models and approaches have been challenged by the disruption of international trade and GVCs caused due to the pandemic with the effects in the longer run like rise in economic nationalism, change in the patterns of industrialization and importance of environment sustainability. To understand as to what measures the firms are taking to handle these pressures, the second round of the survey made an inquiry about the business strategies of the firms. The results show that around 58 percent MNEs have adopted digital technologies to increase the supply chain resilience and it can help the firms to improve logistics, improve visibility of potential vulnerabilities and optimize capacity.

5.3 FAST CHANGING RULES AND SUPPORT OF GOVERNMENT
Among the developed nations, the European Union in March 2020 had introduced new guidance on FDI that emphasized upon protecting strategic health related industries. Countries like Germany, France, Australia, Canada, and the UK have tightened their FDI screening regimes. Changes have also been made in China, South Africa, and India as well. The survey data showed that over a quarter of MNEs indicated that the rules for market entry for foreign investors and the rules for business operations have become less business friendly due to COVID-19 in their country of operation.

5.4 RESULT OF THE SECOND ROUND OF THE GLOBAL PULSE SURVEY
The second survey presents a mixed result overall. On the one hand significant negative effects have already been experienced by the firms and in response they are considering changes to their operations while on the other hand, MNEs expect that the future effects of the pandemic will be less adverse. Thus, this indicates that now, more than ever, the environment for foreign investment should not be made any more
restrictive by the policymakers of the developed countries. Predictable and supportive policy conditions for the FDI can help in expanding, attracting, and retaining investment that in turn will provide much needed capital to support the recovery of the economy.

CHAPTER VI
RESPONSE OF OECD INVESTMENT POLICY TO COVID-19

6.1 IMPACT OF COVID-19 ON CAPITAL FLOWS
It is expected that the Foreign Direct Investment flows will fall more than 30% in the year 2020, even when under the most optimistic situation for the achievement of the public wellbeing and measures for economic support policy taken by the government to address the Coronavirus pandemic and the subsequent recession. In the short term, a substantial drop will be seen in reinvested earnings which play an increasingly significant role in FDI flows since the earnings will be depressed due to crisis caused due the pandemic and it is expected that the investors reinvest a smaller portion of their earnings than they have been doing in the recent past years. It is also expected that a decline will be seen in the equity capital flows since many new investments, including Greenfield investment as well as mergers and acquisitions have been put on hold.

A greater impact has been created by pandemic and the measures taken in response to crisis on few sectors compared to others. An increase might be seen in the earnings in the information and the communication sector and as far as primary and manufacturing sectors are concerned, they will witness a large drop in the earnings. Some of the worst hit sectors, which include food service, accommodation, transportation and storage, their sufferings will not be reflected in the overall FDI statistics as they usually account for small shares of FDI. In many economies of the developing and emerging countries, including South Africa, Indonesia, Brazil, and the Russian Federation, the primary sector plays a much vital role in FDI.
If sufficient results are not provided by economic policy measures and public health, then in the medium term a decline might be seen in the FDI inflows. Other than factors such as fewer new investments and lower earnings, divestments could be an additional factor if the firms that are struggling financially are forced to liquidate or sell some of their foreign operations.

6.2 PREPARING FOR AN INCLUSIVE, GREEN, FAIR, AND RESILIENT RECOVERY

Currently the focus of the government is on the urgent need of their economies and societies, but they will soon be turning their attention to ensuring a swift and sustainable recovery. Though it is uncertain what would be the starting point of recovery, the principles stipulated by the OECD investment instruments which include the principles of transparency, fairness, openness, and sustainability play a vital role at the time of crisis and will continue being important even when the crisis ends.

The OECD has recognised already before the crisis even though the open markets are important, to achieve sustainable development goals, the qualities of investment are very crucial and that should remain and strengthen at the time of recovery. The key considerations are- how can all the economies be benefited to the fullest extent with the international investment policies, how can investment contribute to greater resilience, what are the policies and contributions that are needed to address the problems of, poverty, climate crisis and inequality.

A significant contribution will be made by the FDI Qualities Initiatives of the OECD to this reassessment, that will present a new policy toolkit that will help in maximising the sustainable development impacts of Foreign Direct Investment and this will also include the health sector. The OECD with the help of these initiatives and others will provide a forum from where the policy makers can draw lessons from the crisis cause due to the pandemic which in turn will help in refining domestic policies and will also help in potentially complementing the existing instruments of the investment
policies as a part of the process to encourage the market-based economies which help in creating a more inclusive, resilient and climate friendly society.\textsuperscript{12}

\textbf{CHAPTER VII}

\textbf{CONCLUSION}

Now that the pandemic has weakened and will weaken further, the infrastructure and technology companies and other unregulated sectors, the government may consider reviewing the FDI Regulations to check that the appropriate checks are in place in relation to the acquisition of such companies which also includes acquisition by governments or sovereign funds. The resilience of supply chains and economies is strengthened by Foreign Direct Investment. It is allowed by the extension and the linkages between the companies to absorb stress and shocks that might occur in future resulting from crisis,
climate change or another pandemic. In addition to this, other benefits associated with FDI are management crisis, dissemination of responsible business conduct and strengthening of R&D capacity.

As far as developing countries are concerned it has been expected that the Foreign Direct Investment flows will drop more since areas that have been seriously affected by the COVID-19 pandemic, including the manufacturing and the primary sectors represent a larger portion of their FDI than in the economies of the developed countries.

To support the economy during and after the crisis caused due to the pandemic, FDI can play a significant role by supporting their affiliates financially, helping governments in addressing the pandemic, and through linkages with local firms.

Over the past five years FDI flows have consistently declined and if the economic support policies and public health measures prove to be inefficient, it is expected that the FDI flows would remain below pre-crisis levels all throughout the coming year that is 2021.

As the COVID-19 continues to spread, the scope of the FDI screening mechanism is being expanded by the regulators around the globe to include technology, healthcare, and critical infrastructure to protect the economic and national interest.

The government of India will need to review the security concerns and the permissibility relating to the foreign direct investment in healthcare due to India’s heavy reliance in the sector of private healthcare amidst the unprecedented situation created by the coronavirus.
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