AN ANALYSIS OF THE CAPITALIZATION POTENCY OF 'VALUE-INVESTMENT OPPORTUNITY', ARISING FROM GLOBAL RECESSIONARY PRESSURE THROUGH THE REGULATION OF OUTWARD FOREIGN INVESTMENT POLICY BY INDIA WITH COMPARATIVE REFERENCE DRAWN TO CHINA

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ABSTRACT

The People's Republic of China utilizes the regulation of both it's inward and outward foreign investment policy as it's means of geo-political expansion. Outward Chinese Foreign Direct Investment, quite often implies the investment of capital by Chinese instruments of state (either directly or through the exercise of vicarious control), into private and public foreign enterprises, definitive of critical infrastructure for the recipient state (i.e., the 'Compana General De Electricidad' of Chile, being the Chilean electricity grid, acquired by China State Grid). The Chinese state finances such geo-political expansion, also through the practice of inward FDI policy regulation (incentivizing domestic manufacturing by foreign and local enterprises, contingent upon export assurance), with the advancement of neo-mercantilism and state control- generating a balance of payments surplus (available to the discretionary use of the state).China has been, and will therefore be, well positioned to capitalize upon the widespread 'value-investment opportunity' arising from the market value depreciation of enterprises, devoid of intrinsic value fluctuation, in the light of global recessionary pressure (as exemplified by Chinese investment during COVID-19).

India on the contrary has experienced the augmentation of disparity between outward and inward foreign direct investment, with the former, exceeding the latter by 6.3 times as of 2022,

according to the reserve bank of India. As there is a clear demarcation between private and instrument of state derived outward foreign investment, in the context of India, due to democratic impetus (translating to codification), restraining significant vicarious state control of the private sector; India's prospective capitalization of the recession-induced 'value investment opportunity', may not imply concurrent geo-political expansion.

India's capitalization potential, is therefore at a relatively nascent stage, in comparison to China, however the objective of this essay is to highlight how the strategic regulation of India's outward FDI policy, entailing outward FDI augmentation and imposition of the contingent requisite of national interest alignment/adherence, in conjunction with India's inward FDI policy, fostering a model emblematic of neo-mercantilism with export incentivization/assurance-imposition, may catalyse India's attainment of geo-political prominence.

Keywords: Foreign Investment Regulation, Indian Foreign Direct Investment Law, Indian Overseas Direct Investment Law, Chinese Foreign Investment Regulation Policy, Value Investment, Regulatory Arbitrage, Global Policy, Geo-Politics.

The advent of global recessionary pressure has been definitive of the latter half of the year 2022 (World Bank Group 2022)[i], followed by 2023- with significant inflation (i.e., in excess of 100% in specific developing countries such as Argentina) , and market-value volatility of several asset classes, often resulting in grave detriment, as exemplified by the impending banking crisis (i.e., the liquidation of SVB and the persistent default-insecurity of Credit Suisse, post the extension of leverage valued in excess of collected collateral assets, impairing liquidity), and the depreciation of financial securities, observed from a macroscopic lens (Plummer 2023)[ii]. While the pecuniary detriment incurred by investors of developing countries, resulting from the market-value volatility of assets due to recessionary pressure, may result in the short-run further aggravation of structural inequity (of capital accumulation) in the contemporary world order, between states qualifying as 'developed' and 'developing', there is however, opportunity for the establishment of 'regional spheres of influence' devoid of 'hegemonic-block predominance'; with the onset of pervasive 'Value-Investment opportunity' advancing geo-political interests.

'Value-Investment' may be defined as the capitalization of disparity between the intrinsic value of an asset, and its perceived market value. While the ideal circumstance of a market eco-system would entail the intrinsic value of an asset, within its perceived market value to some degree of reason, recessionary pressure, may induce an anomalous phenomenon. With the depreciation of asset-value, solely due to the loss of demand for the asset (potentially triggered by either an aggregate loss of disposable income, or investor confidence, due to exogenous recessionary impetus), the intrinsic value of the asset, pertinent to the future earning potential of desired investor returns (potentially inclusive of geo-political influence and control beyond profitability, with investment pursued either directly/vicariously or in alignment with the agenda of states), remains unaffected (Rotblut 2023)[iii].

Hence, the relative increase in the supply of asset classes, subject to the consistency of intrinsic value, in comparison to a decrease in demand, reflected by market-value-depreciation, fosters significant 'Value Investment' opportunity, and scope for the accumulation of capital and geo-political influence by developing countries.

India and China, being recognized as the drivers of emergent growth in the global economic eco-system are specifically well-positioned to establish regional spheres of influence, through the capitalization of such opportunity. The objective of this essay is to substantiate my claim, that the degree of success, in optimizing the capitalization of such 'Value Investing' opportunity, by states (either directly/vicariously) is contingent upon the strategic regulation of Outward Investment Policy and Law [Overseas Direct Investment (ODI)[iv] - in the context of India], and the simultaneous optimization of 'Inward Foreign Direct Investment (FDI)[v]', to generate adequate capital to organically sustain the pursuit/allowance of ODI.

The jurisdiction of India is subject to specific local peculiarities, pertinent to the regulation of Outward Investment. While, there is a consolidated Foreign Direct Investment Policy, aligning the interest of the state with recipients and promoters of Foreign Direct Investment in Indian Assets (Debt and Non-Debt Instruments) effected in 2020, by the Department for Promotion of Industry and Internal Trade, there is no outline for the ODI objectives of the state, mandating adherence, in the policy. The objective of the consolidated FDI policy may be inferred as the optimal facilitation of the infusion of foreign capital into Indian enterprises, fostering domestic economic development. The primary legislation pertinent to foreign investment regulation, being the Foreign Exchange Management Act (FEMA), 1999, however, governs the pursuit of ODI, through the prescription of requisite Regulations, conceived by the RBI (with jurisdiction over debt-instruments) and Rules, conceived by the Ministry of Finance (bearing jurisdiction over non-debt instruments, i.e., such as equities).

The regulation of ODI, in the jurisdiction of India, is also subject to continuous evolution. The most significant change, being notified by the Ministry of Finance on August 22, 2022; catalysing the pivot towards specialized ODI regulations. Asset classes, previously differentiated as movable and immovable property, with the former being inclusive of financial securities, were regulated by the FEM (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015 and the FEM (Transfer or Issue of any Foreign Security) Regulations, 2004. However, post the notification by the Ministry of Finance, asset classes subject to ODI, were generally distinguished as equity, Overseas Investment pursued by residents and debt. Based on the FEMA's prescriptive division of jurisdiction between the Ministry of Finance and the RBI, 2 new sets of FEM Overseas Investment Rules[vi] and Regulations[vii], were mandated. The aforementioned division of jurisdiction, is however, not absolute in nature, with FEM (OI) Rule 3[viii]; authorizing the Reserve Bank (in its capacity as a statutory instrument of state), to enforce, and deter-deviation, from rules, conceived by the ministry, thereby amounting to an impugned provision of 'delegating legislature'.

The RBI's master-circular to Authorized Dealer's regarding outward investment in Joint Ventures/Wholly Owned Subsidiaries (overseas), imposes adherence-requisites upon the banks involved in facilitating ODI, to the Rules of the Ministry and the further FEM (OI) Regulations of the RBI. The primary change brought-forth by the new FEM (OI) Rules, 2022, may be perceived as ground-breaking in nature, with the deviation from the preceding generalization of all outward foreign investment as ODI; and the recognition of Overseas Portfolio Investment, beyond the ambit of a subset. The rules define ODI, on the basis of its 4 components[ix]→

a. Investment in the equity of an unlisted foreign entity
b. Assuming the position of subscriber to the Memorandum of Association of a foreign entity
c. Acquisition of more or equal to 10% of the fully-paid equity of a listed foreign entity
d. Investment resulting in control (despite the acquisition of a stake- less than 10% of the fully paid equity of a listed foreign entity).

Control in the context of ODI, is specific to discretionary authority over managerial decision-making, or the appointment of Key-Managerial-Personnel, according to rule 2 (c) of the FEM (OI) Rules, 2022.

Overseas Portfolio Investment on the contrary excludes the components of ODI, and entails investment in foreign securities (potentially through capital markets), devoid of unlisted debt instruments and non-IFSC affiliated issued securities.[x] The 'persons' legally authorized by the FEM (OI) rules and regulations, to engage in the pursuit of ODI and/or OPI, entail natural as well as juristic persons.

Now, while the regulation of Outward Investment, in the context of India, may appear comprehensive and robust, there is substantive ambiguity in numerous rules and regulations, in conjunction with the adoption of a relatively regressive approach, devoid of the proactive incentivization of ODI/OPI, largely, due to the state's paranoia, of capital flight and potential kleptocracy (substantiated by the super-imposition upon the fear of round-tripping), which may however be mitigated through the integration of approval and assurance requisites obtained by the Ministry of Finance (through the RBI); aligning national geo-political expansionary interest with private benefit. Irrespective of whether the route adopted is Automatic or Government

Approval oriented, assurance-requisites from investors seeking to engage in ODI, may be obtained, as qualification thresholds, for the automatic route or the approval route.

The first significant unwarranted regression, that I was able to ascertain from the FEM (OI) Rules 2022, entailed the express prohibition of ODI in Foreign Entities engaged in real estate activity.[xi] Real Estate, is a significant asset class, subject to preserved intrinsic value and exaggerated market-value depreciation, during periods of recession, potentially facilitating strategic geo-political expansion (i.e., directly resulting in the vicarious extension of territory). Real Estate positioned in geographically strategic frontiers may be optimally acquired during periods of recession, specifically when held through the modus of Real Estate Investment Trusts, Holding Instruments or even Land Banks.

I believe, the optimal regulation of outward investment, post the advent of recessionary pressure, may entail the incentivization of investment in strategic real estate, however subject to the pre-qualifications of statutory adherence, and alignment with state interest (devoid of scope for criminal activity), irrespective of whether the adopted route may be automatic or approval-oriented. The authorization of automatic investment, may be in the interest of Indian Geo-Political Expansion, however subject to stringent pre-qualification requisites deterring unlawful practices.

The subsequent issue that I've ascertained pertains to the express prohibition of layering ODI through intermediaries- excessive of 2 layers of subsidiaries[xii]. The justification of such a prohibition, may be the prevention of round-tripping and money laundering, however the prohibition applies to every ODI, and not just ODI pivoting to FDI, hence the absence of intelligible differentia, in such a rule may amount to class legislation (targeting investors pursuing ODI as a whole) inducing arbitrariness, under the test- established in the EP Royappa Case[xiii], with the absence of synonymity between the purported objective of the law and the actual societal implication. The eradication of a limit on the potential layers of routing ODI (devoid of round-tripping), may incentivize greater ODI, with the facilitation of strategic anonymity, crucial to the advancement of Indian geo-political interests. The allowance of layering, devoid of regressive statutory impetus may also empower Indian Investors with tax arbitrage, and greater scope to integrate the interests of the state- directly and commercially.

The OI rules, also prescribe a limit on Total Financial Commitment (TFC)[xiv] via ODI amounting to 400% of the net worth of the investing entity computed via the provisions of S2 (57) of the Companies Act 2013 (inclusive of potential Securities Premium Reserves).[xv] The 400% limit may be intended with the objective of deterring the derivation of excessive, unsustainable and unsecured leverage, for the pursuit of ODI, however, in the light of the pre-existing structural inequity of capital presence, between developing and developed countries, Indian investors originating from a developing country may be further reliant upon leverage as opposed to pre-existing financial wealth, requiring unique consideration, devoid of general regression.

High degrees of leverage may be secured however, through the imposition of the approval route, for such ODI, warranting the requisite-assurance of collateral security by the government to the maximum possible degree prior to the furtherance of approval. The ODI, may also be aligned with national interest, through the imposition of such conditionalities.

The rules also prescribe a distinct TFC limit for OPI's by Indian investors being 50% of the net worth of the investor[xvi], without reference to the character of the investor entity[xvii], being either listed or privately held, thereby amounting to ambiguity, devoid of consideration for the differential degrees of potential accessible capital and the requisite regulatory impetus. In the instance of prospective liquidation of the asset, subject to ODI, there is also ambiguity pertinent to the jurisdiction, mandating adjudicatory adherence, with the specification of "case-by-case" consideration, determining the application of either the Indian jurisdiction or the host country's jurisdiction, impairing the security of investors, in cases of restructuring.[xviii] An ideal outward investment policy would ensure the assumption of control over adjudicatory jurisdiction, through the express imposition of such conditionality- mandating the application of the Indian jurisdiction, fostering regulatory arbitrage.

The regressive and deterrent nature of the Indian outward foreign investment rules and regulations, is further substantiated by the prohibition of further ODI, in cases of delay in the fulfilment of reporting requisites.[xix] Instead of an outright prohibition on ODI- leading to lost opportunity, deterrence may be fostered in the form of stringent consequences of delayed reporting, amounting to considerable pecuniary detriment to the investor. The relaxation of TFC limit of 400% in cases of strategic ODI[xx], is also very narrow, and restrictive in the consideration of 'asset-classes' as strategic. A robust and comprehensive relaxation, would entail the explication of 'Critical-Infrastructure' as strategic ODI avenues, with the comprehensive specification of asset classes, eradicating ambiguity, while still enabling the state, to exercise discretionary authority, over ascertainment. In totality, I believe, the requisite degree of incentivization of ODI for the capitalization of 'Value Investment' opportunity is not persistent in the present day regulatory eco-system of India, and may be subject to further evolution in conjunction with the inward FDI policy.

The ideal inward FDI policy, would ensure, the ease of infusion of foreign financial capital in isolation, mandating the employment of domestic factors of production (inclusive of human capital), while requiring crucial knowledge and technology transfer, subject to the assurance of export, generating a balance of payments surplus, available to the vicarious discretionary use of the state (through directory primary and secondary legislation). The simultaneous optimal deployment of the generated surplus as capital infused in the capture of the pervasive 'Value Investing' opportunity, is contingent upon the success of outward foreign investment regulation. The ultimate policy objective would therefore entail a shift in the paradigm from a protectionist and paranoid outward foreign investment policy and a relaxed inward FDI policy, characteristic of developing countries devoid of surplus capital; to a strategically regressive inward FDI policy, deterring the usurpation of critical infrastructure, in the light of recessionary asset price convenience, and generating surplus capital and an incentivized yet regulated outward investment policy (to the extent of achieving private sector alignment with national interest), capitalizing the pervasive 'Value Investment' opportunity, while advancing geo-political interests.

The aforementioned policy recommendation seem emblematic of Chinese neo-mercantilism, and the incentivized outward and regulated inward- foreign investment policy detailed by the General Office of the State Council, and forwarded to the National Development and Reform Commission of the People's Republic of China[xxi], however, the crucial distinction would lie in the modus operandi of the Chinese State, directly capitalizing Value-Investment opportunity through instruments of state (as exemplified by China's proactive pursuit of the Belt and Road Initiative through private entities- subject to a mandated degree of state control) and India's prospective advancement of vicarious state influence through the alignment of private sector benefit with Indian geo-political expansion.

In conclusion, in an environment of pre-dominant democracy and the protection of private interest, it is my perception, that the prospective model, applicable for India, would outlast the Chinese model of direct state expansion, contingent upon authoritarian machinery and the absence of the doctrine of contractual good conscience.

ENDNOTES

[i] World Bank Group (2022) *Risk of global recession in 2023 rises amid simultaneous rate hikes, World Bank, World Bank*. Available at: https://www.worldbank.org/en/news/press-release/2022/09/15/risk-of-global-recession-in-2023-rises-amid-simultaneous-rate-hikes (Accessed: 27 July 2023).

[ii] Plummer, S. (2023) *Why is the stock market down, and why is it crashing? (2023), The Annuity Expert*. Available at: https://www.annuityexpertadvice.com/why-is-the-stock-market-down-crashing/#:~:text=The%20most%20common%20reason%20is,make%20money%20in%20the%20future. (Accessed: 27 July 2023).

[iii] Rotblut, C. (2023) *Ideas from Benjamin Graham, the father of value investing, Forbes*. Available at: https://www.forbes.com/sites/investor/2023/03/15/ideas-from-benjamin-graham-the-father-of-value-investing/?sh=48d5d9fa2ec3 (Accessed: 27 July 2023).

[iv] FEM (OI) Rules, 2022, Rule 2 (1) (q).

[v] FDI Consolidated Policy Circular 2020, DPIIT, ¶2.1.16.

[vi] FEM (OI) Rules, 2022 (M.O.F).

[vii] FEM (OI) Regulations, 2022 (RBI).

[viii] FEM (OI) Rules, 2022, Rule 3.

[ix] FEM (OI) Rules, 2022, Rule 2 (1) (q).

[x] FEM (OI) Rules, 2022, Rule 2 (1) (s).

[xi] FEM (OI) Rules, 2022, Rule 19 (1) (a).

[xii] FEM (OI) Rules, 2022, Rule 19 (3).

[xiii] E.P Royappa v. State of Tamil Nadu, (1974) 4 SCC 3.

[xiv] FEM (OI) Rules, 2022, Rule 3.

[xv] FEM (OI) Rules, 2022, Rule 2 (p).

[xvi] FEM (OI) Rules, 2022, Schedule II.

[xvii] FEM (OI) Rules, 2022, Rule 12.

[xviii] FEM (OI) Rules, 2022, Rule 17 (3).

[xix] FEM (OI) Regulations, 2022, Regulations: 10, 11.

[xx] FEM (OI) Rules, 2022, Proviso to Rule 3.

[xxi] Statute Council Guidelines of the People's Republic of China, ¶2-4, http://www.gov.cn/zhengce/content/2017-08/18/content_5218665.htm.