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# SOUTH-SOUTH COOPERATION IN INTERNATIONAL INVESTMENT ARRANGEMENTS

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## CHAPTER 2

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## II. KEY FEATURES AND CONTENT

South-South IIAs differ from other (in particular North-South) IIAs not so much in their overall objective, which is to promote and facilitate investment flows, but rather in terms of the depth and breadth in which they cover investment issues. Overall, BITs show less variation than PTIAs, while the network of DTTs presents the most homogenous picture. The following presents a cursory review of the main features of South-South agreements.[1]

### A. Bilateral investment treaties

BITs seek to protect and promote foreign investment flows, flows that have traditionally originated from developed rather than developing countries. Consequently, developed countries, as FDI home countries, have been the ones promoting their own, particular approaches towards BITs. The Canada and United States model BITs, for example, represent the broader, Western Hemisphere approach, while the model BITs of European countries[2] stand for the narrower, European approach. Overall, the European approach tends to focus more on the protection of FDI flows, while the Western Hemisphere approach covers more likely both the protection and liberalization of investment.[3] For a long time, developing countries, when negotiating with developed countries, had a tendency to follow one or the other approach – depending on the negotiating partner.

South–South BITs seem to be closer to the European rather than to the Western Hemisphere approach. They tend to cover mainly investment protection and promotion (i.e. they rarely grant free access and establishment), typically refrain from explicitly prohibiting performance requirements (though these may be covered by the contracting parties' adherence to the WTO TRIMs Agreement when they are members of the WTO) and they typically limit transparency requirements to the stage after the adoption of laws and regulations. In addition, some features appear to be distinctive to South–South BITs. For example, they tend to put more emphasis on exceptions (e.g. for balance of payments or prudential measures) and on so-called "fork-in-the-road" clauses, which oblige investors to make a final choice

between domestic and international dispute settlement mechanisms before engaging in litigation (UNCTAD 2004, box VI. 3, p. 224).

## B. Double taxation treaties

DTTs are a distinctive type of bilateral agreement because they focus on one issue only, taxation. They provide for the allocation of exclusive or shared taxing rights to the contracting parties and for commonly agreed definitions. In addition, they often contain a non-discrimination clause (national rather than MFN treatment, given that the agreements in question are bilateral), provisions designed to avoid tax evasion and procedures for arbitration and the resolution of conflicts.

Such treaties seek to avoid the same income from being taxed by two or more States. Such double taxation occurs, for example, when a company resident in one country is taxed on its worldwide income, including income derived from an affiliate in another country on which that country has already levied a tax. Hence, from a country perspective, the main purpose of international taxation agreements is to deal with tax rights and thus with the balanced trade-off of interests between countries. From the perspective of the investing company, the binding nature of the rules engendered in a tax treaty as an international agreement contributes to the legal certainty of not being taxed twice, hence encouraging FDI flows.

Due to the specific subject matter dealt with in DTTs, the absence of specific South-South features in the DTT universe is not surprising. Noticeably, South-South DTTs do not uniformly include tax-sparing provisions (the Indonesia-Philippines DTT being a prominent example of a DTT containing such a provision),[4] although these are deemed to be advantageous to the recipient country's FDI attractiveness (UNCTAD 2000b).

## C. Preferential trade and investment agreements

First, and most importantly, South-South PTIAs differ from BITs as regards the depth in which they address certain investment issues:

- Some PTIAs focus on the liberalization, as well as the protection of FDI, and contain detailed and specific rules and obligations to that effect. The ASEAN Agreement for the Promotion and Protection of Investments, the Agreement on Investment and Free Movement of Arab Capital among Arab Countries, the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organization of the Islamic Conference and the MERCOSUR Protocol of Colonia are examples. Most Latin American agreements contain detailed and specific commitments at the pre-establishment stage, including national treatment, MFN treatment and fair and equitable treatment, as well as, at the post-establishment stage, expropriation and performance requirements.[5] The 2004 CARICOM-Costa Rica FTA, or the 1998 FTA between Chile and Mexico are examples.

- Other PTIAs are only framework agreements that lay down general principles, committing to further investment liberalization, protection and promotion, including through the follow-up formulation of specific agreements and implementation strategies. Several Asian framework agreements are examples, essentially setting up mandates to formulate specific investment agreements in the future, as well as institutional frameworks to support that process. The 2003 India-ASEAN Framework Agreement, for example, marks the first step towards building an India-ASEAN regional trade and investment area. The BIMSTEC Framework Agreement commits the parties to establish an open and competitive investment regime in order to facilitate and promote investment within a future BIMSTEC free trade area. While stopping short of establishing specific commitments on investment protection as BITs do, these agreements are an expression of commitments to increasing South-South cooperation across a series of

issues; more specifically, they set in motion a process for formulating more specific policy measures on investment in the future.

Secondly, PTIAs vary in nature and form across regions. In part this is due to the fact that the agreements reviewed pursue different overall objectives. While some aim to provide far-reaching liberalization and protection of FDI flows, others tend to focus on the overall promotion of FDI, particularly through the encouragement of specific promotional measures:

- PTIAs in Latin America, accounting for over half of all South-South PTIAs, contain the most far-reaching commitments on investment. Many follow the NAFTA model and contain specific provisions on the definition and admission of investment, on national and MFN treatment and on expropriation. The agreements of Mexico with Bolivia and Chile, the Treaty on Free Trade between Colombia, Venezuela and Mexico (Group of 3), or the MERCOSUR Protocol of Colonia illustrate this trend. This relatively far-reaching nature of investment provisions in Latin American PTIAs might be due to the influence of the BITs with the United States, Foreign Investment Protection Agreements (FIPAs) with Canada and NAFTA.

- PTIAs in Asia represent roughly one quarter of the South-South PTIAs network. The most elaborate regional agreement is the ASEAN Investment Area containing provisions on national and MFN treatment (but without provisions on fair and equitable treatment, expropriation and transfer of funds). The so-called ASEAN "plus one" agreements, however, are of a narrower nature, mainly emphasizing general principles for promoting mutual investment and containing a mandate for setting up overall guiding principles and an institutional framework for negotiations towards the creation of a transparent, liberal

and facilitative investment regime. In the ASEAN-China Framework Agreement, for example, the parties agree to negotiate expeditiously in order to establish an ASEAN-China free trade area within 10 years through a series of commitments to establish an open and competitive investment regime that facilitates and promotes investment within the ASEAN-China FTA. The Agreement also foresees the formulation of action plans and programmes in order to further deepen cooperation in the area of investment. Singapore has also been actively pursuing PTIAs with a number of developing countries. The Closer Economic Partnership Arrangement between the People's Republic of China and Hong Kong (China) contains a detailed plan of action for the promotion and the strengthening of investment cooperation between the parties (Annex 6 of the agreement). Hence, in the near future, it is expected that substantive PTIAs will have an even more prominent role in Asia.

- Africa has seen hardly any comprehensive South-South IIAs until the present. African PTIAs account for about one-tenth of the South-South PTIAs network. ECOWAS and COMESA are the two recent PTIAs in Africa that address investment. Chapter III of the ECOWAS Energy Protocol has a substantive set of investment promotion and protection measures including fair and equitable treatment, MFN, a clause on key personnel, compensation for losses, expropriation, transfers related to investment, subrogation, transparency, taxation and an investor-State dispute settlement mechanism. Similarly, the Treaty Establishing COMESA has a full chapter on investment promotion and protection, with a broad asset based definition of investment and provisions concerning expropriation, compensation, transfer of funds and fair and equitable treatment. However, there is also the draft COMESA

Common Investment Area,[6] suggesting an intensifying level of cooperation in investment. The situation is similar in the Arab world, which has seen some of the first initiatives, but not much of the recent more specific and comprehensive international policies on trade and investment (UNCTAD forthcoming b).

## D. The development dimension in South-South IIAs

The development dimension of IIAs manifests itself through their objectives, structure, substantive provisions and implementation provisions (UNCTAD 2003, chapter V).

### 1. Objectives

The recognition of different stages of economic development among members and the need to facilitate the more effective integration of the less developed members is a common and reoccurring feature of the objectives of South-South PTIAs. In fact, the majority of South-South PTIAs refer in one way or another to the development objective in their preambles. It is sometimes referred to directly, or one can find indirect references to the principle of reciprocity and mutual benefit. A prominent example of a direct reference is the China-ASEAN Framework Agreement, whose preamble "[r]ecogniz[es] the different stages of economic development among ASEAN Member States and the need for flexibility, in particular the need to facilitate the increasing participation of the newer ASEAN Member States in the ASEAN-China economic co-operation and the expansion of their exports, including, inter alia, through the strengthening of their domestic capacity, efficiency and competitiveness". The MERCOSUR-Andean Community Economic Complementation Agreement, the Treaty Establishing the African Economic Community, the CARICOM-Venezuela Agreement on Trade and Investment, the CARICOM-Costa Rica Free Trade Agreement and the Andean Subregional Integration Agreement are other examples of such a direct reference. An indirect

reference is exemplified by the CARICOM-Dominican Republic Agreement Establishing a Free Trade Area.

## 2. Structure

The granting of *flexibility* (aimed to allow signatories to preserve the necessary policy space for putting in place domestic development policies) and the provision of *special and differential treatment* for less developed partners in an agreement are among the structural elements of an IIA's development dimension.

Flexibility is a central feature of the development dimension of IIAs – amongst others because it allows signatories to preserve the necessary policy space for the pursuit of development-oriented policies. Common features of flexibility that can be found in most IIAs include the possibility to lodge reservations, make use of general exceptions and apply balance-of-payments safeguard clauses. These features can also be found in South-South IIAs. For example, the ASEAN-China Framework Agreement, the BIMSTEC framework agreement, the Chile-Republic of Korea Free Trade Agreement and the CARICOM-Venezuela Agreement on Trade and Investment contain provisions that allow for exceptions on grounds of public security or public health considerations or for the protection of the environment and animal wildlife. A majority of the 73 South-South IIAs provide flexibility in the area of performance requirements, i.e. by not prohibiting performance requirements other than those falling afoul of the agreements' national treatment obligation or those ruled out by the WTO TRIMs Agreement.

Provisions on *special and differential treatment* can also be found in South-South IIAs. They recognize the different levels of economic development of the parties (UNCTAD 2000a). Special and differential treatment can take different forms, for example, granting more flexibility (e.g. through longer implementation time frames or lower requirements) or allowing for additional exceptions (e.g. for

balance-of-payments difficulties). For example, the Treaty Establishing the Caribbean Community differentiates between the more and the less developed countries among its membership, establishing a regime for financial assistance, chapter VII, article 59(1) states that:

> "1. With a view to promoting the flow of investment capital to the Less Developed Countries, the More Developed Countries agree to co-operate in:
> (a) facilitating, whether by means of private investment capital or otherwise, joint ventures in those States;
> (b) negotiating double taxation agreements in respect of the income from investments in the Less Developed Countries by residents of other Member States; and
> (c) facilitating the flow of loan capital to the Less Developed Countries.
> …
> 3. Member States agree that in order to promote the development of industries in the Less Developed Countries an appropriate investment institution shall be established."

The Agreement on Investment and Free Movement of Arab Capital Among Arab Countries endorses a policy in article 1 (a) that "Every Arab state exporting capital shall exert efforts to promote preferential investments in the other Arab states and provide whatever services and facilities required in this respect".

Provisions on special and differential treatment also figure in some African and Latin American treaties. For example, the revised CARICOM treaty provides (in Article 142) for the establishment of "a special regime for the Less Developed Countries in order to enhance their prospects for successful competition within the Community, and redress, to the extent possible, any negative impact of the establishment of the CSME [CARICOM Single Market and Economy]". Article 143.2 then specifies the means through which this will be achieved, including, among others, "transitional or temporary arrangements to

ameliorate or arrest adverse economic and social impact arising from the operation of the CSME". Moreover, Article 56 of the CARICOM Protocol on the Disadvantaged Countries, Regions and Sectors states that:

> 'The Council for Finance and Planning (COFAP) shall promote investment in disadvantaged countries by, inter alia, facilitating:
>
> a) the establishment of joint ventures among nationals of disadvantaged countries as well as between nationals of disadvantaged countries and nationals of other Member States;
> b) the establishment of joint ventures between nationals of disadvantaged countries and nationals of third countries;
> c) investment for economic diversification including diversification of the agricultural sector;
> d) research, development and the transfer of technology in the development of disadvantaged countries; and
> e) capital flows from other Member States to disadvantaged countries through the conclusion of double taxation agreements and appropriate policy instruments.'

Other examples include the Economic Complementation Agreement between MERCOSUR and the Andean Community, where the parties recognize differences in their levels of development and in the size of their economies and the need to create opportunities for economic development. Similarly, The CARICOM-Venezuela Agreement on Trade and Investment states in the preamble that the parties take into account the different levels of economic development between Venezuela and the member States of CARICOM.

Among the African PTIAs, the Treaty Establishing COMESA (Chapter 22 on Least Developed Countries and Economically Depressed Areas) is a prominent example of the application of the special and differential treatment principle. Article 144 states that:

> "1. The Member States, recognizing the need for the promotion of harmonious and balanced development in the Common Market and in particular the need for reducing the disparities among various areas in the region and paying attention to the special problems of each Member State, particularly those of the least developed countries and economically depressed areas, agree to take several measures designed to strengthen the capacities of those groups of States of the Common Market to solve these problems. To this end, the Member States shall:
>
> (a) encourage new investments in such areas thereby strengthening their economies so as to enable them to increase the production of exportable goods to other Member States of the Common Market;
>
> (b) encourage the introduction of new technologies properly designed to meet the needs of such areas so as to assist in the transformation of their economies from dependence on one or two primary commodities to a more diversified production and marketing structures"

Along similar lines, the Treaty Establishing the African Economic Community takes into consideration the special economic and social difficulties of the least developed members by permitting temporary exemptions from the full application of certain provisions of the treaty, and by providing assistance through the Solidarity, Development and Compensation Fund (Article 79).

### 3. Substantive provisions

The substantive content of an IIA's provisions is particularly important in reflecting the development dimension, and the overall balance of rights and obligations that arise out of a treaty. Here, it is not only the question of which issues are included, and which ones are excluded, from IIA coverage (through reservations, exceptions, waivers

etc.), but also the question of how the substantive provisions are formulated. [7]

With regard to the formulation of substantive provisions, few specific South-South features are discernable, although with notable exceptions. For example, while South-South IIAs that aim at the protection of FDI provide for a broad definition in their coverage, some tend to retain a measure of host country control over the admission (e.g. the China-Sri Lanka BIT and the ASEAN Agreement for the Promotion and Protection of Investment) and, at times, the treatment of investment (e.g. Singapore-Egypt BIT). Other agreements limit their coverage to a narrow definition that excludes, e.g. portfolio investment and other short-term, capital flows. An example is the Framework Agreement on the ASEAN Investment Area, stating in Article 2:

"This Agreement shall cover all direct investments other than:

> (a) portfolio investments; and
> (b) matters relating to investments covered by other ASEAN Agreements, such as the ASEAN Framework Agreement on Services."

Similarly, South-South IIAs tend to retain control over admission and establishment and not grant pre-establishment rights to foreign investors (e.g. the MERCOSUR Protocol on the Promotion and Protection of Investments from Non-Member Sates of MERCOSUR (Article 2.B.1), the Ethiopia-Yemen BIT and the Bahrain-Jordan BIT). Some seek to encourage the setting-up of supranational forms of business organization aimed at encouraging regional economic integration (e.g. the Community Investment Code of the Economic Community of the Great Lakes Countries, article 11).

With regard to other substantive provisions relating to the treatment and protection of foreign investors, South-South IIAs vary in their approaches. In general, treatment provisions (i.e. national

treatment, MFN treatment) tend to involve a greater emphasis on exceptions (e.g. for balance-of-payments or prudential measures), e.g. in the ASEAN Agreements. In a few cases, national treatment is not granted (e.g. Malaysia-Saudi Arabia BIT and those agreements signed by China). Protection provisions generally include those related to transfer of funds, expropriation and dispute settlement, with the notable absence of provisions for international arbitration of investor-State disputes in a number of the agreements, such as e.g. COMESA and the agreement on Investment and Free Movement of Arab Capital among Arab Countries, and an emphasis on so-called fork-in-the-road clauses, i.e. where investors must choose between the litigation of their claims in host country's domestic courts or international arbitration (e.g. in the Costa-Rica-Argentina BIT).

## 4. Implementation

The implementation of IIAs can be designed to enhance the development dimension. Three elements are relevant here: the legal character, mechanisms and effects of an agreement, including especially its institutional framework; promotional measures, including home country measures; and technical assistance. Some PTIAs are only framework agreements setting up an institutional structure and laying down general principles with respect to committing to further investment liberalization, promotion and protection. Often, these framework agreements pave the way for future more detailed investment agreements.

An *institutional framework* that includes the setting up of a committee responsible for the agreement and a timetable for implementation can not only support the negotiating processes, but also facilitate the developmental review of an agreement. Institutional set-ups can allow for the evolution of an agreement in light of the (developmental and other) experiences that it brought about. Many South-South IIAs contain such mechanisms. In fact, this is the case for 34 out of the 53 South-South PTIAs.

Again two different approaches can be discerned. One provides for a direct link between the institutional framework and the development dimension of the agreement in question. The institutional framework of the Andean Subregional Integration Agreement (referred to in the Agreement as "The Andean Community Commission") is an example. Here, the Commission is responsible to formulate, carry out and evaluate Andean subregional integration policy in the area of trade and investment and to coordinate with the Andean Council of Foreign Ministers; at the same time, the Commission is tasked to give special and differential treatment to the less developed members, in this case Bolivia and Ecuador, and to assess and evaluate the effectiveness of the methods used in their favour (Article 22).

The other approach does not specifically mention the development dimension in the provisions dealing with the institutional set-up, but provides an indirect link through referring to the implementation of the agreement in question as a whole, thereby including development-related issues. An example of this type is the ASEAN Investment Area Council that shall "supervise, co-ordinate and review the implementation" of the Agreement and assist the ASEAN economic ministers in all matters relating to it.

Pro-active *promotional* measures to encourage mutual investment are another important pillar of an agreement's development dimension. Policy measures (such as general policy pronouncements, information, financial and fiscal incentives, investment insurance) can affect TNC decisions regarding the selection of host country investment sites. While many of the IIA provisions related to pro-active policy measures remain of a hortatory or best-endeavour nature, their presence in South-South IIAs remains worth noting. The Framework Agreement on the ASEAN Investment Area is an example for more operational policy measures, setting up a detailed promotion and awareness programmes. Schedule II states that:

> "In respect of the Promotion and Awareness Programme, Member States shall:
> 1. Organise joint investment promotion activities e.g., seminars, workshops;
> 2. Conduct regular consultation among investment agencies of ASEAN on investment promotion matters;
> 3. Organize investment-related training programmes;
> 4. Exchange lists of promoted sectors/industries where Member States could encourage investments from other Member States and initiate promotional activities"

The China-ASEAN Framework Agreement offers another example, where parties agree to undertake measures to strengthen cooperation in areas such as the promotion and facilitation of trade and investment in goods and services. However, such pro-active operational measures do not figure prominently in Latin American and/or African IIAs.

*Technical assistance* and capacity building in relation to less advanced participants are often a feature of South-South agreements. Some 60% of the South-South PTIAs contain provisions dealing with technical assistance, mostly in the form of general provisions. An example is Article 6.2 of the India-ASEAN Framework Agreement, which states that "[t]he Parties agree to implement capacity building programmes and technical assistance, particularly for the New ASEAN Member States, in order to adjust their economic structure and expand their trade and investment with India". The Treaty Establishing the African Economic Community mentions in Article 49 the need to facilitate the establishment of African TNCs by providing financial and technical assistance to African entrepreneurs**.**

Interestingly, most of these provisions are found in Asian IIAs, with only a few Latin American and African IIAs offering examples of such provisions.

* * *

To a large part, South-South IIAs are similar to North-South IIAs. To a certain extent, this is not surprising and indeed follows from the data presented above. Increasingly, developing countries are becoming capital exporting countries. Therefore, an IIA could protect investment of a developing country in the territory of another developing country.

South-South IIAs vary in the extent to which they contain provisions aimed at strengthening the development dimension. A number of South-South IIAs stop short of containing far-reaching substantive obligations, but rather establish frameworks for general principles in promoting investment and mandates for future cooperation. Many agreements also include specific features towards strengthening their development dimension, including the establishment of an institutional framework, the granting of flexibility and special and differential treatment, the provision of technical assistance and capacity building. Other South-South agreements emphasize promotional measures for the facilitation of investment flows, including pro-active investment promotion measures, rather than focusing on pure liberalization and protection.

The key finding is, therefore, that developing countries are actively signing IIAs among each other and that they consider these agreements as "tools" to attract investment flows among themselves. Although South-South investment agreements vary in the extent to which they address development issues, they are one aspect of South-South cooperation that –more broadly – seeks to achieve developmental goals and covers a wide range of activities and issue areas.

[1] For a detailed review of the substantive provisions of these agreements see UNCTAD forthcoming b.

[2] Since the European Commission does not have a mandate to negotiate investment issues on behalf of the member States of the EU, these countries continue to conclude separate BITs, which, nevertheless, possess the same basic features.

[3] See UNCTAD 2004, box VI.3, p. 224, on "Approaches to BITs and FDI in services". The two approaches differ mainly in so far that the Western Hemisphere approach focuses on both establishment and protection (by extending national treatment and MFN obligations to the pre-establishment phase of investment, while accommodating country-specific exceptions to these obligations), while the narrower, European approach concentrates mainly on protection (covering mainly the post-establishment phase). Similarly, the Western Hemisphere approach tends to contain a specific article on prohibited performance requirements, while the other approach mainly addresses these via non-discrimination rules, though it should be borne in mind that the contracting parties to any IIA will be subject to the disciplines of the WTO TRIMs Agreement, as regards performance requirements, if they are members of the WTO.

[4] Many countries insist on including a tax-sparing or matching-credit clause in their treaties. Under such a clause, the country of residence of the investor grants a credit for the tax that would have been levied by the source country in the absence of the tax incentive. In that way, the tax incentive is channeled to the investor and not to the treasury of its home country. The inclusion of a taxation provision in DTTs can enhance the development dimension through the inclusion of specialized clauses on transfer pricing adjustments, transparency guidelines and mechanisms for information sharing.

[5] Note, however, that this study has not analyzed the extent of commitments and/or reservations countries have entered into under these agreements.

[6] See http://www.comesa.int/investment/

[7] For a full discussion, see UNCTAD 2000c and UNCTAD forthcoming b.