

Towards a Repository of Options for IIA Reform

Research Project

Process matters - South Africa's Experience Exiting its BITs¹

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This paper analyses South Africa's decision to **review** its investment policies, to terminate several of its BITs, and to use domestic legislation as the primary mechanism for protecting foreign investors. Foreign investors have raised concerns about the impact of these decisions on the attractiveness of South Africa as an investment destination, suggesting that the termination of BITs is part of a wider government policy to unduly intervene in the activities of foreign investors.

It is worth noting that despite these concerns, South Africa's investment regime for FDI is an open one by international comparison. In fact, the level of openness is comparable with the OECD country average and well above that of other emerging market economies as measured by the OECD FDI Regulatory Restrictiveness Index. Furthermore, where restrictions do exist, they are not unusual among OECD adherents as these are recognized in the Codes and are necessary for specific sectors to function optimally.

The decision of the South African government to change its policies on investment was triggered by a concern that BITs and the international system of investor-state arbitration inhibits the ability of governments to enact legislation and regulatory measures aimed at promoting public policy objectives. The review undertaken by the South African government is laudable. While it had some shortcomings, it was, in the words of a recent report by leading South African think-tanks, **a thorough, frank, and critical approach**, as South Africa sought to build 'its own internal capacity and policy coherence on the topic of investment, taking the protection and promotion of human rights and sustainable development as the point of departure for all future policymaking.' It enabled the South African authorities to **develop a clear idea of the nature and size of the reform required to balance the rights of investors with the public interest**. It was important that South Africa adopted a transparent and interactive strategy throughout the review process engaging the international community and not only the local public.

Given the growing concern about the desirability of key elements of BITs, other countries may well seek to undertake a similar review process. The South African experience provides valuable lessons.

In following the recommendations of the review and the cabinet decision, the South African government was well within its rights to terminate the BITs that had reached their end date. International law recognizes the right of partners to terminate such treaties as per the Vienna Convention on the Law of Treaties, under Article 54, and all the BITs signed by South Africa contain specific provisions for the procedures of termination. Moreover, the termination of the BITs did not result in a radical change in the level of protection of current investors, as the

¹ The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the UNCTAD Secretariat or its Member States.

survival clauses in the BITs mean that the same terms of the treaty will be applied for 10-20 years after termination.

With regards to the termination process, the two areas where the South African government could have paid more attention are the **communication of the termination of BITs, and the timing of the draft bill**. The government had completed all the necessary prerequisites for revising their agreements by providing a thorough review, which illustrated why they needed to address the BITs, and throughout the review process they consistently communicated and consulted with the different stakeholders. However, by not communicating with their partners before termination and simply notifying them with their intention to terminate (which was perfectly legal), the authorities provided grounds for a claim by the investors that South Africa were not willing to discuss or negotiate a more balanced agreement and that it was simply an 'ideological decision'.

South Africa would have been in a stronger position if it had communicated its conclusions to its counterparts before terminating, especially considering that most of their decisions were based on sovereign rights to bring their agreements in line with their constitution. Accordingly, if their counterparts had refused to negotiate these clauses as they intimated in informal meetings with South African officials and as their reaction to the new bill clearly indicates, it would have strengthened South Africa's claim that they were left with little choice but to pursue the route they have taken.

Another critical issue was the delay in issuing the PPIB and the uncertainty it created when it was announced that the BITs would be terminated. This uncertainty created a perceived legal vacuum, which was worsened by the criticism being waged by the investor community. Considering South Africa could not afford to delay the termination due to the renewal clauses in the BITs signed, this situation could have been avoided with better planning and timing of the process during the three year long review to ensure there was no legal vacuum for investors at any point.

The process of drafting the Promotion and Protection of Investment Bill also provides some useful lessons. The objective of the draft PPIB is laudable. As noted by the South African Institute for International Affairs (SAIIA), a leading research institute, the general texture of the Investment Bill reflects a government that is in need of expansive regulatory space for its transformation agenda, industrial policy and the progressive realization of socio-economic rights. The Bill achieves this goal. The government has also made its position clear on specific contentious issues, explaining that it will not enter into any negotiations to revise inter alia, FET, allowing indirect expropriation, and the exclusion of resource to international arbitration.

However, there are a few areas in which unclear wording and or lack of definitions in the draft PPIB have created uncertainties among the investment community. These could have been avoided and, indeed, can be remedied in the final draft of the bill. Three issues stand out. First, the qualification for applying the national treatment standard only in 'like circumstance' is unclear. The condition of like circumstance is meant to determine whether the foreign investor and the domestic investor are in a comparable setting before judging whether the foreign investor is entitled to expect the same treatment provided to the domestic investor. While some investors acknowledge that in order to determine the scope of equal treatment, the circumstances under which the investments are made have to be evaluated, there should be further elaboration on which criteria is used in such an evaluation.

Second, clarification is needed on the extent to which the government can provide physical protection for foreign investments and when the government would be liable, as the current wording of the provision does not clearly define when the government is liable and when it is not.

Third, the expropriation clause could be amended to stay in line with the constitution by keeping the first clause of the provision but by removing the open ended list of exceptions, thus making it more acceptable to investors.

South Africa's experience in revamping its investment regime is far from complete. Ultimately, the success or failure of this experiment will rest on whether the South African government is able to achieve the targeted inclusive economic growth through its new investment regime coupled with its adopted economic and social policies.

To this end, the review highlighted areas of institutional weakness that the government would need to address in order to deliver on its ambitious aims. As a recent report by leading South African think tanks noted, the government needs to invest further in strengthening its institutions in two ways in order to deliver. First, the review highlighted the lack of coordination between various government departments, which characterized the government's investment policymaking efforts and led to the conflict between the obligations in BITs and key domestic policies. To take forward its investment policies in a more coherent way than in the past, it is vital that government develops a well-structured method for streamlining and coordinating the efforts of the various government departments. Second, the review drew attention to the crucial role of continuous strategic planning, evaluation, and monitoring for the success of any overarching investment policy. The government needs to invest to ensure its lead government departments and the central organizing structure are fully equipped to lead the implementation of the new policy.

ⁱ Global Economic Governance Working Paper 2015/97, January 2015. The complete research paper can be downloaded here

http://www.globaleconomicgovernance.org/sites/geg/files/GEG%20WP_97%20Process%20matters%20-%20South%20Africas%20experience%20exiting%20its%20BITs%20Mohammad%20Mossallam.pdf.