Why Is Investment Treaty and Investor–State Dispute Settlement Reform Needed?

Questions & answers

IISD REPORT

International Institute for Sustainable Development

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International Institute for Sustainable Development

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Written by Josef Ostřanský, Florencia Sarmiento, and Suzy Nikiema

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This guide to investment treaties and investor–state dispute settlement builds on IISD's original Q&A on the issue, *Investment Treaties and Why They Matter to Sustainable Development: Questions and answers* (2011). We are inspired to follow in the footsteps of our colleagues and build on their work: raising awareness of investment treaties and the need for reform remains more critical than ever for sustainable development. The authors gratefully acknowledge help in the preparation of this report from Josefina Rosario del Lago, Lukas Schaugg, and Isaak Bowers as well as research assistance from Leonardo Flach Aurvalle and Ovinabo Banerjee.

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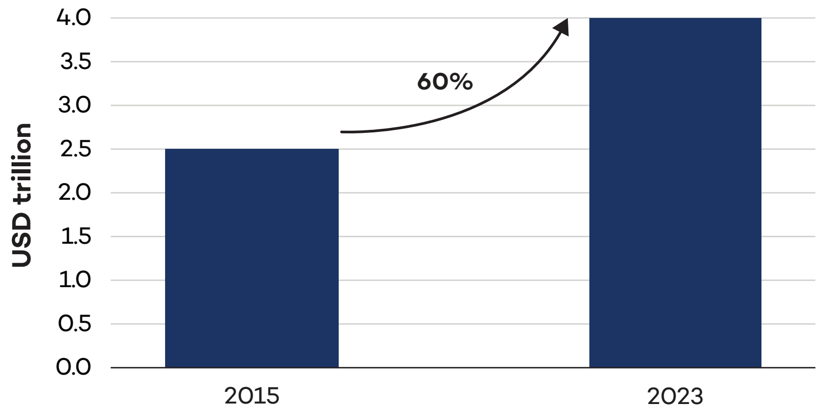
Question 1

Why are legal frameworks critical to ensuring that foreign direct investment fosters sustainable development?

Governments seek foreign direct investment (FDI) to help them develop their economies. FDI may bring needed capital, infrastructure, new technologies, and employment. There is a big investment gap in many countries to achieve national policy objectives and the United Nations (UN) Sustainable Development Goals (SDGs). UN Trade and Development (UNCTAD) highlights that the SDG investment gap in developing countries is about USD 4 trillion annually, half of it in clean energy (UNCTAD, 2023). Governments cannot fund everything on their own, so private investment is important. By tapping foreign private investment, countries can bridge this gap.

Figure 1. SDG investment gap in developing countries over time



Note: As a result, at the midpoint of the 2030 agenda, the SDG investment gap has widened.
Sources: UNCTAD, 2023, 2024b.

From the perspective of the individual investor, **FDI is motivated by profit**: more specifically, foreign investors seek different economies to gain easier access to raw materials, enter new markets, benefit from lower production costs, lower taxation, access concession deals, etc.

Box 1. What is FDI?

FDI is a lasting economic interest in a business or asset in one country (host state) by a legal or natural person residing in a different country (home state). FDI should not be confused with a commercial transaction or portfolio investment. Unlike a commercial transaction, which typically involves a simple exchange of goods or services for money, FDI entails a long-term commitment to the host country's economy, with the investor seeking to exert control over the investment and generate future profits. FDI also differs from portfolio investment, primarily in the level of control and influence exerted by the investor.

Given that private FDI is motivated by profit and that governments seek FDI to achieve their public policy goals, sustainable development is not an inevitable outcome of more FDI. In other words, FDI can have positive as well as negative impacts in the host country.

Table 1. Host country effects of FDI

Positive	**Infrastructure**: Investment in infrastructure may enhance the country's development by improving public goods. **Employment**: Foreign investment might lead to job creation, particularly in sectors like manufacturing, technology, and services. **Tax revenues**: By establishing profitable operations, foreign investors contribute to public revenue through taxes, fees, and duties. **Technology transfer**: Foreign investment might be accompanied by the transfer of advanced technologies and innovative business practices, which can benefit host countries. **Economic linkages**: Foreign investment can lead to positive economic linkages as it engages with local suppliers and service providers, creating a positive impact on the local economy.
Negative	**Environmental damage**: Foreign investors might prioritize short-term profits over long-term environmental protection, particularly in resource-intensive industries like mining or agriculture. **Exploitation of labour**: Foreign investors may exploit workers by paying low wages or providing poor working conditions. **Tax evasion**: By shifting profits to low-tax jurisdictions, they deprive host countries of vital public funds. **Corruption**: Large foreign investment can foster corruption, which occurs when investors offer bribes to local officials to obtain favourable treatment, such as securing permits or avoiding regulations. **Impacts on local communities and entrepreneurs**: While foreign investments can bring economic growth, they sometimes lead to social displacement that can force local communities off their land. The dominance of foreign companies may also stifle local businesses.

Source: Authors.

While a certain *quantity* of FDI is needed to achieve SDGs, it is the *quality* of FDI—and the sectors and industries to which it is channeled—that matters for sustainable development. The Organisation for Economic Co-operation and Development (2022) and others (Sauvant & Mann, 2019) have developed various frameworks for assessing the quality of FDI, linking them with SDGs.

It is only when the right legal and policy frameworks are in place that quality FDI may work toward sustainable development—that is, the right investment (public or private) may be channelled where it is needed. Only deliberate and active policies to attract and support quality and sustainable investment can harness private investment for sustainable development. Such frameworks must clearly define the rights and obligations of all stakeholders, be adaptable, and properly implemented.

Example

A company from Country A builds a solar energy plant in Country B. This is a foreign investment because the company is bringing money and technology from Country A to develop a business in Country B; this investment also helps Country B adopt renewable energies in its transition toward a green economy. This can happen if Country B has in place legal frameworks that contribute to attracting such investment but do not constrain the government from modifying the legal framework based on changed circumstances.

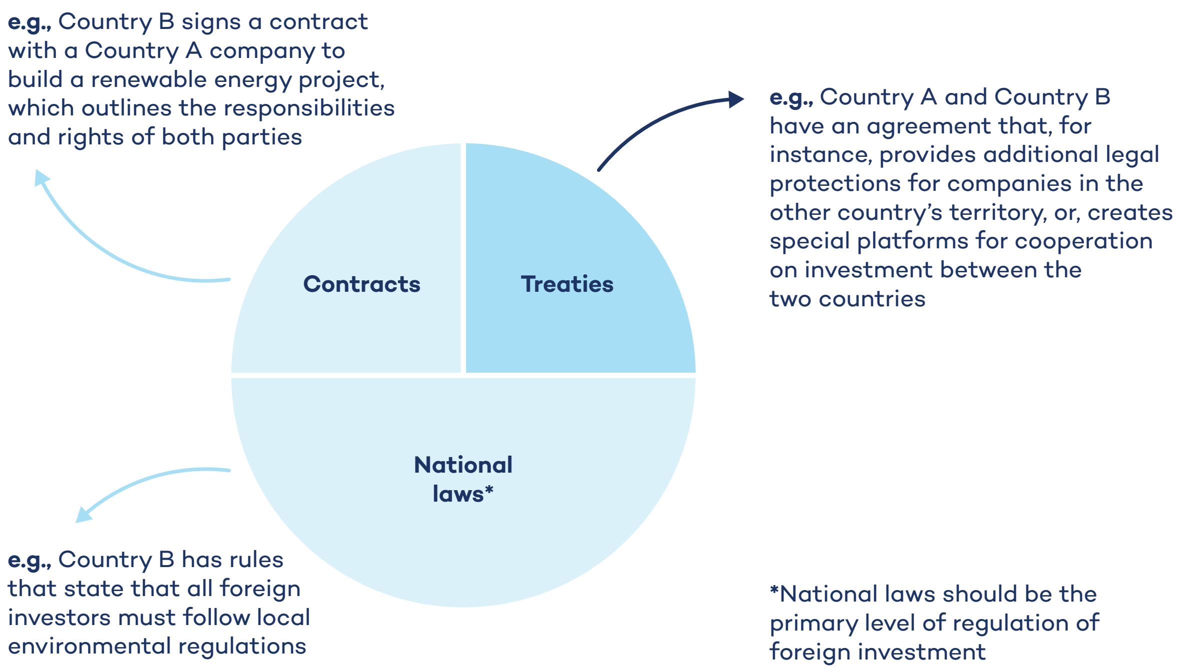
Question 2

What are the legal frameworks governing FDI, and what is the role of investment treaties in these frameworks?

Legal frameworks governing FDI refer to the rules, regulations, and institutions that govern the admission, establishment, operation, and winding up of FDI. Legal frameworks governing FDI can be viewed as risk-allocation tools—they institutionalize which risks are allocated to the host state and the public and which are to be borne by the investor. For example, a contract between an investor and the government may specify myriad ways of how market, economic, technological or other risks are distributed between the parties. National laws and international treaties can also play this role.

There are three main sources of investment law and governance: national laws, investment treaties, and investment contracts. While this guide focuses specifically on treaties, national laws and contracts are just as important when assessing the relationship between the government, the public, affected communities and individuals, and investors.

Figure 2. Sources of investment law

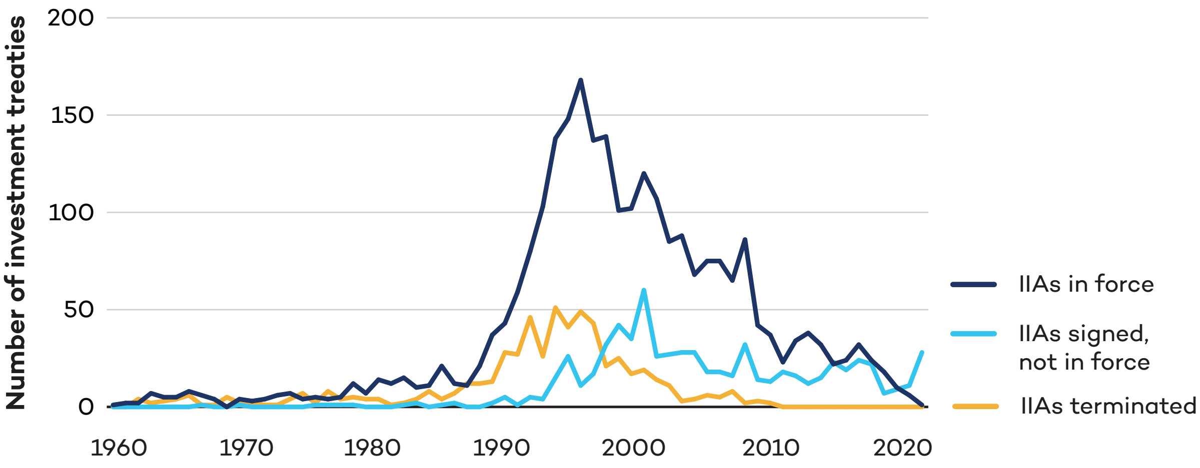


Source: Authors.

Investment treaties are agreements between two or more countries that regulate different aspects of regulation of foreign investment. Investment treaties regulate foreign investment alongside national laws and contracts. Investment treaties are sources of international law.

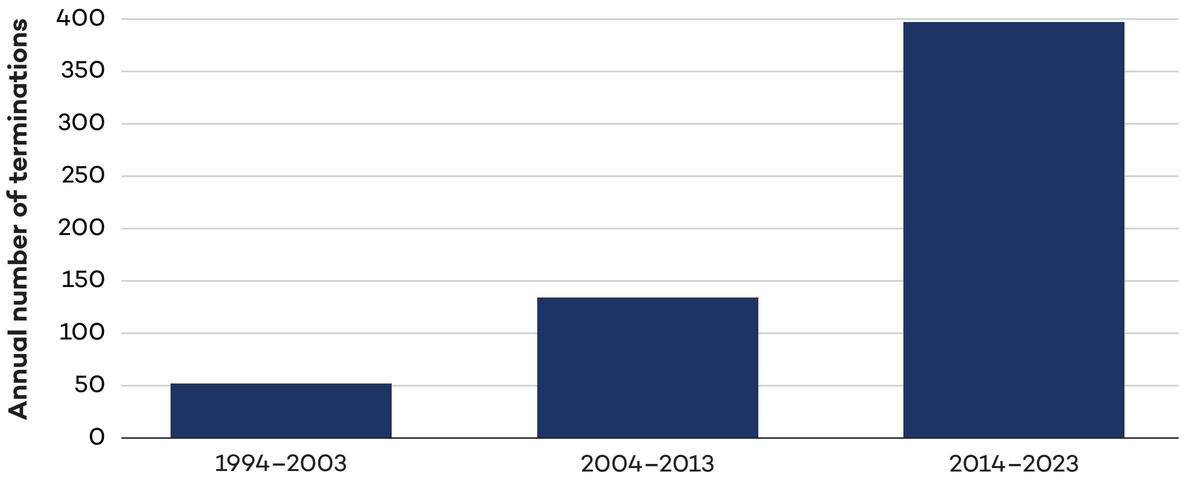
Generally, they have been designed to offer additional legal protection to foreign investment. As a rule, they contain specific obligations for the FDI's host countries. Although usually concluded as stand-alone agreements, investment treaties also refer to investment chapters included in broader treaties, such as free trade agreements (FTAs).

Figure 3. The dramatic rise of investment treaties in the 1990s and 2000s, followed by a recent decline



Note: Number of IIAs in force: 2,608. As of 25 March 2024.
Source: UNCTAD (2024d).

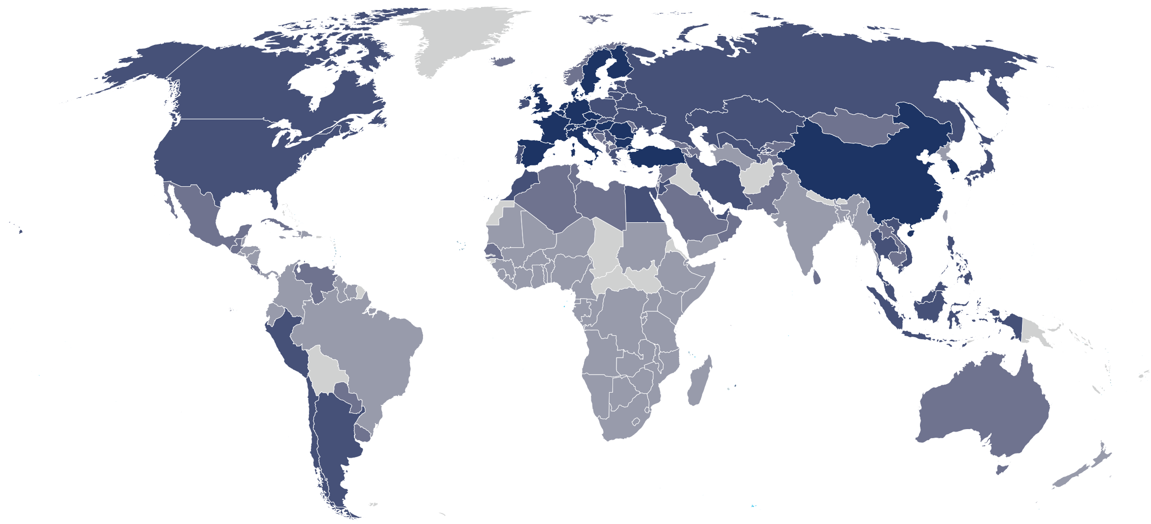
Figure 4. Number of terminations of investment treaties



Note: Total number of IIAs terminated: 585. As of 25 March 2024.
Source: UNCTAD, 2024c.

Investment treaties originated in the post-World War II period, with the first bilateral investment treaty (BIT) signed between Germany and Pakistan in 1959. The early treaties were driven by foreign investors' concerns about the lack of protection in newly independent developing countries. The number of investment treaties surged in the 1990s as developing countries sought to attract FDI by offering greater legal guarantees through these treaties. In recent years, the termination of investment treaties has been more common than the conclusion of new ones, signalling states' increasing dissatisfaction with the current regime.

Figure 5. Number of investment treaties per country



Number of treaties

≥ 100 | 99-50 | 49-30 | 29-10 | < 10

Note: The number per country contains bilateral investment treaties (BITs) and treaties with investment provisions (TIPs) as per UNCTAD Policy Hub terminology, in force as of 15 January 2025.
Source: UNCTAD, n.d.

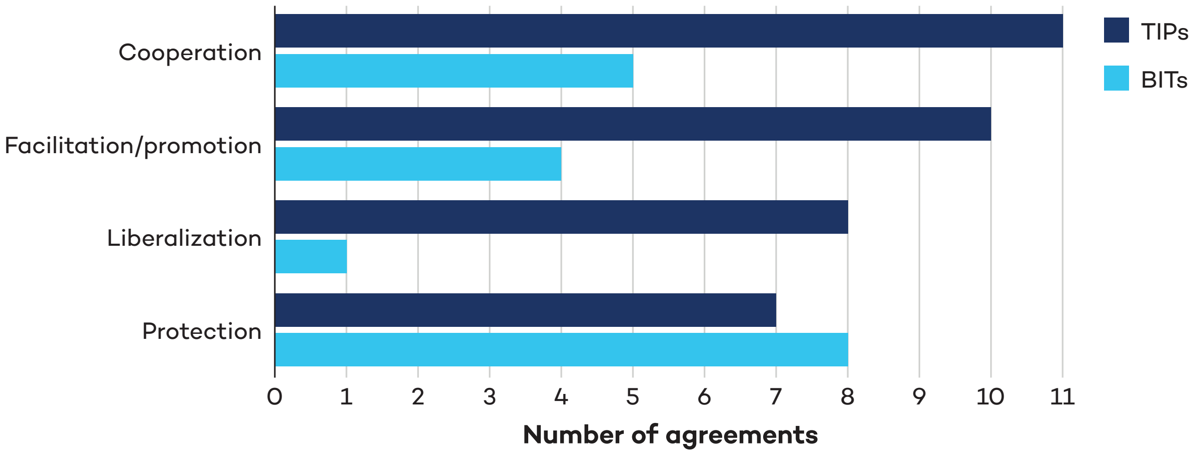
However, investment treaties are not only about investment protection. Recent trends show that investment treaties are increasingly designed to serve a more diverse set of functions.

These include

- international cooperation on investment governance
- investment facilitation
- investment liberalization
- investor obligations and the regulation of the impact of foreign investment.

In fact, recently concluded investment treaties deal less and less with investment protection than with other policy objectives, as Figure 6 shows. The figure also highlights that investment protection commitments are more likely to be included in a bilateral treaty than in a broader FTA or a regional agreement. Bilateral negotiations are more sensitive to power asymmetries between the negotiating parties. This suggests that the bilateral model based on investment protection is outdated (see Question 5).

Figure 6. Functions of investment treaties signed in 2023



Note: TIPs = treaties with investment provisions.
Source: UNCTAD, 2024c.

Question 3

Why are states concluding investment treaties?

For some countries—especially capital-exporting ones—international protection of their investors was and continues to be the main reason for concluding investment treaties.

For most states, however, the promise of investment treaties leading to increased investment inflows has been the main selling point. Due to a lack of national private capital, public resources, and technical expertise, developing states turned to foreign corporations, mostly from the Global North, to develop their national economies.

Historically, the conclusion of investment treaties has been promoted on the basis of the following:

investment protection: Investment treaties typically include provisions that create a special legal regime, enabling investors to commit capital without the fear of discriminatory and arbitrary treatment, including expropriation without compensation, from the host state.

investment attraction: Investment treaties are seen as a way to attract foreign investment into the country. By signing these agreements, countries hope to show investors that their assets will be safe and protected, making the country more attractive for foreign businesses.

creating a "depoliticized" forum for disputes: Investment treaties provide a system where foreign investors can sue governments in ISDS if they believe their rights have been violated. ISDS is said to increase investors' confidence, as they know they can resolve disputes outside the host country's legal system, which they might think is inefficient or biased.

Additional justifications for investment treaties have been offered over time:

- **"good governance" reforms**: It has been claimed that investment treaties induce good governance and "rule of law" reforms in the states that conclude them.
- **signalling effects and competition for FDI**: Signing investment treaties is seen as a signal that a country is attractive for foreign investors, particularly in regions with high competition for investment.
- **improving or consolidating diplomatic relations**: Governments sign investment treaties to signal a willingness to deepen economic relations, and the treaties demonstrate diplomatic prowess to domestic audiences.

While this is how investment treaties have been justified, it **does not** mean that they have been successful in achieving these objectives.

It should be noted that these justifications apply to the more traditional investment treaties that deal only with investment protection and dispute settlement. However, as stated under Question 2, there is no reason future investment treaties cannot address other pressing policy issues of investment governance, including holding foreign investors accountable for misconduct, encouraging technology transfers between developed and developing countries, and decreasing the cost of capital in developing countries. Treaties may be helpful in addressing some of these problems. However, this requires a significant rethinking of what investment treaties are and could be.

Did you know?

Not all countries signed investment treaties, and foreign investment is thus governed mostly by national laws, contracts, and other international obligations.

Brazil is an important example of a country that has never ratified an investment treaty with ISDS but still attracts significant investment flows. It has recently started concluding investment treaties focusing on investment facilitation and cooperation instead of protection and dispute settlement, paving the way for alternative investment treaty models.

Ireland, for instance, has no BIT signed on its own (although it is bound by multiple FTAs concluded by the European Union), as do a number of Small Island Developing States.

Question 4

Are investment treaties delivering on their promises or creating other unexpected problems?

Claiming that a legal instrument achieves a certain policy goal is not the same thing as proving it. Unfortunately, when it comes to investment treaties that focus on investment protection, we mostly have grandiose claims and very little evidence to back them up.

Whereas investment treaties have sometimes benefited investors, they have largely failed to meet their stated policy goals, especially from developing countries' perspectives. Their main purpose was to attract more FDI by offering investment protection, but there is little to no evidence that investment treaties help attract investment.

Moreover, investment treaties often lack any specificity about the types of investments they aim to attract. **As a result, the investments that do come in may not even provide tangible benefits to the host country**. Investment treaties may have encouraged investments that are not sustainable. Some of these investments could harm the environment, deplete natural resources, or lead to social issues, as investment treaties often prioritize investor rights and neglect environmental and social safeguards. In the context of the energy transition, for instance, investment treaties protect existing and new fossil fuel investments that governments should be phasing out.

As a result, instead of attracting more FDI, investment treaties have exposed states to high legal costs and liabilities and have occasionally discouraged necessary regulatory actions. Many investors have used investment treaties to dispute new regulations introduced, for instance, to protect the environment or resolve economic crises. This is because many investment treaties have rules that limit countries' ability to make new laws that could negatively affect foreign investors.

For instance, if a country wants to pass a law to protect the environment or improve labour standards, foreign investors might argue that these new laws hurt their profits. Because of the ISDS mechanism (see Question 5), investors may demand compensation, forcing the state into costly legal proceedings or settlements.

This leads to two main problems:

- **high costs for countries**: If an investor wins an ISDS case, the country may have to pay significant damages, sometimes to the tune of billions of dollars covering the investor's lost profits. And even if the state wins, there are important costs associated with defence and legal expenses—the legal cost of defending the state in ISDS averages around USD 5 million, and states have had at least partial recovery of the cost ordered in only around half the cases they won.
- **"regulatory chill"**: Although investors don't always succeed in their claims, the simple possibility of challenging regulations can dissuade host states from engaging in the necessary reforms that better serve the public interest. Defenders of ISDS

often point out that investment treaties do not prevent countries from regulating, as tribunals cannot order the country to repeal laws and regulations but merely order them to pay monetary compensation to investors. This argument, however, misses the point given the high legal costs of ISDS and compensation awards that have, at times, amounted to several percentage points of the country's GDP. The threat or order of compensation is the main deterrent.

In summary, while investment treaties were meant to attract investment, they have largely failed to do so. They do, however, have significant costs, and their impact on sustainable development has often been negative. They can create legal and financial burdens for states while discouraging legitimate regulatory actions, especially through ISDS (Question 5).

Question 5

What is ISDS, and why is it criticized?

ISDS is a common term used to denote international arbitration based on their common feature—investment treaties. **ISDS gives foreign investors direct access to sue the host state before an international arbitration tribunal** when they believe that state actions have violated obligations under an investment treaty.

ISDS enables foreign investors to avoid domestic courts and bring claims against the host state directly before a party-appointed international arbitration tribunal. This is a highly exceptional right and was uncommon before the advent of investment treaties. Additionally, in other international courts and tribunals, individuals must resort to domestic courts before engaging in international jurisdiction. This is the case, for example, with regional human rights tribunals like the African Court on Human and Peoples' Rights and the European Court of Human Rights.

An international arbitration tribunal usually comprises three individuals—typically private legal practitioners serving in their individual capacities. One arbitrator is appointed by the investor and the other by the host state; the chair arbitrator is appointed either by the two other arbitrators or a third party.

This tribunal's decisions are **binding and enforceable** and not subject to appeal. They can be annulled only on limited grounds. For instance, a wrong application of law or incorrect assessment of facts are not grounds for annulment. The annulment grounds are generally limited to procedural deficiencies and issues related to the tribunal's competence.

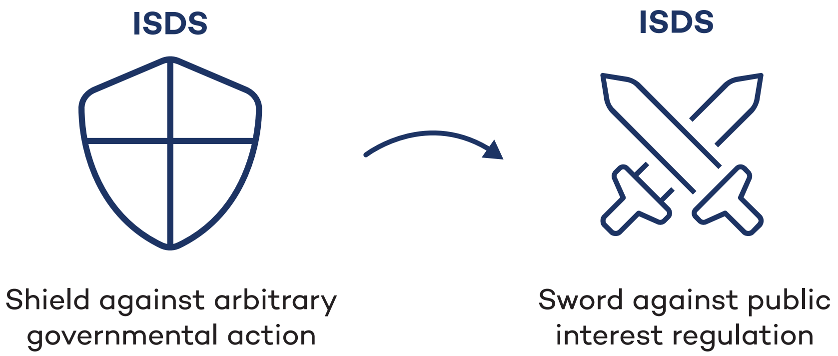
Most investment treaties, especially those signed before 2012, contain advance consent to ISDS. Advance consent means that ISDS is accessible to any investor who satisfies the treaty's requirements. Generally, these requirements have been worded and interpreted broadly.

As a rule, investors ask for damages, i.e., **monetary compensation**, as a remedy.

ISDS has represented one of the main objectives of capital-exporting states and their investors under investment treaties—to have a **forum for disputes with the host state that is perceived as neutral** for not being part of the host state. It was believed that ISDS may "depoliticize" investment disputes.

However, what originally started as a shield against the government's potential arbitrariness has transformed into a veritable sword that foreign investors hold over the host states' governments to challenge regulations, including those necessary to achieve sustainable development goals.

Figure 7. Transformation of ISDS functions



Source: Authors.

There are several reasons why current ISDS processes have become increasingly criticized.

Table 2. Main problems with ISDS

ISDS is lengthy and costly.	**Average duration of an ISDS case**: 3.5 years. **Average legal costs**: USD 4.7 million for states, USD 6.4 million for investors. Successful parties recover some costs in only around half of the case—62% for investors and 52% for states.
Cash compensations in ISDS are high and growing.	**ISDS compensation awards can be very high**: More than USD 100 million was awarded in more than 25% of all ISDS cases won by investors. Compensations amounting to several percentage points of the country's GDP have become increasingly common. **Compensation awards are growing**: The average damages award in the last decade (2014–2023) was USD 256 million; it was USD 98 million in the prior decade. There are no limitations on the size of the claims investors may put forward and no control mechanisms on how tribunals determine compensation.
ISDS is inconsistent and unpredictable.	ISDS practice shows divergent interpretations of the main investment treaty obligations: this leads to an increased lack of predictability of ISDS decisions. This lack of consistency creates incentives for more cases to be brought by investors, as it is difficult to predict at the outset whether the case will be successful. This leads to additional costs and inefficiencies.
ISDS can be used as a threat to extract undue concessions (regulatory chill).	**Only investors can bring ISDS claims**; governments have only very limited options to counterclaim. **Governments' best-case scenario is not to lose while having at least some of their costs recovered.** A threat of costly ISDS proceedings with a potentially high compensation award can cause regulatory chill or undue concessions being extracted from the state in favour of the investor through settlements.

Investors do not have obligations toward the host state under investment treaties.	Especially under older investment treaties, investors have no obligations. This significantly restricts the scope for host states to hold investors accountable for any misconduct in ISDS. Older investment treaties serve as a basis for virtually all ISDS cases.
ISDS is not accessible to all affected parties.	**The only parties to the ISDS proceedings are the investor and the government.** However, investment disputes often concern other stakeholders, such as the local population impacted by the investment project. **ISDS tribunals do not have jurisdiction over other concerned parties**. Local populations can, at best, submit amicus curiae briefs or appear as witnesses; they cannot claim or defend their own rights.
ISDS is increasingly financed through third-party funding.	ISDS becomes increasingly attractive for third-party funding by specialized investors and funds. In return for funding an ISDS claim, they receive a percentage of the compensation the host state is ordered to pay the investor. ISDS is lucrative for litigation funders given that the government is always a respondent, and governments cannot theoretically go bankrupt; the law is inconsistent and unpredictable but largely investor-friendly; compensation is often exorbitant. **The availability of third-party funding contributes to more ISDS cases being filed.**
ISDS has created an industry with a vested interest.	The lack of predictability, high monetary stakes, limited control mechanisms, and long duration of ISDS proceedings, combined with the fact that states are always respondents, provide ideal circumstances for the emergence of a significant interest group with vested interests in the continuing relevance of ISDS—the arbitration industry. The arbitration industry—composed of lawyer counsel, arbitrators, arbitral institutions and associations, dispute settlement practitioners, litigation funders, experts, and academics—is the main beneficiary of the system. **The arbitration industry benefits regardless of who wins ISDS cases, individually or in aggregate.** This interest group is also the most vocal in opposing reforms of ISDS, often hiding its economic interest behind the lofty and seeming neutral values of the rule of law and dispute settlement.
ISDS displaces domestic courts and thus undermines the rule of law.	While one of the justifications in favour of investment treaties was that they promote the rule of law and good governance, they have done the opposite. The fact that ISDS allows investors to bypass domestic courts undermines national judiciaries, as the latter do not have an opportunity to adjudicate investor–state disputes. Additionally, the high legal costs of ISDS—and the often exorbitant compensation—siphon scarce financial resources toward individual investors or the arbitration industry, resources that could have been used to improve national legal systems and judiciaries.

Source: Compiled by authors based on Hodgson et al., 2021; UNCTAD, 2024a, 2024c; Zárate et al., 2020.

Did you know?

Recently, **most developed countries have been removing ISDS from their investment treaties among themselves**, for example, the EU–Canada Comprehensive Economic and Trade Agreement (2016), the United States–Mexico–Canada Agreement (2018), and the Australia–United Kingdom Free Trade Agreement (2021). **However, they kept it in the investment treaties concluded with developing and emerging economies**, for example, the EU Model Clauses with Third Countries (2023), Cabo Verde–Hungary BIT (2019), Canada–Mongolia BIT (2016), and the and Japan–Kenya BIT (2016).

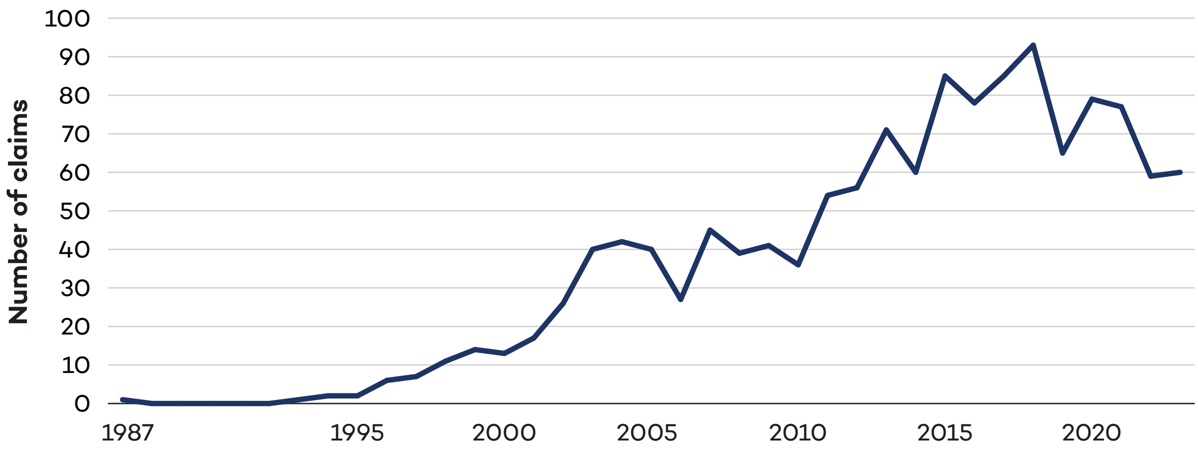
Question 6

Why is compensation the main issue with ISDS?

Compensation is one of the forms of reparation available under international law to remedy a breach of an international law obligation—it is a monetary form of reparation. The other forms are restitution and satisfaction. In ISDS, compensation is used almost exclusively. While other international courts and tribunals also award compensation, they do not do as regularly as ISDS tribunals. The compensation awards by ISDS tribunals are also much larger than those issued by other international courts and tribunals.

The recent report from the UN Special Rapporteur on Human Rights and the Environment that focused on ISDS and its impact on climate action and human rights was entitled "Paying polluters," given that ISDS allows investors to get compensation from the government even in cases in which their activities are known to be harmful to the environment. For example, in a series of cases brought against Argentina for measures adopted during a severe economic crisis, tribunals dealt with investors in the provision of drinking water supply contracts (e.g., *Suez and InterAgua v Argentina*; *Urbaser v. Argentina*). The tribunals held that the government must simultaneously comply with the human right to clean water as well as with investment protection obligations during the crisis. Hence, human rights claims provide no defence.

Figure 8. Number of ISDS claims filed per year



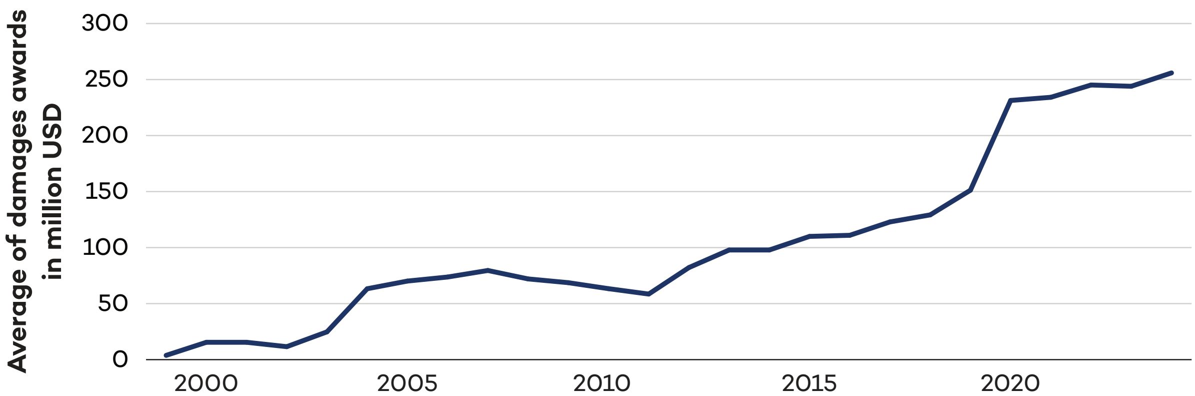
Source: UNCTAD, n.d.

In *Rockhopper v Italy*—an energy transition case—the arbitral tribunal ruled in favour of a British oil company in its dispute against Italy due to the denial of an offshore oilfield licence because of the regulatory ban. The tribunal awarded Rockhopper over 240 million, including interest, as compensation. The decision "increases the (public) price of keeping oil underground" (Marzal, 2023). Conservative estimates of existing fossil fuel investments assess the additional ISDS-related costs of energy transition at around USD 340 billion (Tienhaara et al., 2022).

However, ISDS has also been frequently invoked by renewable energy investors. Many investors in solar energy have sued governments for modifying subsidies (feed-in tariffs) that had been introduced to incentivize private investment in a nascent market through public support. Spain has had to defend itself in over 50 ISDS cases, the majority of which were won by the foreign investors.

The scale of the energy transition will require necessary regulatory experimentation, and taxpayers should not be bearing all the costs. ISDS, therefore, makes the regulation of renewables more costly as well because it places regulatory risks connected with investment activities on the public. ISDS freezes any governmental benefits accruing to investors for the future, making it costly for the government to revoke them when they are no longer relevant, needed, or efficient (as is the case with renewable energy subsidies).

Figure 9. Compensation awards in ISDS are growing



Note: Principal amounts awarded in cases decided in favour of the investor (n=256), excluding pre-award and post-award interest. The graph excludes the three Yukos cases (Hulley Enterprises v. Russia, Yukos Universal v. Russia, Veteran Petroleum v. Russia); the combined 50 billion USD awards are outliers that would significantly increase the average award size.

Source: UNCTAD, 2024a.

Did you know?

The total amount awarded in all known ISDS cases taken together is almost USD 120 billion (Transnational Institute, n.d.). This amount is likely higher as it does not include cases that are not publicly known.

This amount equals approximately

- **the GDP of entire countries**: USD 120 billion surpasses the GDP of over 100 countries, including nations like Kenya, Ecuador, and Luxembourg.
- **funding global development**: USD 120 billion could make a significant dent in global challenges. It's more than double the annual global spending on humanitarian aid, and could fund initiatives like fighting malaria, providing clean water access, or supporting education programs in developing countries for several years.
- **space exploration**: USD 120 billion is roughly the estimated cost of NASA's Artemis program, which aims to return humans to the Moon.

Question 7

What reforms are being made today? By whom?

Reform Options Abound

Reforms of investment treaties and global FDI governance are ongoing. Different actors are using various options.

- **renegotiation and amendment**: Reworking the treaties to introduce more balance between investor rights and public interests or simply replacing the objectives of investment protection with other objectives, such as support and facilitation of sustainable investment. Many states have taken this route and adapted their investment treaties to address some of the issues related to outdated investment treaties and ISDS.
- **adopting treaty models based on different objectives**: One option available to all states is to pave the way for investment treaties that do not take investment protection and dispute settlement as the primary preoccupation of the treaty. Some states have already taken steps toward such as an approach, e.g., Brazil's investment treaties based on facilitation and cooperation or the recent EU–Angola Sustainable Investment Facilitation Agreement. Such treaties may replace outdated and problematic investment protection treaties.
- **carve-outs**: Introducing specific provisions to exempt certain sectors or measures from the treaty scope or from ISDS (e.g., climate action measures).
- **treaty termination**: Countries may choose to exit or terminate treaties that no longer serve their purpose. This can be done by agreement with the other contracting party/parties, e.g., the EU Agreement for the Termination of BITs between member states or unilaterally various states (e.g., South Africa, Ecuador, Indonesia, and India) have selected this option. This may or may not be replaced by a new treaty.
- **withdrawal of consent to ISDS**: Some states are opting out of ISDS mechanisms altogether. International law offers mechanisms for how this can be effected. This option can also be effected with respect to a specific sector or types of measures.

Did you know?

While newer investment treaties move away from the investment protection model and ISDS, most (97%) of the outdated investment treaties remain in force and serve as a basis for virtually all ISDS cases. In addition, the new investment treaties have so far had very limited impact, given that tribunals interpret them as old treaties anyway.

There is a pressing need to reform the outdated investment treaties that contain broad investment protections and wide access to ISDS.

Multiple Reform Levels

Reforms may be adopted at the national, bilateral, regional, and multilateral levels, each of which presents different benefits and drawbacks.

Individual state reforms are the easiest to adopt. These can include redrafting national BIT models or withdrawing from treaties, including ISDS, that no longer serve the state's purpose.

Reforms at the bilateral and multilateral levels are more complex because they require coordination and agreement between states. On the other hand, the fact they are not unilateral enables them to have more consequential effects beyond national borders. For instance, two or more states can renegotiate investment treaties to make them compatible with sustainable development goals, produce statements to clarify certain limitations on how the investment treaty is applied, or coordinate their withdrawals from a multilateral agreement.

Examples of reform at various levels:

national level: Multiple states have adopted comprehensive actions directed at investment treaties. For instance, South Africa withdrew from its investment treaties and replaced them with national legislation that requires the exhaustion of local remedies. Following a series of negative arbitration rulings, Ecuador withdrew from most of its investment treaties. At the same time, Ecuador overhauled its domestic legislation covering foreign investments to clarify that disputes between foreign investors and Ecuador should primarily be resolved at the national level.

bilateral level: Brazil and India have recently designed new and innovative investment treaty models that differ from the typical investment protection treaties signed in the 1990s and 2000s. In the treaty they signed between themselves, they combined innovative features of each other's models. This treaty shows that important emerging economies can forge paths for innovative reform approaches.

regional level: The negotiation of the African Continental Free Trade Area Investment Protocol is an example of a regional reform to address common challenges related to investment governance and advance shared development objectives.

multilateral level: Regarding investment treaty reform, UNCTAD has been proposing various options for states keen on reforming their investment treaties. Regarding ISDS specifically, the most significant ongoing multilateral process is the United Nations Commission on International Trade Law Working Group III, which seeks to reform ISDS at the global level. This includes proposing solutions for some of the major issues with investment arbitration, such as lack of consistency, the manner in which compensation in ISDS is calculated, lack of transparency, and conflicts of interest. Most notably, Working Group III is discussing the creation of a multilateral investment court for resolving investment disputes that would include a dispute tribunal and an appellate tribunal.

Question 8

Why do we need an ambitious reform approach to investment treaties?

An ambitious and holistic approach to investment treaty reform is essential to ensure that investment law and governance promote sustainable development and benefit people and the planet. Reform efforts must go beyond what we see today (Question 7).

Reform efforts should not be primarily reactive, i.e., trying to solve the problems created by the existing investment treaty regime. They must be proactive, i.e., asking what kind of tools and instruments can solve today's policy problems of investment governance. Shoehorning tools to the problems they were not designed to solve in the first place is far from the optimal approach—you wouldn't use a hammer to crack an egg.

The main problems with the current system and its reform are as follows:

- **the prioritization of investor protection**: Most existing investment treaties emphasize the protection of foreign investors over critical public interest objectives, such as sustainable development, human rights, and environmental conservation. Investment is merely a means to deliver broader public goods. In the context of climate change and the gaping SDG investment gap, is the protection of investment really the crucial issue? A deeper reconsideration of policy objectives underpinning investment legal frameworks is, therefore, needed.
- **piecemeal reforms**: While there is merit to addressing ISDS reform starting with more targeted interventions, efforts to address issues in the system often narrowly focus on specific elements, such as ISDS. These piecemeal reforms fail to address the fundamental flaw: the disproportionate prioritization of investor protection at the expense of (a) public interest, (b) sustainability, and (c) solutions to other investment-related policy issues.
- **fragmentation of reform**: Reform initiatives are fragmented across various forums with overlapping but differing agendas. This lack of coordination leads to inconsistent progress and missed opportunities for comprehensive and lasting reform. Additionally, the fragmentation of reform itself causes additional costs and issues.

Did you know?

Countries have withdrawn from the International Centre for Settlement of Investment Disputes (ICSID) Convention, the treaty that provides the procedural and enforcement framework for the majority of ISDS cases. However, these actions are not enough if the country's investment treaties providing for ISDS remain in place. Additionally, countries remain exposed to claims under contracts and to tribunal interpretations that allow investors to file claims even after the denunciation of the ICSID Convention and the termination of the treaties.

Question 9

What would an ambitious investment law and governance reform look like?

Fundamental reform of investment law governance needs to go beyond modernizing investment treaties. It should overhaul the system not only by tackling the root cause of current flaws—how the ISDS system provides exaggerated investment protection and hinders states from tackling urgent challenges—but also by identifying the key governance challenges that need to be addressed.

An ambitious, holistic, and coherent reform should start from several broad principles.

Identification of Policy Problems We Face Today

Understanding the shortcomings of the current investment governance frameworks is essential. However, a crucial step in holistically addressing investment law and governance reform means having a serious conversation about what policy issues a reformed system should address. Various investment governance policy problems have been identified, ranging from support of sustainable investment to regulation of the impacts of investment projects to more specific issues related to investment governance and institutions. The reform discussions should not be held hostage by the policy problems formulated many decades ago and should instead be guided by the policy problems that exist today.

Rethinking the Objectives of Treaties

Relatedly, the purpose of investment treaties needs a fundamental re-evaluation. While many investment governance problems exist today, it is not a given that treaties have a useful role in their solution. In this regard, IISD is working toward developing a model for future investment treaties that respond to the most pressing policy problems of investment governance today.

Coherent and Holistic Reform

A coherent and holistic reform must, therefore, extend beyond investment treaties to encompass other legal instruments that regulate investment, including national investment laws and contracts. Moreover, coherence with other governance areas—such as human rights, environmental protection, and climate action—is key. Aligning investment governance with these domains will ensure consistency and reinforce international commitments. IISD has developed a toolkit to address various aspects of the coherence challenge (e.g., here and here).

Dismantle Outdated Instruments

Ambitious and holistic reform cannot succeed and would not be coherent if outdated legal instruments remain in place; doing so would be akin to building a house on weak foundations. Old-generation investment treaties, which fail to address today's complex policy challenges, must be either terminated or replaced with modern instruments.

Question 10

How can you contribute to an ambitious reform of investment law and governance?

Achieving investment law and policy reform that meets the economic, social, and environmental challenges facing countries today requires a coordinated effort from multiple actors, each playing a distinct role.

Governments must take the lead by modernizing treaties to reflect 21st-century challenges, sharing best practices, and addressing the inequities of the existing investment regime. To ensure reforms are inclusive and sustainable, they should engage a broad range of stakeholders.

Development institutions can provide technical expertise, create platforms for discussions, and support policy-makers navigating multilateral negotiations.

Universities and think tanks can conduct research, produce evidence-based policy recommendations, and facilitate dialogue between decision-makers and stakeholders.

Civil society and non-governmental organizations can raise awareness of the adverse impacts of outdated treaties and mobilize public engagement in reforms.

Media can shed light on harmful investment practices, inform public debates on reform options, and hold investors accountable.

Donors can provide necessary financial resources to enable development institutions, civil society, academia, media, and think tanks to scale up their actions.

Private sector associations can advocate for responsible business conduct and align their practices with sustainability goals and investment governance standards.

Law firms can raise awareness within the legal community about the evolving investment governance landscape and support their clients—particularly private sector actors—to align their investment practices with sustainability goals.

By working together, these actors can reshape investment governance to promote sustainable development that works for people and the planet.

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