

## REFORM OF THE IIA REGIME: FOUR PATHS OF ACTION AND A WAY FORWARD

### Highlights

- While almost all countries are parties to one or several international investment agreements (IIAs), many are dissatisfied with the current regime. Concerns relate mostly to the development dimension of IIAs, the balance of rights and obligations of investors and States, investor-State dispute settlement mechanism, and the systemic complexity of the IIA regime.
- Countries' current efforts to address these challenges reveal four different paths of action: (i) maintaining the status quo, largely refraining from changes in the way they enter into new IIA commitments; (ii) disengaging from the IIA regime, unilaterally terminating existing treaties or denouncing multilateral arbitration conventions; and (iii) implementing selective adjustments, modifying models for future treaties but leaving the treaty core and the body of existing treaties largely untouched. Finally, (iv) there is the path of systematic reform that aims to comprehensively address the IIA regime's challenges in a holistic manner.
- While each of these paths has benefits and drawbacks, systemic reform could effectively address the complexities of the IIA regime and bring it in line with the sustainable development imperative.
- Such a systemic reform process of the IIA regime could follow a gradual approach with carefully sequenced actions: (i) defining the areas for reform, (ii) designing a roadmap for reform, and (iii) implementing it at the national, bilateral and regional levels, with facilitation at multilateral level.
- A multilateral focal point like UNCTAD could support such a holistic, coordinated and sustainability-oriented approach to IIA reform, through its policy analysis, technical assistance and consensus building. The World Investment Forum could provide the platform and the Investment Policy Framework for Sustainable Development (IPFSD) the guidance.



# I. Introduction

Four different paths of IIA reform emerge: status quo, disengagement, selective adjustments and systematic reform.

The IIA regime is undergoing a period of reflection, review and reform. While almost all countries are parties to one or more IIAs, few are satisfied with the current regime for several reasons: growing uneasiness about the actual effects of IIAs in terms of promoting foreign direct investment (FDI)<sup>1</sup> or reducing policy and regulatory space, increasing exposure to investor-State dispute settlement (ISDS)<sup>2</sup> and the lack of specific pursuit of sustainable development objectives. Furthermore, views on IIAs are strongly diverse, even within countries. To this adds the complexity and multifaceted nature of the IIA regime and the absence of a multilateral institution (like the World Trade Organization (WTO) for trade). All of this makes it difficult to take a systematic approach towards comprehensively reforming the IIA (and the ISDS) regime. Hence, IIA reform efforts have so far been relatively modest.

Many countries follow a “wait and see” approach. Hesitation in respect to more holistic and far-reaching reform reflects a government’s dilemma: more substantive changes might undermine a country’s attractiveness for foreign investment, and first movers could particularly suffer in this regard. In addition, there are questions about the concrete content of a “new” IIA model and fears that some approaches could aggravate the current complexity and uncertainty.

IIA reform has been occurring at different levels of policymaking. At the national level, countries have revised their model treaties, sometimes on the basis of inclusive and transparent multi-stakeholder processes. In fact, at least 40 countries (and 5 regional organizations) are currently in the process of reviewing and revising their approaches to international-investment-related rule making. Countries have also continued negotiating IIAs at the bilateral and regional levels, with novel provisions and reformulations. Megaregional agreements such as the Trans-Pacific Partnership (TPP) or the Transatlantic Trade and Investment Partnership (TTIP) are a case in point.<sup>3</sup> A few countries have walked away from IIAs, terminating some of their BITs or denouncing international arbitration conventions. At the multilateral level, countries have come together to discuss specific aspects of IIA reform.

Bringing together these recent experiences allows the mapping of four broad paths that are emerging regarding actions for reforming the international investment regime (table 1):

- Maintaining the status quo
- Disengaging from the regime
- Introducing selective adjustments
- Engaging in systematic reform

Each of the four paths of action comes with its own advantages and disadvantages, and responds to specific concerns in a distinctive way. Depending on the overall objective that is being pursued, what is considered an advantage by some stakeholders may be perceived as a challenge by others. In addition, the four paths of action, as pursued

<sup>1</sup> See UNCTAD, *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries*. UNCTAD Series on International Investment Policies for Development, New York and Geneva: United Nations, 2009.

<sup>2</sup> See UNCTAD, *Latest Developments in Investor-State Dispute Settlement*, IIA Issues Note, No. 1, 2014.

<sup>3</sup> See UNCTAD, *World Investment Report 2014: Investing in the SDGs: An Action Plan*, Chapter III, New York and Geneva: United Nations (2014).

**Table 1. Four paths of action: an overview**

Path	Content of policy action	Level of policy action
<b>Systematic reform</b>	<p><b>Designing investment-related international commitments that:</b></p> <ul style="list-style-type: none"> <li>• create proactive sustainable-development-oriented IIAs (e.g. add SDG investment promotion)</li> <li>• effectively rebalance rights and obligations in IIAs (e.g. add investor responsibilities, preserve policy space)</li> <li>• comprehensively reform ISDS (i.e. follow five ways identified in <i>WIR 13</i>)</li> <li>• properly manage interactions and foster coherence between different levels of investment policies and investment and other public policies (e.g. multi-stakeholder review)</li> </ul>	<p><b>Taking policy action at three levels of policymaking (simultaneously and/or sequentially):</b></p> <ul style="list-style-type: none"> <li>• national (e.g. creating a new model IIA)</li> <li>• bilateral/regional (e.g. (re-)negotiating IIAs based on new model)</li> <li>• multilateral (e.g. multi-stakeholder consensus-building, including collective learning)</li> </ul>
<b>Selective adjustments</b>	<p><b>Pursuing selective changes to:</b></p> <ul style="list-style-type: none"> <li>• add a sustainable development dimension to IIAs (e.g. sustainable development in preamble)</li> <li>• move towards rebalancing rights and obligations (e.g. non-binding CSR provisions)</li> <li>• change specific aspects of ISDS (e.g. early discharge of frivolous claims)</li> <li>• selectively address policy interaction (e.g. not lowering standards clauses)</li> </ul>	<p><b>Taking policy action at three levels of policymaking (selectively):</b></p> <ul style="list-style-type: none"> <li>• national (e.g. modifying a new model IIA)</li> <li>• bilateral/regional (e.g. negotiating IIAs based on revised models or issuing joint interpretations)</li> <li>• multilateral (e.g. sharing of experiences)</li> </ul>
<b>Status quo</b>	<p><b>Not pursuing any substantive change to IIA clauses or investment-related international commitments</b></p>	<p><b>Taking policy action at bilateral and regional levels:</b></p> <ul style="list-style-type: none"> <li>• continue negotiating IIAs based on existing models</li> <li>• leave existing treaties untouched</li> </ul>
<b>Disengagement</b>	<p><b>Eliminating investment-related commitments</b></p>	<p><b>Taking policy action regarding different aspects:</b></p> <ul style="list-style-type: none"> <li>• national (e.g. eliminating consent to ISDS in domestic law and terminating investment contracts)</li> <li>• bilateral/regional (e.g. terminating existing IIAs)</li> </ul>

Source: UNCTAD.

today, are not mutually exclusive; a country may adopt elements from one or several of them, and the content of a particular IIA may be influenced by one or several paths of action.

This note discusses each path from the perspective of strategic regime reform. The discussion begins with the two most opposed approaches to investment-related international commitments: at one end is the path that maintains the status quo; at the other is the path that disengages from the IIA regime. In between are the two paths of action that opt for reform of the regime, albeit to different degrees.

The underlying premise of the analysis here is that the case for reform has already been made. UNCTAD's IPFSD, with its principle of "dynamic policymaking" – which calls for a continuing assessment of the effectiveness of policy instruments – is but one example.<sup>4</sup> Today's questions are not about whether to reform international investment policymaking but how to do so. Furthermore, today's questions are not only about the change to one aspect in a particular agreement but about the comprehensive reorientation of the global IIA regime to balance investor protection with sustainable development considerations.

<sup>4</sup> UNCTAD, *Investment Policy Framework for Sustainable Development: Towards a New Generation of Investment Policies (IPFSD)*, New York and Geneva: United Nations, 2012.

## II. Maintaining the status quo

At one end of the spectrum is a country's choice to maintain the status quo. Refraining from substantive changes to the way that investment-related international commitments are made sends an image of continuity and investor friendliness. This is particularly the case when maintaining the status quo involves the negotiation of new IIAs that are based on existing models. Above all, this path might be attractive for countries with a strong outward investment perspective and for countries that have not yet responded to numerous – and highly politicized – ISDS cases.

Intuitively, this path of action appears to be the easiest and most straightforward to implement. It requires limited resources (e.g. there is no need for assessments, domestic reviews and multi-stakeholder consultations) and avoids unintended, potentially far-reaching consequences arising from innovative approaches to IIA clauses.

At the same time, however, maintaining the status quo does not address any of the challenges arising from today's global IIA regime and might contribute to a further stakeholder backlash against IIAs. Moreover, as an increasing number of countries are beginning to reform IIAs, maintaining the status quo (i.e. maintaining bilateral investment treaties (BITs) and negotiating new ones based on existing templates) may become increasingly difficult.

## III. Disengaging from the IIA regime

At the other end of the spectrum is a country's choice to disengage from the international investment regime, be it from individual agreements, multilateral arbitration conventions or the regime as a whole. Unilaterally quitting IIAs sends a strong signal of dissatisfaction with the current regime. This path of action might be particularly attractive for countries in which IIA-related concerns feature prominently in the domestic policy debate.

Intuitively, disengaging from the IIA regime might be perceived as the strongest or most far-reaching path of action. Ultimately, for inward and outward investors, it would result in the removal of international commitments on investment protection that are enshrined in international treaties. Moreover, this would result in the effective shielding from ISDS-related risks.

However, most of the desired implications will materialize only over time and only for one treaty at a time. Quitting the system does not immediately protect the State against future ISDS cases, as IIA commitments usually endure for a period through survival clauses. In addition, there may be a need to review national laws and State contracts, as they may also provide for ISDS (including arbitration under the International Center for the Settlement of Investment Disputes (ICSID)), even in the absence of an IIA. Moreover, unless termination is undertaken on a consensual basis, a government's ability to terminate an IIA is limited. Its ability to do so depends on the formulation of the treaty at issue and may be available only at a particular, limited point in time.<sup>5</sup>

Moreover, eliminating single international commitments at a time (treaty by

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<sup>5</sup> UNCTAD, World Investment Report 2013: Global Value Chains: Investment and Trade for Development, New York and Geneva: United Nations (2013).

treaty) does not contribute to the reform of the IIA regime as a whole, but only takes care of individual relationships. Only if such treaty termination is pursued with a view to renegotiation can it also constitute a move towards reforming the entire IIA regime.

## IV. Introducing selective adjustments

Limited, i.e. selective, adjustments that address specific concerns is the path of action that is gaining ground rapidly. It may be particularly attractive for those countries that wish to respond to the challenges posed by IIAs but wish to demonstrate their continued, constructive engagement with the investment regime. It can be directed towards sustainable development and other policy objectives.

This path of action has numerous advantages. The selective choice of modifications can permit the prioritization of “low-hanging fruit” or concerns that appear most relevant and pressing, while leaving the treaty core untouched (see for example, the option of “tailored modifications” in UNCTAD’s five paths of reform for ISDS, figure 1). It also allows the tailoring of the modification to a particular negotiating counterpart so as to suit a particular economic relationship. Moreover, selective adjustment also allows the testing and piloting of different solutions; the focus on future treaties facilitates straightforward implementation (i.e. changes can be put in practice directly by the parties to individual negotiations); the use of “soft” (i.e. non-binding) modifications minimizes risk; and the incremental step-by-step approach avoids a “big bang” effect (and makes the change less prone to being perceived as reducing the agreement’s protective value). Indeed, introducing selective adjustments in new agreements may appear as an appealing – if not the most realistic – option for reducing the mounting pressure on IIAs.

At the same time, however, selective adjustments in future IIAs cannot comprehensively address the challenges posed by the existing stock of treaties.<sup>6</sup> It cannot fully deal with the interaction of treaties with each other and, unless the selective adjustments address the most-favoured-nation (MFN) clause, it can allow for “treaty shopping” and “cherry-picking”.<sup>7</sup> It may not satisfy all stakeholders. And, through all of this, it may lay the groundwork for further change, thus creating uncertainty instead of stability.

## V. Pursuing systematic reform

Pursuing systematic reform means designing international commitments that promote sustainable development and that are in line with the investment and development paradigm shift.<sup>8</sup> With policy actions at all levels of governance, this is the most comprehensive approach to reforming the current IIA regime.

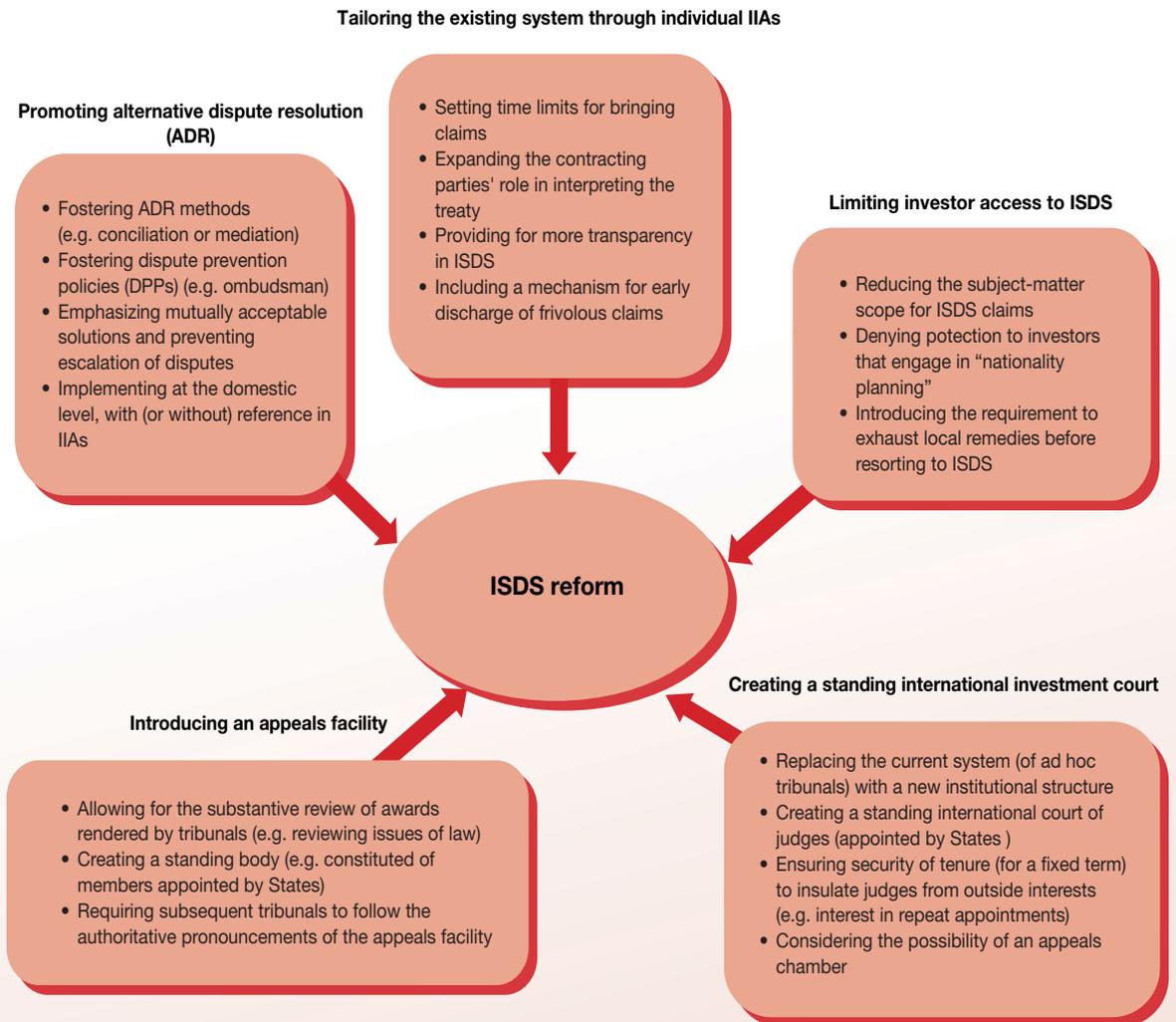
<sup>6</sup> Unless the new treaty is a renegotiation of an old one (or otherwise supersedes the earlier treaty), modifications are applied only to newly concluded IIAs (leaving existing ones untouched).

<sup>7</sup> Commitments made to some treaty partners in old IIAs may filter through to newer IIAs through a MFN clause (depending on its formulation), with possibility unintended consequences. For further information see: UNCTAD, Most-Favoured-Nation Treatment: A Sequel, New York and Geneva: United Nations (2010).

<sup>8</sup> UNCTAD, World Investment Report 2012: Towards a New Generation of Investment Policies, New York and Geneva: United Nations (2012).

This path of action would entail the design of a new IIA treaty model that effectively addresses the challenges of increasing the development dimension, rebalancing rights and obligations, and managing the systemic complexity of the IIA regime, and that focuses on proactively promoting investment for sustainable development. Systematic reform would also entail comprehensively dealing with the reform of the ISDS system, as outlined in last year's World Investment Report (figure 1).

**Figure 1. Five ways of reform for ISDS, as identified in *WIR13*, illustrative actions**



At first glance, this path of action appears daunting and challenging on numerous fronts. It may be time- and resource-intensive. Its result – more “balanced” IIAs – may be perceived as reducing the protective value of the agreements at issue and offering a less attractive investment climate. Comprehensive implementation of this path requires dealing with existing IIAs, which may be seen as affecting investors’ “acquired rights”. And amendments or renegotiation may require the cooperation of a potentially large number of treaty counterparts.

Yet this path of action is the only one that can bring about comprehensive and coherent reform. It is also the one best suited for fostering a common response from the international community to today’s shared challenge of promoting investment for the Sustainable Development Goals (SDGs).

## VI. A way forward: UNCTAD's perspective

Whichever paths countries take, a multilateral process is helpful to bring all parties together. It also brings a number of other benefits to the reform process:

- facilitating a more holistic and more coordinated approach, in the interest of sustainable development<sup>9</sup> and the interests of developing countries, particularly the least developed countries (LDCs);
- factoring in universally agreed principles related to business and development, including those adopted in the UN context and international standards;
- building on the 11 principles of investment policymaking set out in UNCTAD's IPFSD (table 2);
- ensuring inclusiveness by involving all stakeholders;
- backstopping bilateral and regional actions; and
- helping to address first mover challenges.

Multilateral facilitation and a comprehensive gradual approach to reform could effectively address the systemic challenges of the IIA regime.

**Table 2. Core Principles for investment policymaking for sustainable development**

Area	Core Principles
1 <b>Investment for sustainable development</b>	• The overarching objective of investment policymaking is to promote investment for inclusive growth and sustainable development.
2 <b>Policy coherence</b>	• Investment policies should be grounded in a country's overall development strategy. All policies that impact on investment should be coherent and synergetic at both the national and international levels.
3 <b>Public governance and institutions</b>	• Investment policies should be developed involving all stakeholders, and embedded in an institutional framework based on the rule of law that adheres to high standards of public governance and ensures predictable, efficient and transparent procedures for investors.
4 <b>Dynamic policymaking</b>	• Investment policies should be regularly reviewed for effectiveness and relevance and adapted to changing development dynamics.
5 <b>Balanced rights and obligations</b>	• Investment policies should be balanced in setting out rights and obligations of States and investors in the interest of development for all.
6 <b>Right to regulate</b>	• Each country has the sovereign right to establish entry and operational conditions for foreign investment, subject to international commitments, in the interest of the public good and to minimize potential negative effects.
7 <b>Openness to investment</b>	• In line with each country's development strategy, investment policy should establish open, stable and predictable entry conditions for investment.
8 <b>Investment protection and treatment</b>	• Investment policies should provide adequate protection to established investors. The treatment of established investors should be non-discriminatory.
9 <b>Investment promotion and facilitation</b>	• Policies for investment promotion and facilitation should be aligned with sustainable development goals and designed to minimize the risk of harmful competition for investment.
10 <b>Corporate governance and responsibility</b>	• Investment policies should promote and facilitate the adoption of and compliance with best international practices of corporate social responsibility and good corporate governance.
11 <b>International cooperation</b>	• The international community should cooperate to address shared investment-for-development policy challenges, particularly in least developed countries. Collective efforts should also be made to avoid investment protectionism.

Source: IPFSD.

Such multilateral engagement could facilitate a gradual approach with carefully sequenced actions. This could first define the areas for reform (e.g. by identifying key and emerging issues and lessons learned, and agreeing

<sup>9</sup> See UNCTAD, World Investment Report 2014: Investing in the SDGs: An Action Plan, Chapter IV, New York and Geneva: United Nations (2014).

on what to change and what not to change), then design a roadmap for reform (e.g. by identifying different options for reform, assessing them and agreeing on a roadmap), and finally implement the reform. Naturally, such multilateral engagement in consensus building is not the same as negotiating legally binding rules on investment.

The actual implementation of reform-oriented policy choices will be determined by and happening at the national, bilateral, and regional levels. For example, national input is essential for identifying key and emerging issues and lessons learned; consultations between countries (at the bilateral and regional levels) are required for agreeing on areas for change and areas for disagreement; national experiences are necessary for identifying different options for reform; and sharing such experiences at the multilateral level can help in assessing different options.

The successful pursuit of these steps requires effective support in four dimensions: consensus building, analytical support, technical assistance, and multi-stakeholder engagement.

- A multilateral focal point and platform could provide the infrastructure and institutional backstopping for *consensus building* activities that create a comfort zone for engagement, collective learning, sharing of experiences and identification of best practices and the way forward.
- A multilateral focal point could provide general backstopping and *analytical support*, with evidence-based policy analysis and system-wide information to provide a global picture and bridge the information gap.
- A multilateral focal point and platform could also offer effective *technical assistance*, particularly for low-income and vulnerable developing countries (including LDCs, land-locked developing countries (LLDCs) and small island developing States (SIDS)) that face challenges when striving to engage effectively in IIA reform, be it at the bilateral or the regional level. Technical assistance is equally important when it comes to the implementation of policy choices at the national level.
- A multilateral platform can also help ensure the *inclusiveness and universality* of the process. International investment policymakers (e.g. IIA negotiators) would form the core of such an effort but be joined by a broad set of other investment-development stakeholders.

Through all of these means, a multilateral focal point and platform can effectively support national, bilateral and regional investment policymaking, facilitating efforts towards redesigning international commitments in line with today's sustainable development priorities. UNCTAD already offers some of these support functions. UNCTAD's 2014 World Investment Forum will offer a further opportunity in this regard.



*World Investment Report 2014:  
Investing in the SDGs: An Action Plan*  
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