International Investment Law Reform under the Sustainable Development Goals: Conflict, Balance and Institutional Reconstruction

Yiran Song [1], Mengxi Zhang [2,*]

[1] School of Economics and Management, Shandong Agricultural University, Tai'an, China

[2] Sydney Institute of Language and Commerce, Shanghai University, Shanghai, China

* Corresponding Author Email: Mengxi.Zhang@student.uts.edu.au

Abstract. In the context of a fundamental principle of international law for which sustainable development has been widely accepted, this paper studies the structural conflict between sustainable development goals and traditional international investment law. This paper focuses on the imbalance between investor protection and host country regulatory rights. Meanwhile, this paper analyzes the environmental, economic and institutional challenges brought by the current international investment treaties and investor dispute settlement mechanism. Through literature review and typical case analysis, this paper evaluates the practical progress of the international community in rule reconstruction, dispute settlement mechanism reform and regional coordination. The study shows that traditional investment rules often restrict host countries from implementing environmental and industrial policies in line with sustainable development goals, and, points out that institutional reconstruction should be promoted from three ways: strengthening host countries' regulatory rights, reforming Investor-State Dispute Settlement (ISDS) mechanism and optimizing performance requirements, so as to provide support for building a more equitable and sustainable international investment governance system.

Keywords: Sustainable development goals, international investment law, investor-state dispute settlement.

1. Introduction

At present, the concept of sustainable development has gradually been widely accepted by the international community and developed into a recognized principle of international law [1]. This transformation marks the shift of global governance model from a single focus on economic growth to a development paradigm that fully integrates economic, social and environmental dimensions [2]. International investment treaties have long been the focus of both theoretical and practical attention. Traditionally, the Investor-State Dispute Settlement (ISDS) mechanism has provided strong protection for foreign investors. However, these agreements often neglect full recognition of the corresponding responsibilities and regulatory sovereignty of the host country. This imbalance has resulted in systemic tension, exacerbating structural pressures within the system. In other words, these investment treaties limit the ability of countries to develop and implement basic policies related to the environment, labor, and public health which policies are crucial to achieving sustainable development [3]. As a result, these treaties risk exacerbating inequality and inadvertently hindering the achievement of the Sustainable Development Goals (SDGs). The cause of these core conflicts lies in the inherent tension between unfettered investor rights and the regulatory autonomy necessary to promote sustainable development [4]. The core of resolving this conflict lies in assessing and redefining the hierarchy of values in global governance repeatedly.

The traditional investment framework places the property rights of investors at the top of this hierarchy, the SDGS require that non-economic values such as human rights, ecological integrity, and intergenerational equity be prioritized [2]. This means that society is in need of major institutional reforms eagerly Based on this, this paper adopts the method of literature review and typical case analysis. This paper aims to systematically analyze the structural core conflicts between the SDGs and traditional investment rules, evaluate the innovations and limitations of the new

generation of investment treaties in balancing the rights of investors and the regulatory power of host countries in the context of sustainable development, and explore the three key dimensions of the international community's efforts to achieve this balance.

2. Literature Review

In recent years, the concept of sustainable development has progressively entered the global consciousness. To align with the rapid evolution of the world economy, numerous nations have incorporated sustainable development principles into International Investment Agreements (IIAs). Certain provisions in these agreements conflict significantly with sustainable development objectives as traditional international investment law imposes constraints in both environmental and economic spheres. Host nations are compelled to accommodate investor interests while investors prioritise profit maximisation and arbitrarily undermine projects aligned with sustainable development objectives and economically the investment liberalisation principle championed by international investment law traps developing nations in a regulatory dilemma [2]. The lack of uniformity in international investment law hinders the application of sustainable development principles across different sectors and issues like insufficient consistency and transparency in ISDS rulings and the prohibition of enforcement clauses impeding industrial upgrading in developing countries also persist [1,3,5]. How to reform international investment law to address these conflicts has become a matter of global concern.

Current reforms in international investment law have explored multiple avenues for rule reconstruction with a marked increase in both the number and types of environmental provisions in international investment agreements granting host states greater regulatory latitude in public interest areas like environmental protection and public health [6]. To prevent institutional inequity some research advocates classifying states by quantifiable economic criteria and designing differentiated obligations assisting developing countries in progressively enhancing their obligation-fulfilling capacity to achieve substantive equity [7]. These regulatory adjustments provide an institutional foundation for strengthening state regulatory authority and balancing the interests of investors and host states. Addressing the structural flaws of ISDS current dispute resolution mechanisms have two pathways—procedural reform or institutional revolution with some scholars advocating focusing on procedural refinement and transparency enhancement and others proposing establishing a permanent court with an appeal mechanism to unify legal interpretation and accommodate public interests [8]. Regional coordination is regarded as a vital pathway for advancing sustainable development and confronted with the digitalisation and fragmentation of regional agreements scholars recommend incorporating sustainable development goal-oriented provisions coordinating data flows with regulatory authority and further calling on developed nations to support developing countries in establishing data governance frameworks.

On this basis, this paper contends that reforming international investment law requires a three-pronged approach: reconstructing rules, reforming dispute resolution mechanisms, and fostering regional coordination. This will establish an institutional framework aligned with sustainable development objectives.

3. Conflicts and Challenges between Sustainable Development Goals and International Investment Law

3.1. Conflicts in Environmental Dimensions

The case of Suez v. Argentina shows the limitations of traditional investment provisions on environmental measures. Traditional international investment law takes "investor interest protection" as the core rule design, which is a significant conflict with the environmental dimension of the SDGs, such as SDG 13 "climate action", SDG 15 "terrestrial life", etc. This is evident in the limitations imposed by traditional investment provisions on the environmental regulatory authority

of the host state. These restrictions are mainly implemented through vague provisions such as "indirect takings", "fair and equitable treatment (FET)", which lead the Investors often file ISDS claims on the grounds that environmental regulation harms their investment interests, and makes Host countries fall into the " Chilling Effect" and dare not rashly promote environmental policies to achieve SDGs [4].

The case of Vattenfall AB v. Germany provides a classic illustration of this conflict. In order to implement the climate governance goals of the Paris Agreement, Germany has implemented a phased shutdown policy of nuclear power plants to promote the transition of energy structure to renewable energy. However, an energy company from Swedish which is called Vattenfall has filed a claim for approximately €4.7 billion against Germany through the ISDS, arguing that the government shutdown measures constitute indirect expropriation. At the end of this incident the arbitration tribunal did not fully support the investors' claims but clearly determined that Germany's environmental regulation measures "caused material damage to the legitimate investment expectations of investors", and required Germany to adjust the regulation scheme to reduce the impact on the economic interests of investors [4]. The ruling highlights the value of the traditional investment rule that, while aiming to achieve the global environmental public good, host countries need to give priority to the private economic interests of investors. Then, the rights and interests of host countries are compressed to implement the policy space of SDGs.

It had been seen that the total number of ISDS claims involving environmental regulation reached 127 between 2010 to 2020 in the world. In 32% of these cases, the tribunal held that the environmental measures adopted by the host state amounted to a breach of the investment agreement. The fields include renewable energy subsidies adjustment, regional pollution prevention and control legislation revision, national ecological reserve delineation, etc. [8]. These data confirm the prevalence of this conflict further. Lone Pine Resources Inc. v. Canada, for instance, in order to protect the security of fresh water resources, Government of Canada has issued a ban on shale gas development. But Lone Pine filed an ISDS claim on the grounds that the injunction constituted indirect takings. Although the arbitral tribunal has not yet made a final award, the protracted duration of the case has exerted a "deterrent effect" on Canada's subsequent environmental policymaking which has led to a significant delay in its original legislative plan for ecological protection [9]. This shows that traditional investment terms do not reserve reasonable space for host country environmental regulation absolutely. This leads to a confrontation between SDGs environmental goals and investment protection.

3.2. Conflicts in the Economic Dimension

The traditional international investment law maintains "investment liberalization" as the core principle basically. However, the design of the rules does not actually embed supporting mechanisms to support capacity building in developing countries. This leads the developing country is difficult to achieve SDGs economic goals through foreign capital utilization.

Take the Ethiopian textile industry as an example. In order to attract foreign investment into the textile industry, Ethiopia has promised to lower the market access threshold in its IIAs. However, the agreement does not require foreign enterprises to provide technical training or industrial cooperation support. As a result, the local labor force is limited to low-skilled processing links for a long time and cannot enter the high value-added industrial chain. At the same time, the clause of "banning local ingredient requirements" in IIAs makes foreign enterprises import raw materials from overseas, which fails to promote the related development of Ethiopia's local agriculture and textile accessory manufacturing industry, and leads to the "low-end lock" of Ethiopia's textile industry finally, which makes it difficult to optimize the industrial structure through foreign investment [1]. This kinds of the lack of capacity building mechanisms are not Rule oversight, but the result of the skewed interests led by developed countries, however, the developing countries suffer from deficits in bargaining power, which is difficult to promote the inclusion of "capacity building" into the core provisions of the agreement, and eventually fall into the rule dilemma of

"investment liberalization ≠ development" [2]. It can be predicted that the imbalance of voice power of ISDS mechanism will further aggravate the economic disadvantage of developing countries in the field of investment. This is in marked contrast with the goal of the SDGs to "reduce inequality between countries."

3.3. Challenges at the Institutional Level

3.3.1 Imbalance between the regulatory rights of host countries and the rights and obligations of foreign investorsg

The "fragmented" characteristics of IIAs make the implementation of SDGs in the investment field lack the support of unified rules, which leads to the problem of "selective implementation" of SDGs actions at the national level ulteriorly. At the level of "investment definition", some IIAs include "government bonds" and "intellectual property licenses" in the scope of protection (such as the US 2012 BIT model), while others explicitly exclude such assets (such as the Indian 2015 BIT model); In terms of the identification standard of indirect levy, some agreements emphasize the economic impact of measures (such as the Canadian BIT model), while others focus on the public purpose of government measures (such as the Comprehensive Economic and Trade Agreement (CETA) of the European Union) [1,4]. For example, Brazil's BIT model which before 2015 does not specify investors' environmental protection obligations, resulted in foreign mining enterprises ignoring ecological protection when mining in the Amazon region, and it is difficult for the host country to hold them accountable through investment rules [3]. However, the root cause of the imbalance of rights and obligations lies in the "neoliberal" value orientation of traditional investment law and the weak bargaining power of developing countries. Meanwhile, the developing countries are shown to face significant bargaining power deficits in IIA negotiations which always show some certain imbalance problems.

3.3.2 Institutional defects of ISDS

The institutional defects of ISDS mainly involve the defects of independence, consistency and transparency.

It is hard to make sure the appointment mechanism of ISDS arbitrators maintains complete independence from their practice background. It might result in a bias towards investors' interests, which is contrary to SDG 16's goal of "building effective, accountable and inclusive institutions". From the perspective of arbitrator appointment mechanism, ISDS arbitration tribunals, the investor and the host country each appoint an arbitrator and then appoint the chief arbitrator together. However, investors often select arbitrators who are inclined to investors through the arbitrator selection list. This may reflect an implicit bias of the appointment mechanism towards investors.

The lack of a unified precedent system and rules of interpretation in ISDS mechanism leads to significant inconsistency in adjudication results, which not only affects the predictability of investment rules, but also makes the consideration of SDGs in dispute settlement lack stability [5]. However, this inconsistency of adjudication makes it difficult for SDGs to form a systematic consideration in dispute settlement, which may lead to an arbitral tribunal recognizing the legitimacy of the host country's climate policy. The other tribunal may find that such policies constitute a breach of contract, which seriously undermines national confidence in implementing the SDGs through regulation.

In the meantime, ISDS procedures lack effective public participation mechanisms and information disclosure rules, making it difficult for public interests related to SDGs (such as environment and labor rights) to be fully expressed and considered [9]. Most ISDS hearings are closed, only a few arbitration bodies (such as International Centre for Settlement of Investment Disputes, ICSID) allow third parties (such as environmental groups, local communities) to submit written opinions. However, third parties are not allowed to attend hearings or participate in cross-examination. As a result, third-party organizations such as communities cannot confirm whether their environmental rights and interests are protected.

4. Sustainable Development Reforms in International Investment Law

4.1. Rule Reconstruction

4.1.1 Environmental dimension

To align with international environmental treaties such as the Paris Agreement, which require the integration of climate objectives into investment agreements, the exclusion of protection for highly polluting investments, and the encouragement of green investment, the number of IIAs incorporating environmental provisions has increased from approximately 100 to nearly 500 since 1958, particularly over the past two decades. with greater diversity in clause types, including safeguarding host state regulatory authority, incorporating environmental protection as treaty objectives, and establishing state continuing obligations [6,8]. Moreover, in response to global environmental challenges such as climate change and biodiversity loss, international investment law is undergoing a paradigm shift from "neoliberalism" to "embedded liberalism". This transition moves away from a model emphasising market freedom and restricting state intervention towards one permitting states to maintain regulatory space for public interests such as the environment and health while safeguarding markets.

4.1.2 Economic dimension

The existing system for developing member status in the World Trade Organisation causes emerging economies to receive the same treatment as at least developed countries thus giving rise to systemic inequity. The field of international investment law also sees the existence of such a disparity as countries at different stages of development bear the same obligations under investment agreements impeding the sustainable development progress of developing countries. International investment law can classify countries based on quantifiable and verifiable objective criteria such as economic indicators thereby facilitating the design of differentiated environmental obligations, technology transfer provisions, and transition period arrangements and also promoting the establishment of Special and Differential Treatment (SDT) providing developing countries with a "transition period" to progressively open up sensitive sectors [7].

Under the current SDT, some scholars contend that greater emphasis should be placed on capacity-building in developing countries assisting them in gradually adapting to the rules and enhancing their ability to comply, which aligns with the previously mentioned "embedded liberalism" concept in international investment law [7].

4.2. Reform of the Dispute Settlement Mechanism

The current ISDS system has structural flaws impeding sustainable development and on ISDS reform two divergent reform pathways exist: procedural reform and institutional revolution. The United Nations Commission on International Trade Law (UNCITRAL) advocates incremental reform focusing on improving arbitration procedures, codes of conduct and transparency while establishing multi-party advisory centres to assist developing countries in addressing arbitration yet this approach fails to resolve the fundamental issue of unbalanced rights between investors and states. The institutional revolution advocated by the European Union proposes replacing ad hoc arbitration with a permanent court to enhance credibility, establishing an appeal mechanism to correct legal errors in arbitral awards, unifying interpretations of key concepts and better balancing investor rights with public interests. This paper concludes the ultimate goal of ISDS reform is to build an international investment governance system that both protects investment and safeguards host states' regulatory authority to pursue sustainable development objectives.

With these reform pathways combined preliminary outcomes now exist for ISDS. The ICSID remains the most frequently utilised ISDS institution yet has seen declining usage in recent years. In 2020 ICSID revised its rules introducing an appeal mechanism alongside expedited arbitration procedures that cut case duration to around 400 days and set deadlines for awards to avoid delays thus boosting efficiency controlling arbitration costs and increasing hearing transparency [10].

Other institutions have also put forward similar reform proposals reflecting international consensus on integrating sustainable development objectives into investment dispute resolution mechanisms.

4.3. Regional Synergy

Sustainable development requires global cooperation and regulatory coordination the existence of regional agreements has caused divergent national data regulations creating a fragmented digital market that hinders sustainable development. Data localisation requirements and restrictions on cross-border data flows serve as new trade barriers especially disadvantageous to developing countries [11]. IIAs should take the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Digital Economy Partnership Agreement (DEPA) as templates promote the inclusion of SDG-oriented provisions in regional agreements thus safeguarding national regulatory authority while facilitating cross-border data flows and preventing excessive restrictions that impede economic development. Developed nations should provide technological and financial support to assist developing countries in carrying out reforms establishing data security and privacy protection systems and narrowing the digital divide.

5. Conclusion

This paper uses literature review and case analysis to systematically examine structural conflicts between SDGs and international investment law as well as pathways for institutional restructuring. It identifies systemic impediments to SDG achievement in traditional international investment rules across environmental, economic and institutional dimensions and elaborates on the necessity and feasibility of advancing international investment law toward an "embedded liberalism" paradigm. This study shows profound structural conflicts exist between SDGs and traditional international investment law rules which mainly manifest in the weakening of host state regulatory authority, institutional flaws in the ISDS mechanism and restrictions from performance requirement clauses on sustainable development policies. Such conflicts not only restrict national policy space in environmental, social and public interest fields but also hinder global realisation of sustainable development objectives making systemic reform of international investment law urgent. This paper proposes a three-pronged institutional restructuring logic focused on rule reconfiguration, dispute resolution mechanism reform and regional coordination and argues that the future development of international investment law should follow a sustainability-oriented approach to achieve the unity of investment protection and global public interests through institutional restructuring. Future reforms to international investment law should further clarify the legal status of sustainable development principles and it is hoped that more scholars will conduct in-depth research on improving the operational feasibility of international investment agreements and promoting developing countries' substantive participation in these reforms.

Author Contribution

All the authors contributed equally and their names were listed in alphabetical order.

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