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Research Report

Room to move: Building flexibility into investment treaties to meet climate-change commitments

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Room to move: Building flexibility into investment treaties to meet climate-change commitments*

by

Rachel Thrasher**

Science and society speak loud and clear on climate change. Time is running out, and a massive transformation is needed to align our economic lives with the world's climate needs.

Countries worldwide have adopted new laws to incentivize the renewable energy sector and encourage energy transitions, while discouraging the reliance on fossil fuels. Concurrently, developing countries, in particular, must balance this transition with the development needs of their constituents. These new laws, often called “green industrial policy,” are also relevant for foreign investors, prompting them to put their money in green energy while also contributing to the diversification of the local economy. The World Bank, the IMF and other international institutions have begun, albeit inconsistently, to support these laws through institutional policies prioritizing climate-friendly development projects.

But the international investment regime simply lags behind science, society and even international financial institutions. The vast majority of investment treaties focus on protecting investment, while remaining neutral on the impact of that investment. As a result, these treaties discourage measures favoring climate-friendly (or discouraging climate-harmful) investment. New treaty language only marginally increases policy flexibility. Some new treaties address climate change by reaffirming commitments in various multilateral climate accords (e.g., [Brazil-Chile](#), [Ecuador-EFTA](#)). These provisions demonstrate an encouraging orientation by governments, but generally do not allow treaty parties to hold each other accountable to these commitments. Other new treaties contain investment provisions that tackle climate-change challenges through investment-facilitation provisions—seeking to increase investment in environmentally friendly goods and services (e.g., [EU-Japan](#), [EU-Singapore](#)). Facilitation language, however, only goes part of the way and still puts liberalized investment regimes over governments' right to regulate key sectors. Still others preserve the right to roll back certain investment incentives, even if investors' interests are adversely affected (e.g., [CETA](#), [EU-Vietnam](#)), but they have yet to be tested and often (paradoxically) omit any direct mention of climate change.

While recent treaties tinker at the margins of traditional investment commitments, the current regime continues largely to bind policy-makers' hands in climate-change policy. Three types of international cases illustrate the legal obstacles that countries face in this respect:

- When countries tie investment incentives to building up the domestic renewable energy industry through local content requirements, the WTO has found them in violation of its rules (e.g., [Canada-FIT](#), [India-Solar](#), [US-Renewables](#)).
- When countries put in place (otherwise treaty-compliant) investment incentive programs for renewable energy, they have faced investor-state suits when the incentives are too successful, too quickly, and governments cannot meet both the demands of investors and needs of their domestic consumers (e.g., [Foresight v. Spain](#), [Antaris v. Czech Republic](#)).
- When countries attempt to phase out traditional energy sources (such as coal), they have been sued by those companies for violating investment treaty obligations (TransCanada, Westmoreland).¹

This reality has led some countries to withdraw from investor-state enforcement mechanisms and investment treaties entirely. However, not all countries have the political power or will to do so. For those countries, a different approach is needed. Treaties should allow countries to experiment with climate adaptation policies that promote green industrial growth, and discourage such climate “bads” as investment in fossil fuels.

Some modest solutions could make meaningful steps toward that goal. First, countries could agree temporarily to “greenlight” industrial policies that increase (long term) global competition in the renewable energy industry.² This approach, modelled after a [phased-out subsidies rule in the WTO](#), would allow countries to provide domestic supports and implement industrial policies to encourage renewable energy production, thus building up local renewable energy sectors and making renewable energy more accessible and affordable in the long-run.

Furthermore, treaties ought to distinguish between policies and protections for the renewable energy industry and the fossil fuel sector. This approach, adapted from a fisheries subsidies rule in the [Comprehensive and Progressive Trans-Pacific Partnership](#),³ would require countries to treat investment in fossil fuels differently, removing traditional supports in the form of subsidies and discouraging countries from strengthening their own fossil fuel sector through industrial policies. When combined with the greenlit policies permitting subsidies and other support in renewable energy, such provisions could create incentives for fossil fuel companies (and others) to invest in the energy transition effort as well.⁴

The road to structural change is long, and we must begin immediately to align economic and climate goals. Governments must have room to move and respond flexibly to the needs of their constituents. New treaties must reflect this reality, taking an approach that allows countries to evaluate both the short- and long-term impacts of FDI in their economies.

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¹ [Lisa Sachs, Ella Merrill and Lise Johnson, "Environmental injustice: How treaties undermine the right to a healthy environment," *Bilaterals*, Nov. 13, 2019.](#)

² [Thijs Van de Graaf and Harro van Asselt, "Introduction to the special issue: Energy subsidies at the intersection of climate, energy, and trade governance," *International Environmental Agreements: Politics, Law and Economics*, vol. 17 \(2017\), p. 322.](#)

³ [Margaret A. Young, "Energy transitions and trade law: Lessons from the reform of fisheries subsidies," *International Environmental Agreements: Politics, Law and Economics*, vol. 17 \(2017\), p. 382.](#)

⁴ [Sarah Keah-Bright and Steivan Defilla, "Energy Charter Treaty should end protection for fossil fuels," *Energy Post*, Mar. 20, 2019.](#)

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