Chapter 10.
The Regulatory Perspective: Steering Investors

The last Chapter has demonstrated how investor obligations rebalance IIAs by emphasising the public interest more strongly. In doing so, it has considered how investor obligations affect IIAs' original purpose to protect investors and attract foreign investment. This Chapter will show that investor obligations may also provide investment law with an entirely new function: to serve as an international regulatory instrument that steers investors' behaviour.

Considering that, originally, investment law only awarded investor rights, its use to regulate investment was never at stake. As investor obligations have emerged, they prompt an inquiry if IIAs could now serve such a purpose (I.). The Chapter presents two regulatory approaches that investor obligations could follow: 'command-and-control' and 'incentive-based' regulation (II.). It is submitted that investor obligations hardly ever serve the former function. They allow states to 'command and control' investors only reactively because the investor has to invoke investment protection first (III.). Instead, they constitute a promising incentive-based regulatory approach: Investor obligations use investor rights as leverage to induce compliance (IV.).

I. Considering international regulation of foreign investment

Chapter 10 takes a perspective that is unusual for investment law. It asks if IIAs could represent an international tool to steer foreign investors' behaviour.

The term 'regulation' has been employed in various ways. Generally, regulation aims to make sure that persons behave in a certain manner to meet a regulatory goal. Traditionally, regulation is understood as authoritative rule-making to control the behaviour of private actors, typically by the state in its domestic legal system.[1] Many international treaties serve to

1 For such an understanding see for example Jacob K Cogan, 'The Regulatory Turn in International Law' (2011) 52(2) Harvard International Law Journal 321, 324.

harmonise such rules or to provide minimum standards. For example, human rights treaties address how states should protect human rights against infringements by private parties such as investors. ILO Conventions define minimum labour standards in the relationship between employers and employees. Therefore, these international treaties embody obligations for states to regulate the behaviour of private actors. In contrast, originally IIAs did not serve this regulatory purpose. Instead, as seen,[2] they should discipline host states in their actions towards investors.

The findings of Parts I and II could change this assessment. As investor obligations have been established, IIAs may take over new functions beyond the attracting of (quality) foreign investment. In that, they could become more similar to treaties that engage in international regulation, such as human rights and labour protection treaties mentioned above.

This leads to a further question that Chapter 1 has presented: Could IIAs play a part in addressing the regulatory problems that states encounter vis-à-vis transnationally operating corporations? To recall,[3] their economic power challenges states' capacity to effectively regulate them within their territory. Foreign investors form a subgroup of these corporations. For example, investors' main assets may be located in third states and thus out of host states' reach. What is more, the host state may be unwilling to protect the public interest – or unable to do so due to organisational, financial, political or other deficits.[4]

II. Relevant regulatory strategies

Domestic and international regulatory approaches are plenty. States have adopted regulatory strategies that go beyond the above-mentioned authoritative rule making.[5] For the present purpose, the study will concentrate on contrasting two regulatory strategies which serve to classify investor obligations' potential best: 'command-and-control' (1.) and 'incentive-based' (2.) regulation.

---

2 See Chapter 9.I and Chapter 9.III.2.

3 See in more detail Chapter 1.III.1.

4 On the unwilling and the unable state see Anne Peters, *Beyond Human Rights: The Legal Status of the Individual in International Law* (Cambridge University Press 2016) 76.

5 For an in-depth analysis of different regulatory approaches see Peter Drahos (ed), *Regulatory Theory: Foundations and Applications* (Australian National University Press 2017).

1. Command-and-control

The term 'command-and-control' shall be understood as regulation that relies on law's authoritative character. It operates by prohibiting unwanted behaviour and actively responding, suppressing or punishing it when it occurs. In domestic legal systems, it relies on courts and executive agencies to investigate violations and enforce rules against the non-compliant person's will[6] – conforming with the traditional understanding of regulation mentioned above.

But command-and-control regulation also takes place on the international level. The most advanced example is that of international criminal law. These international norms are enforced against individual perpetrators before international tribunals such as the International Criminal Court. However, similar international command-and-control mechanisms against businesses are missing. As seen above, critics argue that non-binding CSR rules are not enough to compel businesses to comply with human rights.[7] It is one of the main reasons why a Working Group at the UN level is currently debating 'an international legally binding instrument to regulate, in international human rights law, the activities of transnational corporations and other business enterprises'.[8] However, regulatory gaps

---

6 This term builds for example on literature on international environmental protection governance, see for example Sanja Bogojević, 'Ending the Honeymoon: Deconstructing Emissions Trading Discourses' (2009) 21(3) Journal of Environmental Law 443, 460–461; see also the overview and comparison with other policy instrument terms in a regulatory theory-perspective by Neil Gunningham and Darren Sinclair, 'Smart Regulation' in Peter Drahos (ed), *Regulatory Theory: Foundations and Applications* (Australian National University Press 2017) 140; for a more general theoretical contextualisation of coercion in inter-state international law from the perspective of international relations see Beth A Simmons, 'International Law' in Walter Carlsnaes, Thomas Risse and Beth A Simmons (eds), *Handbook of International Relations* (2nd edn, Sage 2013) 366–367.

7 See Chapter 1.III.1.

8 See the original mandate in UN Human Rights Council 'Elaboration of an Internationally Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with Respect to Human Rights' UN Doc A/HRC/RES/26/9 (14 July 2014), no 1; for a comprehensive scholarly analysis see Surya Deva and David Bilchitz (eds), *Building a Treaty on Business and Human Rights: Context and Contours* (Cambridge University Press 2017). However, it is important to note that the envisaged treaty should not only reflect command-and-control regulation but also contains cooperative elements, see for example UN Human Rights Council 'Elements for the Draft Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with Respect to Human Rights' (29 September

exist for the protection of other individual rights and public goods too, and call for similar command-and-control approaches – for example international labour law.[9]

2. Incentives

'Incentive-based regulation' is a regulatory strategy which aims to achieve voluntary compliance. To that end, it offers advantages to the addressee and makes them contingent on a certain desired behaviour. In contrast to the command-and-control setting, it does not primarily rest on proscribing behaviour and investigating, as well as punishing, non-compliance. Instead, the threat of possible, enforceable sanctions stands in the background and can fuel the incentivising effect.[10]

Domestic legal systems have a long tradition of incentive-based policy strategies to steer foreign investment. One may name the granting of fiscal incentives like tax breaks and tariff reliefs or grants, aids and credits.[11] For example, in 2018, the UN Human Rights Council has proposed that states should condition export credits upon respect for human rights.[12]

2017) ‹www.ohchr.org/Documents/HRBodies/HRCouncil/WGTransCorp/Session3/LegallyBindingInstrumentTNCs_OBEs.pdf› accessed 7 December 2021, 12.

9 cf on labour standards Patrick Abel, 'Comparative Conclusions on Arbitral Dispute Settlement in Trade-Labour Matters Under US FTAs' in Henner Gött (ed), *Labour Standards in International Economic Law* (Springer International Publishing 2018) 164–180.

10 See for example the importance of the loss of advantages as a form of reciprocal self-enforcement of international law from the perspective of rationalist international relations, laid out by Simmons (n 6) 367–369; for an economic viewpoint see Eric A Posner and Alan O Sykes, *Economic Foundations of International Law* (Belknap Press of Harvard University Press 2013) 20–26 for an interpretation of international law as a mechanism of bargaining and incomplete contracting. Incentive-based regulation appears comparable to the so-called 'leverage regime' that is contrasted with the 'cessation regime' in the business and human rights discussions as for example distinguished by Radu Mares, 'Legalizing Human Rights Due Diligence and the Separation of Entities Principle' in Surya Deva and David Bilchitz (eds), *Building a Treaty on Business and Human Rights: Context and Contours* (Cambridge University Press 2017) 288–292.

11 Further details with examples of specific countries are presented by Peter Muchlinski, *Multinational Enterprises and the Law* (2nd edn, Oxford University Press 2007) 219–226.

12 UN Human Rights Council 'Report of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises'

Here, it is the home state of a corporation which incentivises public interest-friendly behaviour abroad. In this example, investors have an interest to comply with human rights to receive export credits. If they do not meet the requirements, they are disqualified from obtaining them. In situations of non-compliance, the state may also demand export credits back – which constitutes the mentioned threat of a sanction.

Incentive-based regulation should be distinguished from policies which rest on pure cooperation. The latter do not offer defined advantages for compliance. Similarly, they exclude threatening legal sanctions. Instead, cooperation builds on common moral perceptions which should persuade private actors to act in accordance with the public interest. It assumes that the majority of persons are willing to behave, at least to a certain extent, altruistically.[13] For example, CSR norms largely follow this cooperative approach – possible consumer pressure is too diffused to qualify as a defined threat and is not of a legal character.[14] In contrast, incentive-based regulation relies on addressees' self-interest to gain advantages the state offers.

UN Doc A/HRC/38/48 (2 May 2018), paras 38–79. cf the general overview on conditionality by Cesare Pinelli, 'Conditionality' in Anne Peters (ed), *Max Planck Encyclopedia of Public International Law* (November 2013); on the conditionality practice of the EU, see Daniela Donno and Michael Neureiter, 'Can Human Rights Conditionality Reduce Repression? Examining the European Union's Economic Agreements' (2018) 13(3) The Review of International Organizations 335, 336–357; for the practice of the IMF see Randall W Stone, 'The Scope of IMF Conditionality' (2008) 62(4) International Organization 589, 591–617; on the potential impact on the public interest see Matthias Sant'ana, 'Risk Managers or Risk Promoters? The Impact of Export Credit and Investment Insurance Agencies on Human Development and Human Rights' in Johan F M Swinnen, Jan Wouters and Olivier D Schutter (eds), *Foreign Direct Investment and Human Development: The Law and Economics of International Investment Agreements* (Routledge 2013) 193–230.

13 In international relations, this approach is categorised as ideational, see for example Simmons (n 6) 369–372; specifically on the role of reputation see for example Mark J C Crescenzi, *Of Friends and Foes: Reputation and Learning in World Politics* (Oxford University Press 2018) 29–84. There are also other models, for example theory on so called value-driven behaviour, see Tom R Tyler, 'Value-Driven Behavior and the Law' in Francesco Parisi (ed), *The Oxford Handbook of Law and Economics*, vol I Methodology and Concepts (Oxford University Press 2017) 405–416. On the advantages of such a 'soft law'-approach from the relevant actors' perspectives see Kenneth W Abbott and Duncan Snidal, 'Hard and Soft Law in International Governance' (2000) 54(3) International Organization 421, 434–450.

14 See further Chapter 1.III.1 on international CSR norms.

III. IIAs as limited command-and-control regulation

This section will first consider if investor obligations can serve as a form of international command-and-control regulation. It is suggested that they qualify as such only to a very limited extent.

At first glance, their legally binding character appears to conform with the command-and-control setting (1.). However, states cannot initiate their enforcement. Rather, their sanctions come into effect only *reactively* after investors have themselves invoked an investor right. Thus, investor obligations are not well suited to actively respond to unwanted behaviour and punish investor misconduct (2.).

1. Binding international public interest standards

Investor obligations fit the command-and-control approach to the extent they bring about legally binding international standards.[15] One can illustrate this with a comparison to the business and human rights discussion. Many investor obligations realise core suggestions of the 2017 Elements for the Draft Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with Respect to Human Rights of the related UNHRC Open-ended Intergovernmental Working Group. These draft elements included the proposal to create human rights obligations directly applicable to corporations – a property which the three subsequently discussed treaty drafts developed by the Working Group did not pursue any further.[16] From its proposals, investor obligations adopt for example the following:

– Corporations should comply with all applicable laws,[17]
  resonating in investor obligations to comply with domestic and international law;[18]

15 On the legally binding character of direct obligations see Chapter 2; on the partly compulsory character of indirect obligations see Chapter 6.II.

16 See above Chapter 1.III.1.

17 UNHRC 'Elements for the Draft Legally Binding Instrument on Transnational Corporations' (n 8) 6.

18 See for example Chapter 3.IV, Chapter 3.VI, Chapter 7.I.2, Chapter 7.I.3.

- businesses should abide by internationally recognised human rights, prevent human rights impacts of their activities and use their influence to help promote and ensure respect for human rights,[19]
  reflected in many investor obligations which build on international standards outside of investment law;[20]
- enterprises should be bound by human rights with a broad substantive scope, including the protection of labour rights, the environment and the combatting of corruption,[21]
  mirrored by the comprehensive and inclusive scope of investor obligations;[22]
- entrepreneurs should face legal liability for human rights abuses,[23]
  brought about by the investor obligations' legal consequences of a breach: compensation or loss of investor rights;[24]
- corporations should be responsible for human rights abuses beyond limitations by territorial jurisdiction,[25]
  features that investor obligations serve because they are international legal instruments as recurrently found.

2. Reactive enforcement

Nevertheless, it is suggested that by and large, investor obligations are not suitable as an international tool for command-and-control regulation. They operate too reactively. Their sanctions only become effective after the investor has invoked an investor right against the host state. As such, the state cannot actively apply investor obligations to respond to misconduct – a defining feature of command-and-control regulation. This holds true for both direct and indirect obligations.

---

19 UNHRC 'Elements for the Draft Legally Binding Instrument on Transnational Corporations' (n 8) 6.
20 See for example Chapter 3.I, Chapter 3.II, Chapter 7.I.3, Chapter 7.II.4.
21 UNHRC 'Elements for the Draft Legally Binding Instrument on Transnational Corporations' (n 8) 4–5.
22 See Chapter 9.II.1.
23 UNHRC 'Elements for the Draft Legally Binding Instrument on Transnational Corporations' (n 8) 8.
24 See Chapter 4.III and Chapter 6.V.
25 UNHRC 'Elements for the Draft Legally Binding Instrument on Transnational Corporations' (n 8) 5, 11.

In the case of direct obligations, states cannot *initiate* international enforcement. Counterclaims require a prior, primary arbitral claim by the investor against the host state. The host state can only sue the investor back. Therefore, IIAs do not provide states with the means to actively respond to misconduct.

Of course, states may enforce direct obligations domestically. One could argue that the element of 'command' remains international; direct obligations exist as a matter of substantive international law. They unconditionally call for a certain behaviour. It is only the enforcement – the element of 'control' – that takes place reactively through arbitral counterclaims. Domestic administrative agencies and courts do not face such a limitation. They can actively apply these substantive international obligations to investors. However, as the actual responding and punishing of non-compliance would take place on the domestic level, this would rather qualify as a domestic command-and-control approach. In particular, it cannot remedy regulatory problems encountered with transnationally operating investors – it remains confined to the state's territory and depends on the state to act. Thus, it is outside of this Chapter's scope concerned with truly *international* command-and-control regulation.

All the more, indirect obligations do not qualify to serve as command-and-control regulation. Already the fact that investors can choose whether to comply is alien to a command-and-control approach which rests on unconditional authority of the law. One could argue that such an authoritative character is present in the automatic sanction of depriving investors of rights – indirect obligations' partly compulsory nature.[26] However, also this sanction comes into effect only reactively. Investors will experience it only if they actually invoke an investor right. Again, indirect obligations do not qualify as means to actively coerce investors to behave in a certain way.

To illustrate these observations, one could revisit the above-mentioned example and imagine an IIA which contains an investor obligation to comply with a certain ILO Convention. As a direct obligation, the IIA does not provide the state with any international means to actively respond to an investor's violation of the Convention. The state must wait until the investor files an arbitral claim against it alleging violation of an investor right. Only then can the state react with a counterclaim and enforce the obligation. Similarly, if the obligation was indirect, investors could violate the ILO Convention without immediately experiencing a sanction. Only

26 On this aspect see Chapter 6.II.

later may they find that they cannot invoke an investor right against the state for that reason. That investor obligations fall short from fitting a command-and-control setting becomes clear if compared with international criminal law. Here, international criminal courts can actively try perpetrators for committing an international crime.

IV. IIAs as promising incentive-based regulation

Rather, it is suggested that investor obligations have promising potential as a form of international incentive-based regulation.

Investment protection has an economic value to investors due to its risk-reducing effect (1.). IIAs can hence operate as incentive or leverage for complying with investor obligations (2.). As a result, investor obligations may influence investors' behaviour (3.) even in situations in which states fail to do so through domestic means (4.). Even though it is currently hard to determine the concrete incentivising effect, the regulatory potential is remarkable (5.).

1. Investment protection's economic value

Substantive investor rights and the right to file an investment arbitration claim are of economic value to investors. They reduce the investment risk premium by providing the possibility of compensation against possible infringements by the host state. Especially in politically unstable environments, the risk can be substantial – up to a complete loss in case of a full expropriation. Thus, investor rights represent a form of international insurance against wrongdoing by the host state.[27] As seen, precisely with

27 Alan O Sykes, 'Public Versus Private Enforcement of International Economic Law: Standing and Remedy' (2005) 34(2) Journal of Legal Studies 631, 632–633; Joseph E Stiglitz, 'Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World Balancing Rights with Responsibilities' (2007–2008) 23(3) American University International Law Review 451, 465, 528–529; Posner and Sykes (n 10) 288–290; for a categorisation as 'liability rules' see Jonathan Bonnitcha, *Substantive Protection Under Investment Treaties: A Legal and Economic Analysis* (Cambridge University Press 2014) 58–62; see also the birds-eye perspective applying theory of law and economics by Alan O Sykes and Andrew Guzman, 'Economics of International Law' in Francesco

this motive in mind, states have devised investment law to attract foreign investment.[28]

What is more, investors rarely rely exclusively on their own assets. Most foreign investments receive loans, credits and insurances from the private[29] and public[30] sector. By reducing their investment risk through IIAs, investors may receive cheaper credits and insurances from other parties.[31] This may further increase the economic value of investment protection. This economic value is even additionally underlined by the existence of a market for third party-funding of investment claims.[32]

Parisi (ed), *The Oxford Handbook of Law and Economics*, vol III Public Law and Legal Institutions (Oxford University Press 2017) 461–462.

28 See Chapter 9.III.2.

29 On equity investments, loans and credits see Annie Dufey and Maryanne Grieg-Gran, 'The Linkages Between Project Finance and Sustainable Development' in Sheldon Leader (ed), *Global Project Finance, Human Rights and Sustainable Development* (Cambridge University Press 2011) 13, 16–18; on political risk insurance see Kaj Hobér and Joshua Fellenbaum, 'Political Risk Insurance and Financing of Foreign Direct Investment' in Marc Bungenberg and others (eds), *International Investment Law* (Nomos 2015) paras 64–69.

30 For example on the substantial quantitative and qualitative importance of public political risk insurance in comparison to the private counterpart see Clint Peinhardt and Todd Allee, 'Political Risk Insurance as Dispute Resolution' (2016) 7(1) Journal of International Dispute Settlement 205, 207; on political risk insurance by home states see Hobér and Fellenbaum (n 29) paras 39–63; on credits by the International Finance Corporation see Peter Woicke, 'Putting Human Rights Principles into Development Practice Through Finance: The Experience of the International Finance Corporation' in Philip Alston and Mary Robinson (eds), *Human Rights and Development: Towards Mutual Reinforcement* (Oxford University Press 2005) 335–351.

31 cf with the pivotal role that risk insurances play to promote foreign investment necessary for environmental protection in developing countries as observed by Swenja Surminski, 'The Role of Insurance Risk Transfer in Encouraging Climate Investment in Developing Countries' in Pierre-Marie Dupuy and Jorge E Viñuales (eds), *Harnessing Foreign Investment to Promote Environmental Protection: Incentives and Safeguards* (Cambridge University Press 2013) 238–251; on the general steering potential of investment insurance see Karsten Nowrot, 'Obligations of Investors' in Marc Bungenberg and others (eds), *International Investment Law* (Nomos 2015) para 28; on the high interest of investors in receiving money from the insurer see Peinhardt and Allee (n 30) 215.

32 Third parties fund claims in exchange for a portion of any compensation eventually awarded, see *EuroGas Inc. and Belmont Resources Inc. v Slovak Republic*, ICSID Case No. ARB/14/14, Procedural Order No. 3: Decision on the Parties' Request for Provisional Measures (23 June 2015) para 123 observing that third party-funding had become 'a common practice'.

In the same vein, the ICSID Tribunal in *Saipem v Bangladesh* affirmed that curtailing the right to file an investment claim can constitute expropriation. To accept the right as the object of expropriation means that it is worth to protect it similar to property, reflecting its economic value. In line with this assessment, the Tribunal referred in its reasoning to the ECtHR's jurisprudence on the right to property.[33]

2. Investment protection as obligations' leverage

Because of this economic value, investor rights represent leverage to incentivise compliance with investor obligations. Investor obligations condition the receiving of this economic value: If investors violate indirect obligations, they are deprived of protection and hence, of the IIA's value to them. The same is true for direct obligations: a potential counterclaim may offset or even exceed any worth that the investor rights otherwise offer.[34] The prospect of receiving investment protection can, thus, deter investors from breaching these obligations.

Considering the incentives more specifically, direct obligations may be considered to be 'sticks' – threatening a possible sanction in the background. Indirect obligations operate more as 'carrots' – as what the investor must do to receive the reward of investment protection. Generally,

33 *Saipem S.p.A. v The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures (21 March 2007) para 130; *Saipem S.p.A. v The People's Republic of Bangladesh*, ICSID Case No. ARB/05/7, Award (30 June 2009) paras 128–130 with reference to the right to property as applied by *Case of Stran Greek Refineries and Stratis Andreadis v Greece* App no 13427/87, ECHR Series A no 301-B (European Court of Human Rights, 9 December 1994) paras 59–62; *Case of Brumărescu v Romania* App no 28342/95, ECHR 1999-VII 201 (European Court of Human Rights, 28 October 1999) paras 75–77 which related to a court's judgment.

34 James Harrison, 'Environmental Counterclaims in Investor-State Arbitration: Perenco Ecuador Ltd v Republic of Ecuador, ICSID Case No ARB/08/6, Interim Decision on the Environmental Counterclaim, 11 August 2015 (Peter Tomka, Neil Kaplan, J Christopher Thomas)' (2016) 17(3) Journal of World Investment & Trade 479, 487; too limited is the assessment by Jose D Amado, Jackson S Kern and Martin D Rodriguez, *Arbitrating the Conduct of International Investors* (Cambridge University Press 2018) 118 that counterclaims are limited in their usefulness because they only apply *ex post facto*.

scholars consider the use of 'carrots' and 'sticks' as equivalent incentives for behavioural change, given that they often overlap.[35]

3. Steering investors' behaviour

The steering potential of these incentives for public interest-friendly investor behaviour can be substantial. Investors never know if they will need investment protection in the future. For instance, unexpected changes of governmental policies can occur through, for example, a change of administration. Yet, many investor obligations require investors to comply throughout the entire span of the investment. Thus, there is a constant incentive to abide by them.

This observation rests on the economic assumption that investors take rational choices: that they 'engage in purposive, means-ends calculation in order to attain their goals – that is, they select actions so as to maximize their utility' based on 'relevant environmental constrains'.[36] Investors' main goal is to carry out the investment and gain profits. The environmental constrain they face is the alien legal system in which they operate and the insecurity concerning the host state's future behaviour. IIAs represent a means to reduce this risk and thus to further their goal. A strategical investor will compare the costs of fulfilling investor obligations with the gain to reduce the investment risk of unknown host state behaviour. Because the risk can be substantial, investors may select compliance with investor obligations to maximise the prospect of a successful investment.

One can illustrate this by the above-mentioned example of an IIA with the investor obligation to comply with the ILO Convention. Here, the

---

35 On distinguishing 'sticks' and 'carrots' and general remarks on their use in different situations see only Giuseppe Dari-Mattiacci and Gerrit de Geest, 'Carrots vs. Sticks' in Francesco Parisi (ed), *The Oxford Handbook of Law and Economics*, vol I Methodology and Concepts (Oxford University Press 2017) 440–464; but see Anne van Aaken and Betül Simsek, 'Rewarding in International Law' (2021) 115(2) American Journal of International Law 218–241 who especially draw on psychological literature and submit that rewards have certain advantages over penalties for governance mechanisms between states – a position which is not necessarily in conflict with the proposal submitted here which relates to an international compliance mechanism for private actors.

36 This basic idea of rational choice theory is for example presented in the context of international law by Alexander Thompson, 'Applying Rational Choice Theory to International Law: The Promise and Pitfalls' (2002) 31(1) Journal of Legal Studies 285, 287.

rational investor will weigh two different types of costs. On the one hand, the ILO Convention will prescribe a certain minimum standard which will increase labour costs. On the other hand, the IIA reduces the overall risk encountered in the host state's legal system – and may even compensate for a total loss of the investment. If investors perceive the investment environment as risky, they will opt for complying with the ILO standard. That is especially the case if available investment protection was decisive for them to invest in the host state in the first place.

This allows to carefully generalise the regulatory effect as follows: The less secure and stable the investor perceives the host state, the greater the role of IIAs and hence the incentivising effect.[37] Likewise, the more long-term an investment, the less calculable are the risks, and the more important becomes compliance. In the same vein, the stronger an international investment law instrument's design, the more one perceives it to reduce risks,[38] and hence the more leverage does it offer for investor obligations.

4. Compensating for the unwilling or unable host state

Importantly, investor obligations may steer investors in advance of any measure taken by the host state and without the need for a resulting investment arbitration. The described incentivising effect applies pre-emptively. Investors will conduct the mentioned means-ends calculation in advance in order to decide how they should arrange their investment. If they breach investor obligations first before adapting their conduct, it might be too late. They may already be deprived of protection or face a potential counterclaim. Thus, the incentives are unaffected by the fact that states can

37 This finds ground for example in the study by Cédric Dupont, Thomas Schultz and Merih Angin, 'Political Risk and Investment Arbitration: An Empirical Study' (2016) 7(1) Journal of International Dispute Settlement 136, 151 who observe that investment arbitration especially relates to the political risk of corruption and a lack of the rule of law in the host state.

38 See for example Jay Dixon and Paul A Haslam, 'Does the Quality of Investment Protection Affect FDI Flows to Developing Countries? Evidence from Latin America' (2016) 39(8) The World Economy 1080, 1100 who find that high protection treaties with broadly formulated international investor rights have a positive effect on foreign direct investment flows.

enforce investor obligations only reactively.[39] This is also beneficial for the host states because they can spare enforcement costs.[40]

To continue the above-mentioned example: To qualify for the IIA's protection, rational investors will pre-emptively comply with the ILO Convention. Only then will they actually reduce their investment risk. This incentive applies irrespectively of the state's domestic actions, precisely because IIAs serve to protect against unforeseeable future state conduct. Even if the state does not demand the investor to comply with the ILO standard, the incentive applies. If investors breach the Convention, they lose the possibility to invoke the IIA later. To reuse the comparison of IIAs as an insurance policy: Investors lose 'insurance coverage' by the IIA. Therefore, even if the host state is inactive, the IIA may still steer the investor to abide by the ILO Convention.

In consequence, with all due care, investor obligations may even compensate for host states unwilling or unable to protect the public interest. They exert the described incentives without requiring the host state to be active. It is sufficient that the state *could* file a counterclaim at later date, or that the investor may be deprived of investment protection automatically. Moreover, unwilling or unable states often constitute a relatively insecure and instable investment environment. Especially there, investors may fear that the state might turn against them at some point and threaten their investment. Therefore, the economic value of investment protection may be particularly high – and similarly so may be the incentive to comply with investor obligations, potentially filling the regulatory gap left by the home state to some extent.[41]

5. Limits and potentials

To be sure, the analysis can only outline a *potential* steering effect of investor obligations for the following reasons.

Currently, there is a lack of awareness. Because investor obligations have not yet been studied comprehensively, investors do not know that they

39 See Chapter 10.III.2.

40 On the relevance of such 'self-enforcement' in the ambit of international law's enforcement from a law and economics perspective, see Posner and Sykes (n 10) 27 who consider that such self-enforcement, while not achieving the '"first-best", […] can often accomplish a great deal'.

41 cf Dupont, Schultz and Angin (n 37) 151.

may be subject to obligations in investment law. Hence, they cannot make an informed decision whether to comply.[42] A better understanding of investor obligations which this book aims to achieve is a requirement for their regulatory potential to unfold.

Furthermore, the incentive to comply with investor obligations relies on the economic value of investment protection. Yet, how much IIAs affect the decision to invest abroad remains controversial.[43] Earlier empirical studies indicated a low impact of IIAs on attracting foreign investment.[44] In contrast, more recent analyses do find significant correlations while pointing out differences between countries and investment sectors.[45] The value of investment protection may also depend on the specific investor. For example, an investment may have other strong insurances and forms of security, or plenty of assets. In such cases, fulfilling investor obligations may be more costly than forfeiting investment protection. What is more, it is problematic that many encountered investor obligations remain relatively indeterminate in their scope. Then, investors may not know how they should behave, which would curtail the described steering effect. And there is the concern if investment arbitration represents an adequate

42 cf that rational choice theory depends on the fact that the actor in question has relevant and accurate information available to make an informed decision, see for example the observations in the context of international law by Robert O Keohane, 'Rational Choice Theory and International Law: Insights and Limitations' (2002) 31(1) Journal of Legal Studies 307, 308–309.

43 See for example the critical study by Jason W Yackee, 'Do BITs "Work"? Empirical Evidence from France' (2016) 7(1) Journal of International Dispute Settlement 55, 58; Bonnitcha (n 27) 102–113; contrast it with the more positive overall assessment by Dixon and Haslam (n 38) 1082–1100; see also Sykes and Guzman (n 27) 461 who, in light of the variety of empirical studies, consider the matter unsettled.

44 See for example Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit … And They Could Bite' [2003] World Bank Policy Research Working Paper 3121, 18–23 ‹https://openknowledge.worldbank.org/handle/10986/18118› accessed 7 December 2021.

45 See for example Arjan Lejour and Maria Salfi, 'The Regional Impact of Bilateral Investment Treaties on Foreign Direct Investment' [2014] CPB Netherlands Bureau for Economic Policy Analysis Discussion Paper 298, 18–23; a good overview on the empirical studies and the methodological problems provide Eugene Beaulieu and Kelly O'Neill, 'The Economics of Foreign Direct Investment and International Investment Agreements' in John Anthony VanDuzer and Patrick Leblond (eds), *Promoting and Managing International Investment: Towards an Integrated Policy Approach* (Routledge 2020) 110–115.

forum for assessing investor obligations at all, for example in light of the often-limited expertise of arbitrators in these matters.[46]

It is also submitted that investor obligations cannot replace domestic regulation and strong host state institutions.[47] Incentive-based regulation can complement it and, to some degree, compensate its deficiencies as seen. But a single IIA of course cannot substitute the comprehensive regulatory environment for which the state with its institutions provides. In particular, there remains a need to actively respond to misconduct of investors.[48]

Nevertheless, the claim being made here is more fundamental: investor obligations may turn IIAs into an international tool for steering foreign investors' behaviour.[49] This is remarkable because originally investment law was not meant to regulate foreign investment at all. This Chapter's findings indicate that it may play a part in better regulating transnationally operating corporations in the future. Investor obligations may be clarified and become more transparent as investment law continues to change. And they may even alleviate situations in which the host state is unwilling or unable to do so domestically – a problem to which international solutions are greatly desired.

46 Markus Krajewski, 'A Nightmare or a Noble Dream? Establishing Investor Obligations Through Treaty-Making and Treaty-Application' (2020) 5(1) Business and Human Rights Journal 105, 127–129.

47 This is supported by empirical studies on the effect of IIAs, see for example Beaulieu and O'Neill (n 45) 114–115.

48 Similarly UNCTAD, *World Investment Report: Reforming International Investment Governance* (United Nations Publications 2015) 126.

49 cf Stephan Schill and Vladislav Djanic, 'International Investment Law and Community Interests' in Eyāl Benveniśtî and Georg Nolte (eds), *Community Interests Across International Law* (Oxford University Press 2018) 244 who argue that counterclaims against investors 'could provide an important additional mechanism to ensure that obligations that are of interest to the wider international community are complied with by foreign investors.'