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Preserving Regulatory Space for Sustainable Development in Africa

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Investment has an important role for achieving sustainable development in developing countries. Although international investment agreements (IIAs) can serve as instruments to promote such objective, protection oriented IIAs have undermined the ability of States to regulate in the benefit of the community. Likewise large financial reparations imposed by arbitral tribunals have increased the threat of regulatory chill in the face of major global challenges. Strengthening the right to regulate of States and addressing regulatory chill are key matters to consider in the reform of IIAs and the international investment regime.

L'investissement constitue un outil essentiel pour les pays en développement en vue d'atteindre les objectifs de développement durable. L'accord multilatéral sur l'investissement auraient pu permettre de promouvoir ces objectifs, mais il a eu pour seul effet, en ce qu'il était exclusivement orienté vers la protection des investissements, de saper la capacité des États à introduire des réglementations qui soient dans l'intérêt de tous. De même, les réparations financières importantes infligées par les tribunaux d'arbitrage ont accru la menace d'un gel réglementaire à l'heure où nous nous heurtons à des défis considérables à l'échelle mondiale. Le renforcement du droit de réglementer des États et la lutte contre le gel réglementaire sont des questions essentielles à prendre en compte dans la réforme de l'accord multilatéral sur l'investissement et du régime des accords internationaux d'investissement.

La inversión es una herramienta esencial para que los países en desarrollo alcancen los objetivos de desarrollo sostenible. Aunque los acuerdos internacionales de inversión (AII) pueden servir como instrumentos para promover estos objetivos, los AII orientados a la protección han debilitado la capacidad de los Estados para regular en beneficio de la comunidad. Del mismo modo, las grandes reparaciones financieras impuestas por los tribunales de arbitraje han aumentado la amenaza de enfriamiento normativo frente a los grandes desafíos mundiales. Reforzar el derecho de los Estados a regular y afrontar la paralización de la regulación son cuestiones clave que deben tenerse en cuenta en la reforma de los AII y del régimen internacional de inversiones.

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Introduction

This paper presents broad observations on the concept of regulatory chill and how it is applicable in the African context. The discussions note the importance of investment to economic development; and outline the problems and consequences caused by strong protections for foreign investors under investment treaties.

It considers how these have led to some countries incurring huge losses in financial penalties awarded by arbitral tribunals; and the resultant impediment and hinderance to policy development and implementation in matters of public interest. It also addresses the current discussions on reform of procedural aspects of investor-State dispute settlement (ISDS) under the auspices of the United Nations Commission on International Trade Law (UNCITRAL) Working Group III (WG III), and the need to preserve the right to regulate.

The paper concludes by presenting some solutions to strengthen the right to regulate and address the issue of regulatory chill.

The role of investment for achieving sustainable development

At the outset, it must be recognized that foreign investment can play an important role in supporting the efforts of countries achieving the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDGs), as well as Agenda 2063 in the African context. However, the current framework governing international investment protection has proved problematic for many countries, and especially developing and least-developed countries.

In a Briefing Note commissioned by the African Continental Free Trade Area (AfCFTA) Secretariat[1], it was observed that there is now widespread concern that protection-oriented international investment agreements (IIAs) have undermined the ability and duty of States to regulate investment in the interest of the environment, human rights, and other matters of public interest. Some countries have become vulnerable to large financial reparations imposed by international arbitration tribunals set up to adjudicate investor-State disputes, which in turn has impeded their ability to implement policies in support of the SDGs. A fact observed by the United Nations Secretary-General in 2018 was that international investment agreements, which are meant to support foreign investment, often result in unintended consequences, such as constraining regulations that support sustainable development when the regulations may impact investor profits.[2]

The now well-known phenomenon of “regulatory chill”[3]has highlighted the risk that investors can use ISDS as a threat to seek regulatory or financial concessions from governments. Regulatory chill is a concept that occurs when State actors fail to enact or enforce bona fide regulatory measures because of a perceived or actual threat of investment arbitration[4].

For many developing countries, attracting foreign investment is a key objective, and the threat of a public ISDS case could be perceived to impact their image as an attractive investment destination. This is of particular concern to States that may be in the process of developing more robust legal regimes to balance public interest and sustainability issues in line with their obligations under international investment agreements[5]. Because protections afforded to investors under current IIAs are so strong and enforceable, and because the costs of ISDS claims are steep, even the mere threat of an ISDS claim can be sufficient for host States to abandon or dilute regulatory measures or actions to avoid the risks associated with international investment arbitration.

[1] Brooke Guven, Jesse Coleman, Ella Merrill, and Lise Johnson, Briefing Note: Investment Governance and Trends Prepared to Support AfCFTA Investment Protocol Negotiations, August 2021 (AfCFTA Secretariat and CCSI).
[2] United Nations General Assembly, Report of the Secretary-General on the International Financial System and Development, A/73/280 (31 July 2018), para. 62. Available from http://undocs.org/A/73/280.

[3] UNCITRAL WG III, 37th Session Report, paras. 36-37.
[4] This concept was discussed in a study, “The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership,” prepared for the Minister for Foreign Trade and Development Cooperation, Ministry of Foreign Affairs, The Netherlands by Dr. Christian Tietje, University Halle, Germany, with the assistance of Trent Buatte, J.D. and Associate Prof. Dr. Freya Baetens, Leiden University with the assistance of Theodora N.Valkanou, LL.M., and Ecorys, Rotterdam, 24th June 2014.
[5] Concerns over regulatory chill and potential solutions are flagged by the Government of the Republic of South Africa in its submission to Working Group III. Submission from the Government of South Africa to UNCITRAL Working Group III, 38th Session, para. 63. Available from http://undocs.org/en/A/CN.9/WG.III/WP.176. See also Gus van Harten, Jane Kelsey, David Schneiderman, “Phase 2 of the UNCITRAL ISDS Review; Why ‘Other Matters’ Really Matter”, All Papers, 328 (Osgoode Hall, 2019). Available from https://digitalcommons.osgoode.yorku.ca/all_papers/328/.

The effects of regulatory chill

Regulatory chill is a critical issue for developing countries, and in particular for African States. The State Parties to the AfCFTA Agreement are likely to be even more susceptible to the effects of regulatory chill for several reasons, in particular because:

- The countries are currently in the process of aligning their national legislations to the AfCFTA and negotiating protocols such as the Protocol on Investment that will require alignment and policy shifts. Any threat to policy space, or possibility of ISDS as a result of a regulatory change will weaken efforts of low- and middle-income countries to develop and refine their regulatory and legal frameworks. These countries require policy space necessary to pass new laws and regulations. and for amending old legal frameworks, sometimes developed under the colonial era;
- Developing countries generally have limited financial resources available to defend against ISDS claims or pay an adverse award;
- Many States may also lack the in-house legal expertise to effectively evaluate the prospects and risks of a threatened ISDS claim and so are more likely to back down and withdraw a planned regulation in the face of such a threat.

Regulatory chill is also becoming an increasingly serious concern considering two major global problems that require regulatory solutions: (i) recovering from the COVID-19 pandemic, and (ii) ensuring a just transition to clean energy to prevent the worst impacts of climate change. In developing new regulatory and policy measures to address these pressing challenges, States should not be deterred by regulatory chill driven by the prospect of possible ISDS claims. Rather, they should create and sustain sufficient policy space to achieve their national development objectives and meet global challenges.

The African Union Member States have expressly recognised the risk of regulatory chill with regard to measures adopted to face the COVID-19 pandemic. The Declaration on the Risk of Investor–State Dispute Settlement with respect to COVID-19 related measures, adopted at the 14th meeting of the African Union Ministers of Trade (AMOT) on 24 November 2020, recognises the need to promote a "mutual temporary suspension of ISDS provisions in investment treaties in relation to COVID-19 Pandemic government measures".

It is worth noting that the challenge of regulation and re-regulation, which could be impacted by a regulatory chill, is not specific to developing countries alone. Developed countries have also shown this concern given the implications of challenges like climate change and the continuous scientific revelations in this regard, or the potential of repetitive pandemics in the future, as well as the implications of rapid digitalisation and the fourth industrial revolution. For instance, the European Commission has indicated that a withdrawal of the European Union (EU) from the Energy Charter Treaty (with its ISDS mechanism) appears to be 'unavoidable', given that the treaty would "clearly undermine" the EU's climate targets[6].

Although regulatory chill remains difficult to fully define and measure, the scope and impact of its effects can be deeply felt in public policy making. There is a growing body of empirical evidence suggesting that regulatory chill has resulted in the detriment of the public interest, caused by a regulatory measure not being taken or being substantially delayed. Likewise, there is no single set of procedural solutions or rules that can address regulatory chill, unlike other more discrete issues that can be efficiently regulated.

The need to include provisions on the 'Right to regulate' in IIAs

In order to the address regulatory chill, reference to the 'right to regulate' has been included in the texts of some IIAs. However, it might not be sufficient to limit the substantive effects of these agreements. It also usually does not add any legal obligations or rights. It may serve as an interpretative tool but does not guarantee that the State's policy space and tools will go unchallenged. The main problem is that IIAs limit the policy options and choices of States on how to exercise the right to regulate, and the 'right to regulate' language included in existing investment agreements does not change this.

[6] Kate Abnett, "Brussels says EU exit from Energy Charter Treaty 'unavoidable'", Reuters, 7 February 2023. Available from https://www.reuters.com/world/europe/brussels-says-eu-exit-energy-charter-treaty-unavoidable-2023-02-07/.

Strengthening the right to regulate and addressing regulatory chill are likely to require a complementary set of solutions that place a greater number of checks and balances, or 'filters' between an investor and the ISDS mechanism. Broad provisions referring to the "right to regulate" in new investment agreements may not provide adequate protection against vague investment rules and pro-investor approaches of arbitral tribunals, and lead to continuing threats on governments' regulatory sovereignty.

One solution pertaining to regulatory chill and the right to regulate is limiting the subject-matter jurisdiction of arbitral tribunals, to allow for removing issues concerning the public interest from the realm of arbitration. There are multiple ways to do this, which could be further investigated during the ongoing discussions under UNCITRAL's WG III. However, there is also ample evidence that arbitral tribunals have already tried to find their ways around such subject-matter limitations (for example, in the case of tax carve-outs, some tribunals have qualified taxation measures as violations of the expropriation standard to get around the exclusion of tax matters (see Tza Yap Shum v. Republic of Peru, ICSID, Case No ARB/07/6, among other examples)).

Conclusion

In conclusion, it is important to reiterate the need for a holistic approach to reform that combines both procedural and substantive issues, as well as structural reforms that ensure governments can regulate for the public good. Many different options are being considered under the WG III mandate, in particular, alternatives to international arbitration, exhaustion of local remedies, mandatory cooling-off periods, enhanced strike out procedures, participation of third parties and affected communities, all of which can play an important filtering role. Nevertheless, more in-depth discussions in the formal sessions of WG III are still necessary to address these concerns, and arrive at reforms that have a positive impact on the policy space of developing countries.

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