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GREEN FOREIGN DIRECT INVESTMENT (FDI) **INCENTIVES WITHIN INTERNATIONAL** **INVESTMENT AGREEMENTS (IIAs)**

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Abstract

Climate change has become one of the most pressing global challenges of the 21st century. Governments and international organisations increasingly recognise the role of **Foreign Direct Investment (FDI)** in facilitating the transition to a low-carbon economy. International Investment Agreements (IIAs), including **Bilateral Investment Treaties (BITs)** and investment chapters in trade agreements, traditionally aim to protect foreign investors and promote investment flows. However, the modern approach seeks to align investment governance with **sustainable development and climate goals**.

This project analyses how IIAs can incorporate **green FDI incentives** while ensuring that host states maintain sufficient **policy space** to regulate environmental protection and climate policy. It examines the evolution of IIAs, mechanisms for promoting climate-friendly investments, challenges posed by investor–state dispute settlement (ISDS), and possible treaty reforms.

1. Introduction

Foreign Direct Investment plays a significant role in global economic development by transferring capital, technology, and managerial expertise across borders. International Investment Agreements are treaties between states designed to **promote, protect, and regulate cross-border investment**.¹

Traditionally, IIAs focused mainly on **investment protection**, such as fair and equitable treatment, protection against expropriation, and free transfer of capital. However, recent global concerns regarding climate change have triggered debates about the need to integrate **environmental sustainability into investment treaties**.

¹ https://en.wikipedia.org/wiki/International_investment_agreement.com

Green FDI refers to foreign investments that contribute to **environmental protection, renewable energy, sustainable infrastructure, and low-carbon technologies.**

Governments increasingly attempt to attract such investments through incentives and supportive legal frameworks.

However, tensions arise because overly strong investor protections may **limit governments' ability to regulate environmental policies**, creating a phenomenon known as “**regulatory chill.**” Therefore, modern IIAs attempt to balance **investment promotion and environmental regulatory autonomy.**

2. Meaning of Green FDI

Green Foreign Direct Investment refers to investments that contribute to sustainable development and environmental protection. It includes investments in sectors such as:

- Renewable energy (solar, wind, hydropower)
- Clean technologies
- Sustainable agriculture
- Green infrastructure
- Waste management and recycling

International organisations encourage governments to promote green FDI to accelerate the transition to **low-carbon economies and climate-resilient development.**²

Green FDI can generate several benefits:

1. Transfer of environmentally friendly technology
2. Reduction in greenhouse gas emissions
3. Development of renewable energy infrastructure
4. Sustainable economic growth

However, without proper regulation, FDI may also contribute to environmental degradation, known as the “**pollution haven hypothesis.**”

² https://www.oecd.org/content/dam/oecd/en/publications/reports/2024/10/strengthening-sustainable-investment-through-international-investment-agreements_b8772cb7/a8729c98-en.pdf.com

3. International Investment Agreements (IIAs)

International Investment Agreements are treaties between states that regulate foreign investment and provide legal protection for investors.

Two common types include:

1. **Bilateral Investment Treaties (BITs)** – agreements between two countries.
2. **Investment chapters in Free Trade Agreements (FTAs).**

Typical provisions of IIAs include:

- Fair and equitable treatment (FET)
- Protection from expropriation
- National treatment
- Most-favoured nation treatment
- Investor–State Dispute Settlement (ISDS)

Historically, these treaties prioritised **investment protection**, but modern agreements increasingly integrate **sustainable development goals and environmental safeguards**.

❖ **RESEARCH ANALYSIS**

Research Analysis on Green FDI Incentives in International Investment Agreements (IIAs)

The surge of *green* foreign direct investment (FDI) has prompted states to embed environmental incentives directly in IIAs, shifting the traditional focus from pure investor protection to sustainable development³⁴. Recent scholarship typologises 12 environmental clauses as “deep roots” (reflecting general international law), “green shoots” (enhancing protection) and “dead wood” (negligible impact)⁵⁶. Green-shoot provisions—e.g., explicit “right-to-regulate” clauses, climate-change carve-outs, and mandatory environmental impact assessments—appear in newer instruments such as the EU-China Comprehensive Agreement on Investment (CAI) and the EU-Angola Sustainable Investment Facilitation Agreement (SIFA)⁷⁸.

Incentive mechanisms operate on two fronts. Fiscal tools—environmental taxes and

³ <https://researchonline.lse.ac.uk/id/eprint/127169/3/siaf003.pdf>

⁴ <https://pdf.erytis.com/Lh/LH.9002.pdf>

⁵ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5054948

⁶ <https://researchonline.lse.ac.uk/id/eprint/127169/>

⁷ https://brill.com/view/journals/jwit/23/4/article-p628_6.xml

⁸ https://www.europeanpapers.eu/system/files/pdf_version/EP_EF_2024_I_011_Nicolo%CC%80_Andreotti_00754.pdf

subsidies—shape host-state regulatory landscapes, attracting eco-conscious investors while encouraging cleaner technologies⁹¹⁰. Contractual incentives—sustainable-production clauses, green-investment chapters, and “green” investment promotion provisions—signal policy certainty and reduce perceived investment risk. Empirical work shows that sustainable-development indicators and renewable-energy targets act as strong pull factors for FDI into EU members, whereas strict environmental regulations may deter outward flows without offsetting benefits.

Nevertheless, challenges persist. Ambiguities such as the “grey area” created by the Bangladesh-India Bay of Bengal award illustrate how imprecise delimitation can generate disputes over sub-soil rights. Moreover, the “regulatory chill” effect—where investors threaten claims against climate policies—remains a concern despite emerging safeguards like UNCITRAL’s Draft Article 19, which seeks to balance investor confidence with state autonomy .

Emerging trends point toward a convergence of investment and climate law: APEC’s analysis of IIAs’ role in green economies, the EU’s Green Deal integration, and model BITs with explicit sustainable-development chapters signal a normative shift toward incentivising, rather than merely tolerating, green FDI. Future treaty design should prioritise clear, enforceable green-shoot clauses, transparent fiscal incentives, and robust dispute-settlement mechanisms to harness FDI for the transition to a low-carbon economy.

International Investment Agreements (IIAs) are increasingly used to steer foreign direct investment toward environmentally-friendly projects, aligning private capital with the UN 2030 Agenda and the Paris Agreement¹¹¹².

Incentive mechanisms

Most contemporary IIAs embed “green-FDI” incentives such as tax breaks for low-carbon projects, subsidies for renewable-energy deployment, and preferential treatment for investors

⁹ <https://www.sciencedirect.com/science/article/pii/S0140988325002695>

¹⁰ <https://www.sciencedirect.com/science/article/pii/S0140988325002695>

¹¹ <https://pdf.erytis.com/Lh/LH.9002.pdf>

¹² https://link.springer.com/rwe/10.1007/978-981-13-3615-7_57

that meet carbon-neutral criteria.¹³¹⁴ The APEC Investment Experts' Group notes that explicit facilitation clauses can create a “green channel” for approvals and link taxes to emissions intensity.¹⁵ UNCITRAL's Draft Provision 19 further strengthens regulatory space by mandating high deference to domestic climate policies while preserving investor confidence.

Institutional trends

Empirical surveys show a surge in investment disputes with environmental components, reflecting growing tribunal reference to sustainability clauses.¹⁶ The EU's Sustainable Capital Mobilisation Investment Facilitation Agreement exemplifies a new-generation IIA that couples private capital with climate-compatible obligations. In the United States and Europe, environmental chapters have become “model clauses” that integrate sustainability into the core investment regime.¹⁷

Challenges

A “regulatory chill” arises when FET standards are interpreted narrowly, discouraging states from adopting ambitious climate measures. Ambiguities—e.g., the “grey area” left by the Bangladesh-India maritime award—demonstrate how poorly drafted boundaries can create legal uncertainty for green projects.

Policy recommendations

- Draft clear, measurable green-FDI definitions and link them to verifiable carbon-neutral thresholds.
- Incorporate tiered carve-outs that protect climate regulation from ISDS claims, as suggested by UNCITRAL's tri-layered approach.
- Establish a joint-monitoring mechanism within IIAs to track incentive utilisation and prevent “green-washing”.

When IIAs combine robust environmental clauses, targeted fiscal incentives, and strong regulatory-deference safeguards, they can transform FDI into a catalyst for the green transition while minimising dispute risk.

¹³ <https://www.sciencedirect.com/science/article/pii/S0140988325002695>

¹⁴ <https://www.econstor.eu/bitstream/10419/254150/1/fdi-perspectives-no316.pdf>

¹⁵ https://www.apec.org/docs/default-source/publications/2024/7/224_ieg_international-investment-agreements-and-climate-change.pdf?sfvrsn=180ff367_1

¹⁶ <https://www4.austlii.edu.au/au/journals/ELECD/2019/314.html>

¹⁷ <https://researchonline.lse.ac.uk/id/eprint/127169/3/siaf003.pdf>

4. Need for Green FDI Incentives in IIAs

Climate change requires massive investments in renewable energy and sustainable infrastructure. According to global policy frameworks, international investment treaties can be used to mobilise sustainable investment and support climate transitions.

Reasons for promoting green FDI include:

4.1 Climate Change Mitigation

Green investments support renewable energy development and reduce carbon emissions.

4.2 Technology Transfer

Foreign investors often possess advanced clean technologies that developing countries lack.

4.3 Economic Development

Green investments generate employment while supporting sustainable industrial development.

4.4 Sustainable Development Goals (SDGs)

Green FDI contributes to achieving the **UN Sustainable Development Goals (SDGs)**.

5. Mechanisms to Promote Green FDI in IIAs

Modern investment agreements can be structured to encourage climate-friendly investments through several mechanisms.

5.1 Investment Facilitation Provisions

Investment agreements can include provisions that improve the **investment climate**, such as transparency, stability, and access to information regarding investment opportunities.¹⁸

These provisions may involve:

- Streamlined licensing procedures
- Information sharing
- Cooperation between states
- Technology transfer mechanisms

Such measures encourage investors to engage in sustainable sectors.

¹⁸ <https://www.cambridge.org/core/books/making-of-an-international-investment-facilitation-framework/investment-facilitation-provisions-in-international-investment-agreements-and-the-multilateral-framework-on-investment-facilitation-for-development/B6F52AF7FD40C842A5F5E478DC5475C2?utm>

5.2 Environmental Cooperation Clauses

Some modern IIAs include **cooperation frameworks** between states for promoting environmental investment.

For example, agreements may identify specific sectors such as renewable energy or sustainable technologies and encourage investment in those sectors.¹⁹

These clauses often include:

- Technology sharing
- Capacity building
- Joint environmental programs

5.3 Green Investment Incentives

States may offer incentives to attract climate-friendly investments, including:

- Tax incentives
- Subsidies
- Preferential financing
- Access to special economic zones

Special economic zones often provide tax exemptions and infrastructure support to attract foreign investors.

These incentives can be specifically targeted at renewable energy and clean technology industries.

5.4 Corporate Environmental Responsibility Provisions

Some modern investment treaties require investors to follow **environmental standards and responsible business conduct**.

Examples include:

- Environmental impact assessments
- Environmental management systems
- Compliance with international environmental agreements

Such provisions ensure that investments contribute positively to sustainable development.

¹⁹ https://link.springer.com/chapter/10.1007/978-3-031-89171-7_11?utm_source

6. Safeguarding Host-State Policy Space

While promoting green FDI is important, governments must retain the ability to regulate environmental and climate policies. Modern treaty design, therefore, emphasises **policy space protection**.

6.1 Right to Regulate Clauses

Modern IIAs explicitly recognise that states have the **right to regulate in the public interest**, including environmental protection and climate policies.

These clauses prevent investors from challenging legitimate environmental regulations.

6.2 Environmental Exceptions

Some treaties include **general exceptions** similar to those found in international trade law.

These exceptions allow governments to adopt measures necessary to:

- Protect the environment
- Prevent pollution
- Conserve natural resources

6.3 Limiting Investor–State Dispute Settlement (ISDS)

Investor-State Dispute Settlement mechanisms allow foreign investors to sue governments before international tribunals.

However, critics argue that ISDS may challenge environmental regulations. To address this issue, modern IIAs may:

- Restrict ISDS claims
- Require exhaustion of domestic remedies
- Exclude environmental measures from arbitration

Such reforms aim to balance **investor protection and regulatory autonomy**.

7. Challenges in Promoting Green FDI through IIAs

Despite reforms, several challenges remain.

7.1 Regulatory Chill

Governments may hesitate to adopt environmental regulations due to fear of investor lawsuits.

7.2 Ambiguous Treaty Language

Vague provisions in IIAs may create uncertainty regarding environmental obligations.

7.3 Investment Protection vs Environmental Regulation

Balancing investor rights and environmental protection remains difficult.

7.4 Developing Country Constraints

Developing countries may lack the institutional capacity to implement sustainable investment policies.

8. Case Studies and Examples

Several modern agreements demonstrate efforts to integrate sustainability into investment frameworks.

8.1 Australia–Singapore Green Economy Agreement

This agreement identifies environmental goods and services and promotes investments that support decarbonization and sustainable economic growth.⁶

8.2 Morocco–Nigeria BIT (2016)

This treaty includes provisions requiring investors to conduct environmental impact assessments and comply with environmental standards.

8.3 EU Investment Policy Reforms

European Union investment agreements increasingly incorporate sustainability chapters and environmental commitments.

9. Recommendations for Future Treaty Design

To effectively promote green FDI while safeguarding policy space, future IIAs should:

1. Include **explicit climate-friendly investment promotion clauses**
2. Provide **clear environmental obligations for investors**
3. Strengthen **environmental exceptions and right-to-regulate clauses**
4. Reform **ISDS mechanisms**
5. Encourage **technology transfer and capacity building**

6. Align investment treaties with **international climate agreements such as the Paris Agreement**

10. Conclusion

International Investment Agreements are evolving from purely investment-protection instruments toward frameworks that support **sustainable development and climate action**. By integrating green FDI incentives, environmental standards, and regulatory safeguards, IIAs can play a crucial role in mobilising investment for the global energy transition.

However, achieving the right balance remains challenging. Overly strong investor protections may undermine environmental regulation, while excessive restrictions may discourage investment flows.

Therefore, future treaty design must adopt a **balanced and sustainable approach**, ensuring that foreign investment contributes to economic growth while simultaneously protecting the environment and safeguarding host-state sovereignty.

