Article: **FDI Law: Balancing Investor Protection and State Sovereignty**

Executive Summary

Foreign direct investment, or FDI, depends on a legal bargain. Investors seek certainty: protection against discrimination, uncompensated expropriation, arbitrary treatment, and politically motivated interference. Host states seek capital, technology, infrastructure, and jobs, but must preserve the sovereign authority to regulate in the public interest. The central question in modern FDI law is therefore not whether investor protection matters. It is how investment treaties, domestic FDI regulation, and FDI arbitration can protect legitimate expectations without freezing democratic regulation.

That question has become more urgent. UNCTAD reported that global FDI fell by **11 percent to USD 1.5 trillion in 2024**, a second consecutive annual decline, while FDI to developed economies fell by **22 percent** and European inflows fell by **58 percent**. OECD later reported that global FDI flows rose by **15 percent in 2025 to USD 1,660 billion**, though sustained inflationary pressures and geopolitical tensions continued to weigh on the outlook. In short, capital is mobile, but confidence is fragile.

For international investors, policymakers, and legal professionals, the practical issue is clear: treaty protection remains valuable, but regulatory risk now extends beyond traditional expropriation to climate policy, data governance, sanctions, national security screening, and ESG compliance.

The Paradox of Certainty vs. Sovereignty in FDI Law

Investment treaties were designed to reduce political risk. Bilateral investment treaties, free trade agreements, and multilateral frameworks commonly protect foreign investors through standards such as national treatment, most-favored-nation treatment, fair and equitable treatment, full protection and security, compensation for expropriation, and access to investor-state dispute settlement.

ICSID describes itself as the world's leading institution for international investment dispute settlement and provides facilities for conciliation and arbitration between states and foreign investors. UNCITRAL's Working Group III is addressing possible reform of investor-state dispute settlement, including concerns over cost, consistency, duration, and legitimacy. UNCTAD notes that most of the world's **3,200** international investment agreements historically focused on investment protection, while newer agreements increasingly add facilitation, transparency, and sustainable investment features.

The paradox is that the same legal certainty that attracts investment can be perceived as constraining state sovereignty in FDI. A host state may need to tighten environmental rules, regulate tobacco, screen foreign acquisitions in critical infrastructure, or impose data localization

requirements. If treaty language is broad and imprecise, such regulation may trigger claims for indirect expropriation or breach of fair and equitable treatment. Modern FDI law is moving from absolute protection toward calibrated protection.

Expropriation vs. Legitimate Regulation

The classic dividing line in FDI arbitration is between compensable expropriation and non-compensable regulation under a state's police powers.

Case example: Methanex v. United States. Methanex challenged California measures restricting MTBE, a gasoline additive, under NAFTA Chapter 11. The tribunal rejected the claim and held that a non-discriminatory regulation for a public purpose, enacted with due process, is not expropriatory merely because it affects a foreign investor.

Case example: Philip Morris v. Uruguay. Philip Morris challenged Uruguay's tobacco packaging and graphic health-warning measures, alleging indirect expropriation and breach of FET. UNCTAD records that the ICSID tribunal dismissed all claims and found no breach of the applicable investment treaty. The case is a leading illustration of public health regulation prevailing over investor claims where the measure was adopted for a legitimate public purpose.

Case example: Rockhopper v. Italy. Climate and energy policy can produce different outcomes. Rockhopper challenged Italy's restrictions affecting offshore oil activity near the coast under the Energy Charter Treaty. Commentary on the award reports that the tribunal found Italy liable and awarded compensation after Italy's legislative change affected the Ombrina Mare project. The lesson is not that climate regulation is unlawful. It is that timing, reliance, permitting history, and treaty wording matter.

For host states, the drafting lesson is to define indirect expropriation carefully and preserve bona fide regulation for public welfare. For investors, the diligence lesson is to assess the policy trajectory before committing capital.

Fair and Equitable Treatment: From Open-Ended Protection to Defined Standards

FET is often the most litigated standard in investment treaties because it can capture conduct that falls short of expropriation: denial of justice, manifest arbitrariness, discrimination, abusive treatment, or frustration of legitimate expectations.

In **Saluka v. Czech Republic**, an UNCITRAL tribunal recognized that foreign investors are entitled to fair and equitable treatment, but also stated that a host state is not liable for every regulatory change affecting an investment. The award is widely cited for the principle that investors must expect a degree of legal and business risk in a regulated economy.

Modern treaties increasingly narrow FET. CETA Article 8.10 identifies specific categories of conduct that may breach the minimum standard, such as denial of justice, fundamental breach of due process, manifest arbitrariness, targeted discrimination, and abusive treatment. CETA also confirms in Article 8.9 that parties reaffirm their right to regulate to achieve legitimate policy objectives, including public health, safety, environment, public morals, social or consumer protection, and promotion of cultural diversity.

This evolution matters. Older treaties often left tribunals to infer the content of FET. Newer treaties increasingly codify the balance between investor protection and state sovereignty in FDI.

Public Interest Carve-Outs in Modern Investment Treaties

Recent investment treaties and regional instruments show a clear policy shift. States are not abandoning investor protection; they are integrating it with public interest carve-outs.

Key innovations include:

- **Express right to regulate:** CETA expressly preserves regulatory autonomy for legitimate policy objectives.
- **Investment screening:** Regulation (EU) 2019/452 establishes a framework for screening foreign direct investments into the European Union on grounds of security or public order. The European Commission's fifth annual report also confirms continuing EU-level cooperation on FDI screening.
- **Sustainable investment and investor duties:** On the African side, the AfCFTA Protocol on Investment was adopted by African Union heads of state and government in February 2023. It reflects a regional move toward investment protection aligned with sustainable development and investor responsibilities.

These provisions reduce interpretive uncertainty. They also help states defend health, environmental, security, and consumer-protection measures without undermining the rule of law.

Contemporary Flashpoints: Climate, Data, and Security

Three areas now dominate FDI regulation and FDI arbitration risk.

1. **Climate change regulation.** The Netherlands' coal phase-out generated ICSID claims by RWE and Uniper under the Energy Charter Treaty. The measures concerned a 2019 law phasing out coal-fired electricity generation by 2030; both arbitrations were later discontinued. The cases show how net-zero policy can collide with long-lived energy investments.
2. **Digital and data sovereignty.** UNCTAD's Digital Economy Report emphasizes the development implications of cross-border data flows and data governance. OECD reports that data localization measures are growing and increasingly restrictive, with potential effects on business activity. For investors in cloud, fintech, telecoms, health-tech, and AI, data rules are now central FDI law issues.
3. **National security screening.** Security review has moved from exceptional to mainstream. The EU FDI Screening Regulation applies to investments likely to affect security or public order, including critical infrastructure, critical technologies, supply of critical inputs, access to sensitive information, and media pluralism. And similar approaches are expanding globally.

ESG Obligations and Country Case Studies

Modern investment policy increasingly embeds ESG considerations, anti-corruption expectations, sustainability commitments, and responsible business conduct. This trend is visible in treaty design and domestic investment climate reform.

Rwanda. The 2025 Investment Climate Statement notes that Rwanda has implemented comprehensive business reforms for over a decade, streamlining procedures and improving the ease of starting businesses. Its Investment Code offers benefits and incentives for registered investors in strategic growth sectors.

Uganda. The 2025 Investment Climate Statement also reports that Ugandan officials welcome foreign investment, but also notes a gap between rhetoric and implementation. This illustrates a common emerging-market issue: that legal openness must be matched by administrative predictability.

Tanzania. Tanzania's 2025 statement notes that foreign investors require at least **USD 500,000** in capital for protection under the 2022 Tanzania Investment Act, compared with **USD 50,000** for Tanzanian investors. Thresholds can promote serious investment but may also affect market entry.

Singapore. Singapore remains a leading Asian investment hub. Its 2025 statement reports that Singapore received more than double the U.S. FDI invested in any other Southeast Asian nation. Its strength lies in regulatory reliability, connectivity, and proximity to high-growth regional markets.

Panama. Panama attracts an average of **USD 2 billion to USD 4 billion** in FDI annually and hosts the world's second largest free trade zone. Logistics, trade facilitation, and legal certainty remain central to its investment proposition.

India, South Africa, and Germany. India generally permits FDI in most sectors through the automatic route, but Press Note 3 requires government approval for investment from entities in countries sharing a land border with India or with beneficial owners there. South Africa remains relatively open to foreign investment while pursuing domestic transformation and public-interest objectives. Germany reflects the European trend toward openness combined with more active security screening.

Practical Takeaways for Investors and Host States

For investors:

- Map treaty coverage before structuring an investment.
- Conduct regulatory-risk diligence in climate, data, tax, sanctions, procurement, and national security-sensitive sectors.
- Avoid assuming that FDI arbitration will compensate every adverse regulatory change.
- Build ESG and responsible business conduct into project design.

For host states:

- Draft investment treaties with clear FET language, indirect expropriation annexes, and public interest exceptions.
- Maintain transparent, proportionate, and non-discriminatory FDI regulation.
- Document the public purpose, evidence base, and procedural fairness of regulatory measures.

- Use investment facilitation and aftercare to reduce disputes before they become arbitration claims.

Conclusion

The future of FDI law lies in balance. Investor protection remains essential to mobilize capital, particularly for infrastructure, energy transition, technology, and sustainable development. But state sovereignty in FDI is equally essential: governments must retain policy space to protect public health, national security, the environment, data integrity, and financial stability.

Modern investment treaties, EU screening rules, AfCFTA reforms, UNCITRAL ISDS reform, and evolving FDI arbitration all point in the same direction: the most resilient investment regimes are neither investor-only nor state-only. They provide certainty, preserve legitimate regulation, and align cross-border investment with sustainable development.

Stabit Advocates advises investors, governments, and businesses on FDI law, investment treaties, FDI regulation, market-entry structuring, ESG obligations, and cross-border investment compliance. For tailored legal guidance on foreign direct investment strategy, regulatory approvals, treaty protection, or investor-state risk management, contact Stabit Advocates to discuss your project and jurisdiction-specific requirements.

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