

Investment Treaties as a Risk Allocation Tool

The missing link in the reform agenda

Josef Ostřanský, Lukas Schaugg
July 2025

Investment treaties are often seen as rule-of-law anchors for unpredictable environments—but in practice, they tend to function like unpriced public insurance. In an age of fiscal constraint and de-risking statecraft, it is time to rethink what that means for the public interest. The International Institute for Sustainable Development (IISD) is leading this work as part of its broader focus on sustainable investment governance. We are actively engaging partners to support a focused reform effort, grounded in robust analysis and long-term impact.

As global development agendas increasingly rely on private capital flows to finance infrastructure, energy transitions, or deliver public services, governments are being called upon to make investments “bankable.” However, many investors continue to view development-related investments as high risk and politically volatile, reflecting not only actual investment conditions but also a broader trend of private sector risk aversion. In response, public institutions are deploying a range of risk-reducing instruments, including political risk insurance, export credits, blended finance mechanisms, and sovereign loan guarantees. These tools are designed to de-risk investments and absorb categories of private sector risk that are considered to deter capital flows into developing and emerging economies (see, e.g., Perera et al., 2018).

Despite being traditionally framed as legal instruments to protect foreign investors from expropriation or unfair treatment, treaties continue to play an outsized role in this context. While debates around investment treaties often focus on investor–state dispute settlement (ISDS) procedures or legal technicalities, comparatively little attention has been paid to the function of treaties within the expanding ecosystem of public risk allocation.



To better align investment treaties with the public interest in this “de-risking” era, this policy brief recommends that policy-makers

- assess investment treaties as risk allocation instruments alongside other, functionally equivalent or similar instruments;
- terminate or revise treaties that duplicate or undermine more effective, accountable mechanisms, especially where public funds are involved;
- incorporate financial impact, distributional effects, and public interest alignment goals when reforming investment governance instruments;
- promote coordination among public de-risking institutions—finance ministries, development banks, and insurers—to streamline efforts, avoid double recovery, and ensure fair, transparent risk sharing.

These policy recommendations are grounded in a functional rethinking of investment treaties (Ostránský & Bonnitcha, 2024). In line with others, we argue that investment treaties operate as public insurance instruments that shift political and regulatory risks away from foreign investors and onto host states (Directorate for Financial and Enterprise Affairs Investment Committee, 2025). This allows us to evaluate investment treaties not simply by their legal pedigree, but by their financial and economic implications, interaction with other risk allocation tools, and the distributive consequences.

Unlike most de-risking instruments, investment treaties do not condition coverage on risk management behaviour, and do not include embedded safeguards for policy coherence, environmental sustainability, or human rights. As a result, they function as implicit financial burdens on host states.

This understanding opens new pathways for policy reform, including through ongoing processes at the United Nations Commission on International Trade Law (UNCITRAL) Working Group III (IISD, n.d.), UN Trade and Development (UNCTAD, 2025), and emerging efforts at the Organisation for Economic Co-operation and Development (Schaugg et al., 2024) and the International Institute for the Unification of Private Law (2021). Our brief helps illuminate why investment treaties have remained resistant to meaningful reform (UNCTAD, 2024), and why, in the current era of “de-risking” statecraft, they warrant renewed scrutiny as instruments of economic and political governance—not merely legal dispute settlement. From this approach, we derive concrete steps for investment policy-makers to better align investment risk allocation frameworks with public policy objectives.

Investment Treaties in the De-Risking Era

Over the past decade, the landscape of international investment governance has undergone a quiet but profound shift. No longer confined to international law’s doctrinal or juridical domains, investment treaties today function within a broader policy architecture that positions the state as an enabler of capital flows. This shift is particularly pronounced in what scholars have called the “de-risking” paradigm—a political-economic approach that tasks governments, especially in the Global South, with absorbing key investment risks in order to attract private capital.



In this context, investment treaties serve as powerful instruments of “risk absorption” by the (host) state. While originally justified on the basis of attracting foreign direct investment or reinforcing the “rule of law,” these treaties have become embedded in a larger policy assemblage alongside other risk transfer mechanisms: political risk insurance, export credits, public–private partnerships, and blended finance models. However, the absorbed risks are always borne by someone: they never disappear. Each of these tools reallocates specific categories of risk—political, regulatory, financial, and macroeconomic—from private investors to public institutions. Unlike some of these instruments, however, investment treaties offer unconditional, automatic protection and enforceable remedies without requiring prior vetting, premiums, or performance benchmarks.

Treaty-based investor protection, when viewed from a risk allocation perspective, reveals a distinct form of financial exposure. Where political risk insurance or sovereign guarantees may require rigorous ex-ante evaluation and integration of policy goals such as sustainability, investment treaties operate as open-ended commitments that can be triggered by a wide range of investor grievances. The result is an asymmetrical regime in which host states carry substantial downside risk, often without the procedural, financial, or strategic tools to mitigate these obligations.

Moreover, the architecture of ISDS transforms political risk into legally enforceable financial liabilities. Where other de-risking mechanisms are structured around contingent obligations or negotiated settlements, investment treaties channel disputes into a system where damages awards are growing in size and often include speculative assessments of lost future income (Ostřanský et al., 2024). These awards are increasingly treated by credit rating agencies and bond markets as contingent fiscal liabilities, reinforcing the budgetary implications of ISDS exposure and compounding the financial and debt constraints on developing countries (Moody’s, 2025).

Situating investment treaties within the broader ecology of de-risking instruments helps reframe ongoing debates. Rather than exceptional legal artifacts, they emerge as one among many tools governments use to subsidize investment by absorbing private sector risk. From this vantage point, the key questions become: What risks do these treaties allocate? Who bears the financial burden when claims arise? How do investment treaties interact with other risk mitigation tools in ways that either duplicate protections or distort incentives? Moreover, ultimately, what is the cost of maintaining this particular form of risk insurance—often without transparency, safeguards, or accountability?

By recasting investment treaties as instruments of public risk allocation, this policy brief offers policy-makers a foundation for the assessment of the utility, efficiency, and fairness of investment treaties within the shifting terrain of international investment governance. This perspective is especially urgent considering the current global emphasis on mobilizing capital for climate transitions, digital infrastructure, and sustainable development, domains where the need for equitable, accountable, and coherent de-risking is most acute. Ultimately, it will support policy-makers’ efforts to reform treaties in line with public policy priorities.



Investment Treaties and Adjacent Tools: A comparative risk allocation framework

To contextualize treaties' risk allocation function, it is helpful to compare them to adjacent de-risking instruments:

- **political risk insurance** (Alschner, 2025) provided by multilateral institutions (e.g., the Multilateral Investment Guarantee Agency), export credit agencies (e.g., United States International Development Finance Corporation, China's Sinosure), or private insurers. These typically cover well-defined political risks such as expropriation or currency inconvertibility and require investor due diligence (UNCTAD, 2025).
- **export credit guarantees** and investment guarantees, which underwrite cross-border commercial and investment activities, often on concessional terms and with explicit home state strategic interests in mind (Jones, 2024).
- **public-private partnerships** and investor-state contracts, which frequently include stabilization clauses, change-of-law provisions, or other contractual commitments that allocate risk over time (IISD, 2018).
- **sovereign loan guarantees and blended finance**, where public institutions absorb a "first-loss" position to improve the credit profile of development projects and attract private co-financing (Gouett et al., 2023).
- **jurisdictional infrastructure**, such as the use of arbitration-friendly third-party jurisdictions or investor-favoured procedural rules, which shape enforcement pathways and legal predictability (Ostřanský et al., 2025).

Each of these tools involve trade-offs, pricing, or conditions that reflect evolving standards of responsible risk allocation. Investment treaties, by contrast, provide protection without a fee or performance conditions. When layered over these tools, they create risks of redundancy, regressive financial burdens, and strategic claims. For example, an investor may benefit simultaneously from a treaty-based right to compensation, a political risk insurance payout, and a contractual stabilization clause—all covering variations of the same risk event. In some cases, this creates the potential for "double recovery" or strategic arbitrage, where risk instruments are leveraged not for genuine loss mitigation, but for financial gain.

In light of these interactions, any serious reform effort must go beyond procedural tweaks to ISDS or minor recalibrations of treaty language. It must instead ask what role investment treaties should play within a larger risk governance strategy—particularly one aimed at just transitions, public accountability, and sustainable investment. Understanding investment treaties as risk allocation instruments—and comparing them directly to their functional peers—offers a more grounded, policy-relevant basis for answering this question.



Policy Implications: Rethinking investment treaties as public risk instruments

Recasting investment treaties as instruments of public risk allocation carries important implications for investment policy, treaty reform, and broader development financing strategies. It foregrounds treaties' material function: transferring risk from foreign investors to host states, often without compensation, performance obligations, or political accountability.

This reorientation suggests a need for a more systemic evaluation of investment treaties, not only in isolation but within the wider “de-risking toolbox” that states increasingly rely on to attract and manage private investment (Mann, 2018). In this light, the key question becomes not whether treaties offer legal certainty, but whether they do so efficiently, equitably, and in alignment with the policy objectives of host governments, especially in the context of climate action, sustainable development, and financial sustainability.

One immediate implication is the recognition that investment treaties often stand apart from the evolving norms and practices of other de-risking tools. For instance, export credit arrangements and development finance institutions have begun integrating environmental and human rights safeguards into their operations. These safeguards serve to condition support on the public interest value of an investment and mitigate negative externalities. In contrast, most investment treaties still provide blanket coverage, regardless of an investor's social or environmental performance.

Another key issue is asymmetry in financial exposure. While public guarantees or insurance schemes typically include a pricing mechanism—via premiums, underwriting, or capped liability—investment treaties do not. Investors gain access to enforceable compensation without paying for the risk coverage, making treaty protections effectively a public subsidy. This unpriced, uncapped exposure places a disproportionate burden on the public sector, especially in developing economies where fiscal space is already constrained.

In addition, investment treaties may interfere with or duplicate other forms of risk mitigation, producing inefficient or regressive outcomes. Where an investment is already backed by political risk insurance, for example, treaty-based ISDS claims can lead to overcompensation or overlapping financial liabilities. Subrogation mechanisms, by which insurers reclaim damages from states after compensating investors, create further financial risks and governance opacity. These interactions are rarely addressed in treaty reform discussions but are central to the overall cost-benefit calculus of maintaining treaty networks.

A more functional understanding of investment treaties also raises questions about their comparative value. If similar protections can be provided through contracts, guarantees, or insurance—with greater oversight, risk-based pricing, and policy safeguards—then the added utility of treaties becomes unclear. Indeed, some investors already treat investment treaties as backstops, supplementing primary instruments like political risk insurance or public-private partnerships contracts. Others, especially those using third-party funding, may exploit treaties to extract speculative gains from distressed states with limited legal capacity or budgetary flexibility.



Finally, this perspective invites governments to reassess treaty reform priorities. Much of the debate in multilateral fora like UNCITRAL Working Group III remains focused on procedural fairness or arbitrator selection. However, these issues, while important, do not address the core question: what function do these treaties serve in today's investment landscape? A risk allocation lens calls for a broader shift, from formalistic or symbolic notions of legal certainty to a more grounded, policy-based understanding of how public resources are mobilized, allocated, and exposed to contingent liabilities.

This shift is particularly urgent for host states, especially in the Global South. In an era where public budgets are increasingly tied to international development goals and climate transitions, the continued use of opaque and asymmetric investment treaties as risk-bearing instruments demands far closer scrutiny. Reform efforts that fail to account for these financial and policy dynamics risk preserving outdated mechanisms at significant public cost. This framework is particularly useful for the much-needed rethinking of investment treaties for the problems of the 21st century (Ostránský et al., 2024).

Conclusion and Way Forward

Going forward, policy-makers should:

- assess investment treaties as one risk allocation instrument among other functionally equivalent or similar tools;
- consider phasing out or revising treaties that duplicate or undercut more effective and accountable tools, particularly where public finance is at stake;
- revisit treaty design through a policy-oriented lens, integrating financial impact assessments, distributional analysis, and coherence with national and international public interest objectives;
- encourage coordinated dialogue across institutions responsible for public de-risking—such as ministries of finance, development banks, and insurance providers—to reduce redundancy, prevent double recovery, and promote more transparent and equitable risk-sharing mechanisms.

This analysis marks the beginning of a focused, IISD-led effort to reframe investment treaties as instruments of public risk allocation. Building on our role as a leading voice in sustainable investment governance, we aim to deepen this typology, map financial exposures, and clarify how treaties interact with other de-risking tools across varied contexts to inform our ongoing work with policy-makers and partners to reform treaties in line with public interest priorities.



References

- Alschner, W. (2025). *To transform the international investment regime, look to political risk insurance and not (only) to investment treaties*. Investment Treaty News. <https://www.iisd.org/itn/2025/01/27/transform-international-investment-regime-political-risk-insurance-wolfgang-alschner/>
- Directorate for Financial and Enterprise Affairs Investment Committee. (2025). *Future of investment treaties track 1—Investment treaties and climate change: Methods to align investment treaty benefits for energy investment with the Paris Agreement and net zero* (Note by the Secretariat). Organisation for Economic Co-operation and Development. [https://one.oecd.org/document/DAF/INV/TR1/WD\(2024\)1/REV2/en/pdf](https://one.oecd.org/document/DAF/INV/TR1/WD(2024)1/REV2/en/pdf)
- Gouett, M., Murphy, D., & Parry, J.-E. (2023). *Innovative financial instruments and their potential to finance climate change adaptation in developing countries*. International Institute for Sustainable Development. <https://www.iisd.org/publications/report/financial-instruments-climate-change-adaptation>
- International Institute for Sustainable Development. (2018). *Public-private partnerships (PPPs) in infrastructure and public services* (Workshop). https://www.iisd.org/events/public-private-partnerships-ppps-infrastructure-and-public-services?gad_source=1&gad_campaignid=22208053183&gclid=CjwKCAjwpMTCBhA-EiwA_-MsmekBJwyb23-tD9dH2mzYbsG4uco9YEWiIftP2J_oVUDq1h1NwGibaBoCaRsQAvD_BwE
- International Institute for Sustainable Development. (2025). *UNCITRAL Working Group III and reform of investor-state dispute settlement*. <https://www.iisd.org/projects/uncitral-working-group-iii-and-reform-investor-state-dispute-settlement#:~:text=The%20UN%20Commission%20on%20International,disputes%20that%20enhances%20sustainable%20development>
- International Institute for the Unification of Private Law. (2021). *International investment contracts: Study L-IIC - International investment contracts*. <https://www.unidroit.org/work-in-progress/investment-contracts-upicc/>
- Jones, N. (2024). *An OECD deal on ending oil and gas export credits is urgently needed. Here's what it could look like*. International Institute for Sustainable Development. <https://www.iisd.org/articles/explainer/oecd-deal-ending-oil-gas-export-credits-what-it-could-mean>
- Mann, H. (2018). *The high cost of “de-risking” infrastructure finance*. The Project Syndicate. <https://www.project-syndicate.org/commentary/world-bank-ppp-de-risking-by-howard-mann-2018-12?barrier=accesspaylog>
- Moody's. (2025). *Sovereigns - Latin America & Caribbean: Billion-dollar Investor-state Disputes can Threaten Credit Strength*. www.moody.com/research/docid--PBC_1421990
- Ostránský, J., Atanasova, D., & Beyer, V. (2024). *Compensation and damages in investor-state dispute settlement: Options for reform*. International Institute for Sustainable Development. <https://www.iisd.org/publications/report/compensation-damages-isds-reform>



- Ostránský, J., & Bonnitcha, J. (2024). *Rethinking investment treaties: A roadmap*. International Institute for Sustainable Development. <https://www.iisd.org/publications/report/rethinking-investment-treaties-roadmap>
- Ostránský, J., Sarmiento, F., & Nikiéma, S. (2025). *Why is investment treaty and investor–state dispute settlement reform needed? Questions & answers*. International Institute for Sustainable Development. <https://www.iisd.org/system/files/2025-03/investment-treaty-and-isds-reform-questions-answers.pdf>
- Perera, O., Uzsoki, D., & Wuennenberg, L. (2018). *Credit enhancement for sustainable infrastructure*. International Institute for Sustainable Development. <https://www.iisd.org/publications/report/credit-enhancement-sustainable-infrastructure>
- Schaugg, L., Nikiéma, S., & Bernasconi-Osterwalder, N. (2024). *Investor–state dispute settlement and fossil fuels: What role for a carveout?* Investment Treaty News. <https://www.iisd.org/itn/2024/04/02/investor-state-dispute-settlement-and-fossil-fuels-what-role-for-a-carveout/>
- United Nations Conference on Trade and Development. (2024). *International investment agreements trends: The increasing dichotomy between new and old treaties*. https://unctad.org/system/files/official-document/diaepcbinf2024d4_en.pdf
- United Nations Conference on Trade and Development. (2025). *Derisking investment for the Sustainable Development Goals: The role of political risk insurance*. https://unctad.org/system/files/official-document/diaepcb2025d1_en.pdf

© 2025 International Institute for Sustainable Development
Published by the International Institute for Sustainable Development

This publication is licensed under a [Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License](https://creativecommons.org/licenses/by-nc-sa/4.0/).

INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT

The International Institute for Sustainable Development (IISD) is an award-winning independent think tank working to accelerate solutions for a stable climate, sustainable resource management, and fair economies. Our work inspires better decisions and sparks meaningful action to help people and the planet thrive. We shine a light on what can be achieved when governments, businesses, non-profits, and communities come together. IISD's staff of more than 200 experts come from across the globe and from many disciplines. With offices in Winnipeg, Geneva, Ottawa, and Toronto, our work affects lives in nearly 100 countries.

IISD is a registered charitable organization in Canada and has 501(c)(3) status in the United States. IISD receives core operating support from the Province of Manitoba and project funding from governments inside and outside Canada, United Nations agencies, foundations, the private sector, and individuals.

Head Office

111 Lombard Avenue, Suite 325
Winnipeg, Manitoba
Canada R3B 0T4

Tel: +1 (204) 958-7700

Website: iisd.org

X: [@IISD_news](https://twitter.com/IISD_news)



iisd.org