

Reforming the investment treaty regime

A ‘backward-looking’ approach

Summary

- Investor–state dispute settlement (ISDS) – which allows foreign investors to sue governments through international arbitration – has become increasingly controversial. Reasonable observers disagree about the value and fairness of the mechanism, but ISDS has become politically toxic even in capital-exporting states.
- The most important reform effort lies not with future treaties but with those already in place. Even if all newly negotiated investment treaties were improved, or governments stopped negotiating agreements with ISDS provisions altogether, the existing stock of 3,000 investment treaties continues to provide access to ISDS on the same terms as before.
- This briefing paper outlines a practical, flexible and low-cost option for catalysing reform of ISDS: plurilateral ‘interpretative statements’, whereby governments endorse joint statements clarifying and defining their positions on contentious clauses in their existing investment treaties.
- The mechanism provides a viable alternative, or complement, to renegotiations and terminations. It should be prioritized within the broader reform discussions in the United Nations Commission on International Trade Law (UNCITRAL). Alternatively, the new US administration could fast-track the initiative by taking the lead through the OECD, possibly together with the UK.

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Introduction

Few issues in global economic governance have sparked more controversy or public backlash than the system of investor–state dispute settlement (ISDS), which allows foreign investors to sue sovereign governments through international arbitration. Investors have filed more than 1,000 ISDS claims based on the global network of 3,000 investment treaties. More than half of all claims are from the past decade alone, and a growing number of awards involve compensation of hundreds of millions of dollars or more. In 2019, for instance, Pakistan was ordered to pay \$6 billion in compensation to a single foreign investor, a sum equal to the total amount the country had received in an IMF bailout that same year.¹

Reasonable observers disagree about the value and fairness of ISDS. Regardless of where one stands on this debate, however, the mechanism has become politically toxic, as even many capital-exporting states now agree. Reform has become a prominent political agenda. The EU is proposing a revised form of ISDS after investment protection provisions helped torpedo prospects for a Transatlantic Trade and Investment Partnership (TTIP) and sparked a political crisis in the final stages of ratifying the Canada–EU Comprehensive Economic and Trade Agreement (CETA). Meanwhile, the EU's efforts to reform the multilateral Energy Charter Treaty (ECT) have intensified after foreign investors used the treaty to target climate change policies, including Germany's regulation of a coal-fired power plant and the Dutch decision to phase out coal power. In North America, as well, a rise of ISDS claims under the old North American Free Trade Agreement (NAFTA) attracted widespread condemnation, and the relevant mechanism is now removed from the US–Canada investment relationship in the United States–Mexico–Canada Agreement (USMCA).²

With the notable exceptions of the ECT and NAFTA, however, senior policymakers and elected officials are mostly focused on how to constrain or replace ISDS in *future* treaties.³ This is misguided. Forward-looking reform proposals can help address some of the public backlash surrounding new agreements. But even if all newly negotiated treaties were improved, or a government decided to stop negotiating agreements with ISDS provisions in them altogether, the existing stock of investment treaties continues to provide access to ISDS on the same terms as before.

Indeed, most new ISDS cases derive from treaties signed at least 15 to 20 years ago, rather than from those ratified in recent years. Unless policymakers revisit existing investment treaties, the current treaty network will continue to expose host states

¹ *Tethyan Copper Company Pty Limited v. Pakistan*, ICSID Case No. ARB/12/1, Award, 12 July 2019.

² On US government concerns with ISDS, see, for example, Yong, L. (2018), 'Lighthizer justifies opposition to ISDS in NAFTA', *Global Arbitration Review*, 22 March 2018, <https://globalarbitrationreview.com/lighthizer-justifies-opposition-isd-in-nafta>; and Simson, C. (2020), 'Biden comes out against 'special tribunals' for corporations', *Law360*, 28 July 2020, <https://www.law360.com/articles/1295978/biden-comes-out-against-special-tribunals-for-corporations>. When removing ISDS from the US–Canada investment relationship, Canada's then foreign minister, Chrystia Freeland, noted that it 'strengthened our government's right to regulate in the public interest'; see Government of Canada (2018), 'Prime Minister Trudeau and Minister Freeland deliver remarks on the USMCA', 1 October 2018, [youtube.com/watch?v=UORmufEVD4](https://www.youtube.com/watch?v=UORmufEVD4).

³ On important investment agreements without ISDS, see, for example: recent Brazilian BITs; the EU's recent investment agreements with China and Japan (which may include the EU's version of ISDS in the future, but which for now include post-establishment national-treatment clauses without the mechanism); the USMCA as described above; the US–Australia FTA; and New Zealand's relationship with several signatories to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

based on outdated terms.⁴ And keeping outdated treaties in place makes home states complicit in facilitating investor claims that are sometimes misaligned with domestic and foreign policy agendas, for instance in the area of energy transition.

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In this briefing paper, we outline a flexible and low-cost option for catalysing reform of the existing stock of 3,000 investment treaties: a plurilateral mechanism for 'interpretative statements' by states, which in turn could provide a stepping-stone for amending or replacing provisions. The mechanism could, but does not have to, be linked to ongoing reform efforts at the United Nations Commission on International Trade Law (UNCITRAL).⁵

Roadblocks to reform

At the core of the controversy over ISDS are the expansive interpretations taken by tribunals, which have occasionally gone beyond property rights protections in advanced legal systems.⁶ This not only distorts competition between foreign and domestic firms, but also has knock-on effects on other international regimes.⁷ 'Mega-awards' of billions of dollars can have considerable fiscal implications, pressuring public finances and foreign-exchange reserves.⁸ The rise of claims against climate change measures has caused considerable outrage. In the area of public health, the risk of claims against COVID-19 measures has led to calls for an ISDS moratorium during the pandemic, including by a former chair of the World Trade Organization (WTO) Appellate Body and by a former World Bank chief economist.⁹ International monetary lawyers have also raised concerns, as most investment

⁴ See Gaukrodger, D. (2016), 'The legal framework applicable to joint interpretative agreements of investment treaties', OECD working paper No. 2016/01, Paris: OECD, <https://www.oecd-ilibrary.org/docserver/5jm3xgt6f29w-en.pdf>; and United Nations Conference on Trade and Development (UNCTAD) (2020), 'Possible reform of Investor-State dispute settlement (ISDS): Multilateral instrument on ISDS reform (Note by the Secretariat)', UNCITRAL Working Group III Paper # 194, 16 January 2020.

⁵ See Roberts, A. and St John, T. (2019), 'UNCITRAL AND ISDS Reform: Visualising a Flexible Framework', *EJIL:Talk!*, 24 October 2019, <https://www.ejiltalk.org/uncitral-and-isds-reform-visualising-a-flexible-framework>.

⁶ Gaukrodger, D. (2014), 'Investment treaties and shareholder claims for reflective loss: Insights from advanced systems of corporate law', OECD working paper No. 2014/02, Paris: OECD, http://www.oecd.org/daf/inv/investment-policy/WP-2014_02.pdf; and Clifford Chance (2019), *UK nationalisation: the law and the cost – 2019 update*, London, 5 July 2019, https://www.cliffordchance.com/briefings/2019/07/uk_nationalisationthelawandthecost-201.html.

⁷ On distortion of competition, see Gurria, A. (2016), 'The growing pains of investment treaties' in Love, P. (ed.) (2016), *Debate the Issues: Investment*, Paris: OECD, <https://www.oecd-ilibrary.org/docserver/9789264242661-12-en.pdf>.

⁸ Paparinskis, M. (2020), 'A Case Against Crippling Compensation in International Law of State Responsibility', *Modern Law Review* 83 (6).

⁹ Bacchus, J. and Sachs, J. (2020), 'Why we need a moratorium on investment disputes during COVID-19', *The Hill*, 6 September 2020, <https://thehill.com/opinion/international/501872-why-we-need-a-moratorium-on-trade-disputes-during-covid-19>; and Columbia Center for Sustainable Investment (2020), 'Call for ISDS moratorium during Covid-19 crisis and response', 6 May 2020, ccsi.columbia.edu/2020/05/05/isds-moratorium-during-covid-19.

treaties clash with the IMF's Articles of Agreement by preventing states from using capital controls to address balance-of-payments difficulties.¹⁰ The historical record suggests states did not necessarily intend to grant investors such extensive legal rights when signing on to investment treaties, and did not foresee the wide-ranging implications for other public policy areas.¹¹

While there are still important disagreements among key actors on how to reform ISDS, there is broad consensus among governments on the directional thrust of most states' agendas: to more narrowly circumscribe and define the rights which investment treaties grant to foreign investors; and to give greater interpretative power to states to ensure that tribunals are responsive to the intentions of the treaty parties. But while considerable time and resources are spent on 'upgrading' future investment agreements, hardly any governments have revisited their existing deals. This is not because of corporate resistance. Industry groups have rarely mobilized in investment treaty politics or stood in the way of modernizing investment treaties.¹² Rather than corporate lobbying, the main roadblock to reform is the presumption that revisiting past treaties would be too time-consuming and costly. Indeed, the two most obvious channels for addressing existing treaties – termination or large-scale renegotiation – are unappealing to most states.

Termination. A handful of states have terminated some of their existing treaties, and EU states have terminated almost 300 intra-EU bilateral investment treaties (BITs) due to intra-EU concerns. Still, there is limited political support for treaty terminations in most countries. Moreover, in the case of unilateral treaty denunciation, 'survival' clauses keep protections in place for years and sometimes decades after termination, which means this option has limited near-term effect in shielding states from controversial claims.¹³

Renegotiation. Renegotiating treaties would not leave states exposed to new claims via survival clauses. Yet renegotiations can present a daunting task when a dense web of primarily bilateral treaties is involved, requiring significant diplomatic time and resources. Some states are nonetheless trying: the Netherlands, for instance, obtained authorization from the European Commission in 2019 to renegotiate part of its BIT network as part of its new sustainable trade and investment policy. Yet, even if successful, the process could take many years, and while the EU is focused on reforming the ECT – an important task – other treaties are further down the priority list. While European states, as mentioned, have

¹⁰ Siegel, D. (2004), 'Using free trade agreements to control capital account restrictions: Summary of remarks on the relationship to the mandate of the IMF', *ILSA Journal of International and Comparative Law* 10 (2): 297–304; and Waibel, M. (2009), 'BIT by BIT – The silent liberalization of the capital account', in Binder, C., Kriebaum, U., Reinisch, A. and Wittich, S. (eds) (2009), *International Investment Law for the 21st Century – Essays in Honour of Christoph Schreuer*, Oxford: Oxford University Press.

¹¹ Poulsen, L. (2015), *Bounded Rationality and Economic Diplomacy: The Political Economy of Investment Treaties in Developing Countries*, Cambridge: Cambridge University Press; and Hepburn, J., Paparinskis, M., Poulsen, L. and Waibel, M. (2020), 'Investment law before arbitration', *Journal of International Economic Law* 23 (4).

¹² This is at least in part because the legal costs of ISDS *de facto* prevent many firms from using it, and because a range of alternative investment protection instruments are often available for firms concerned with political risks; see Bonnitcha, J., Poulsen, L. and Waibel, M. (2017), *The Political Economy of the Investment Treaty Regime*, Oxford: Oxford University Press. Arbitration lawyers and law firms have been more active, but while they often act as policy advisers, they are not an important constituency for governments.

¹³ For example, even though India terminated its BIT with the Netherlands in December 2016, following the Indian government's comprehensive review of its investment treaty programme, established Dutch investors will still be able to initiate new ISDS claims for a further 15 years, until 2031.

terminated intra-EU BITs, they are still party to more than 1,400 BITs with non-EU countries. Equally, while the US curtailed ISDS in renegotiating NAFTA into the USMCA, it still has 39 BITs in place.

With both terminations and renegotiations, an added complication is that foreign investors often have ample opportunity to pick and choose which treaty, or treaties, they want to base their claims on. The most important challenge is arguably tribunals' attitude to shareholder claims – more permissive than in advanced systems of national corporate law – which leaves considerable leeway for so-called 'treaty-shopping'.¹⁴ The problem is aggravated where states only require incorporation as a test of corporate nationality, as many foreign investors rely on offshore holding companies.¹⁵ The implication is that, while most investment treaties are bilateral, reforms of the investment treaty regime must go beyond ad hoc bilateralism to be effective. Unpicking a global web of thousands of treaties requires an approach that covers a considerable number of treaties and does so swiftly.

State interpretations

There is, however, a third option available to states, which could be a cheaper and quicker alternative – or at least a complement – to termination and renegotiation: the use of interpretative statements by governments. Under international law, states have the right to constrain how international adjudicators interpret treaties, including after the treaties have been ratified.¹⁶ The Vienna Convention on the Law of Treaties requires tribunals to take such statements into account,¹⁷ and in recent years a number of domestic courts have affirmed the status of interpretative statements as well.¹⁸ The effects are greatest when statements are made by both (or all) treaty parties. State interpretative statements provide a viable way for governments to bring their concerns, already clearly expressed when discussing new investment treaties, to the far more important world of existing treaties without going through the pains of terminations or renegotiations.¹⁹

¹⁴ OECD (2018), 'Investment Treaties: Treaty shopping and tools for treaty reform', background note for 4th Annual OECD Conference on Investment Treaties, 12 March 2018, <https://www.oecd.org/daf/inv/investment-policy/4th-Annual-Conference-on-Investment-Treaties-agenda.pdf>.

¹⁵ Damgaard, J., Elkjaer, T. and Johannesen, N. (2019), 'What is real and what is not in the global FDI network?', IMF working paper 19/274, <https://www.imf.org/en/Publications/WP/Issues/2019/12/11/what-is-real-and-what-is-not-in-the-global-fdi-network>.

¹⁶ See, for example, Roberts, A. (2010), 'Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States', *American Journal of International Law* 104 (12); UNCTAD (2011), *Interpretation of IIAs: What states can do*, Geneva: UNCTAD; Johnson, L. and Razbaeva, M. (2014), *State Control Over Interpretation of Investment Treaties*, New York: Columbia Center on Sustainable Investment, https://scholarship.law.columbia.edu/sustainable_investment_staffpubs/89; and Gordon, K. and Pohl, J. (2015), 'Investment treaties over time – treaty practice and interpretation in a changing world', OECD Working Papers on International Investment 2015/02, Paris: OECD, <http://www.oecd.org/investment/investment-policy/WP-2015-02.pdf>.

¹⁷ See, for example, *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (AF)/00/1, Award, 9 January 2003, para. 177.

¹⁸ French Constitutional Council, decision of 31 July 2017, Comprehensive Economic and Trade Agreement between Canada, on the one hand, and the European Union and its Member States, on the other (CETA), no. 2017-749 DC (CETA decision), par. 36; and Constitutional Court of Colombia (CCC), Judgment C-252 2019. Some courts have been more sceptical; see *Sanum Investments v. Laos (I)*, Judgment of the Court of Appeal of Singapore, 29 September 2016, par. 116.

¹⁹ Sharpe, J. (2020), 'From delegation to prescription: interpretative authority in international investment agreements', draft on file with authors.

In principle, states can issue such statements at any time.²⁰ Some existing treaties, such as the USMCA and CETA, include formal mechanisms for issuing joint interpretations.²¹ Even where such mechanisms don't exist, treaty partners can issue joint interpretative statements through ad hoc exchanges of diplomatic notes. In practice, however, states have rarely resorted to interpretative statements. India has tried but largely failed so far, for instance, and in the NAFTA context the parties only managed to proceed with one substantive note of interpretation despite wide-ranging agreement across a range of issues. Why? In some cases, treaty partners may disagree on substantive issues, or the risk of claims may not yet be politically salient. Yet based on the authors' engagement with investment negotiators over the past decade – both in Latin America and within the OECD – it appears that for many states the main constraints are logistical and practical rather than rifts among treaty partners.²² The principal such constraints are as follows:

Information. Some government officials remain unaware of the legal standing of interpretative statements and of the 'dual role' of states in ISDS as both respondents *and* interpreters.²³ This is particularly the case where officials rotate in and out of investment policy jobs or are not exposed to regular cases. Other officials overestimate the risk that state interpretations might result in amendments requiring cumbersome domestic ratification (often an unpersuasive objection given the vague nature of core investment treaty standards). And officials who have thought about the potential use of these instruments sometimes find it hard to identify areas with scope for agreement among treaty partners.

Transaction costs. Some governments find the organizational transaction costs associated with serial bilateral interpretations prohibitive. As mentioned, joint interpretations can be done through something as simple as a diplomatic exchange. Still, initiating joint interpretations with dozens of treaty partners requires bilateral planning meetings, possibly the sending of delegations, and so forth – particularly when the treaties do not have institutionalized mechanisms for interpretations to act as diplomatic focal points of engagements.

Visibility. Finally, even when attractive among technocrats, bilateral interpretations provide no visible political 'photo-ops' similar to a large treaty renegotiation or denunciation, which might otherwise appeal for political reasons to ministers and senior officials. This further reduces the appetite of government officials to spend administrative resources on this reform instrument.

²⁰ Notably, however, tribunals will likely afford greater weight to states' interpretative statements if they are general statements announced unrelated to any specific dispute, rather than statements seeking to influence a ruling in a specific dispute where a claimant has already challenged a state's actions.

²¹ States can also issue unilateral interpretative statements on their treaty commitments, either as submissions to specific claims (as a disputing or non-disputing party – see, for instance, El Salvador's non-disputing party submission in *Spence International Investments et al. v. Republic of Costa Rica*, and Switzerland's letter to the International Centre for Settlement of Investment Disputes (ICSID) in response to *SGS v. Pakistan*) or simply through a government's website. However, unilateral statements are less likely to be determinative on a tribunal if the other party to the treaty disagrees with the interpretation.

²² For one discussion of such engagement, see Gertz, G. and St John, T. (2015), 'State interpretations of investment treaties: feasible strategies for developing countries', Global Economic Governance Programme working paper, University of Oxford, <https://www.geg.ox.ac.uk/publication/policy-brief-state-interpretations-investment-treaties-feasible-strategies-developing>.

²³ Roberts (2010), 'Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States'. On a similar challenge in the WTO, see Lamp, N. (2021), 'Arrested Norm Development: The Failure of Legislative-Judicial Dialogue in the WTO', unpublished working paper, on file with the authors.

A plurilateral interpretative mechanism

These constraints could be largely or wholly alleviated through a plurilateral arrangement facilitated and hosted by an existing international organization. UNCITRAL would likely be the preferred choice for the EU, and perhaps for a number of non-EU states as well, as it is becoming the centre of gravity on investment treaty reform. Discussions are already under way through UNCITRAL's working group on ISDS reform to support state interpretations as a complement to the main objective of establishing a new dispute settlement architecture.²⁴ If UNCITRAL ends up being the forum, states should ensure that the interpretative agenda takes priority, as this is currently bundled up with a considerable number of other reform suggestions in the draft work plan.²⁵

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Alternatively, a group of states could kick-start the process without having to wait for the already-lengthy UNCITRAL deliberations on multilevel structural reform. For instance, if the administration of US President Joe Biden is more serious about investment treaty reform than previous US administrations have been, it could lead the process through the OECD, possibly with the UK. OECD membership is more limited than that of some other multilateral groupings, of course, but its secretariat has the expertise and experience with effective reform efforts in related fields, for instance with its Multilateral Instrument designed to update thousands of bilateral double-taxation treaties.²⁶

Whichever forum is chosen, the secretariat leading this effort will have two core functions, both of which must be pursued in close cooperation with states. It should map out common ground among potential signatory states. Much of this work has already been done by researchers and international organizations – as well as by states themselves in the context of discussing future treaties.²⁷ And on the basis of this mapping exercise, the secretariat should produce a series of interpretative statements on contentious provisions and issues, possibly organized into a tiered

²⁴ See, for example, UNCITRAL (2020), 'Possible reform of investor-State dispute settlement (ISDS). Interpretation of investment treaties by treaty Parties', note by secretariat, UNCITRAL Working Group III, 17 January 2020. See also UNCITRAL (2019), 'Possible reform of Investor-State dispute settlement (ISDS): Submission from the Governments of Chile, Israel, Japan, Mexico and Peru', UNCITRAL Working Group III paper #182, 2 October 2019; as well as UNCITRAL (2019), 'Possible reform of Investor-State dispute settlement (ISDS): Submission from the Government of Colombia', UNCITRAL Working Group III paper #173, 14 June 2019. For more general discussion on this topic, see Roberts and St John (2019), 'UNCITRAL AND ISDS Reform: Visualising a Flexible Framework'.
²⁵ UNCITRAL (2021), 'Work and resourcing plan to implement investor-State dispute settlement (ISDS) reform and resource requirements', note by secretariat, UNCITRAL Working Group III.

²⁶ See Alschnner, W. (2019), 'The OECD Multilateral Tax Instrument: A Model for Reforming the International Investment Regime?', *Brooklyn Journal of International Law* 45.

²⁷ This work will need to include clarifying which issues and provisions lend themselves to 'standalone' interpretations (such as shareholder claims, for instance), and which are so inherently interconnected that they need to be considered jointly. Government officials must also clarify to the secretariat what is constitutionally feasible without having to go back to parliaments – as is sometimes required in the case of amendments.

ladder of ambition with associated commentary.²⁸ Governments could then, in turn, opt into some or all of these statements on an individual basis during meetings facilitated by the secretariat.

This mechanism is potentially attractive. First, it is flexible. It allows governments to pick and choose how ambitious or cautious they want to be. Second, the proposal is more politically attractive than bilateral interpretations, as states taking the lead can present themselves as reformers and rule-makers in the investment regime. Third, a plurilateral mechanism is not just cheaper than serial bilateral efforts but also has economies of scale. Once the process is completed for a few provisions and states, the transaction costs associated with future interpretations will decrease further. Importantly, this could generate an institutional focal point for states ready to amend or replace provisions.

During the early 2000s, when the risks of ISDS were less clear than today, the United Nations Conference on Trade and Development (UNCTAD) facilitated many successful 'mass-weddings' in which state negotiators came to Geneva to negotiate BITs. The process was quick and efficient. Now is the time to do the same, but in an attempt to revise the global investment treaty network rather than expand it. A plurilateral interpretative mechanism will by no means be a silver bullet. In some cases, renegotiations or terminations will be more meaningful. But at a moment when governments around the world are looking to address mounting pressures on the investment regime, it offers a practical and politically feasible option for states to revisit the most contentious corner of international economic law.

²⁸ See, for example, UNCTAD (2020), *International Investment Agreements Reform Accelerator*, Geneva: UNCTAD, <https://investmentpolicy.unctad.org/publications/1236/international-investment-agreements-reform-accelerator>.

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About this series

This briefing paper is part of a series being published by Chatham House's Global Economy and Finance Programme under the project 'Rebuilding International Economic Cooperation'. The recent election of Joe Biden as US president raises the prospect of a renewed push to find multilateral solutions to global economic problems, coordinated by the G7 and G20 in 2021 and beyond. But the mechanisms of the past won't simply snap back into place. The extent of common ground needs to be established; trust needs to be rebuilt; and technical solutions to problems found.

This project seeks to support that process by putting forward practical, collaborative, politically viable solutions to some of the economic challenges the world currently faces. The papers are authored by independent economic policy experts from the private sector, academia and think-tanks, often with a public policy background. Each paper addresses a specific problem, made more acute by the COVID-19 pandemic, where international economic cooperation can make a significant difference.

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Cover image: Members of the European Parliament hold panels reading 'Stop ISDS' (for 'investor-state dispute settlement') as they take part in a voting session at the European Parliament in Strasbourg on 13 February 2019.

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