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Sanctions as an Institutionalized Structural Barrier in International Investment Law

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In recent decades, economic sanctions have evolved from a merely political and ad hoc instrument into a structural and institutionalized mechanism for regulating international economic relations. This transformation has had profound effects on the international investment law regime, such that sanctions are no longer regarded merely as an external and exceptional factor affecting foreign investment; rather, they operate as a structural barrier to the establishment, continuation, operation, and protection of foreign investments. The principal question addressed in this study is how, and through which mechanisms, sanctions have become an institutionalized structural barrier within the framework of international investment law, and what consequences this development entails for states' obligations, investors' legal certainty, and the effectiveness of the foreign investment protection regime. Employing a descriptive–analytical method and drawing on library-based sources and legal doctrine, this article demonstrates that sanctions, particularly unilateral and secondary sanctions, have become a systematic and self-reproducing barrier within the international investment order by disrupting capital flows, fund transfers, contractual performance, access to financial systems, regulatory stability, and investors' legitimate expectations. The findings indicate that the institutionalization of sanctions in the investment sphere undermines the fundamental principles of this regime, including fair and equitable treatment, investment protection, the prohibition of indirect expropriation, and the principle of predictability. This situation further reveals that the international investment law regime still lacks an adequate institutional and normative response to the structural effects of sanctions. It is therefore concluded that reconsidering the balance between states' sovereign considerations and the need to provide effective protection for foreign investment requires the regulation of sanctions, the limitation of their extraterritorial effects, and the redefinition of compensatory mechanisms under international investment law.

Keywords: *sanctions, international law, international investment law, state responsibility, structural barrier, foreign investment, fair and equitable treatment, indirect expropriation.*

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1. Introduction

In its historical development, the international investment law regime emerged as a legal response to the growing need of states and investors to establish security, predictability, and stability in cross-border economic relations. This regime was founded on the premise that foreign investment, in order to fulfil its developmental functions and facilitate the transfer of capital, technology, and managerial knowledge, necessarily requires an environment in which the rules of the game are known in advance, governmental commitments are reliable, and dispute-settlement mechanisms are effective. Accordingly, since the second half of the twentieth century, there has been a remarkable expansion of bilateral investment treaties, free trade agreements containing investment chapters, state contracts, and the institutionalization of international investment arbitration as the principal mechanism for protecting foreign investors. Within this framework, legal certainty is not regarded merely as an ancillary advantage; rather, it constitutes a fundamental foundation for the formation and continuity of capital flows in international economic relations. Nevertheless, the structural transformation of the international environment in recent decades has demonstrated that this legal foundation is more vulnerable than previously assumed to disruptions arising not from the classical logic of contract or state appropriation, but from modern mechanisms of economic and financial pressure (Esfandiyari Zahedani et al., 2024).

Among these mechanisms, economic sanctions have acquired a distinctive and increasingly prominent position. Sanctions, which were previously regarded primarily as temporary, exceptional, and reactive instruments intended to compel states to alter their political or security-related conduct, have gradually moved beyond the level of ad hoc measures in the contemporary international order and become one of the enduring and structural elements of global economic governance. This transformation has changed the nature of sanctions from a purely political device into a multilayered and systematic instrument—one that affects not only the target state but also a complex network of private persons, banks, transportation companies, insurance institutions, technology providers, financial entities, and even third-party investors. In other words, sanctions in the contemporary world are no longer merely "measures against a state"; at a deeper level, they may affect the economic and legal ecosystem of foreign investment and disrupt ordinary operations, fund transfers, financing, insurability, and the performance of contractual obligations. From this perspective, sanctions can no longer remain peripheral to the analysis of investment law; rather, they must be studied as an internalized and determining factor in the architecture of international investment risk (Sadeghipour & Mohammadzadeh, 2021).

The significance of this issue becomes even more apparent when the effects of sanctions, particularly unilateral and secondary sanctions, are considered. Unlike classical sanctions, which were primarily directed at the target state or persons subject to its jurisdiction, secondary sanctions extend their effects beyond the borders of the sanctioning state by threatening third parties, including companies, banks, insurers, investors, and even other states. This extraterritorial characteristic transforms secondary sanctions into a mechanism that not only obstructs the free movement of capital but also exerts pressure on the economic decision-making of private actors, compelling them to choose between maintaining a lawful relationship with the target country and avoiding severe financial penalties or banking restrictions. The result of such a situation is not merely the restriction of a single transaction or contract; rather, it often disrupts the entire life cycle of an investment, from planning and market entry to operation, development, profit transfer, and even market exit. Thus, as a structural barrier, sanctions operate not as an isolated event but as a persistent, recurring, and self-reproducing pressure capable of weakening foreign investment from within (Gholizadeh, 2022).

From a legal perspective, this situation raises fundamental questions for international investment law. First, can sanctions, particularly secondary sanctions, constitute a breach of investment-related obligations such as fair and equitable treatment, full protection and security, the prohibition of direct or indirect expropriation, freedom of capital and revenue transfers, and the principle of regulatory stability and predictability? Second, if the answer is affirmative, what conditions must be satisfied for the economic effects of sanctions to move beyond ordinary commercial hardship and amount to a legally attributable breach by a state? Third, do the existing international investment arbitration regime and current treaties possess sufficient interpretive and normative tools to address such a phenomenon, or do they confront a form of institutional lacuna and conceptual inadequacy? These questions are important because international investment law has consistently oscillated between two competing poles: on the one hand, preserving state sovereignty and regulatory authority in matters of national security, foreign policy, and public order; and, on the other hand, guaranteeing a minimum degree of stability and legal confidence for foreign investors. Sanctions, especially when employed extensively as instruments of states' foreign policy, intensify this conflict and render the boundary between the legitimate exercise of sovereign authority and unjustified interference with investors' acquired rights increasingly ambiguous.

Moreover, sanctions may, in practice, affect the foundational principles of investment law in ways that extend beyond ordinary economic restrictions. When sanctions result in the obstruction of banking systems, the termination of access to insurance services, exclusion from financing, increased difficulty in importing equipment and spare parts, the refusal of third parties to cooperate, or abrupt instability in the regulatory framework, investors face circumstances in which not only the profitability of the project but also its very continuation is called into question. Under such conditions, investors' legitimate expectations, which constitute one of the elements in the interpretation of fair and equitable treatment, may be impaired because the environment on the basis of which the investment was made is transformed by sanctions. Furthermore, where the economic effects are sufficiently severe and prolonged, sanctions may amount to a form of indirect expropriation; although title is not formally transferred by the state, the economic value of the asset may decline to such an extent, or its use may become so impossible, that the investor is effectively deprived of the essential benefits of ownership (Kimasi et al., 2016).

Accordingly, in investment law, sanctions are not merely an "external restriction"; in many instances, they become a mechanism through which economic constraints are gradually transformed into legal disruption. This issue also confronts the international law of state responsibility with new challenges. The sanctioning state generally seeks to justify its measures by invoking considerations such as national security, responses to transnational threats, the maintenance of international peace and security, counterterrorism, or the implementation of foreign policy. Nevertheless, acceptance of these justifications under international law is neither absolute nor unlimited. The principles of proportionality, necessity, good faith, respect for the rights of third parties, and the restrictive interpretation of exceptions may all limit the scope of the legitimacy of sanctions. The issue becomes particularly sensitive in the context of secondary sanctions because the pressure imposed is directed not only at the target state but also at third-party private and legal actors who may have no connection whatsoever with the conduct alleged by the sanctioning state. From this perspective, secondary sanctions may be analysed as a form of extraterritorial extension of jurisdiction and indirect interference in lawful economic relations—a situation that is not readily compatible with the traditional logic of investment law, which is based on the protection of legitimate expectations and the stability of commitments.

On this basis, the central question of this study is how, and through which mechanisms, sanctions operate as an institutionalized structural barrier in international investment law, and what consequences this development has for investors' legal certainty, states' international obligations, and the effectiveness of the foreign investment protection regime. The underlying hypothesis is that sanctions, particularly in their unilateral and secondary forms, have moved beyond the level of reactive instruments and have, in many cases, become part of the mechanisms through which risk is produced and reproduced in the international economy. Their effects therefore manifest not as isolated occurrences but as persistent and recurring structures. Under these conditions, the existing international investment law regime, which was primarily designed to address expropriation, discrimination, breaches of contractual obligations, and overtly interventionist conduct, faces serious difficulties of conceptual and practical adaptation. These difficulties arise not only in the interpretation of legal concepts but also in the assessment of compensation, the determination of attribution, the establishment of causation, and the identification of the boundary between legitimate regulation and the effective deprivation of proprietary benefits.

2. The Position of Sanctions in the Architecture of International Investment Law

The international investment law regime is founded upon a set of fundamental and essential objectives whose ultimate purpose is to facilitate and promote the free flow of cross-border capital into host territories and to establish a robust framework for the admission of foreign investors. Through comprehensive legal guarantees, the reduction of non-commercial risks such as expropriation, discrimination, or abrupt legislative changes, and the creation of stability and predictability in investment relations, this regime seeks to provide investors with the necessary degree of confidence. By contrast, the logic governing sanctions is based on increasing the costs of economic interaction, rendering commercial relations insecure, restricting access to vital resources, and exerting systematic pressure on economic actors. At both functional and normative levels, these two logics are manifestly and structurally incompatible: the purpose of the investment regime is economic integration and interdependence, whereas sanctions seek separation and disengagement. By creating cross-border barriers, sanctions effectively neutralize states' protective obligations and call into question the underlying rationale of investment treaties, which is based on mutual confidence and legal stability. This inherent conflict demonstrates that sanctions are not merely temporary political instruments but elements that fundamentally destabilize the normative architecture of investment law (Askari et al., 2022).

A substantial proportion of bilateral investment treaties and related multilateral agreements were designed and concluded during a period in which sanctions had not yet acquired their present breadth, complexity, and extraterritorial character. This historical legacy has resulted in many such instruments lacking explicit and sufficient rules concerning critical matters such as the legal effects of sanctions on investment relations, the extent of host-state responsibility under external economic pressure, the legal status of injured investors, and the relationship between protective obligations and security considerations. This relative silence and legislative gap have placed the principal burden of addressing sanctions on general and flexible concepts, such as fair and equitable treatment, freedom of transfer, and indirect expropriation, which ordinarily function as protective guarantees. International arbitral tribunals are therefore compelled to reinterpret these concepts in the context of sanctions, a process that has contributed to inconsistent awards and fragmentation in arbitral practice. The absence of a clear normative framework leaves investors and states in a condition of legal uncertainty and seriously undermines the predictability of the arbitration regime. This structural deficiency demonstrates that the traditional architecture of investment treaties has not yet kept pace with contemporary geopolitical realities and the widespread use of sanctions (Mellat, 2020).

Legal certainty, as the cornerstone of every foreign investor's decision to enter a new market, requires legislative stability, predictability in sovereign decision-making, and effective mechanisms of legal redress. The greater the likelihood of abrupt legislative changes, asset freezes, payment disruptions, or the frustration of contracts, the lower the economic attractiveness of that market to foreign investment. Economic sanctions, particularly in their chronic, continuous, and recurring forms, systematically and purposefully weaken this legal certainty and, by creating an atmosphere of uncertainty, erode the psychological and legal foundations of investment (McLaughlin, 2018).

The direct consequence of this process is the transformation of sanctioned markets, or markets exposed to the risk of sanctions, into environments characterized by high structural and systemic risk, even where domestic law or international treaties formally provide investors with broad and adequate protections. Under such circumstances, legal guarantees on paper lose their practical effectiveness in the face of extraterritorial pressures and become merely theoretical commitments. This gap between nominal legal protection and actual protection destabilizes the foundations of investor confidence and transforms investment risk from a manageable variable into an uncontrollable factor.

By targeting the vital arteries of an economy, sanctions indirectly frustrate the fundamental obligations of host states under investment treaties and confront the structure of international responsibility with a complex challenge. When a host state, under pressure from extraterritorial sanctions, is compelled to restrict an investor's access to financial resources, banking systems, or commercial networks, it may in practice fail to fulfil obligations such as fair and equitable treatment, full protection and security, and freedom of transfer. Within this normative gap, states commonly invoke treaty security exceptions or defences such as force majeure and necessity in order to avoid liability for compensation. Arbitral tribunals, however, face considerable difficulty in distinguishing sovereign fault from emergency circumstances beyond the state's control, and the resulting awards frequently lack consistency and reliability. Moreover, where sanctions are imposed by a third state, current international law does not provide a clear dispute-settlement mechanism for determining that state's responsibility for interference with investors' acquired rights (Azizi et al., 2024).

This legal impasse reflects a structural deficiency in the international responsibility regime, which is unable to establish a fair balance between the interests of injured investors and the sovereign constraints facing states. The conflict between the logic of sanctions and the objectives of the investment regime ultimately results in a redefinition of the risk paradigm and a transformation of investors' decision-making structures at the global level. Institutionalized sanctions have converted political risk from an isolated and localized danger into a constant and structural variable in project-evaluation models that operates beyond the borders of the host state. In conducting feasibility analyses, foreign investors no longer focus solely on domestic stability and the laws of the host state; they also consider the complex network of transnational sanctions, the dependence of banks and commercial partners on Western financial systems, and the possibility of expanding secondary restrictions as decisive variables. This paradigmatic shift directly affects market-entry decisions, the legal structure of contracts, financing costs, project discount rates, and even the final valuation of assets. In such an environment, even the lifting of sanctions may not rapidly restore lost confidence because overcompliance and heightened caution among financial institutions leave enduring psychological effects. Sanctions therefore create a new risk-evaluation paradigm that structurally removes target countries from global investment flows and subjects them to sustained economic and legal isolation.

3. Mechanisms Through Which Sanctions Become an Institutionalized Structural Barrier

Foreign investment, in both its economic and legal meanings, is not merely a contractual agreement between an investor and a host state. In practice, it depends on a range of institutional, banking, financial, insurance, and communications infrastructures that make possible the realization, continuation, and repatriation of capital. From this perspective, sanctions become an institutionalized structural barrier when they cease to function merely as external and temporary restrictions and gradually penetrate the various layers of investment operations, creating conditions in which effective implementation of a project becomes impossible even where the parties remain willing to cooperate. The structural character of sanctions lies in the fact that their effects are not confined to a particular field; rather, through a causal chain, they simultaneously influence financing, fund transfers, ancillary contracts, intermediary services, risk assessment, and the decision-making of market actors. Sanctions consequently move beyond the status of ad hoc political or economic measures and become an enduring institutional condition that redefines the rules governing market behaviour. Under such circumstances, the barrier created by sanctions no longer derives solely from the text of binding regulations; it is reproduced in the perceptions of economic actors, the practices of financial institutions, insurers' calculations, and even patterns of legal decision-making (Sajedianfard et al., 2019).

The institutionalization of sanctions therefore means that restrictions move beyond the level of formal policy and penetrate the everyday logic of cross-border economic interactions. This transformation changes the position of the target country from that of a market subject to conventional political risk into a costly and unpredictable jurisdiction. Accordingly, analysing the mechanisms through which sanctions become an institutionalized structural barrier requires attention to their institutional, network-based, and self-reproducing dimensions, rather than merely examining their direct and explicit legal effects.

The first and most fundamental mechanism of institutionalization is the disruption of access to international banking and financial networks, because foreign investment cannot effectively be established or operated without access to the global banking system. Every investment project, from the entry of initial capital and supplementary financing to payments to contractors, settlements with suppliers, receipt of revenues, and repatriation of profits, depends on the regular functioning of banks, financial institutions, correspondent services, payment systems, and credit instruments. By freezing accounts, terminating or restricting correspondent-banking relationships, denying access to international payment systems, and increasing compliance and monitoring costs, sanctions directly target the financial foundations of a project.

Even where the investment itself is not legally prohibited, the inability to open operational accounts, obtain loans, issue guarantees, establish documentary credits, or regularly settle financial obligations may render the project practically impossible or prohibitively expensive. The issue is not merely the closure of a particular banking channel but the emergence of a condition in which the investor loses confidence in the reliability of the entire financial network. In other words, by undermining the financial infrastructure, sanctions hollow out the project from within and transform it from an economically executable relationship into a legal obligation lacking practical support. It is precisely this systematic disruption that elevates sanctions beyond ordinary legal restrictions and turns them into a structural barrier whose continuation does not necessarily require constant and direct intervention (Zamani-Touni & Rahmati, 2023).

The second major mechanism is the restriction of fund transfers and disruption of the investor's ability to withdraw capital, which constitutes one of the fundamental pillars of foreign investment protection in most treaties and national legal systems. Foreign investors do not enter a host market merely to establish a physical presence; the economic rationale of investment rests on the assumption that the principal capital, profits, proceeds of sale, loan repayments, contractual instalments, royalties, and other financial benefits can be transferred when due. When sanctions target banking and foreign-exchange networks, this possibility is either eliminated entirely or pursued through alternative, opaque, and costly channels. The consequence is not merely a reduction in the economic return of the project but a transformation in the legal and financial nature of the investment. Capital that cannot be transferred, liquidated, or effectively withdrawn ceases to function as a manageable asset and becomes a trapped asset exposed to escalating risks. Furthermore, difficulties in transferring funds affect the assessment of the project's actual value, because any economic benefit is meaningful only where it can be realized and freely used. Sanctions-related restrictions in this field also have cascading effects on relationships among investors, shareholders, creditors, financing banks, and guarantee institutions (Mihami, 2019).

The blockage or increased cost of fund transfers is therefore not merely a technical obstacle; it is one of the principal mechanisms through which sanctions become an institutional and enduring barrier within the structure of cross-border investment.

The third mechanism is the collapse of the contractual and operational chain of investment, a chain that generally extends far beyond the principal contract between the investor and the host state or local company. Every foreign investment project depends on a network of ancillary and complementary contracts, including agreements for the supply of equipment, international transportation, insurance, technical and engineering services, technology transfer, workforce training, guaranteed purchase of output, feedstock supply, construction, installation, commissioning, and operation. Sanctions do not necessarily prohibit all these contracts directly; it is sufficient for one or more essential links in the chain to be disrupted for the entire project to come to a practical standstill. For example, if an insurer refuses to provide coverage, a transportation company declines to carry goods, an equipment supplier refuses to export or dispatch products, or a technology provider suspends cooperation because of concerns regarding secondary consequences, the principal contract also loses its practical capacity for performance (Abedian Kalkhoran & Golshani, 2017).

The importance of this mechanism lies in the fact that sanctions, by destroying the operational and practical links required for implementation, may render the principal contract ineffective without necessarily resulting in its formal invalidity. In such circumstances, the legal appearance of the project may remain intact, while the material and technical foundations required for its execution collapse. Sanctions thus consolidate themselves as a structural barrier through disruption of the surrounding contractual network, allowing their effects to penetrate from the regulatory level into the core of economic operations.

The fourth mechanism through which sanctions become institutionalized is the phenomenon of overcompliance, which in practice constitutes one of the most effective and enduring means of reproducing sanctions-related restrictions. In this situation, banks, multinational corporations, insurers, transportation intermediaries, law firms, and even potential commercial partners adopt conduct that is considerably more cautious than the express requirements of sanctions legislation in order to avoid legal, financial, regulatory, and reputational risks.

As a result, economic cooperation may cease even in fields where no direct legal prohibition exists or where exemptions have been provided. The logic of overcompliance is based on a cost-benefit calculation: for a major financial or commercial institution, an error in interpreting sanctions regulations, the imposition of severe penalties, serious reputational damage, or loss of access to principal markets is regarded as far more costly than foregoing an economic opportunity in the target market. At this stage, sanctions therefore no longer operate merely through direct commands issued by the sanctioning state; rather, they are reproduced and intensified by the market and private actors themselves (Moradi, 2025).

This dynamic transforms sanctions into a self-executing structure whose effects do not rapidly disappear even where formal pressures are partially reduced. The genuine institutionalization of sanctions occurs precisely at this point, where fear of risk replaces direct legal compulsion and restrictions become embedded in the ordinary and pre-emptive conduct of economic actors.

Another mechanism is the structural redefinition of investment risk at the international level, whereby institutionalized sanctions convert political risk from an isolated and manageable danger into a permanent variable in project-evaluation models. Under ordinary circumstances, foreign investors base their decisions on the host state's domestic stability, regulatory quality, judicial effectiveness, governmental implementation capacity, and the availability of dispute-settlement mechanisms. In a sanctions environment, however, this calculation changes, and the sanctions network, the dependence of banks and commercial partners on sensitive jurisdictions, the possibility of expanding restrictions, the risk of sanctions being reimposed, and their effects on the project's daily operations become central variables in the analysis. This shift affects not only the initial decision to enter the market but also the structure of contracts, the expected rate of return, the cost of capital, financing methods, the level of guarantees required, and even asset valuation. More precisely, the target market is no longer viewed merely as a high-risk market but as one carrying continuous institutional costs—a market in which the investor must bear the expense of adapting to sanctions-related uncertainty throughout the life of the project. Consequently, even where the target country possesses natural resources, geographical advantages, or significant commercial opportunities, it may be marginalized in informal market rankings (Mihami, 2019).

Institutionalized sanctions are therefore not merely external barriers; they are factors that permanently reshape global perceptions of a country's investability. The transformation of sanctions into an institutionalized structural barrier results from the simultaneous and interconnected operation of several complementary mechanisms: disruption of financial infrastructure, restrictions on fund transfers, collapse of the contractual chain, expansion of overcompliance, and the enduring redefinition of investment risk. The importance of this process lies in the fact that the effects of sanctions no longer remain dependent on the text of a particular regulation or political decision; instead, as a pervasive institutional condition, they restrict the operational capacity of investment at every level. For this reason, even where legal avenues for cooperation formally remain available, they may be rendered ineffective in practice by banking blockages, the reluctance of intermediary institutions, increased transaction costs, and instability in contractual chains. Within this framework, foreign investment is halted not because of the absence of explicit legal authorization but because its practical and economic feasibility has been destroyed. This is the point at which sanctions are transformed from instruments of political pressure into institutionalized structural barriers within the architecture of the international economy. Accordingly, the legal analysis of sanctions in the investment field must not remain confined to the question of their legality or illegality; it must also demonstrate how these instruments erode the foundations of investment feasibility through their penetration into financial, contractual, and perceptual networks. Understanding these mechanisms is essential to assessing state responsibility, interpreting investment treaties, and designing legal and institutional responses to the effects of sanctions.

4. Sanctions and the Erosion of the Fundamental Principles of International Investment Law

Fair and equitable treatment, as one of the most important and frequently invoked protective standards in international investment law, is founded on concepts such as transparency, stability of the legal framework, the prohibition of arbitrariness, and respect for investors' legitimate expectations. The imposition of economic sanctions, particularly in abrupt, extensive, and asymmetrical forms, seriously disrupts this normative balance and removes economic activity from a predictable environment. When a state is compelled, under sanctions pressure, to make sudden changes to its foreign-exchange, trade, or regulatory policies, or when extraterritorial sanctions prevent the host state from fulfilling its protective obligations, foreign investors' calculations and legitimate expectations concerning the continuity of the project, access to banking networks, and transfer of proceeds are frustrated. This structural instability challenges the host state's obligation to preserve a stable legal environment and places arbitral tribunals in a difficult position when assessing whether fair and equitable treatment has been breached. On the one hand, investors' legitimate expectations may have been seriously impaired; on the other hand, the host state may have been compelled by external sovereign pressure to adopt emergency measures (Askari et al., 2022).

Sanctions therefore not only erode the practical effectiveness of this fundamental principle but also weaken its normative stability and coherence in international investment doctrine and arbitral practice.

Indirect or creeping expropriation occurs where measures adopted by the host state, without formally or physically depriving an investor of title, substantially and permanently destroy the economic value of the investment or the possibility of its effective use. By blocking financial channels, severing access to export and import markets, prohibiting the supply of parts and services, and obstructing monetary transfers, economic sanctions produce precisely such destructive effects on foreign investors' assets. In this scenario, although legal title to the project remains with the investor and no physical seizure occurs, the asset loses its economic function and is effectively transformed into an inactive and valueless entity. The legal challenge becomes more complex when arbitral tribunals must determine whether the erosion of the asset's value resulting from sanctions constitutes indirect expropriation attributable to the host state or a non-attributable consequence of measures adopted by third-party sanctioning states. Sanctions thus shift the traditional boundaries of state responsibility in relation to expropriation and, by effectively neutralizing the right to use and benefit from an asset, structurally challenge treaty guarantees prohibiting uncompensated expropriation (Lupo Pasini, 2011).

In contemporary international investment law doctrine and jurisprudence, the concept of full protection and security is no longer confined to the physical protection of property against material damage or local violence; it also encompasses legal, administrative, and commercial security. Where sanctions regimes disrupt or prevent investors' access to ordinary legal instruments, effective judicial systems, international financial networks, and commercial supply chains, the practical and legal security of a project is seriously impaired. Under such circumstances, even a willing host state may be unable, because of external pressure or weaknesses in sanction-affected regulatory structures, to provide a secure administrative and judicial environment for the preservation of investors' acquired rights. This structural ineffectiveness causes the standard of full protection and security to lose its protective function and leaves investors exposed to severe market volatility and reactive sovereign measures (Asadlou, 2022).

Sanctions therefore indirectly deprive investors of access to a secure legal and administrative environment, empty the full protection and security standard of its substantive protective content, and reduce the host state's obligations to formal conduct lacking practical effectiveness in resolving the project's daily challenges.

The right to the free transfer of funds is one of the most explicit, vital, and indispensable obligations that states undertake to observe and guarantee under bilateral and multilateral investment treaties, because without the possibility of freely transferring profits, principal capital, and payments due under contractual obligations, investment lacks economic justification. By targeting the channels through which funds are settled and obstructing financial messaging systems such as SWIFT, financial and banking sanctions effectively suspend and neutralize this treaty right. In this context, even if the host state facilitates the outward transfer of foreign currency under its domestic law, the investor may remain unable to move its resources because of the termination of correspondent-banking relationships and financial institutions' fear of extraterritorial penalties. This practical obstruction transforms the guarantee of free transfer from a binding treaty obligation into an ineffective theoretical proposition and substantially increases the risk of trapped liquidity. Sanctions thus do not merely create a temporary trade barrier; by depriving investors of access to the material proceeds of their assets, they structurally suspend one of the most basic and transparent principles of international investment law, which guarantees the mobility and circulation of capital (Behbahani et al., 2021).

To preserve its dynamism and effectiveness, the international investment regime requires stability, predictability, and clarity in laws and regulations so that investors can properly plan the long-term horizons of their projects. Sanctions, particularly because of their fluid, ambiguous, multilayered, and constantly changing character, destabilize the decision-making environment and render investors' planning horizons significantly shorter, less certain, and permeated by uncertainty. Under such circumstances, foreign investors face continuous legal and operational challenges not only in preserving and managing their existing assets but also in considering the expansion of their operations or entry into new projects. This systematic withdrawal entirely weakens and suspends the developmental and constructive function of international investment law, whose objective is to contribute to the host state's economic growth by attracting foreign resources. The ultimate consequence is a normative transformation of the investment regime: a system intended to provide a platform for economic integration and investor protection becomes, under the fluidity of sanctions, an insecure environment in which the economic survival of the project takes precedence over any prior legal analysis (Teymouri et al., 2018).

The simultaneous erosion of fair and equitable treatment, the prohibition of indirect expropriation, full protection and security, freedom of transfer, and predictability reveals a profound normative crisis within international investment law in its confrontation with sanctions. The intersection of these challenges causes treaty-based protective frameworks to lose their practical effectiveness in the face of geopolitical realities and leaves investors in a condition of enduring protection deficiency. This process also undermines the credibility of international arbitration because arbitrators are compelled to choose between states' express treaty obligations and necessities arising from external sanctions pressure, often producing inconsistent awards. The institutionalization of this normative crisis alters the delicate balance between the public interests of host states and the private rights of investors in favour of the coercive logic of sanctions. By neutralizing the classical principles of investment law, sanctions therefore not only cause individual projects to fail but also seriously and structurally weaken general confidence in the effectiveness of international investment law as an autonomous legal regime intended to protect the free flow of capital.

5. Sanctions as a Risk Beyond the Host State

Under the classical model of international investment law, the prevailing assumption was that the principal risks faced by an investor arose primarily from the conduct of the host state—the state in whose territory the investment was made and which could undermine the project's legal security through nationalization, expropriation, discrimination, breach of contract, or abrupt regulatory change. The traditional architecture of investment treaties was accordingly founded on the assumption that the source of the threat lay within the bilateral relationship between the investor and the host state. Economic sanctions, however, have fundamentally altered this assumption by demonstrating that investment risk is not always generated by the host state. In many cases, the host state not only lacks any intention to harm the investor but actively wishes to support the investment and provide the stability required for the project's continuation. Nevertheless, where the investor becomes trapped within a network of financial, banking, insurance, and commercial restrictions, the host state's protective intent is rendered practically ineffective (Torki & Mazaheri, 2022).

Investment risk is consequently transformed from a purely state-based and territorially confined phenomenon into a network-based, transnational, and multilayered one. This transformation seriously challenges the conceptual foundations of many traditional rules of investment law.

A distinctive feature of contemporary sanctions is that a third state may profoundly affect the economic fate of an investment without directly participating in the relevant contractual or treaty relationship. This influence is commonly exercised through measures such as blocking banking transactions, prohibiting insurance and transportation services, restricting the supply of parts and technology, or threatening penalties against persons and institutions cooperating with the project. The investor therefore confronts not only the domestic rules of the host state but also a network of external obligations and prohibitions imposed by third states or affiliated institutions. From the perspective of investment law, this situation is highly problematic because investment treaties generally focus on the direct and bilateral relationship between the investor and the host state and do not provide clear mechanisms for disruptions originating outside that relationship (Asadlou, 2022).

Sanctions create a form of disjunction between normative structure and economic reality. On the one hand, the treaty promises protection; on the other hand, transnational rules eliminate the possibility of benefiting from that protection. This gap demonstrates that sanctions risk can no longer be analysed within the traditional category of "domestic political risk." Under such circumstances, identifying the principal source of loss becomes one of the most difficult legal questions. Should the sanctioning state be held responsible because its extraterritorial restrictions effectively prevented the use and enjoyment of the investment? Should the host state be held responsible because it failed to provide the conditions necessary for the continuation of economic activity, even though it was itself exposed to external pressure? Or should private actors, banks, insurers, transportation companies, and suppliers be treated as independent causal factors because they refused to cooperate out of fear of penalties or secondary restrictions?

This ambiguity in determining causation is not merely a technical issue; it reflects the inability of the traditional framework to comprehend the nature of modern sanctions. In the law of responsibility, attribution of loss is generally based on a direct relationship between conduct and consequence. In a sanctions environment, however, this relationship becomes sequential, dispersed, and indirect. It is therefore extremely difficult to establish precisely which conduct constituted the source of the rights violation. This difficulty not only complicates compensation but also limits the possibility of initiating and successfully pursuing an investment arbitration claim. Sanctions transfer investment risk from the level of "state conduct" to the level of the "structure of international power." Under the traditional model, the investor faced a host state that could either violate or protect its rights. Under sanctions, by contrast, the investor is situated within a network of power relations in which multiple actors simultaneously affect the project: the host state, the sanctioning state, international banks, insurance companies, shipping companies, financial settlement institutions, and even private intermediaries. Within such a network, risk is produced not by a single act but by the cumulative effect of restrictions and cascading reactions. For example, the host state may continue to authorize the activity, while banks refuse to transfer funds because of sanctions risk, insurers decline to provide coverage, and international suppliers terminate their contracts (Oloumi Yazdi & Razi, 2024).

In such a case, the investment remains legally permissible but becomes practically impossible. This is the point at which sanctions displace risk from "territory" to "network." Legal analysis of investment must therefore move beyond traditional bilateralism.

One important consequence of this transformation is that the concept of "control" in investment law also requires redefinition. In the past, the central question was whether the host state had directly engaged in expropriation or discrimination. In a sanctions environment, however, the state may lack effective control over the outcome, even though it formally remains responsible for implementing its treaty obligations. The sanctioning state, in turn, may argue that its measures pursue security, political, or foreign-policy objectives and are not specifically directed against a particular investment. In such an environment, neither causation nor the element of fault or responsibility is readily established. This situation is also detrimental to the investor because it becomes difficult to determine against whom a claim should be brought and on what legal basis. Moreover, even where the host state is willing to provide compensation, it may lack the financial or legal capacity to do so (Oloumi Yazdi & Razi, 2024).

Sanctions therefore create a gap between "legal responsibility" and "practical capacity to compensate," a gap that was less evident in the traditional investment regime. This characteristic makes sanctions a risk extending beyond the host state and beyond conventional models of responsibility. It may therefore be argued that sanctions demonstrate the need for international investment law to undertake a profound reconsideration of its foundational concepts in order to address new forms of risk. If the traditional regime was based on the premise that investors should be protected against the host state, it is now clear that investment security must also be considered in relation to transnational structures of power. By disrupting financial, commercial, and contractual flows, sanctions elevate risk from the level of a bilateral legal dispute to that of a structural crisis in global economic governance. This development confronts investment treaties with new questions: Should these treaties be revised to address third-state sanctions? Should more explicit rules be adopted regarding indirect responsibility, multilayered causation, and compensation under sanctions? Can the classical state-centred model continue to explain every form of investment loss? Responses to these questions demonstrate that sanctions are not merely political instruments but structural factors in the redefinition of investment risk. Their analysis must therefore move beyond the relationship between the investor and the host state and account for the network-based, transnational, and multi-causal logic of investment disruption.

6. Sanctions and the Crisis of Effectiveness in Investment-Law Protection Mechanisms

The analysis of sanctions in international investment law demonstrates that a significant part of the current crisis arises from the mismatch between the traditional design of investment treaties and the complex reality of contemporary sanctions. Bilateral and multilateral investment treaties were generally drafted on the assumption that the principal threat to foreign investors would arise from the host state through measures such as direct expropriation, discriminatory treatment, breach of the fair and equitable treatment standard, or restrictions on capital transfers. Under sanctions, however, the principal source of disruption is not necessarily a classical act of the host state but a set of banking, financial, insurance, commercial, and technological restrictions that are frequently imposed from outside the host state's territory through extraterritorial mechanisms. In such circumstances, an investor may remain legally entitled to protection while losing the practical ability to benefit from that right. This gap between the "existence of a right" and the "capacity to exercise that right" constitutes one of the most important dimensions of the effectiveness crisis within the investment protection regime. More precisely, sanctions undermine not only the economic benefits of the project but also the enforceability of legal guarantees. The issue of sanctions in this field is therefore not merely an economic barrier; it is a fundamental test of the actual capacity of investment law under conditions of structural pressure (Askari et al., 2022).

One of the most important dimensions of this crisis is that investment treaties, in their conventional form, do not provide clear and explicit responses to injuries generated through an indirect and multilayered network of restrictions. When international banks refuse to process transactions, insurers terminate risk coverage, foreign suppliers cancel contracts, and commercial partners withdraw from the market out of fear of secondary penalties, the investor's losses are real and substantial, but their legal attribution to a single and identifiable act becomes difficult. A treaty designed to regulate the direct conduct of the host state often lacks adequate conceptual and practical instruments for addressing such a dispersed and network-based situation. Even where the host state has not formally breached its obligations, the investment environment may become so profoundly disrupted that the investor's legal and economic security disappears. This demonstrates that the effectiveness of treaty protection depends not only on the wording of obligations but also on whether those obligations correspond to the actual pattern of threats (Alizadeh, 2017).

From this perspective, sanctions create a form of "intervention without direct intervention," whose effects may be more severe than many traditional measures adopted by a host state. The investor is theoretically protected but practically situated within a protection vacuum.

Investment arbitration, as the principal compensation mechanism within this regime, encounters obstacles in sanctions-related cases that significantly reduce its effectiveness. The first obstacle is the difficulty of establishing jurisdiction over the sanctioning state because, in most cases, no treaty relationship exists between the investor and the state imposing the sanctions, and the traditional structure of investment arbitration is generally limited to disputes between an investor and the host state. Consequently, even where the principal cause of loss is the extraterritorial conduct of a third state, the investor does not necessarily have the ability to bring a claim against that state through investment arbitration. Conversely, proceedings against the host state may also fail to provide an adequate response because the host state may argue that it was not the principal source of the restrictions and was itself affected by the sanctions. A clear institutional gap therefore emerges: the actor principally responsible for the disruption frequently lies beyond the reach of the compensatory mechanism, whereas the actor against whom arbitration may be initiated may not bear direct and complete responsibility. Despite its central role, arbitration therefore faces serious jurisdictional limitations in relation to sanctions. One manifestation of the effectiveness crisis is consequently the inability of the compensatory mechanism to reach the principal actor responsible for producing the loss (Schreuer, 2015).

In addition to jurisdictional difficulties, sanctions-related cases also involve serious problems in establishing causation, which plays a decisive role in investment claims for determining liability and calculating damages. The investor must demonstrate that the loss suffered was directly caused by, or at least attributable to, sanctions and their effects rather than to other factors such as mismanagement, market volatility, currency crises, domestic recession, geopolitical developments, or ordinary commercial risks. In practice, distinguishing among these factors is extremely complex because sanctions frequently operate within a broader environment of economic and political instability. Under such circumstances, the arbitral tribunal must differentiate among multiple causes of loss and determine the contribution of each, a task that is difficult from both legal and economic-expert perspectives. This complexity may lead to a reduction in compensation, the rejection of part of the claim, or even the claimant's complete failure to establish the case. Particularly where sanctions produce indirect and gradual effects, traditional standards of causation may be inadequate to explain the economic reality (Mihami, 2019).

Sanctions therefore impede not only the enforcement of rights but also the proof that those rights have been violated, thereby revealing another dimension of the ineffectiveness of protective mechanisms.

Even where the investor succeeds in overcoming jurisdictional and evidentiary obstacles and obtains a favourable award, the enforcement stage presents difficulties that may call into question the practical value of the entire arbitration process. Enforcing arbitral awards in an environment characterized by strict oversight of financial transfers, banking blockages, asset freezes, or secondary restrictions is highly complex and costly. Where the assets of the condemned state or related entities have been frozen in different jurisdictions, recognition and enforcement of the award will face numerous legal and practical barriers. Banks, financial institutions, and payment intermediaries may also refuse to cooperate in enforcing the award out of fear of violating sanctions regulations or incurring secondary liability. The problem is not merely the theoretical enforceability of the award but the actual possibility of transferring funds and realizing compensation in practice. An arbitral award may be legally valid while remaining economically and practically ineffective. This gap between the "recognition of a right in an award" and the "realization of that right through enforcement" demonstrates that sanctions possess the capacity to paralyse the entire protective cycle. The crisis of effectiveness is therefore not confined to the adjudicatory stage but becomes even more pronounced during enforcement (Mirzazadeh et al., 2022).

The consequence of this situation is the gradual erosion of investors' confidence in the entire international investment law regime, confidence that constitutes the cornerstone of decision-making in cross-border investment. Where investors conclude that their treaty rights lack effective enforcement guarantees against a complex sanctions structure, the treaty no longer merely fails to cover part of the risk; it may be reduced to a symbolic and minimally effective instrument. This erosion of confidence is not confined to individual investors but also affects broader market conduct: the cost of capital increases, willingness to enter high-risk markets declines, multinational corporations prioritize exit or suspension strategies, and host states experience greater difficulty in attracting long-term investment. At the theoretical level, this transformation raises a fundamental question: Can the international investment law regime continue to claim that it effectively protects investment stability, predictability, and security without reconsidering its approach to extraterritorial sanctions? The answer appears to be negative unless the regime moves toward redefining attribution, causation, compensation, and award enforcement in the context of sanctions. Otherwise, sanctions will remain not merely an external challenge but a factor exposing the internal and structural limitations of investment law.

7. Legal Responses to Sanctions as a Structural Barrier

Effectively addressing sanctions as a structural barrier in international investment law requires, above all, reconsideration of the normative architecture of investment treaties, because many existing treaties were drafted during a period in which the principal threat to investors was understood to be the direct conduct of the host state rather than a complex network of financial, banking, and commercial restrictions originating extraterritorially. New treaties should therefore regulate more explicitly the relationship between sanctions, protective obligations, security exceptions, and rules on compensation. The inclusion of specific provisions defining sanctions, identifying the different direct and indirect effects they may have on investment, determining the legal status of third-party investors, and clarifying the extent of state responsibility could substantially reduce current interpretive ambiguities. It is also necessary to determine the circumstances under which the host state may invoke the effects of sanctions as a factor limiting the performance of its obligations and the cases in which it remains responsible for preserving minimum protective standards. Such clarification would not only increase the legal certainty of the parties but also prevent the proliferation of conflicting interpretations and inconsistent arbitral awards.

One of the most important responses is to ensure that arbitral tribunals and treaty-interpreting bodies prevent security exceptions from becoming general and uncontrollable authorizations to neutralize investment obligations. Although security exceptions are included in many treaties to protect states' vital interests, sanctions-related cases create a risk that states may invoke these exceptions expansively to suspend or negate all their protective obligations. To prevent such an outcome, the principles of proportionality, necessity, good faith, and reviewability must occupy a central position in the interpretive process. Any reliance on security considerations should therefore be limited, substantiated, proportionate to the asserted objective, and subject to judicial review rather than treated as a domain immune from arbitral assessment. An approach that places security exceptions beyond any form of scrutiny disrupts the balance between state sovereignty and investor protection in favour of unilateral state authority. By contrast, a restrictive and disciplined interpretation of such exceptions can ensure that genuine security necessities are respected without sacrificing the fundamental principles of investment law to unlimited interpretations. From this perspective, restoring the effectiveness of the protective regime depends substantially on interpretive discipline in relation to security exceptions (Bahmaei & Sabzevari, 2022).

Reform in the field of compensation also constitutes an integral component of the legal response to sanctions because, in many existing disputes, traditional models of damages assessment cannot adequately reflect the distinctive and multilayered effects of sanctions. In calculating compensation, arbitral tribunals should consider not only direct losses resulting from the suspension or disruption of a project but also broader consequences, including increased capital costs, loss of market opportunities, reductions in the current value of assets, disruption of supply chains, sanctions-compliance expenses, and difficulties in transferring funds. Under sanctions, loss frequently assumes a composite and gradual form and does not appear solely through reduced revenue or physical expropriation. Traditional standards for proving and calculating damages must therefore be adapted to the economic realities created by sanctions. The use of advanced financial expertise, counterfactual scenario methods, and comparative analysis of project performance under normal and sanctioned conditions can contribute to greater accuracy in assessing loss. The closer the assessment of damages corresponds to the actual effects of sanctions, the more the compensation mechanism moves beyond formalism and becomes an effective instrument for restoring the economic balance between the parties. Reform of compensation law is therefore a fundamental requirement for improving investor protection under sanctions (Oloumi Yazdi & Razi, 2024).

Contractual instruments may also play an important complementary role in reducing investors' structural vulnerability. Investment, financing, construction, operation, and commercial partnership agreements should be drafted in a manner that anticipates and manages the potential effects of sanctions. The inclusion of provisions relating to sanctions, force majeure, hardship, risk reallocation, temporary suspension of obligations, revision of contractual terms, and alternative payment mechanisms may partially mitigate losses resulting from widespread disruption. For example, the use of alternative payment methods, diversified financial channels, different currencies, intermediary accounts, or barter arrangements may prevent the complete breakdown of contractual relations. Renegotiation and adaptation clauses may also enable the parties, following the imposition of sanctions, to restructure their obligations rather than allow the contract to collapse. Nevertheless, these contractual instruments, although useful and necessary, cannot substitute for institutional reform at the international level because their function remains largely confined to private risk management (Houshmand, 2013).

Because sanctions produce transnational, network-based, and multilayered effects, an effective response cannot remain confined to the bilateral relationship between the investor and the host state. One essential solution is to move toward multilateral regulation of the permissible limits of economic sanctions, the scope of their extraterritorial effects, and the legal status of injured investors. In the absence of such a framework, any state may invoke security or foreign-policy considerations to impose restrictions whose cascading effects are transferred to international investments in third countries without being accompanied by proportionate legal accountability. A multilateral approach could generate consensus around several principal issues: the definition of lawful sanctions, the distinction between necessary security measures and disproportionate economic pressure, limits on extraterritorial application, recognition of minimum rights for affected investors, and the establishment of compensatory or facilitative mechanisms in cases of severe injury. Such regulation could also reduce conflicts among different regimes of international law, including international trade law, the international law of state responsibility, and investment law. From this perspective, multilateralism is not merely a political option but a legal necessity for restoring normative balance within the international investment regime. Without such a perspective, responses will remain fragmented, ad hoc, and incapable of containing the systemic effects of sanctions (Kazerouni et al., 2015).

Legal and institutional responses to sanctions will be effective only if they are designed within an integrated and multilayered approach encompassing treaty reform, interpretive discipline among arbitral tribunals, the development of accurate compensation models, the strengthening of contractual instruments, and the advancement of multilateral regulation. The crisis caused by sanctions has demonstrated that an investment law regime relying solely on classical investor-protection models will remain vulnerable to structural and indirect barriers. Reconsideration of this regime must therefore move toward explicit recognition of sanctions as a factor affecting protective obligations and toward the development of proportionate legal responses. The objective of such reforms should not be the complete elimination of political or economic risk but the creation of a legal order in which investors can engage in cross-border activity with a reasonable degree of predictability and confidence. The greater this predictability, the lower the cost of capital, the more stable corporate strategic decisions become, and the more treaty protection moves from a symbolic to a practical level. Conversely, continuation of the present ambiguity will intensify distrust, reduce investment, and deepen the gap between legal obligations and economic reality. Responding to sanctions in investment law is therefore not a marginal reform but part of a fundamental reconstruction of the regime's effectiveness in the contemporary world.

8. Conclusion

Within the contemporary global economic system, sanctions can no longer be interpreted merely as temporary, political, and exceptional reactions to the conduct of a state. They have gradually become enduring, influential, and structural components in the organization of international economic and investment relations. This conceptual and functional transformation demonstrates that sanctions have moved beyond the level of purely sovereign instruments and become institutionalized factors determining the scope of legal certainty, predictability, and stability in the investment environment. Their effects are manifested not only through direct legal prohibitions or formal restrictions on trade and investment but also, at a deeper level, through the redefinition of economic risks, changes in investors' decision-making patterns, disruption of the operations of banks, insurers, arbitrators, and financial intermediaries, and the collapse of contractual chains. From this perspective, sanctions must be analysed not as external and exceptional factors but as internal, enduring, and structural barriers within the operation and conceptual framework of international investment law. Moreover, sanctions, particularly in their unilateral and secondary forms, possess the capacity to seriously weaken the principal foundations of foreign investment protection. Under such circumstances, the investment environment no longer provides the degree of confidence and reliability upon which the underlying rationale of investment treaties is based. In other words, sanctions do not merely make the performance of obligations more difficult; they erode the protective logic of the investment regime at both theoretical and practical levels.

On this basis, sanctions, particularly in their extraterritorial and secondary forms, directly or indirectly challenge fundamental principles of international investment law, including fair and equitable treatment, full protection and security, freedom of transfer, and the prohibition of indirect expropriation. In many cases, they place investors in conditions of instability, uncertainty, and practical deprivation of contractual and treaty rights. At the same time, examination of existing frameworks demonstrates that investment treaties and international arbitration mechanisms have not yet developed a coherent, sufficient, and effective response to the structural effects of sanctions. This deficiency has created a significant gap between the protective logic of investment law and the sanctions-based reality governing the global economy. Recognition of sanctions as institutionalized structural barriers is therefore not merely a theoretical or analytical recharacterization; it is a necessary preliminary step toward normative and institutional reconsideration in this field. Without such recognition, there is a serious risk that international investment law will gradually lose its principal functions of guaranteeing legal certainty, preserving investors' legitimate confidence, and encouraging capital flows. The future of this field consequently requires targeted reforms at multiple levels, including revision of the text and structure of investment treaties, restriction of expansive interpretations of security exceptions, strengthening of compensation mechanisms, clarification of the status of sanctions in investment arbitration, and movement toward the regulation of sanctions within a multilateral and law-based framework. Only through such reforms can a reasonable balance be established between states' sovereign considerations and the need to preserve stability, predictability, and justice in the international investment regime.

Authors' Contributions

Authors contributed equally to this article.

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In order to correct and improve the academic writing of our paper, we have used the language model ChatGPT.

Transparency Statement

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