International Journal of Law and Society
2025, Vol. 8, No. 3, pp. 140-151
https://doi.org/10.11648/j.ijls.20250803.11

Research Article

The Return of the State and the Reform of the International Investment Dispute Settlement Mechanism: Reasons and Reflections

Yanyan Tang*, Qingxia Guo

School of International Governance Innovation, Guangdong University of Foreign Studies, Guangzhou, China

Abstract

In recent years, as economic globalization has deepened, international investment has expanded rapidly. This growth has been accompanied by a surge in investment disputes, making the reform and development of the international investment dispute settlement mechanism one of the most important topics in international investment governance. As criticisms of investor-state dispute settlement (ISDS), the dominant mechanism for resolving international investment disputes, have intensified, the evolution of dispute settlement provisions in certain international investment agreements reveals a significant shift, with some treaties reinstating a state-centric paradigm in the design of investment dispute settlement mechanisms. This transformation has brought the role of the state back to the forefront of debate in the field of investment dispute resolution. This paper asks whether, and why, states are reclaiming a central role in investment treaty dispute settlement, as evidenced by Brazil's Cooperation and Facilitation Investment Agreement (CFIA) dispute settlement model, the Sustainable Investment Facilitation Agreement (SIFA) between Angola and the European Union, and the Free Trade Agreement between the Southern Common Market and Singapore (MCSFTA). By investigating the underlying drivers behind the renewed prominence of state-led approaches, the article offers policy recommendations for the future reform of investment dispute settlement mechanisms in light of these developments.

Keywords

The Return of the State, Dispute Settlement Mechanism between Countries, Investor-state Dispute Settlement Mechanism, Investment Protection

1. Introduction

Following the end of the Cold War in the late 20th century, globalization emerged as the most influential development trend. Countries across the world have become increasingly interdependent. This brings substantial economic growth and social prosperity while also accelerating the development of global governance. In the context of this rapidly evolving system, the status of sovereign states within the global governance system has significantly declined. The globalist paradigm is characterized by the diversification of governance actors, diminishing the central role traditionally held by sovereign states. This paradigm expands the scope of global governance to include a range of affected actors, such as sovereign states, intergovernmental international organizations, international non-governmental organizations, and

*Corresponding author: tangyanyan@gdufs.edu.cn (Yanyan Tang)

Received: 9 May 2025; **Accepted:** 26 May 2025; **Published:** 30 June 2025

multinational corporations, making the governance of international public affairs more flexible. In addition, humanitarian intervention policies and the increased flow of global economic resources have further challenged the political and economic sovereignty of states [1], forcing them to share the governance space with non-state actors. The field of global investment governance has also been affected by globalization. Attempts to build a global investment governance system that centered around international organizations have been unsuccessful[1]. However, in terms of designing an international investment dispute settlement mechanism, the prevailing approach has largely aligned with the trajectory of Neo-liberal globalization and gone further on the path of "de-nationalization" to promote the flow of private capital globally. The mainstream investor-state dispute settlement (ISDS) mechanism has raised serious concerns within the international community, particularly among the host country, due to institutional deficiencies, such as a legitimacy crisis, lack of transparency, consistency in arbitration outcomes, lack of independence and impartiality of arbitrators, and the absence of appeal and correction mechanisms [2]. In this context, some countries have begun to reassert their role by incorporating diplomatic and state-centric elements into the reform of international investment dispute settlement mechanisms through investment treaties or domestic laws. This shift has brought "countries" back into focus as a key actor of international investment dispute settlement mechanisms in the international community.

2. State and Investment Dispute Settlement Mechanism: Origin and Fall

In the early stage of economic globalization, the risks of investing abroad were enormous. Unlike trade disputes, investment disputes are usually highly individualized, and investors often need to invest a large amount of resources to obtain expected returns. During this period, investors highly depend on the host country, which requires strong legal protection [3]. However, in the early stages of international investment treaty development, the resolution of foreign investment disputes was predominantly managed through state-state dispute settlement mechanisms (SSDS). Examining the origins and subsequent decline of the SSDS provides critical insights into why it was eclipsed over time and lays the groundwork for understanding the resurgence of the state in investment dispute settlement, an evolution aimed at reconstructing the dynamic balance between state sovereignty and the protection of foreign investors' rights by strengthening state-level participation and coordination [4].

2.1. The Origin of State-State Dispute Settlement (SSDS) System

Regarding historical development, the SSDS system predates the ISDS (Investor-State Dispute Settlement) system. SSDS can be traced back to the dispute resolution clauses recorded in the early Treaty of Amity for Commerce and Navigation (FCN). According to some scholars, the first stage in the evolution of modern investment protection broadly protects investment based on international customary law and FCN and through the SSDS system. In other words, the responsibility for investment protection was assumed and enforced by the state [5]. By the late 18th century, advancements in communication and the expansion of global investment driven by the Industrial Revolution brought capital to regions across the world. However, at that time, most FCN treaties did not include provisions for arbitration or other binding third parties for resolving investment disputes. Therefore, if the dispute could not be resolved through friendly negotiations, the investor's home country would file a claim against the host country based on diplomatic protection. This meant the home country would consider the infringement of its national rights as an infringement on itself and safeguard the commercial interests of its nationals in weak developing countries [6]. Under this system, the investor's home country had full discretion in initiating, suing, and resolving such claims, as well as exempting any damages already awarded [7]. Diplomatic protection in this situation included both legal measures and threats of force [8]. Before 1969, the SSDS system was the main dispute resolution mode in international investment treaties [9]. It was also the principal method for addressing international investment disputes at that time.

2.2. The Fall of State-State Dispute Settlement (SSDS) System

However, foreign investors have shown limited enthusiasm for the SSDS system due to its diplomatic nature and politicization of investment disputes. Another reason is the lack of confidence, particularly among small and medium-sized investors, in their home country's willingness to negotiate with the host country for their rights [10]. With the establishment of the Washington Convention and the creation of the International Centre for Settlement of Investment Disputes (ICSID), the Chad Italy Bilateral Investment Treaty (BIT) was signed in 1969, and the world's first ISDS clause was included in the investment treaty [9]. Since then, the subject of dispute resolution mode has changed. Modern investment treaties increasingly grant investors the direct right to bring claims against host states, allowing them to bypass administrative and judicial measures of the host country and instead resort to third-party international arbitration tribunals to resolve disputes, which has been welcomed by international investors, as it enables them to directly file

1 Efforts by the OECD and WTO to conclude a global multilateral investment agreement have been shelved for various reasons.

arbitration claims with the host country independently of their home countries. As a result, compensation awarded through arbitration is paid directly to them. The ISDS mechanism has since become one of the most important tools in international investment treaties to protect the rights and interests of investors, representing a significant transformation in international law, marking a shift from state-centered principles toward a framework increasingly influenced by globalization [11]. The rise of the ISDS has led to the relative decline of SSDS. Although both systems still coexist in the dispute resolution of bilateral investment treaties, the application of SSDS has become highly limited, only targeting the resolution of disputes between contracting parties regarding the "interpretation and application" of the treaty. In practice, successful cases involving SSDS have been rare [12]. Therefore, the mechanism has gradually faded from the forefront of international investment dispute resolution.

3. A Practical Case of the Return of the State in Investment Dispute Settlement Mechanism

Since 2000, the ISDS mechanism has faced growing criticism for its perceived excessive protection of investor rights, its "legitimacy crisis", and its exploitation by legal practitioners and investment funds for profit [13], leading some scholars to label it as the "most problematic and infuriating judicial system in the world" [14]. This has sparked a wave of discussion on the need to reform the ISDS mechanism, establishing it as one of the central issues in the reform of international investment agreement system [15]. Against this backdrop, the role of the ISDS in international investment agreements has been gradually diminished. In its place, alternative mechanisms, including dispute prevention framework and state-state dispute settlement mechanisms, have gained increasing prominence [16]. Recent developments in the design of dispute settlement provisions in international investment agreements, including the exclusion of the ISDS mechanisms and the reintroduction of other state-based arbitration procedures, signal a practical return of the state as a central actor in investment dispute resolution.

3.1. Brazil's Cooperation and Facilitation Investment Agreements (CFIA)

In 2015, the CFIA mode issued by Brazil had never previously passed an effective bilateral investment agreement. As a result, the CFIA's dispute settlement design has drawn considerable attention in academic circle. Notably, the CFIA model explicitly excludes the application of the investor-state arbitration and replaces it with a three-staged investment dispute settlement model, comprising dispute mitigation, dispute prevention, and state-state arbitration mechanisms. This hybrid mechanism reconstructs the roles of investors, home countries, and host countries in the dispute resolution process. During the dispute settlement phase, investors are granted the right to directly communicate with designated institutions in host country to address their concerns. If these efforts prove unsuccessful, the responsibility for dispute resolution shifts from investors and the host country to the respective home and host states. As stakeholders, investors are also allowed to participate in joint committee meetings to express their demands. At the stage of state-state arbitration, the investor's home country and the host state serve as the parties to the arbitration, while the investor does not have the right to initiate proceedings directly against the host state as in the ISDS model. The dispute resolution framework thus shifts from a public-private dispute to one between sovereign states. The subject of dispute resolution shifts from public-private disputes to disputes between public entities [17].

Brazil's CFIA completely exclude the ISDS mechanism from the dispute resolution framework. Instead, they adopt a three-stage model—comprising dispute mitigation, dispute prevention, and state-to-state arbitration—centered around the role of the "state". The core design philosophy of this mechanism focuses on how states, both host governments and home country governments of investors, can more effectively assist investors in resolving disputes. In this model, states shift from being passive recipients of ISDS claims (host states) or invisible actors (home states) to active participants. This transformation represents a significant practical step toward the reintegration of the state as a central actor in the reform of international investment dispute settlement mechanisms. Brazil's approach provides a compelling model for Global South countries seeking to reclaim the policy regulation space constrained by ISDS frameworks. Notably, beyond Brazil, a growing number of Global South countries have adopted a cautious stance toward the use of ISDS mechanisms. In January 2020, Brazil and India signed a CFIA. According to India's 2016 Model Bilateral Investment Treaty (BIT), ISDS is not abandoned entirely, but is conditional on the exhaustion of local remedies prior to arbitration. However, in the Brazil-India CFIA, India accepted Brazil's state-centered dispute resolution model, signaling its endorsement of shifting the focus toward dispute prevention and creating a more facilitative dispute resolution pathway for investors from both countries. Similarly, South Africa's Protection of Investment Bill which came into force in 2018, implemented sweeping reforms to investment dispute settlement between investors and host states. The most notable feature of this legislation is its exclusion of ISDS, instead offering investors a range of domestic legal remedies, with final recourse through state-to-state dispute settlement mechanisms. The Global South's increasing skepticism toward ISDS reflects a broader reconsideration among emerging economies about the trade-off between regulatory sovereignty and the attraction of foreign direct investment. This cautious approach seeks to preserve domestic policy priorities and protect public interests. Ultimately, it represents a paradigmatic shift in investment dispute governance—from a focus on "attracting foreign capital" to one centered on "sovereign development"—that is increasingly being championed by states in the Global South.

3.2. Angola-EU Sustainable Investment Facilitation Agreement (SIFA)

On November 17, 2023, the European Union (EU) and Angola signed the EU's first Sustainable Investment Facilitation Agreement (SIFA), aimed at improving Angola's business environment and supporting the sustainability of its broader economic development. It also aims to help Angola diversify its economy and reduce its reliance on the oil and gas industry. Strengthening capital flows between Angola and the EU in areas such as green energy, agricultural value chains, digital innovation, fisheries, logistics, and key raw materials is considered vital to achieving this goal.

According to the agreement, chapter 6 establishes a three-tiered dispute settlement framework focused on the prevention and resolution of disagreements. The first tier involves consultation. When a dispute arises regarding the interpretation or application of the agreement, efforts should be made to resolve it through good-faith dialogue with the aim of reaching a mutually agreed solution [18]. The second tier is a solution mutually agreed upon. Based on the consultations, the parties should agree upon a resolution, take necessary measures to implement it and define a reasonable timeline for doing so [18]. The third tier is arbitration. If, within 120 days from the date of the request for consultation, no resolution is achieved, or if an agreed solution is not implemented within a reasonable period thereafter, the requesting party may resort to arbitration between countries to resolve the dispute [18].

In fact, for the European Union—a "thorough reformer" of the ISDS mechanism—the exclusion of ISDS from the SIFA is hardly an exception. From the perspective of the evolution of international dispute settlement mechanisms, the deliberate omission of ISDS in SIFA reflects a reaffirmation of the centrality of state sovereignty in the realm of international investment. This approach not only represents a practical extension of the EU's reform agenda for investment dispute settlement mechanisms but also constitutes a systematic critique of traditional investor-state dispute models. The first tier of the SIFA dispute settlement mechanism—a 120-day consultation period—provides a buffer zone during which Angola, as a sovereign state, can thoroughly assess its policy space and potential adjustments. The second tier, which involves the formulation of a mutually agreed solution, builds on the principle of sovereign equality [19] and offers developing countries a framework of "rule-based assurance" rather than "rule-based constraints" in their engagement with international investment. The third tier—state-to-state arbitration—retains the professionalism and authority of international arbitration, and by preceding it with mandatory consultations and a joint solution process, it enhances the policy voice and agency of the host state. SIFA's dispute settlement regime stands as a new EU-led alternative to ISDS reform, alongside the proposed Multilateral Investment Court. It safeguards Angola's autonomy in national development while facilitating EU investment, thereby helping to redress the structural imbalance faced by developing countries in negotiations with powerful capital-exporting states. In doing so, it addresses the longstanding dilemma of "foreign investment hijacking national policy" [20].

3.3. Southern Common Market-Singapore Free Trade Agreement (MCSFTA)

The Southern Common Market-Singapore Free Trade Agreement (MCSFTA) marks the first trade agreement between the member states of the Southern Common Market (Argentina, Brazil, Paraguay, and Uruguay) and Singapore, as well as the first free trade agreement between the Southern Common Market and Southeast Asian country. MCSFTA has established a dedicated chapter on investment, outlining the rights and obligations of the contracting parties in terms of definition, scope of application, national treatment, information protection, and dispute settlement methods. Given Latin America's historical association with Calvo Doctrine principles—which emphasize the primacy of national sovereignty and the rejection of external arbitration in favor of domestic remedies [21], countries in the region should pay special attention to balance national sovereignty and public interests with international investment protection in the selection of dispute settlement methods. For instance, in Singapore's recent bilateral investment agreement with Myanmar, the ISDS mechanism is still accepted. It grants investors the right to initiate international arbitration or litigate against the host country in court. In contrast, the MCSFTA represents a deliberate departure from the ISDS model, consistent with Calvo-inspired principles. It instead emphasizes access to justice and due process and while establishing institutional mechanisms such as Ombudspersons and prevention and mediation channels to resolve investment disputes. The Ombudsperson is tasked with engaging directly with individuals or legal entities in the contracting state, addressing investor concerns, and facilitating timely communication between investors and domestic government agencies. Additionally, the Ombudsperson plays a key role in ensuring transparency by providing up-to-date information on investment-related policies, regulations, and procedures. The agreement's provisions on dispute prevention and mediation requires investors and the host country to resolve investment-related conflicts through consensual processes—such as mediation—at any stage.

The dispute settlement mechanism under the MCSFTA takes state sovereignty as both the point of departure and the ultimate goal of its institutional design, placing national interests, jurisdictional authority, and governance autonomy at the core. The MCSFTA emphasizes a balance between state sovereignty and investment protection, while also introducing the Ombudsperson mechanism and state-led dispute prevention and mediation procedures. This design reflects the legal traditions of Latin American countries and represents an exploration of new modes of international investment governance. By explicitly excluding the ISDS mechanism, the MCSFTA continues the legacy of the Calvo Doctrine, aligning closely with Latin American countries' strong emphasis on "economic sovereignty". Ombudspersons — appointed or recognized by the state—function as extensions of the national administrative system. They are responsible for addressing investor inquiries, facilitating communication between investors and government agencies, and directly responding to investor concerns regarding "information asymmetry", thereby reducing potential disputes through enhanced transparency. The introduction of non-adversarial, state-led mechanisms such as dispute prevention and mediation serves to expedite the resolution process while maintaining cooperative relationships between investors and host states. This "state-centered" institutional framework positions the state as the designer, implementer and guardian of the dispute settlement system, strongly reflecting the principle of "state centrality".

The above three case studies demonstrate that SSDS has re-emerged as a primary means of dispute resolution in certain bilateral and multilateral investment agreements. This trend is driven by a complex set of factors and carries significant implications. The following section seeks to explore the underlying causes behind this shift.

4. Drivers of the Return of the State in the Investment Dispute Settlement Mechanism

Throughout the historical evolution of international investment dispute settlement, sovereign states have traditionally acted as primary protectors of their nationals' overseas investments, asserting claims against host states through the doctrine of diplomatic protection. However, the establishment of the ISDS mechanism changed this dynamic, aiming to reduce political or military conflicts between sovereign states arising from investor disputes. This development granted investors greater autonomy and independence from their home states. Nevertheless, as the limitation of the ISDS mechanism became increasingly apparent, a growing number of countries across the world are reconsidering its use and exploring other dispute settlement methods, leading to the resurgence of state-state dispute settlement mechanisms. Several factors contribute to the return of dispute settlement mechanisms between countries, including the shift in global investment governance goals, the ISDS mechanism's divergence from the core goals of international investment dispute settlement reform, the influence of state-led dispute settlement practices in international trade, the inherently political nature of international investment disputes and the "weak judicial character" of ISDS mechanisms.

4.1. The Shift of Global Investment Governance's Goal from Singularity to Diversification

Global investment governance is an important part of global economic governance. Since the 1990s, cross-border investment has grown rapidly. In contrast to the multilateral trading system centered on the World Trade Organization (WTO), the field of international investment lacks a centralized governance institution and comprehensive multilateral agreements. As a result, global investment governance remained predominantly shaped by bilateral and regional investment agreements [22]. The primary objective of the first generation of international investment agreements was to enhance the legal protection of private investments abroad. Emerging in the Cold War context, these agreements aimed to resist the expansion of Soviet communism beyond post-World War II borders and the growing decolonization movement of the 1960s [23]. This dual threat generated significant political uncertainty, heightening risks for private capital. In such cases, the first generation of international investment agreements focused on affirming investor rights and imposing obligations on host states, seeking to bolster investor confidence in foreign ventures through international investment agreements. This governance model only aimed to protect the rights and interests of private investors. However, the goals of global investment governance began to evolve from singularity to diversification amid profound shifts in international power dynamics and global investment patterns. Historically, Western countries dominated the formation and interpretation of international investment rules. They provided more comprehensive protection for the interests of investors from developed countries operating in developing countries with weaker financial and judicial institutions [24]. In this context, the global investment system became a tool for major powers to maintain monopolistic advantages to some extent [25]. As a result, many developing countries were compelled to accept an unfair investment governance mechanism to attract or retain foreign capital. However, entering the 21st century, the collective rise of emerging economies and developing countries has become an irreversible trend. With the increasing diversification of the international investment, there is a diminishing distinction between capital-importing and capital-exporting countries. Not only has investment become bidirectional between developed and developing countries, but investment among developing countries is also rapidly increasing. This has made more and more countries assume dual roles as both capital-importing and capital-exporting countries [26]. The dominance of developed countries in capital export is waning, as many developing countries have made systematic advancements in governance, economic systems, and business environments. They are also raising expectations for inbound investment in areas such as environment, labor treatment, and national regulatory sovereignty [26]. As a result, the bargaining dynamics between developed and developing countries have shifted significantly. This has driven global investment governance beyond the singular goal of investor protection to more diversified goals, ones increasingly emphasized by developing states. These include safeguarding national regulatory autonomy, promoting sustainable development, and strengthening corporate social responsibility. This indicates that global investment governance will move towards a more fair and reasonable direction in the future.

4.2. ISDS Mechanism's Divergence from the Core Values of International Investment Dispute Settlement Reform

As global investment governance shifts from a singular to a more diversified set of goals, the ISDS mechanism is still one of the most widely used tools for attracting foreign investment and protecting investors' economic interests in environments perceived as carrying "investment risks". However, it has inevitably sparked intense debates over reform. Following Bolivia and Venezuela's successive withdrawals from the International Centre for the Settlement of Investment Disputes (ICSID), Australia issued a Trade Policy Statement, declaring that it would no longer include provisions on investor-state dispute settlement in bilateral and regional trade agreements. India began reviewing its existing bilateral investment agreements and suspended all bilateral investment agreement negotiations. The revised North American Free Trade Agreement (US-Mexico-Canada Agreement) excludes Canada from the ISDS mechanism, eliminating the possibility of ISDS procedures between Canada and the other two parties. In addition, countries like China, Brazil, and South Africa have also abandoned the ISDS mechanism in favor of mechanisms applicable between countries. Sovereign countries, particularly developing countries, are increasingly dissatisfied with the core value of the ISDS mechanism, which places too much emphasis on the rights of private investors while neglecting public interests of sovereign countries [26]. Some scholars, through model-based calculations, have shown that although excluding ISDS may reduce investment protection and investment flows, negotiations can still succeed if parties compensate for investors' "sense of security" through alternative mechanisms [27]. In fact, the role of international investment dispute settlement mechanisms has evolved beyond merely resolving disputes. More importantly, they have reshaped the global investment governance mechanism through arbitration [28]. The current focus of reform efforts has shifted toward correcting the consequences of international investment arbitration tribunals reviewing state behavior, which has often resulted in the marginalization of national public interests and restricts the exercise of state authority [29]. The reform agenda now emphasizes the recognition of the legitimate public policy rights and interests of the host country, while still taking into account the legitimate rights and interests of foreign investors. However, the ISDS system has failed to keep pace with this transformation in core values. Scholars analyzing ISDS cases from 1993 to 2015 found that most investment disputes submitted to the ISDS mechanism do not concern direct expropriation but involve indirect expropriation, which is more uncertain and ambiguous. Moreover, most host countries are not countries with low levels of rule of law, but democratic countries with independent and stable judiciary. In short, most ISDS cases today revolve around claims for monetary compensation due to host states' regulatory actions [30]. According to the *World Investment Report*, investors filed 60 new arbitrations under international investment agreements in 2023. The total number of ISDS cases is up to 1332, with approximately 70% of the new cases targeting developing countries [15]. A significant portion of these cases directly challenge the host state's regulatory authority in the public interest. For example, the tobacco giant Philip Morris demanded $2 billion in compensation from Uruguay for requiring health warnings on cigarette packaging [31]. Swedish state-owned energy company Vattenfall sought over $3.7 billion from Germany for phasing out nuclear energy following Japan's Fukushima disaster [32]. Canadian company Lone Pine sued its own government through a US subsidiary, demanding over $110 million in compensation for a ban on shale gas extraction in Quebec due to environmental concerns [33]. Objectively, the promulgation of new regulatory measures will inevitably affect the assets of private investors to some extent. Yet, the core concern for future reforms in international investment dispute resolution is whether restoring private property should take precedence over broader societal goals such as social welfare, economic justice, and environmental protection.

4.3. Experience Reference on the State-led International Trade Dispute Settlement Mechanism

The international trade dispute settlement mechanism and the international investment dispute settlement mechanism are the two most representative mechanisms for maintaining international rules and resolving global economic disputes. They play a crucial role in promoting global economic stability and development. Among them, the World Trade Organization's dispute settlement mechanism is recognized as an upgraded version of the SSDS mechanism. It provides a more just, efficient, and predictable platform for resolving global trade disputes and offers judicial safeguards for the multilateral trading system in terms of predictability and security. As a high-yield and efficient dispute resolution platform [34], the World Trade Organization's dispute settlement mechanism includes a series of rules and procedures —including consultation, mediation, conciliation, expert group review, and appellate bodies—all centered around sovereign states. Objectively speaking, the dispute settlement mechanism of the WTO represents an institutional innovation in international dispute settlement procedures. It provides WTO members with access to almost all forms of dispute settlements to resolve international trade disputes, characterized by high comprehensiveness, inclusiveness, and flexibility [35]. This not only helps maintain the stability and authority of the multilateral trading system, but also effectively promotes the liberalization and facilitation of global trade. In fact, the mutual learning and reference among various international dispute settlement mechanisms have never ceased. It is precisely because of the success of the WTO dispute settlement mechanism that it has become a model for reform in the investment dispute settlement mechanisms. For instance, the introduction of the Joint Management Committee in Brazil's CFIA, the consultation mechanism in Angola-EU's SIFA, and the mediation mechanism in the Southern Common Market-Singapore MCSFTA all draw on the design experience of the WTO dispute settlement mechanism. These measures enable multiple paths of dispute resolution—including mediation, arbitration, and justice—entered on sovereign states, to coexist within the same international convention of investment dispute settlement mechanism. This also marks a return to the status of states as "masters of treaties". It needs to be recognized, however, that the dispute settlement mechanism in international investment treaties possess certain particularities. While international investment treaties result from negotiations between contracting parties, their traditional purpose is the protection of investors' interests. As a result, the equality of rights and obligations between contracting parties and beneficiaries (i.e., investors) in international investment treaties cannot be fully realized [36]. Consequently, both contracting parties often prefer dispute resolution mechanism with a more "diplomatic" character to resolve investment disputes. First, this approach recognizes the partnership between the contracting parties and returns responsibility for resolving investment risks to them. In many cases, disputes may be resolved through friendly negotiations. Second, even if disputes escalate to inter-state arbitration, both parties are likely to consider each other's development needs and exercise caution in challenging one another's public interest regulatory authority.

4.4. The Political Nature of International Investment Disputes and the "Weak Judicial Nature" of ISDS Mechanisms

Dating back to the 19th century and the first half of the 20th century, international investment disputes in practice have often carried a strong political dimension. Disputes between foreign investors and host countries frequently triggered diplomatic interventions from the investor's home country, and in extreme cases even lead to military conflicts [37]. Scholars analyzing causes of existing ICSID arbitration cases have found that most involve politically sensitive issues, including energy allocation, natural resource allocation, environmental regulation, taxation, financial regulation, and so on, nearly all of which challenge the public laws and regulations of the host countries [38]. Against this backdrop, the historical evolution of investment dispute settlement mechanisms has shifted from a state-based model to an investor-based one [39]. This shift transferred the resolution of investment disputes from the jurisdictional interplay between host and home countries to international arbitrary mechanisms, thereby weakening the role of states. The inevitable consequence of voluntarily restricting or transferring elements of state sovereignty is a reevaluation of national interest maximization [40]. Host countries have come to realize that once their dominant role in resolving investment disputes is diminished, and their regulatory space for safeguarding public interests is squeezed, their capacity to maximize national interests is compromised—posing risks to their long-term sustainable development. This may inevitably lead to increased resistance against the ISDS mechanism. Given the inherently political nature of many investment disputes, whether a "thoroughly de-nationalized" dispute resolution framework can effectively serve both host states and investors has become a point of international concern. In addition, the "weak judicial nature" of the ISDS mechanism has drawn significant criticism, particularly regarding the inconsistency and even contradiction in arbitration awards. This issue has once again come under the spotlight during the ongoing reform negotiations of the Third Working Group of the United Nations Commission on International Trade Law [41]. Within this context, the resurgence of the state's role reintroduces a necessary "political dimension" to a mechanism that was initially designed to be overly "depoliticized". It also contributes to the establishment of political balancing tools and provides home-country protection for investors who may no longer benefit from the protection of the ISDS mechanism. Before formal arbitration disputes arise, investors can have direct contact with government agencies in the host country with the support of their home country to express their reasonable demands. Such practices are expected to restore a balance between the regulatory sovereignty of host states and the rights and interests of foreign investors under the framework of diplomatic support, and seek to address the current imbalance within the ISDS framework, which is often perceived as disproportionately favoring investors at the expense of host states' policy autonomy.

In light of the aforementioned driving factors, the following section of this paper will further explore the design principles of dispute settlement mechanisms, aiming to address the dual demands of sovereign states in safeguarding developmental interests and promoting the stability of cross-border investment, thereby contributing to the establishment of a fair, efficient, and sustainable new order in global investment governance.

5. Policy Reflections on the Return of the State in International Investment Dispute Settlement

Since the 1970s, the rise of neoliberalism has had a significant impact on the formulation of international economic, trade, and investment policies. This became an important theoretical trend in economic globalization [42]. At the time, the international community generally believed that foreign direct investment was crucial for a country's economic development. Therefore, it was necessary to provide robust protection for private investors through international investment law to promote the free flow of private capital [43]. In this context, the ISDS mechanism, as a product of "neoliberalism", largely sidelined the role of sovereign states. However, the ISDS mechanism has increasingly come under scrutiny for its arbitration rulings on cases involving the public policies of host country that excessively favor foreign investment [42]. These developments have prompted sovereign nations to re-evaluate the core values and practical shortcomings of existing investment arbitration mechanisms. In response, there has been a partial revival of Calvo Doctrine, with countries increasingly showing a "return" trend in investment dispute resolution mechanisms and international investment law. In light of this development, it is essential for states to critically reassess the design of international investment dispute settlement mechanisms.

5.1. The Design of the Investment Dispute Mechanism Needs to Be Guided by the Goal of Diversified Global Investment Governance

The legal basis of the investment dispute resolution mechanism lies in investment treaties. This mechanism is expected to be regulated through mandatory and binding global multilateral agreements and aims to promote the establishment of a top-down investment dispute governance system centered on investment arbitration institutions. Its objective is to enhance foreign investors' confidence by focusing on the singular goal of protecting private property, thereby facilitating the cross-border flow of private capital. As of the end of 2023, there are a total of 3291 international investment treaties in the current international investment treaty system worldwide, including 2831 bilateral investment treaties and 460 treaties containing investment provisions [44]. Among them, the old-generation agreements still cover 71% of the global stock of foreign direct investment [44]. However, as previously noted, the goal of global investment governance has shifted from singularity to diversification. With the advance of global economic liberalization and the collective rise of emerging economies and developing countries, excessive marketization will inevitably undermine the social value it deserves [45]. As capital-importing countries, developing countries have higher development requirements in areas such as environmental protection, public health, and labor rights, and are no longer willing to sacrifice their own public interest regulatory space to attract foreign investors. Therefore, in terms of program design, the investment dispute resolution mechanism must ensure alignment with the goal of diversified global investment governance. It should not blindly pursue economic liberalization or diminish the role of states in investment governance. Nor should it undermine the status of the state in the investment dispute resolution mechanism or overlook the diverse governance goals of safeguarding regulatory sovereignty, promoting sustainable development, and strengthening corporate social responsibility. Take the goal of addressing climate change as an example: countries are actively engaging in climate legislation and policy reforms, including incentivizing climate-friendly investments and regulating environmentally harmful industries. However, these reform efforts—aligned with global climate governance goals—are highly likely to "infringe" on the rights and interests of foreign investors. This reveals an inherent contradiction between the traditional international investment dispute resolution mechanism's emphasis on "investment protection" and the goals of climate action, which is highly likely to hinder global efforts to combat climate change and to achieve the goals of the Paris Agreement [46]. Moreover, examples from ISDS cases have shown that investors will be cross-boundary and sued for compensation, especially for challenging the legitimate public policy measures of the host country [9]. In promoting the transformation of international investment law to support climate action, sovereign states remain the backbone [47]. Climate and environmental disputes are characterized by their political, technical, and complex nature, creating an urgent need to balance the obligation of states to mitigate climate change with its duty to protect foreign investors. Therefore, there is a pressing need to design an investment dispute settlement mechanism that comply with the rights and obligations of countries to regulate public interests such as sustainable development. This mechanism should prevent private companies from using dispute resolution mechanisms to challenge global climate policies and should reduce conflicts between host countries and foreign investors.

5.2. The Break-down of Barriers Between National and Global Governance to Achieve a Balance of Interests Between Investors and Host Countries

The underlying opposition between investors and host countries reflects a conflict between global governance and national sovereignty [48]. The international investment dispute governance system—centered on the ISDS mechanism—serves as a microcosm of global governance and exemplifies its challenges [49]. The regulation of foreign investment originally belonged to the scope of national sovereignty. Unlike trade, investment engages more deeply with the host country's social and economic development, directly impacting the exercise of sovereign autonomy. As a result, governments have generally adopted a more cautious approach to investment regulation [8]. Multiple attempts by the international community to construct a multilateral investment governance framework have ultimately failed, leading to a lack of comprehensive and authoritative institutional arrangements in global investment governance. The development and decline of the SSDS mechanism illustrate the transition to ISDS. The ISDS mechanism was designed to exclude investors' home country from formal proceedings in order to avoid the escalation of tensions between the home country and the host country to protect investors. It also allows foreign investors bypass what are often perceived as "non-neutral and opaque" domestic remedies to directly access international arbitration forums. At the same time, the ISDS mechanism has emphasized investor protection by downplaying the role of the host state to protect the private rights of foreign investors and promote the flow of global investment capital. However, the marginalization of the "national role" has begun to reveal its limitations, particularly in its failure to support sustainable relationships between host countries and investors. To achieve a dynamic balance of interests, it is necessary for investors and host countries to situate their respective interest within a global perspective, build a community with a shared future for mankind, coordinate the promotion of national governance and global governance, and innovate traditional investment governance paradigms, concepts, and methods. First, national governance should be the logical point of departure, while global governance should be the value pursuit. Global governance goals must be embedded within the national governance agenda to promote effective resolution of investment disputes. Second, the conceptual framework of investment dispute governance must go beyond the binary of "investment protection" and "state management". It should also strive to balance the interests of investors, national sovereignty, and the common interests of all mankind. If the goals of national governance cannot be effectively protected, it will be even more difficult to realize the value of global governance. Finally, governance practices must evolve with the times. The internal governance of a country and its participation in global governance are decisive factors that affect the direction of global governance [50]. Investors and host countries are not inherently opposed. The global governance concept of "jointly built through consultation to meet the interests of all" provides a methodology for host countries to handle investment disputes within the framework of national governance. International investment dispute governance should comprehensively and evenly reflect the rights and obligations of both host countries and investors, while accommodating the interests of all stakeholders and promoting the common interests of humanity.

5.3. The Development of More Diversified Investment Dispute Prevention and Resolution Tools Centered on "Sovereign States"

Recent treaties such as Brazil's CFIA, the Angola-EU Sustainable Investment Facilitation Agreement (SIFA), and the Southern Common Market-Singapore Free Trade Agreement (MCSFTA), have notably refrained from adopting the traditional ISDS mechanism as the last defense to protect investors' rights. Instead, these agreements emphasize the role of investors' home countries, strengthen their status as treaty parties, and re-center "states" in the investment dispute resolution framework. They provide more reasonable and legal channels for home countries to intervene, such as dispute prevention mechanisms, and negotiation and mediation from the WTO. Therefore, they strengthen home countries' control of disputes before formal arbitration disputes arise, while also preserving greater regulatory space for public interest governance in host countries. It should be pointed out that the procedure between states, as a prerequisite for the formal investment dispute settlement procedure, can effectively prevent or resolve investment disputes and has a complementary or alternative role [51]. And the international arbitration mechanism has restored the status of the country as the "master of the treaty" [52]. It enables investors to apply for arbitration through their home countries and use a public-law approach to handle investment disputes of a political nature. In this way, the imbalance between public and private interests inherent in the ISDS model is addressed. Future design of international investment dispute settlement mechanisms should incorporate procedures that can amicably resolve investment disputes before arbitration, with more emphasis on supplementary or alternative resolution procedures. Brazil's investment dispute resolution and prevention mechanism offers a practical example. It introduces institutional governance and sets up national contact points and joint committees between contracting states. This dual-layer structure facilitates direct communication between investors and host countries, supported by the home country, to address investor concerns early on. Notably, the Joint Committee mechanism allows relevant challenges to be addressed by representatives of both contracting states, alongside private sector stakeholders and civil society participants. It builds a platform where all stakeholders—investors, home countries, and host countries—can convene to identify mutually beneficial solutions, thereby avoiding unilateral actions and promoting efficient, timely conflict resolution [53]. In addition, integrating consultation, mediation, and conciliation procedures from the WTO's trade dispute settlement mechanism marks an important step forward. As the principal forum for resolving international trade disputes, the WTO system encompasses a wide range of trade and investment-related agreements and has evolved into a comprehensive economic dispute resolution framework [42]. Its state-centric design and operational success serve as a valuable reference for reforming investment dispute mechanisms. Furthermore, home countries tend to be much more cautious about the demands of public interest, given the potential implications for their own future regulatory autonomy. In short, state-led informal domestic dispute resolution procedures—such as dispute prevention and mediation—can also offer foreign investors convenient channels for resolving conflicts [54]. The intervention of government agencies to facilitate dialogue and seek amicable solutions may help break the deadlock in investment disputes. However, regardless of the approach adopted by international investment treaties, the role of the state in investment dispute settlement should never be overlooked.

6. Conclusion

From a historical perspective, the SSDS mechanism is the predecessor of the ISDS mechanism. Although SSDS once played a prominent role, it was later replaced by the "depoliticized" ISDS model due to criticisms of the former's overly "politicized" procedures. However, as the excessive "depoliticization" of ISDS triggered a series of dispute governance challenges, the sovereign state-centered approach to dispute resolution has begun to reemerge in recent international investment agreements. Meanwhile, more and more practical cases, such as the CFIA dispute resolution mechanism in Brazil, the Angola-EU SIFA, and the Southern Common Market Singapore MCSFTA, illustrate this trend of reversion. This resurgence is underpinned by several factors: the shift in global investment governance goals from investor-centric to more balanced and diversified objectives, the ISDS mechanisms' divergence from the core goals of international investment dispute settlement reform, the influence of state-led international trade dispute settlement mechanisms, as well as the inherently political nature of international investment disputes and the "weak judicial nature" of ISDS mechanisms. In light of these developments, the design of future international investment dispute settlement mechanisms should prioritize the promotion of diversified global investment governance goals and break down barriers between national and global governance. Furthermore, the development of more diversified investment dispute resolution tools around "sovereign states" is essential. These mechanisms should seek to balance fairness with efficiency and encourage continuous innovation and exploration. Such reforms will help build a more just, efficient, and sustainable international investment environment, ultimately injecting new vitality into global economic development.

Abbreviations

ISDS	Investor-state Dispute Settlement
SSDS	State-state Dispute Settlement
CFIA	Cooperation and Facilitation Investment Agreement
SIFA	Sustainable Investment Facilitation Agreement
MCSFTA	Southern Common Market-Singapore Free Trade Agreement
FCN	Treaty of Amity for Commerce and Navigation
ICSID	International Centre for Settlement of Investment Disputes
BIT	Bilateral Investment Treaty
EU	European Union
WTO	World Trade Organization

Funding

This research was funded by the Innovation Program of Guangdong Provincial Education Department [Grant No. 2023WTSCX022].

Conflicts of Interest

The authors declare no conflicts of interest.

References

[1] Ren, J. Rediscovering the Nation: The Triumphant Return of the Nation in Global Governance. Exploration and Contention. 2020, 3, 26.

[2] Lifshits I. M., Shatalova A. V. Modernization of the Investor-State Dispute Settlement System: Reform or Revolution? Russian Journal of World Politics and Law of Nations. 2024, 2(3), 130-149.

[3] Schreuer, C. "Do We Need Investment Arbitration?" in Reshaping the Investor-State Dispute Settlement System. Leiden: Brill Nijhoff; 2015, pp. 879 - 889.

[4] Salman, M. Navigating Investor-state Dispute Settlement: The Dynamics Between Investment Protection and Sovereign Control. China and WTO Review. 2024, 10(1), 1-14.

[5] Roberts, A. State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority. Harvard International Law Journal. 2014, 1.

[6] Amerasinghe, C. F. Diplomatic Protection in International Law. Oxford: Oxford University Press; 2008, pp. 14.

[7] Vandevelde, K. J. Bilateral Investment Treaties: History, Policy, and Interpretation. Oxford: Oxford University Press; 2010, pp. 49-59. Also see Roberts, A. State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority. Harvard International Law Journal. 2014, 1.

[8] Gao, Z. Global Governance of International Investment Disputes. Beijing: Social Sciences Academic Press; 2018, pp. 12.

[9] Bernasconi-Osterwalder, N. State-State Dispute Settlement in Investment Treaties. Rethinking Bilateral Investment Treaties. 2014, 253.

[10] Potestà, M. State-to-state Dispute Settlement Pursuant to Bilateral Investment Treaties: Is There Potential?. In International Courts and the Development of International Law. Hague: TMC Asser Press; 2013, pp. 753-768.

[11] Damjanovic, I. The Reform of International Investment Law: Whose Rule of Law? European Journal of Risk Regulation. 2014, 15(3), 524-540.

[12] Kulick, A. State-State Investment Arbitration as a Means of Reassertion of Control-From Antagonism to Dialogue. Reassertion of Control over the Investment Treaty Regime. Cambridge: Cambridge University Press; 2016, pp. 128-152.

[13] Also see Sachs, L. "ISDS Reform at UNCITRAL: Two Guiding Principles." Available from: https://ccsi.columbia.edu/news/isds-reform-uncitral-two-guiding-principles. [Accessed 22 June 2025].

[14] Southcentre.org. "The World's Worst Judicial System?" Available from: http://justinvestment.org/2013/07/the-worlds-worst-judicial-system/. [Accessed 22 June 2025].

[15] UNCTAD. "The World Investment Report 2023." Available from: https://unctad.org/publication/world-investment-report-2023 pp. 56. [Accessed 22 June 2025].

[16] Zhang, S. & Ma, Y. The Inter-State Dispute Settlement Mechanism in the China-EU Comprehensive Agreement on Investment: Contents, Characteristics and Impacts. Wuhan University International Law Review. 2022, 1, 146.

[17] Tao, L. New Trends in International Investment Agreements and Their Implications for China: Taking the Brazil-India Investment Cooperation and Facilitation Agreement as a Sample. International Economic Review. 2021, 6, 84.

[18] European Commission. "Sustainable Investment Facilitation Agreement Article 36." Available from: https://trade.ec.europa.eu/access-to-markets/en/content/eu-angola-sustainable-investment-facilitation-agreement-sifa [Accessed 22 June 2025].

[19] Chen, H. The Investor-State Dispute Settlement Mechanism: New Developments in the Early Twenty-First Century. China's Practice in International Investment Law. Singapore: Springer; 2025, pp. 109-140.

[20] Lugg, A., Ganeson, K., Elsig, M., et al. Why is there no investor-state dispute settlement in RCEP? bargaining and contestation in the investment regime. Business and Politics, 2024, 26(4): 449-476.

[21] Polanco Lazo, R. The No of Tokyo Revisited: Or How Developed Countries Learned to Start Worrying and Love the Calvo Doctrine. ICSID Review - Foreign Investment Law Journal. 2015, 30(1), 172.

[22] Zhao, L. Institutional Power: Reconstruction of International Rules and China's Strategies. Beijing: People's Publishing House; 2016, pp. 291.

[23] Bernasconi-Osterwalder, N., Cosbey, A., Johnson, L., et al. Investment Treaties and Why They Matter to Sustainable Development: Questions and Answers. 2011, 3.

[24] Cui, J. Global Investment Governance: A Call for Greater System Diversity and Rule Uniformity. Beijing Law Review. 2020, 11, 614 - 625.

[25] Zhang, X. & Li, W. The Dilemma and Reform of the International Investment Rule of Law from the Perspective of Global Governance. Law Science Magazine. 2020, 1, 31.

[26] Liao, F. New Developments in the Investor-State Dispute Settlement Mechanism. Jiangxi Social Sciences. 2017, 10, 201.

[27] Horn, H, & Tangerås, T. Investor-State vs. State-State Dispute Settlement." Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3285102. [Accessed 22 June 2025].

[28] Wang, S. The Resolution of the Legitimacy Crisis?—Re-discussion on the Reform of the EU Investment Dispute Settlement Mechanism. Studies in Law and Business. 2018, 35(2), 163.

[29] Deng, T & Qu, D. On the Role Transformation of the State in the Investor-State Dispute Settlement Mechanism. Journal of Central South University (Social Science Edition). 2021, 27(2), 69.

[30] Pelc, K. Does the International Investment Regime Induce Frivolous Litigation? Also see Lencucha, R. Is It Time to Say Farewell to the ISDS System? Comment on 'The Trans-Pacific Partnership: Is It Everything We Feared for Health?. International Journal of Health Policy and Management. 2017, 6(5), 289. http://dx.doi.org/10.2139/ssrn.2778056

[31] Philip Morris Brands Sàrl, Philip Morris Products S. A. and Abal Hermanos S. A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7.

[32] Vattenfall AB and others v. Federal Republic of Germany, ICSID Case No. ARB/12/12.

[33] Lone Pine Resources Inc. v. Canada, ICSID Case No. UNCT/15/2.

[34] Sun, J. International Economic Law from the Perspective of Global Governance. Beijing: Peking University Press; 2021, pp. 149.

[35] Zhao, H. From "Contract" to "Quasi-Judicial": The Development Path of International Dispute Settlement and the Reform of the WTO Dispute Settlement Mechanism. Tsinghua Law Review. 2023, 17(6), 108 - 123.

[36] He, Y. Research on the "Joint Control" Mechanism of Investment Dispute Settlement—Starting from the Reform of the Investment Dispute Settlement Mechanism. Studies in Law and Business. 2020, 37(4), 144.

[37] Innerebner, L. F. Politicization of a Future International Investment Tribunal's Appointment and How to Avoid It. Trento Student Law Review. 2019, 1, 138.

[38] Brower II, C. H. Politics, Reason, and the Trajectory of Investor-State Dispute Settlement. Loyola University Chicago Law Journal. 2017, 49.

[39] Shi, H. On the Evolution of Dispute Settlement Methods between Investors and States—From the State-oriented to the Investor-oriented. Industrial Technology & Economy. 2007, 7, 58 - 61.

[40] Yu, Z,, Chen, Y. & Su, C. 21st Century Global Political Paradigm. Shanghai: Fudan University Press; 2005, pp. 23.

[41] Kelsey, J. & Mohamadieh, K. UNCITRAL Fiddles While Countries Burn. Friedrich Ebert Stiffung. 2021, 20 - 24.

[42] Qi, T. & Yu, Q. From Neo-liberalism to Embedded Liberalism: On the Paradigm Shift of Recent International Investment Law. Journal of International Relations and International Law. 2014, 4, 204.

[43] Sornarajah, M. Mutations of Neo-Liberalism In International Investment Law. Trade, Law and Development. 2011, 3, 203.

[44] UNCTAD. "World Investment Report 2024." Available from: https://unctad.org/system/files/official-document/wir2024_en.pdf. pp. 65. [Accessed 22 June 2025].

[45] Xu, C. Evaluation of the Recent Practice of International Investment Dispute Settlement: The Introduction of "Global Governance" Theory. Jurist. 2010, X (3), 145.

[46] Martini, C. From Fact to Applicable Law: What Role for the International Climate Change Regime in Investor-State Arbitration?. Canadian Yearbook of International Law/Annuaire canadien de droit international. 2024, 1-36.

[47] UNCTAD. "The International Investment Treaty Regime And Climate Action." Available from: https://investmentpolicy.unctad.org/publications/1269/the-international-investment-treaty-regime-and-climate-action pp 2. [Accessed 22 June 2025].

[48] Tung, K. "Global Governance and State Sovereignty: One Belt, One Road and Multiple Disputes - Speech at the International High-Level Forum on Rule of Law and Reform." Available from: http://www.ghls.zju.edu.cn/ghlscn/2018/1110/c13708a1142780/page.htm [Accessed 22 June 2025].

[49] Zhang, J. The Reform of the Global Governance System for International Investment Disputes and China's Response. Theoretical Horizons. 2021, 11, 69.

[50] Xu, X. The Thinking Transformation and Path Remodeling of Global Governance in the Post-Pandemic Era. Foreign Affairs Review. 2022, 5, 17.

[51] Titi, C, Liu, Y. & Liu, K. Non-adjudicatory Inter-State Mechanisms for Investment Dispute Prevention and Resolution: Joint Interpretation, Screening Mechanisms and Focal Points. Journal of International Law. 2021, 2, 131.

[52] Lin, H. The Correction of Treaty Control Mechanism to International Investment Dispute Settlement from the perspective of Rebalancing—A Review of 'The Return of Investor-State Dispute Settlement to Home State Doctrine: Is Diplomatic Protection Back?. Tribune of Political Science and Law. 2021, X (1), 158.

[53] Tang, Y. The Reform of Brazil's International Investment Dispute Settlement Model and Its Enlightenment for China. Journal of Latin American Studies. 2021, 43(2), 78.

[54] McLaughlin, M. Conceptualising State-centric Mediation: An Analysis of China's Foreign Investment Complaints mechanism. Asian Journal of Comparative Law. 2024, 19(1), 1-21.