ALLIANCE FOR TRADE ENFORCEMENT

Modelling Enforcement Mechanisms for the Indo-Pacific Economic Framework

A White Paper by the Alliance for Trade Enforcement

The Alliance for Trade Enforcement

The Alliance for Trade Enforcement (AFTE) is a coalition of trade associations and business groups that advocates for foreign governments to end unfair trade practices that harm American workers and companies from every sector of the economy and supports U.S. policymakers in their efforts to hold our trading partners accountable. AFTE's members operate in the manufacturing, services, and technology sectors, among others, creating good-paying high-quality jobs. AFTE supports efforts by the Administration to demonstrate economic and diplomatic leadership in the Indo-Pacific region and publishes this white paper with the goal of further strengthening the framework agreement.[1]

The Indo-Pacific Economic Framework

On May 23, 2022, President Biden officially launched the Indo-Pacific Economic Framework for Prosperity (IPEF) with several partners in the Indo-Pacific region. The IPEF is not envisioned as a traditional free trade agreement, and administration officials have committed to excluding new market access from the framework.[2] Instead, it is focused on four key pillars to "establish high-standard commitments that will deepen [the United States'] economic engagement in the region"[3] (1) fair and resilient trade; (2) supply chain resilience; (3) infrastructure, clean energy, and de-carbonization; and (4) tax and anti-corruption. Each pillar is addressed in more detail below.

To start, the United States is partnering with thirteen countries to negotiate the IPEF: Australia, Brunei, Fiji, India, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand, and Vietnam.[4] Combined with the United States, these nations represent

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[1] AFTE's public submissions to the United States Trade Representative and the Department of Commerce are available at https://www.regulations.gov/comment/USTR-2022-0002-1206 and https://www.regulations.gov/comment/ITA-2022-0001-0054, respectively.

[2] Remarks by Ambassador Katherine Tai at the 2022 United Steelworkers Constitutional Convention (August 10, 2022) available at https://ustr.gov/about-us/policy-offices/press-office/speeches-and-remarks/2022/august/remarks-ambassador-katherine-tai-2022-united-steelworkers-constitutional-convention (see, e.g., "Because of that, tariff elimination is not on the table.")

[3] FACT SHEET: In Asia, President Biden and a Dozen Indo-Pacific Partners Launch the Indo-Pacific Economic Framework for Prosperity, The White House (May 23, 2022); see also On-the-Record Press Call on the Launch of the Indo-Pacific Economic Framework, The White House (May 23, 2022).

[4] Statement by National Security Advisor Jake Sullivan on Fiji Joining the Indo-Pacific Economic Framework for Prosperity (May 26, 2022) available at https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/26/statement-by-national-security-advisor-jake-sullivan-on-fiji-joining-the-indo-pacific-economic-framework-for-prosperity/

40% of world gross domestic product (GDP).[5] The United States intends for additional countries to join the agreement as it continues to be developed.

Coming approximately five years after the United States withdrew from the Trans-Pacific Partnership, the IPEF is the Biden administration's signature trade and economic plan for demonstrating American leadership and developing a modern regional framework that links and strengthens emerging partnerships in the Indo-Pacific. It is also seen as a key effort to counter China's increasing economic influence in the region.[6]

The IPEF consists of four pillars:

1. **Connected Economy** – Development of this pillar will be led by the United States Trade Representative (USTR) and will deal with a range of issues concerning trade, including digital economy and emerging technology, labor commitments, trade facilitation, transparency and good regulatory practices, and corporate accountability.

2. **Resilient Economy** – This pillar, led by the Commerce Department (DOC), will involve commitments related to supply chain security, such as establishing early warning systems, mapping critical mineral supply chains, improving traceability in key sectors, and coordinating on diversification efforts to prevent disruptions in supply chains.

3. **Clean Economy** – This pillar will be led by DOC and will address the climate crisis by focusing on commitments to clean renewable energy, carbon removal, and additional climate-related initiatives.

4. **Fair Economy** – This pillar, led by DOC, will focus on the enactment and enforcement of tax, anti-money laundering, and anti-bribery laws and standards.

Unfortunately, as noted above, the Biden Administration has indicated that it will not include market access provisions in the IPEF. In testimony before the Senate Finance Committee in March, U.S. Trade Representative Katherine Tai stated that the Administration is "not starting these conversations with tariff liberalization," arguing that traditional free trade agreements (FTAs) have led to "considerable backlash" in the United States.[7] While tariff concessions have

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[5] FACT SHEET: In Asia, President Biden and a Dozen Indo-Pacific Partners Launch the Indo-Pacific Economic Framework for Prosperity, The White House (May 23, 2022); see also On-the-Record Press Call on the Launch of the Indo-Pacific Economic Framework, The White House (May 23, 2022).

[6] https://crsreports.congress.gov/product/pdf/IN/IN11814.

[7] Senate Finance Committee Hearing, *The President's 2022 Trade Policy Agenda* (March 31, 2022), https://www.finance.senate.gov/hearings/the-presidents-2022-trade-policy-agenda.

drawn the most attention, the scope of negotiations also does not include other topics that create market access and competitiveness like investment, regulatory cooperation, and intellectual property protections, among others. These omissions will limit the scope and enforceability of the IPEF. Many of the counterparties to the IPEF either already have or would like to negotiate an FTA with the United States. Including market access as part of the IPEF negotiations would serve as an important carrot to both entice countries to accept robust trade provisions under the trade pillar and deter potential violations of the agreement down the line. AFTE therefore strongly supports the inclusion of market access commitments in the IPEF.

Requirements of an Effective Enforcement Mechanism

The IPEF is most likely to succeed if the parties consider themselves bound by its provisions and have an effective means of settling disagreements regarding its application. Strong enforcement mechanisms are the best way to deter parties from enacting measures that are inconsistent with the terms of the agreement. Further, an effective enforcement mechanism responds to the reality that in all agreements there will be ambiguities in the text. It is imperative that the IPEF include processes that allow the parties to recognize and mediate differences, and ultimately provide for a fair resolution to disputes.

Effective enforcement mechanisms in trade agreements share several characteristics:

1. **Objectivity** – The process must be objective and unbiased, driven by the rule of law rather than political whims. Decisions should be based off the text of the agreement and interpretation consistent with the Vienna Convention on the Law of Treaties.

2. **Transparency** – Procedures should be open and transparent to both governments and interested stakeholders. Decisions should be explained in writing and available to the public.

3. **Timeliness** – The process must be deadline-driven, preventing cases from languishing. This is important not only to parties to the dispute, but also to third parties seeking clarity on the interpretation of the agreement.

4. **Proportionality** – The amount of retaliation awarded must relate rationally to the level of the violation. The goal of retaliation should be to encourage parties to come into compliance with the agreement; barring this, retaliation should return the parties to the competitive position they were in prior to the violation.

5. **Independence** – Arbiters must be determined by a mutually agreed-upon process and be independent from the dispute at hand. Neutral arbiters must be free from undue influence of the parties that nominated them.

Experience has shown that agreements that adopt these key characteristics of dispute settlement tend to succeed, whereas systems that are not designed with these principles in mind have largely failed. The following examples highlight this point.

A. The WTO Dispute Settlement Process

The most prominent example of enforcement of international trade obligations is the World Trade Organization (WTO) dispute settlement process. Dispute settlement at the WTO is governed by the "Understanding on Rules and Procedures Governing the Settlement of Disputes," referred to as the "Dispute Settlement Understanding" or "DSU," which provides detailed requirements for the entire process.[8]

The process consists of two stages. First, the members must enter into consultations with a view toward settling their differences by themselves. The consultation period must last at least 60 days to provide an opportunity for the parties to find a satisfactory solution without resorting to litigation. To date, a majority of disputes at the WTO have not proceeded beyond consultations,[9] indicating that mediation is often an effective means of dispute resolution.

If the parties fail to reach a resolution through consultations, a panel can then be established to hear the case and make a determination. The panel procedure typically consists of a few rounds of written submissions and oral hearings, after which the panel will submit a first draft of the factual and argument sections of its report (this draft does not include findings and conclusions) to the parties for their comment, then issue interim and final reports. Throughout the panel process, the parties to the dispute are encouraged to negotiate a settlement outside of the dispute proceedings. The panel report must be officially adopted by the members of the WTO, but it requires a consensus of all the members to block adoption, so this is generally a formality. In theory, the entire process – from consultations to the adoption of the panel report – is intended to take one year, but typically cases take longer to complete.

Following the adoption of the panel report, the parties to the dispute may appeal the decision of the panel to the Appellate Body, which is – in principle at least – limited to analyzing points of law, rather than reexamining existing evidence or new issues. Each appeal is heard by three members of the permanent seven-member Appellate Body. However, there are currently no members of the Appellate Body, as the United States has blocked the appointment of new judges since 2016, so it is unable to review appeals.

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[8] Understanding on Rules and Procedures Governing the Settlement of Disputes, Annex 2 of the WTO Agreement, https://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm.

[9] World Trade Organization, *The Process — Stages in a Typical WTO Dispute Settlement Case, 6.2 Consultations* (accessed on August 3, 2022), https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s2p1_e.htm.

Despite this and other challenges facing the WTO dispute settlement system, the procedures have proven remarkably successful. Since 1995, over 600 disputes have been brought to the WTO and over 350 rulings have been issued.[10] This is due in large part to the system embodying many of the characteristics described above.

The United States has been a major beneficiary of WTO dispute settlement, bringing and winning more cases than any other WTO member. In fact, the United States has won or favorably settled more than 90% of the completed WTO cases it has brought, which total more than 100 of the more than 350 disputes on which decisions have been issued.

The process is based on detailed rules, agreed upon by the members in advance, and carried out by objective decision-makers through transparent procedures. Importantly, the WTO agreements have "teeth." If a panel determines that a member is failing to comply with the terms of an agreement and has not withdrawn the offending measure, complaining members may retaliate against the member by withholding benefits, typically in the form of increased tariffs.

B. NAFTA/USMCA

In the North American Free Trade Agreement (NAFTA) and its successor, the United States-Mexico-Canada Agreement (USMCA), the parties established three distinct dispute settlement processes: one each for state-to-state disputes, investor-state disputes, and reviews of antidumping and countervailing duty determinations. We will focus here on the state-to-state dispute settlement process.

Chapter 31 of the USMCA governs state-to-state disputes under the agreement. It allows for the resolution of disputes regarding the interpretation or application of the USMCA. As under the WTO system, the parties are required to begin with a consultation process, under which the parties are expected to negotiate to try to settle the dispute without arbitration. If consultations are unsuccessful, the parties may request the establishment of a five-person panel to settle the dispute. The panelists are drawn from a standing roster of 30 qualified arbitrators.

Once the panel is established, the parties argue their case before the full panel in a series of written submissions, including at least an initial submission and a rebuttal, and at least one oral hearing. Panel proceedings are generally intended to take no more than 180 days under Article 31. Panels seek to achieve consensus in making their decisions, although in rare cases individual panelists may also write their own separate reports if they have major disagreements. Panel reports are not binding on the parties, and panels have no enforcement authority; thus, panels will make "recommendations" for a party to come into compliance if it finds a violation of the agreement.

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[10] World Trade Organization, *Dispute Settlement* (accessed on August 3, 2022), https://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm.

Following the issuance of the panel's report, the parties to the dispute have 45 days to identify and implement a resolution to the dispute. If the responding party fails to carry out the panel's recommendation, the complaining party may suspend benefits that they would otherwise owe to the responding party under the agreement. If the responding party believes that the level of the suspension of benefits by a complaining party is excessive or believes that it has rectified the violation but the complaining party disagrees, then the responding party may request that the panel reconvene to consider its positions. If the panel agrees with the responding party that the suspension of benefits is excessive or unwarranted, it will opine on the appropriate level of benefits that it considers to be equivalent. Or if the panel agrees with the responding party that it has in fact rectified the violation, it will determine that the suspension of benefits by the complaining party must cease.

The NAFTA dispute settlement process was largely unsuccessful because the rules under NAFTA allowed any party to block the establishment of a panel by refusing to appoint its arbitrators or agree with the other party on the chairperson. The parties could also not agree on the thirty-person roster for most of the time NAFTA was in effect. The USMCA appears to have resolved these issues, however, by allowing the complaining party to select one or more of its own panelists if the responding party does not appoint its panelists within 40 days. The USMCA also features shorter timelines than the NAFTA or some other trade agreements, a shift intended to address the criticism that dispute settlement has traditionally been excessively slow-moving. Although the USMCA has only been in force for two years, the dispute resolution process appears to be functioning more effectively and seems to have buy-in from the three parties, which have each participated in state-to-state disputes under the new procedures.

C. U.S.-China "Phase One" Agreement

The U.S.-China "Phase One" Agreement was focused on specific structural reforms to China's economic and trade regime with respect to intellectual property, technology transfer, and other matters, as well as a commitment by China to increase its purchases of U.S. goods and services in exchange for changes to the U.S. Section 301 tariffs. Unlikely many such issue-specific agreements, the Phase One Agreement included its own unique dispute settlement process narrower than those typically seen in free trade agreements.

The Phase One Agreement provided for a multi-tiered consultation process, whereby issues would be negotiated by increasingly senior officials. However, this was where the dispute settlement process ended. If the parties failed to come to a resolution through consultations, the complaining party was permitted to unilaterally impose a remedial measure. The responding party was then faced with only two options: accept the remedial measure with a promise not to retaliate or withdraw from the agreement. Unlike the WTO and USMCA processes, the Phase One Agreement did not provide for dispute settlement before an independent arbitral body.

Throughout the course of the Phase One Agreement, there was no public indication that the consultation process had been used in specific cases, despite clear signs at an early stage that China was unlikely to meet its purchasing commitments. The lack of objectivity and independence in the process resulted in an ineffective mechanism for settling disputes.

Recommendations for the IPEF

While the IPEF is constrained by the lack of market access provisions, and the parties will therefore need to think creatively in constructing an effective dispute settlement mechanism, the principles described above should guide the discussion. As with all of the systems summarized above, the dispute settlement process should begin within a consultation period in which the parties may attempt to resolve the conflict themselves. This period should have a reasonable deadline, to allow the parties sufficient time to negotiate but not result in the proceeding to drag on if no negotiated resolution is to be found.

If consultations are unsuccessful, the parties should have the opportunity to dispute the issue in front of an independent, objective body. Arbitration procedures could be modeled off of the USMCA and, to the extent applicable, the WTO system. Historically, arbitration procedures under multilateral and plurilateral trade agreements have been underpinned by the threat of withdrawing concessions. If the IPEF does not include tariff concessions, parties would be unable to threaten to "withdraw" such concessions. However, the IPEF arbitration procedures could still permit aggrieved parties to increase tariffs to induce respondents to bring their measures into compliance with the agreement; in other words, the withdrawal of concessions is not the only available remedy. Moreover, there may be concessions other than tariffs that could be withdrawn to encourage compliance, or the parties could impose procedural penalties on parties that do not comply with the results of dispute settlement, excluding them, for example, from supply chain coordination mechanisms until they bring their offending measure into compliance.

In some circumstances where an arbitration model is not possible, the parties could consider a mediation model, whereby an independent third party can guide discussions and negotiations, allowing each party to have its say, but avoiding a litigious procedure. As a framework that is unprecedented in its scope and priorities, the IPEF may provide an excellent opportunity to test this new type of dispute settlement format.

Conclusion

The success of the IPEF will likely rest on the effectiveness of its enforcement mechanisms. AFTE again strongly recommends the adoption of market access commitments, which would allow the parties to implement a dispute resolution process with actionable penalties. In the absence of market access commitments, IPEF enforcement should be evaluated by the five criteria set out above: objectivity, transparency, timeliness, proportionality, and independence. The parties should include consultations as a first step, then consider enhanced proceedings, such as mediation or arbitration, ensuring that arbitration is backed by enforceable penalties.