



## TPP DOESN'T ADDRESS THE CHINA PROBLEM. WITH THESE FOUR CHANGES, IT MIGHT

COVID-19 is exposing what many of us have known for a long time: our fealty to efficiency has left us dependent on a hostile authoritarian power for the supply of essentials, like medicines and medical equipment.

TPP has been marketed for years as the antidote to the Chinese Communist Party's mercantilist view of the world and a way of having like-minded countries [write the "rules of the road"](#) so China doesn't. Japan is recruiting new TPP partners [as it spends \\$2 billion](#) to diversify supply chains away from China.

But the actual rules of TPP *prevent it* from addressing the China problem in any meaningful way. Below are four changes to the agreement that would change that. To be clear, there is a [much deeper problem](#) with the way these agreements are structured to produce returns to capital, with little regard for other stakeholders. However, for the narrow purpose of using TPP to address the corrosive effects of state capitalism, these changes are the minimum necessary to deliver on the goal.

The changes are:

- Tighten supply chain rules to make sure China is not a *de facto* beneficiary;
- Strengthen the rules against anticompetitive behavior, whether by governments or private actors;
- Strengthen the sustainability rules to mitigate the incentives to suppress labor and environmental rules;
- Deploy the data flow provisions to protect against having all the data end up in the hands of the CCP.

### 1. Tighten the supply chain rules so that the PRC is no longer a *de facto* beneficiary.

TPP was, and is, perceived as a way of creating a bloc to counter the economic dominance of the CCP. But the TPP [rules that govern supply chains](#) mean that most of the content for industrial goods can come from China itself. That's what the [auto rules of origin fight](#) was about when TPP was debated during the Obama Administration: more than half the content of a car trading under TPP can come from China.

The rules for all the other industrial products are even worse. In some cases only 30% of the content has to come from the TPP countries (including [medical equipment!](#)) The [agricultural](#)



[sector would never allow such an absurd result](#): imagine asking an American farmer to support a TPP that allowed more than half of a bushel of soybeans to be Chinese.

TPP includes Mexico, Canada, Japan, Malaysia, and Vietnam. Surely with that membership we can source more than 50% of what we need within the TPP region itself. And for those products where we can't do it today, we can do it over time, with phased in content requirements. That's how you incentivize a shift in production from dependence on the CCP to the pooled risk with the TPP parties themselves.

The usual suspects will complain about higher prices, just as they've done [with the \(alleged\) strengthening of the auto rules](#) under the new NAFTA. That's always been a hyperbolic claim: but whether that's true or not (any increased costs [might be absorbed by the producer](#), rather than passed on to consumers) is irrelevant if the goal is to reduce our dependence on the CCP and create a true trading bloc. As we discussed [here](#), the (flawed) efficiency goals pushed by economists are in tension with the foreign policy goals of these agreements.

As a result, if we want to reduce our dependence on the CCP and create a true trading bloc among TPP nations, then we're going to have to be prepared to absorb higher costs, whether they're borne by the producer or the consumer. China put us over a barrel with massive subsidies that made everything cheap for us to consume. As COVID-19 is teaching us in a horrifying way, [we've paid a high price for those cheap goods](#).

If we aren't prepared to absorb higher costs, then we're not going to move away from supply chain fragility. It's that simple.

Let's remember that [moving supply chains to Vietnam](#) was supposed to be one of the virtues of TPP. But the rules don't match the rhetoric. Ironically, it's the Section 301 duties that are driving that result.

Senator Bob Casey is working on a proposal to limit the amount of content from third parties that can come from non-market economies. If we're interested in promoting market principles in the global economy – fair competition – then limiting the ability of non-market economies to free ride off market-oriented agreements signed by others is a good place to start.

## 2. Strengthen the Rules Against Anticompetitive Behavior

It is fashionable to portray the problem with Chinese state capitalism as one of unfair competition by state-owned enterprises. This, for example, is the focus of the push to [revise rules at the WTO](#) to address anticompetitive Chinese behavior.

TPP was marketed in part on the notion that it set out rules that [would deal with this problem](#). And the [substance of many of the TPP state owned enterprise rules](#) is fine. They attempt to deal with forms of subsidies that are common in China but less so elsewhere, like chronic use of debt-for-equity swaps to bail out zombie companies.



But these rules are no substitute for real rules to address anticompetitive behavior. By focusing on SOEs, we are forced to try to define them. Yet the threshold for what qualifies as a SOE in TPP is high, and easily dodged. Especially by a centralized government like China, [which can treat SOE and non-SOE companies interchangeably if it wishes](#). The [largest aluminum company](#) in the world, and a beneficiary of tremendous government largesse, was private, until an accounting scandal turned into an existential threat – and the government bailed it out. [Huawei is also not necessarily an SOE](#). We shouldn't waste our time debating it, because it doesn't really matter.

Moreover, Chinese industrial policy is full of mergers, whether horizontal or vertical. Not long after the September 2019 oil shock, the PRC decided to create a super-SOE [to address its domestic energy supplies](#). This follows other mergers in rail and shipping.

If we really want to deal with the threat of anticompetitive behavior, then we need a proper [competition chapter](#), not the ode to concentration reflected in the current version. There's a basis for including rules on anticompetitive behavior in our global trading regime, going [all the way back to 1948](#). Those rules required each signatory to take appropriate measure to

to prevent, on the part of private or public commercial enterprises, business practices affecting international trade which restrain competition, limit access to markets, or foster monopolistic control, whenever such practices have harmful effects on the expansion of production or trade . . . .

Now that's a rule that gets at the heart of CCP state capitalism. Public or private, the point is to address the problem of restraining competition (what China does internally), limiting access to markets (also what China does internally), or fostering monopolistic control (the effect of China's rampant subsidies on foreign companies trying to survive under market conditions).

### **3. Strengthen the Sustainability Rules**

It's ironic that Communist countries have terrible labor regimes, but a one-party state that believes it's the ultimate union doesn't want real, independent unions. Vietnam is, of course, a one-party Communist state, and the Obama Administration crafted a set of labor rules designed to address the lack of independent unions there. Lack of such unions creates a false comparative advantage, where the suppression of rights – and wages – lowers the cost of producing the good. This is part of the reason there has been so much offshoring to China.

Labor rights suppression is also a problem with Mexico, and the impetus for a new enforcement regime crafted by Senators Brown and Wyden and negotiated into the new NAFTA by Speaker Pelosi. As Japan recruits new TPP partners with appalling labor practices, this model must be folded into TPP with respect to any country that suppresses labor rights, which distorts markets and creates beggar-thy-neighbor cost advantages. For example, the Trump Administration [sanctioned Thailand](#), one of Japan's TPP recruits, for its inadequate labor protections.



But back to the PRC. We've seen what happens when we do a deal with the PRC that doesn't build in incentives down the road for ongoing compliance. We're now forced to try to renegotiate WTO rules that the PRC has honored in the breach – and of course the PRC is rejecting those reform efforts. (In this context, calls to have China join the WTO Government Procurement Agreement are baffling – if past is prologue, China will use the rules to access everyone else's procurement market, while denying them access to the Chinese market.)

If we want to set the rules of the road on labor – and signal to the PRC what we expect of it -- the labor rules should be structured so that compliance with them is a prerequisite of receiving any of the agreement's benefits. TPP has consistency plans for countries with sub-par labor regimes, but [the lack of confidence in enforcement left many in the labor movement cold](#).

The combination of withholding benefits until the labor rules are in place, a Brown/Wyden rapid response enforcement mechanism, and strong rules of origin starts to look like a TPP that deals with the PRC.

But just as companies arbitrage labor rules, they arbitrage environmental rules. That is another false comparative advantage the PRC has created to lure investment to its shores – and away from countries with environmental standards. TPP has a chapter on environment, with a [mixed bag of improvements and underachievements](#).

If the goal is to write the rules of the road for the region, then these rules have to be shored up. They must deal more comprehensively with industrial pollution. One way is, perhaps, to build on the efforts in the new NAFTA by making multilateral environmental agreements such as the [Stockholm Convention](#) enforceable. And not only do the rules on prohibiting imports of illegally harvested goods need to be rock solid and truly enforceable – [China is a huge consumer of prohibited substances](#) such as rhino horn – but [Singapore's ports are a notorious transit point](#) for illegal take and trade.

Tackling these issues in a comprehensive and serious way would start to make TPP live up to the hype of creating “rules of the road” that reflect the values we seek to promote.

#### **4. Make Sure Data Flows Don't Mean Data Flows to the CCP**

The globalization model of the last 30 year has focused on liberalizing capital flows. That's how all those supply chains ended up in the PRC: business was seduced by the large Chinese market, cheap Chinese labor, and weak Chinese environmental rules.

The discussions around digital trade have followed the same line of thinking, without pausing to consider where the data might end up. In 2019, we questioned whether this unfettered liberalization [would produce the same results with digital supremacy that we saw with manufacturing supremacy](#), *i.e.*, rather than preserving an American advantage, unfettered liberalization dissipates it.



Put that in the context of data, and we must ask ourselves whether data liberalization – which means no restrictions on cross-border data flows, and restrictions on requiring the data to be stored in your own territory -- will mean that, just as our supply chains have ended up in the hands of the CCP, so will our data end up in the CCP. With the execution of the CCP's Social Credit System and facial recognition, we could be facing a [real life, global Big Brother](#).

The solution is to make sure the rules are implemented to prevent data from ending up in the PRC. TPP provides that [each Party can't require the data to be stored in its own territory](#) as a condition of doing business there. But it doesn't mean each Party can't require that the data be stored somewhere other than the PRC, or any other authoritarian power likely to misuse it. (The same rules are in the new NAFTA – a good place to start to execute this policy.)

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What is set out here is a discrete list of changes that would address the ways in which TPP, as currently drafted, aggravates the China problem and fails to establish appropriate rules of the road. By thwarting the CCP's ability to free ride off the agreement, we begin to forge a true trading bloc. By improving the competition, labor, and environmental rules, we craft rules of the road that signal our values and set expectations for Chinese behavior.

TPP parties have already availed themselves of the U.S. withdrawal to suspend the investor-dispute settlement regime (also pared back in the new NAFTA) and excessive pharmaceutical rules (also pared back in the new NAFTA). The suspended rules should remain suspended.

But there is a wholesale reevaluation of what the prevailing rules of globalization have meant for national security, including the economic welfare of democracies. This reevaluation is coinciding with a pre-COVID revolt against the ISDS and Big Pharma rules in these agreements. These rules have [favored capital over labor](#).

A [closer look](#) at some of the chapters that tend to fly under the radar exposes the scope of the problem. Whether it's the inclusion of the consumer welfare standard in the competition chapter, the cost-benefit analysis in the regulatory chapter, or the convoluted prohibition on corporate social responsibility in the investment chapter, these agreements have been subject to [outsized influence by multinational – stateless -- corporations](#), with comparatively little influence by any other stakeholders. American agreements shaped by their interests cannot be presumed to serve American interests.

Still, for those Americans who believe our foreign policy and security interests are best pursued by rejoining TPP, we must, as a matter of basic due diligence, make sure the agreement's rules actually serve that purpose.

Otherwise, it's just another deal that gets marketed as shoring up our national security -- while [doing the opposite](#).