

Global Value Chains and Domestic Politics Response to Trade: China, Japan, and the United States Compared

Hiroki Takeuchi (htakeuch@smu.edu)

Southern Methodist University (SMU)

ABSTRACT

During the 1990s, the nature of globalization began to change. Fragmentation of manufacturing led to the development of global value chains (GVCs) by multinational corporations, and it has become common practice for different stages of manufacturing production to be located in different countries. GVCs based intra-industry trade requires a different kind of rule-making for international trade, and it has changed the political economy of domestic response to international trade agreements. Domestic politics of foreign economic policy differs depending on the state's domestic political and economic institutions as well as the nature of the international economic agreement. Interestingly, the free trade agreements for GVCs based trade such as the Trans-Pacific Partnership—now the Comprehensive and Progressive Agreement for Trans-Pacific Partnership—tend to be intrusive, which require the signatories to commit to politically sensitive domestic economic reforms—such as the state-owned enterprise reform in China. This paper explores how the spread of GVCs has changed political economy of domestic response to international trade. Its scope is limited to an analysis of China, Japan, and the United States, as lessons from these three countries could translate to other countries.

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When Donald Trump bashed the North American Free Trade Agreement (NAFTA) as a candidate for the Republican nomination before the 2016 United States presidential election, auto industry workers in Michigan gave him enthusiastic cheers. But Edward Porter (2016), a reporter for the *New York Times*, suggests that the autoworkers picked the wrong target to blame for their economic difficulties in the face of global competition. Actually, Porter argues, NAFTA has saved a good number of high-skilled jobs in the U.S. auto industry, because without NAFTA the assembly lines in foreign countries or other regions of the United States (like the American South) might have shifted their parts supplies away from Michigan. Indeed, auto producers, like other manufacturers, are procuring parts produced beyond national borders.

During the 1990s, the nature of globalization began to change. Since then, the global value chains (GVCs) of multinational corporations (MNCs) have spread all over the world, and it has become common practice for different stages of manufacturing production to be located in different countries (Baldwin 2016, Kiyota 2015).¹ Particularly in the Asia-Pacific region, over the last two decades the development of GVCs has brought a new international division of labor between developed and developing countries, which includes both authoritarian and democratic countries (Kimura 2013, Yeung 2016). Under this division of labor, components, parts, and intermediate goods are manufactured in several countries, assembled elsewhere, and then exported to global markets. Closely associated with the growth of GVCs is the growth of intra-industry

¹ The international division of labor among different production stages is also called “international production networks” or “global supply chains,” which I use interchangeably with “global value chains.”

trade, in which components and parts are traded across national borders when moving from one production stage to another, and protectionist policies would damage any domestic firm that use imports as inputs (Ravenhill 2009).

GVCs based intra-industry trade requires a different kind of rule-making for international trade, and it has changed the political economy of domestic response to international trade agreements. As more international economic interactions have become GVCs based trade, the focus on trade negotiations has shifted from national border measures such as tariffs into domestic regulations. Lowering tariffs would be sufficient to manage inter-industry trade, in which nations trade raw materials and final goods under the international division of labor among different industries. However, building complex and comprehensive rules is necessary to manage intra-industry trade where nations trade parts and intermediate goods within the same industry under the international division of labor among different production stages. Nations need to agree on the rules on “rules of origin,” customs administration, foreign direct investment (FDI), state-owned enterprises (SOEs) and government procurements, intellectual property rights, regulatory coherence, dispute settlement, and anti-corruption measures, to name a few.

For the nations that are involved in the global economy and benefit from international economic transactions, governments have a strong incentive to establish internationally adopted rules to manage GVCs based intra-industry trade. In the meantime, the World Trade Organization (WTO) has not functioned as a forum to discuss the new trade rules any more. As a result, nations—especially in the Asia-Pacific region—have shifted the focus on their trade policies from negotiations in the WTO to those in regional free trade agreements (FTAs) such as the Trans-Pacific Partnership (TPP)—now the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

Interestingly, the FTAs for GVCs based trade tend to be intrusive, which bring with them externally-imposed reform imperatives for the domestic political economy by requiring the signatories to be committed to politically sensitive domestic economic reforms—such as the SOE reform in China. In the dynamics of domestic politics, reformist leaders might have a strong incentive to use the intrusive FTAs as external pressure to advance structural reforms to achieve sustainable economic growth. Structural reforms undermine the vested interests of the collusive rent-seeking mechanism. Thus, the reformists who want to advance structural reforms often face the backlash from those who benefit from the vested interests. The intrusive FTAs for GVCs based trade will impose a yes-or-no answer on the governments regarding the politically sensitive issues that would undermine the vested interests, and hence will empower the reformists in domestic politics.

The effects of international trade on the domestic political economy will differ depending on each state's economic interests and domestic institutions. In this paper, I explore how the development of GVCs has changed the political economy of domestic response to international trade. First, the paper maps out the configuration of theories that explains the domestic political economy of trade. Second, it explains the economic and psychological incentives that impact strategic interactions in trade politics. Domestic stakeholders may behave differently as GVCs based trade has made it more difficult to protect domestic producers and workers with trade restrictions because the domestic producers that import intermediate goods for their production would be hit by higher tariffs. Finally, the paper conducts an empirical demonstration of domestic politics response to GVCs based trade. Its scope is limited to an analysis of China, Japan, and the United States, as lessons from the world's three largest economies could translate to other countries.

Global Value Chains and the Political Economy of International Trade

The argument for international trade based on comparative advantage is centuries old, but it is not outdated and still can explain benefits of GVCs based trade. Endowments of productive factors, and more broadly geography, create certain international relationships between buyers and sellers (Leamer 2007). Whereas economies have different endowments in capital, labor, land, and knowledge and skills, all countries—developed or developing—have a comparative advantage in producing some goods and services, and hence they all benefit from the international division of labor. In other words, comparative advantage promotes trade by giving each nation a strong economic incentive to overcome the transaction costs that geographic barriers bring (Eaton and Kortum 2002).

Explaining why nations trade, the Heckscher-Ohlin (H-O) theory takes the logic of comparative advantage a step further, pointing out that nations will export goods that require large inputs of their more abundant factors, and import goods that require inputs of more scarce factors. In the traditional inter-industry trade, developing countries that are abundant in unskilled labor (or land) should export labor-intensive manufactured goods such as textiles and clothing (or agricultural products), whereas developed countries that are abundant in (human) capital should specialize in more high-skilled intensive products and services (Krugman 1995; Rodrik 2007). Thus, in trade negotiations developing countries not only try to protect their own domestic markets but also demand access to developed countries' markets of the labor-intensive products.

GVCs based trade benefits both developed and developing countries. Applying the H-O theory, in the new intra-industry trade developing countries should concentrate on low-skilled intensive downstream production stages by assembling components and parts to produce final goods *regardless* of the goods they produce, whereas developed countries should concentrate on

high-skilled intensive upstream production stages by making components and parts to produce intermediate goods (Baldwin 2014). With this division of labor, much of international trade takes place *within* a company whereas parts are manufactured in developed countries that have a comparative advantage in high-skilled stages, assembled in developing countries that have a comparative advantage in low-skilled stages, and then exported to markets in developed countries where consumers have more purchasing power (Ruhl 2015).

In developing countries, GVCs based FDI further motivates them to turn to the global markets. It is easier to implement industrial policy for stage-level industrialization than to attract large integrated factories that require various skill levels of workers including high-skilled ones (Baldwin 2016, chap. 9). The government of a developing country can first attract foreign investment by building infrastructure for the industrial zone where agglomeration of assembly plants is created and then MNCs locate some of the parts suppliers in the industrial zone, which would create skilled jobs in the developing country.

Developed countries also benefit from GVCs based FDI and trade, although foreign based MNCs often become psychologically convenient targets of blame by populist politicians. For example, in January 2017, then President-elect Trump picked a fight with Toyota on Twitter accusing it of building a new plant in Guanajuato, Mexico (Rich 2017). He tweeted: “Toyota Motor said will build a new plant in Baja, Mexico, to build Corolla cars for U.S. NO WAY! Build plant in U.S. or pay big border tax” (grammatical errors uncorrected).² In reality, however, Toyota’s new assembly plant in Mexico would increase high-skilled parts-supplying jobs in the

² <https://twitter.com/realDonaldTrump/status/817071792711942145>, accessed May 19, 2019. Trump’s Twitter post was not accurate. Trump said that Toyota would build a new Corolla factory in Baja, but the company was planning to build a new plant in Guanajuato and it already had a factory in Baja. The new plant in Guanajuato would build Tacoma pick-up trucks, not Corollas. Perhaps most importantly, it would not replace any of Toyota’s 10 factories in the United States.

United States, since the NAFTA based GVCs connected the United States and Mexico and Mexican assembly plants would use American-made parts. In sum, just as Toyota's investment in Mexico would increase manufacturing jobs in *both* Mexico and the United States, so GVCs based FDI would make—not kill—jobs in developed countries.

Why Protectionism? The Domestic Political Economy of International Trade

If trade is economically beneficial, why then do governments restrict trade? The recent backlash to globalization suggests complex relations over costs, benefits, and compensation in trade politics. The logic of collective action suggests that organized groups would have more impact on policymaking than disorganized public opinion (Olson 1965). Thus, in trade politics organized producers would be more influential than disorganized consumers.

Table 1 draws the organized producers' interests, focusing on two competing models of trade policy preferences. On the one hand, the Stolper-Samuelson (S-S) theorem postulates that trade liberalization benefits the abundant factor of production while protectionism benefits the scarce factor of production (e.g., Rogowski 1989). Trade liberalization would increase the income of the relatively abundant factor by increasing its exports while decreasing the income of the relatively scarce factor by increasing import competition. On the other hand, the Ricardo-Viner (R-V) model suggests that interests in trade policy may be industry-specific (e.g., Milner 1988). Among the industries that benefit from international trade, while exporting industries benefit from open *foreign* markets, industries involved in GVCs based trade benefit from the open *home* market because trade liberalization would reduce production costs.

TABLE 1. *Summary of primary interests in trade*

		S-S theorem	
		<i>Relatively abundant factor of production</i>	<i>Relatively scarce factor of production</i>
R-V model	<i>Firms that export</i>	Trade liberalization for open foreign markets	Social welfare protection
	<i>Firms that compete with imports</i>	Trade protectionism to reduce competition	Trade protectionism and social welfare protection
	<i>Firms that use imports as inputs</i>	Trade liberalization for the open home market to reduce production costs	Social welfare protection

Source: Made by the author.

The growth of GVCs based international economic transactions brings two changes in trade politics. First, it empowers internationally competitive firms which use imports as inputs by giving them stronger incentives to lobby for trade liberalization. Unlike exporting industries which want open foreign markets, they want the home market to be open regardless they are exporters or not. In the trade politics literature, the new firm-centered approach explaining the divided interests between pro-globalization *firms* and anti-globalization groups (not necessarily firms) has replaced the traditional industry-centered approach focusing on the conflict of interests between internationally competitive *industries* and import competing ones (Kim and Osgood 2019).

Highlighting firm-level productivity differences within an industry, an economist Marc Melitz (2003) introduced a canonical model which makes its way into the political science literature looking empirically at lobbying by firms over trade policy. The Melitz model shows that trade liberalization will induce the most productive firms to export, less productive firms to produce goods for the domestic market, and the least productive firms to exit. Moreover, trade liberalization will further benefit more productive firms with the trade-induced intra-industry reallocations of market shares and profits for exporting firms. Thus, each firm will have an incentive to become more productive by differentiating themselves from other firms *within* the industry. Empirically, In Song Kim (2017) demonstrates that in the United States productive firms whose products are sufficiently differentiated tend to lobby for trade liberalization. Iain Osgood (2017) echoes to Kim by identifying that U.S. firms in net-importing industries tend to support free trade if their products are differentiated.

Second, if an economy is involved in and benefits from GVCs based trade, protectionism is not a good means to protect domestic producers and workers because it will hit the domestic firms that use imports. As a result, those whose income would suffer from trade (e.g., U.S. unskilled labor) would not necessarily demand trade protectionism but demand social welfare protection. Trade creates winners and losers. The state's leader may have some difficulty building support for trade, given that firms are the entities that realize the gains from trade. However, the losers' losses can be compensated with the winners' gains because in aggregate winners' gains always exceed losers' losses. Such a move is called Pareto improvement, which makes at least somebody better off without making anyone worse off. Some form of redistribution (social safety net, universal health care, education reform, and other welfare programs) may create Pareto improvement and help to build public support for trade in each state's domestic politics.

Almost four decades ago, John Ruggie (1982) introduced the argument of embedded liberalism, which suggested that after World War II policymakers in developed countries had increased social welfare expenditures to compensate potential losers of trade while advancing free trade, and hence that they had successfully built support for trade. Empirical studies have shown positive correlations between the government’s social welfare spending and the advancement of trade liberalization (e.g., Mayda et al. 2007; Scheve 2000; Scheve and Slaughter 2004). However, Jude Hays (2009) argues that the Anglo-American democracies have found it increasingly difficult to maintain the embedded liberal virtuous circle due to their majoritarian political systems and competitive—but not coordinating—economic systems while they need to adjust their social welfare systems to the new GVCs based global economy. Social welfare systems might not be adjusted if politically influential people find the adjustment too costly. For example, the survey experiment conducted by Sean Ehrlich and Eddie Hearn (2014) shows that in the United States knowledge of compensation is negatively associated with support for trade liberalization among high-income individuals, who are concerned with a tax hike when trade induces the need to increase the government’s social welfare expenditure. Thus, as Edward Alden (2017) summarizes, the United States has failed to adjust its economic and trade to growing global economic competition. Lawrence Katz, quoted in a *New York Times* article, said: “Just allowing the private market to automate without any support is a recipe for blaming immigrants and trade and other things, even when it’s the long impact of technology” (Miller 2016). In other words, those who have lost the social welfare safety net see immigrants and trade as the cause of their economic difficulties even though the main cause of their difficulties is not globalization but automation.³

³ For the argument that automation is the main cause of job losses and replacements in the United States and other developed countries, see Baldwin (2019) and Engler, et al. (2018).

Strategic Interactions in the Domestic Political Economy of Trade

GVCs based trade has changed behavior of domestic stakeholders in strategic interactions in trade politics. First, empowered pro-globalization firms are in the advantageous position to lobby for trade liberalization and FTAs. GVCs based intra-industry trade brings high levels of product differentiation, and Kim (2017) suggests that it makes the competitive firms easier to solve the collective action problem because a smaller number of firms are stakeholders in firm-level lobbying. Second, pro-globalization firms benefit from intrusive FTAs because they are productive and appreciate competitive market structures that the FTAs require the signatories to implement. Third, given the domestic dynamics, governments have found it easier to commit to trade liberalization because product differentiation makes issue linkage work better.⁴

In the meantime, import competing interests are structurally undermined by the dominance of lobbying by pro-globalization firms. Given the lack of effective producer-led opposition, populist opposition to trade—as witnessed in the recent American politics—has been rising to champion the anti-trade voice. In fact, in American political discourse Trump and other anti-trade populist politicians blame pro-globalization firms when criticizing trade and FTAs. For example, when commenting on NAFTA renegotiation, Senator Sherrod Brown, Democrat of Ohio, said: “Any trade proposal that makes multinational corporations nervous is a good sign that it’s moving in the right direction for workers” (Swanson 2017). However, in reality GVCs based trade has made it difficult for trade protectionism to protect domestic industries and workers, and hence those who lose from trade demand social welfare protection. If sufficient protection is not provided,

⁴ On issue linkage and how it helps the government to counteract domestic obstacles for trade liberalization, see Davis (2004).

they may take trade as a target of blame. Thus, in addition to an economic incentive people may have a psychological incentive to blame trade.

Blaming Foreigners: Psychological Logic of the Backlash to Globalization

It is often taken for granted that people usually attempt to further economic interests, as long as economic interests are involved, and then political leaders are expected to respond by maximizing the economic interests people seek. In fact, in liberal democracies elected officials can be held responsible for responding to people's economic preferences, at least to a certain extent, most typically through electoral institutions. However, domestic politics of international trade is not so straightforward. The answer to why governments take trade protectionism lies in the free riding problem.

Bruce Russett (1990, 20) suggests that politicians respond to popular demands using four strategies: "To prevent voters' dissatisfaction, officials can deliver what the voters want, persuade the voters that they are delivering what the voters want, persuade the voters not to want what the officials cannot or do not wish to deliver, or distract the voters' attention by creating or dealing with a new problem." The first two strategies are straightforward. Politicians will deliver what the voters want if they can. Even if they cannot deliver what the voters want, they will try to persuade the voters that they can deliver it. However, if they cannot pretend to deliver what the voters want, they will have a strong incentive to distract the voters' attention, so that the voters will not demand what they cannot or do not want to deliver. For example, during the electoral campaign Trump told workers that he would bring back unskilled jobs by restricting trade and immigration although the jobs lost will almost certainly never come back because automation ensures that manufacturing employment will continue to be a small percentage of the labor force.

Even though technology is a much bigger threat to unskilled jobs than trade or immigration, foreign countries or immigrants are more convenient scapegoats than machines or robots. Many politicians still believe in the mercantilist argument that exports are good because they increase jobs while imports are bad because they decrease jobs. For the most prominent instance, Trump has run on the idea that the United States loses when it runs trade deficits with other countries and that we impoverish ourselves when we enrich other countries. A large number of Americans support this idea as shown by a CBS poll in 2016 where more individuals believed that trade caused job losses than the opposite (Blinder 2019, 119–21).

One can see this support in places like Indiana where Trump won the election and the hearts of many voters including the three brothers—Brandon, Jeremy, and Troy—reported by a *New York Times* article (Gabriel 2017). The three brothers felt patriotism in listening to Trump’s promises to increase taxes on imports and to deport unauthorized immigrants, although protectionist trade policies would possibly jeopardize Troy’s factory floor supervisor job at Toyota’s Indiana plant because tariffs increase the production cost—and hence decrease the demand for vehicles—by raising the price of imported auto parts.⁵ Blaming foreigners or immigrants does not create jobs, but it is politically appealing to people’s nationalist sentiment. Thus, when Trump found it difficult to deliver what voters wanted (i.e., bringing back unskilled jobs), he took advantage of popular discontent with globalization to distract the voters’ attention from the real cause of their economic difficulties—automation of production and the loss of the social welfare safety net.

⁵ In fact, 40 percent of the Toyota Highlander SUV, one of the three models made at the Indiana plant, are imported. Protectionism would also affect Jeremy, a public school teacher having trouble making ends meet. The budget of the Indiana state that administrates public schools relies on corporate tax revenue, and Toyota is one of the largest corporate taxpayers. It used to be said that what is good for GM is good for America. Now it can be said that what is bad for Toyota is bad for Indiana.

Voters also find globalization to be a convenient scapegoat. Yotam Margalit (2012) finds that popular discontent with globalization has rested—at least some degree—on the social psychological effects such as the fear of foreign influence and the loss of sovereignty and national identity. Even though globalization is not a main cause of job losses, the perception that globalization is taking our jobs has proven to be politically potent in developed countries (e.g., Mayda and Rodrik 2005; O’Rourke and Sinnott 2002; Scheve and Slaughter 2001a, 2001b). Moreover, the survey experiment conducted by Michael Hiscox (2006) shows that respondents who are suggested that trade can lead to lower prices for consumers are not more likely to support trade than those who receive no suggestion. Furthermore, the survey experiment by Alberto Alesina and his coauthors (2019) find that the misperceptions regarding immigrants are not corrected even after respondents are given correct information. Human beings are psychologically more tangible target of blame than machines. Thus, those who are tired of what they deal with each day and want change—but misinformed about how to get it—will gain psychological satisfaction by blaming foreigners or immigrants, while they do not gain such satisfaction by blaming machines or robots. Therefore, the optimal outcome for voters is where they can free ride on the economic benefit that globalization will bring while gaining the psychological benefit of blaming globalization for loss of security and identity.

The Game-Theoretic Analysis Incorporating Psychological Logic

Considering the psychological payoff, domestic politics of international trade can be drawn as a game-theoretic concept, the Stag Hunt—also known as the assurance game—as depicted in Figure 1. In this game, two players, Leader and Public, have a choice of supporting or scapegoating trade. Assume that the the state will take pro-trade policy if and only if both Leader

and Public support trade, and that neither can gain the economic benefit that trade will bring (i.e., R_L for Leader and R_P for Public) unless pro-trade policy is adopted. Each player will gain an additional payoff by scapegoating trade (i.e., α for Leader and β for Public). Each player now faces a decision: you could gain from the psychological benefit by scapegoating trade, but to do so you must abandon the economic benefit that trade will bring. At the same time, even if you give up the psychological benefit, there is no guarantee that you can gain the economic benefit because it depends on whether the other player will also give up the psychological benefit.

FIGURE 1. *The trade liberalization Stag Hunt*

		Public	
		Support	Scapegoat
Leader	Support	R_L, R_P	$0, \beta$
	Scapegoat	$\alpha, 0$	α, β

Note that in this game “Public” does not mean the majority of public opinion but means a key domestic actor whose support is crucial for the government to take trade liberalization policy. We expect such an actor to gain a significant amount of economic benefits from trade, so that the economic benefit is larger than the psychological benefit. Thus, I assume that $R_L > \alpha > 0$ and $R_P > \beta > 0$.⁶ Hence, bashing trade will bring the psychological benefit but not as much as the

⁶ The assumption $R_L > \alpha > 0$ means that the political leader would gain a significant amount of economic benefits from trade bringing—such as, a good economy or pro-trade interest groups’ support.

economic benefit that trade will bring. Thus, in this game both Leader and Public are best off supporting trade and enjoying the economic benefit. The next best outcome is to secure the psychological benefit while giving up the economic benefit. The worst outcome for each player is to support trade while the other player bashes it, leaving the player unable to gain either benefit. Despite the clear superiority of mutual support for trade, an assurance dilemma arises. If each player, Leader and Public, expects that the other will seek the economic benefit, each is best off supporting trade. However, if each expects that the other will be tempted to scapegoat trade, thereby losing the economic benefit, the player will also bash trade and secure the psychological benefit. Lacking a dominant strategy, each can do no better than what one expects the other to do—creating two equilibria: (Support, Support) and (Scapegoat, Scapegoat).

If $R_L < \alpha$ or $R_P < \beta$, then (Scapegoat, Scapegoat) will be the unique equilibrium. Intuitively, this means that if the economic benefit from trade is so small or the psychological benefit from bashing is so large, then *both* Leader and Public will scapegoat trade. Note that for both to choose this strategy, it is sufficient for *either* player to have a low payoff from the economic benefit or a high payoff from the psychological benefit. This equilibrium implies: (1) from the leader's perspective, if failing to build sufficient support from pro-trade actors or fails to manage the anti-trade voice then s/he will not push trade liberalization but join the populist anti-trade voice; and (2) from the pro-trade actor's perspective, if the administration takes a clear stance against trade then they will find it optimal to join the leader's anti-trade voice.

The logic of the Stag Hunt game points to the importance of political leadership in the domestic politics of international trade. As long as voters are tempted to seek the psychological benefit of bashing trade and free ride on the economic benefit that trade brings, the domestic political debate on trade policy will not converge unless a political leader leads the policy debate

in the direction to trade liberalization by mobilizing pro-trade interest groups. If the political leader abandons the leadership role, the debate will drift and may end up with a suboptimal outcome for all players. Moreover, the logic of the Stag Hunt captures conditions in which domestic stakeholders may push the leader for a policy that public prefers—as one of these equilibria is an optimal outcome in the Stag Hunt. If they can send a credible signal of their unified preference for trade liberalization by solving the collective action problem, the political leader may respond accordingly. Finally, whether the leader leads or follows the public's preference, because not only economic payoffs but also psychological payoffs matter a great deal to public opinion and attitudes of key interest groups, the international rule-making of GVCs based trade should be accompanied with Pareto improving compensation in democratic countries. Otherwise, even those who economically benefit from trade may blame trade.

Empirical Demonstration

As Phillip Lipsy (2017) argues, the outcomes of international negotiation for institution building is significantly influenced, if not determined, by support and opposition of key actors in domestic politics of powerful states. The growth of GVCs based trade has changed the domestic political economy of each state's trade policymaking. While in the traditional inter-industry trade states follow a comparative advantage towards a specific industry, in the new GVCs based intra-industry trade states follow a comparative advantage towards a specific stage of production within an industry. While the S-S theorem's proposition that protectionism benefits the scarce factor of production still holds, winners and losers of trade predicted by the R-V model should be amended. Instead of focusing on whether a specific sector of the economy is exporting or import-competing, the updated R-V model should focus on whether a specific stage of production is exporting,

competing with imports, or using imports as inputs. More importantly, the increasing GVCs based trade will empower the voice from the *firms*—not industries—using imports as intermediate goods, which have a strong incentive to lobby for opening the home market and can easily solve the collective action problem.

Table 2 shows that the summary of how the response of the three largest economies (i.e., China, Japan, and the United States) to FTAs for GVCs based trade varies depending on their political regimes, capitalist systems, and key structural reforms. First, public opinion impacts democratic policymaking in Japan and the United States while it is not a significant factor in China's authoritarian policymaking. Regardless of the regime types, interest groups may influence policy outcomes. Second, under China's state capitalist system SOEs are politically dominant although they are economically inefficient compared with private companies. By contrast, Japan and the United States are classified into a market capitalist system but they are different from each other. Following the framework of varieties of capitalism provided by Peter Hall and David Soskice (2001), capital and labor share common interests more easily under Japan's coordinated market capitalism while they are more likely to be in conflict under the U.S. liberal market capitalism. Finally, whether each state can lead the international rule-making of GVCs based trade depends on how they wrestle with politically sensitive domestic economic reforms such as such as the SOE reform in China, the agricultural reform in Japan, and the social welfare reform in the United States.

TABLE 2. *Summary of domestic regimes*

	Political regime	Capitalist system	Domestic reform
<i>China</i>	Authoritarianism: interest groups matter but public opinion doesn't	State capitalism: SOEs economically inefficient but politically dominant	SOE reform
<i>Japan</i>	Democracy: both interest groups and public opinion matter	Coordinated market capitalism: capital and labor share common interests	Agricultural reform
<i>The United States</i>	Democracy: both interest groups and public opinion matter	Liberal market capitalism: capital and labor in conflict	Social welfare reform

Source: Made by the Author.

China

Although China has never been a member of the negotiation of TPP or CPTPP, whether China should be included has been a question discussed frequently. One official of the Office of the United States Trade Representative (USTR) once said: “China is actually very interested in joining the TPP. Thus, we should keep the possibility for China to join the TPP membership in the future.”⁷ More recently, Chinese Premier Li Keqiang told reporters at a press conference on May 28, 2020, that China was willing to consider joining the CPTPP, which could help President Xi Jinping implement his reform agenda transforming China’s economic structure (Lu 2019, 2020;

⁷ Author’s interview with a senior official of the Office of the USTR, Dallas, TX, February 11, 2014.

Wang 2020; Zhou and Gao 2020).⁸ Following Li's comments, Wendy Cutler (2020), who had been the chief negotiator of the TPP agreement in the Office of the USTR, argued that the United States should take China's interest in the CPTPP seriously because "[i]f China were to take the market-opening actions over time to match the positive attitude expressed by Li, this would be a welcome step for a beleaguered global trading system."

When examining China's response to the CPTPP, one should consider China as a "plural form." Specifically, the Chinese leadership is divided into reformist internationalists (*kokusai kyōchō kaikaku-ha*) and conservative hardliners (*taigai kyōkō hoshu-ha*) (Takeuchi 2019). Yūji Miyamoto (2013), former Japanese ambassador to China, suggests that the 2008 world economic crisis empowered hardliners in Chinese domestic politics. Since then, hardliners and internationalists have been in conflict over China's international relations. At the same time, reformists on domestic politics and internationalists on international relations are aligned while anti-reformist conservatives on domestic politics are aligned with nationalist hardliners on international relations. Both the reformist internationalists and the conservative hardliners agree that maintaining social stability is most important to achieve the utmost goal of regime resilience, but they have exactly opposite views on how to achieve this goal (Takeuchi 2020). On the one hand, reformist internationalists argue that China should commit to domestic economic reforms such as the SOE reform by joining international economic institutions like the CPTPP, so that it could benefit from interdependent relations with the global economy and achieve sustainable economic growth, which would bring social stability and enable one-party rule to be maintained. On the other hand, conservative hardliners argue that China should protect the collusive vested

⁸ "Premier Li Keqiang Meets the Press: Full Transcript of Questions and Answers." May 29, 2020. (http://english.www.gov.cn/premier/news/202005/29/content_WS5ed058d2c6d0b3f0e9498f21.html, accessed June 26, 2020).

interests under state capitalism to maintain one-party rule, that the CPTPP would directly undermine the rent seeking mechanism of the vested interests, and hence that China should project its power by adopting nationalist foreign policies even if they cause friction in international relations.

Deng Xiaoping, who introduced the market economy with the slogan “reform and open-up” (*gaige kaifang*) proclaimed that China should implement domestic economic reforms (Fewsmith 1994; Gewirtz 2017; Vogel 2011). However, the Tiananmen democratization movement in 1989 launched a series of effects that have stalled reform efforts since then (Minzner 2018; Shambaugh 2016). In the 1990s, the new President Jiang Zemin employed the cooptation strategy, encouraging former officials and former SOE managers to start businesses by using their political connections, and this strategy prevented the market economy from threatening China’s one-party rule (Chen and Dickson 2010; Tsai 2007). Many of the nominally private entrepreneurs are successful because of their political ties with the regime that was established during their previous professional experience as an SOE manager or as a government official (Chen and Dickson 2010). Not surprisingly, those who benefit from the state capitalist system do not demand democratization but support the current one-party rule, nor want to see the SOE reform that would diminish the benefit of the revolving door built between the Chinese Communist Party (CCP) and SOEs (Dickson 2016; Wright 2010).

These vested interests are also rooted in patron-client relationships between businesses and local bureaucrats that manage SOEs, who can attain political achievements under China’s personnel management mechanism called the cadre evaluation system (Chen 2018). Many firms, which have found their own bureaucratic patrons, compete in a “race to the bottom” for predatory pricing instead of raising their productivity. Moreover, because of China’s less secured property

rights protection as other authoritarian countries, not only SOEs but also private companies have a strong incentive to form collusive relations with local bureaucrats (Hou 2019). Consequently, the cooptation strategy formed basis of the state capitalist system where the CCP champions the distribution of economic rents (Huang 2008).

Hu Jintao, who succeeded Jiang in 2002/2003, raised the slogan of “harmonious society” (*hexie shehui*) to curb the corruption rooted in the state capitalist system and to solve the economic inequality that had rapidly expanded in the Chinese economy during the 1990s. However, Hu was never able to consolidate his power base and failed to undermine the rent-seeking mechanism, and as a result economic inequality expanded during his ten-year tenure between 2002 and 2012 (Kokubun 2017). To shrink the economic inequality, it was inevitable that the vested interest structure be curbed and structural reforms such as the SOE reform be implemented, but Hu faced desperate resistance and the backlash from conservative hardliners and as a result Hu’s reform attempt floundered (Miyamoto 2015, 60–88). Although Barry Naughton (2018, 122–3) evaluates that reform slowed down during the Hu administration, in reality the administration failed to advance reform because Hu did not have a power basis to implement it.

When coming to office in 2012/2013, Xi Jinping had observed that China had maintained rapid economic growth since 1978 primarily because of private firms (Lardy 2014). Thus, the early years of Xi’s presidency began with hopes of market reform. However, the Xi administration has since expanded the state’s role in the economy and deviated from the reform that would threaten the dominance of SOEs (Economy 2018, chapters 4–5; Leutert 2016). As a result, from 2010 to 2017 the total number of SOEs increased from 120,000 to 170,000 (Magnus 2018, 67). Financial backing from the government allows SOEs to over-invest, and as a result they have excessive productive capacities (Shi 2015). China’s outbound investment is dominated by SOEs,

which take advantage of better access to credit and monopolistic power in the domestic market—although they find it difficult to compete globally (Li and Zeng 2019). Overall, the productivity of SOEs is lower than that of private firms but Xi seems to give a priority to political control over economic efficiency. In fact, Nicholas Lardy (2014, 2019), who contended in 2014 that markets had driven China’s economic growth, now argues that resurgent state dominance has diminished the vital role of the market and private firms in the Chinese economy.

In recent years, China has attempted to build its influence in developing countries through different initiatives. One of them is the Belt and Road Initiative (BRI). China seeks to connect over 60 different countries through the creation of ports, railroads, highways, and energy infrastructure (Economy 2018, 190–6). Min Ye (2020) dismisses the perception that the BRI is a cohesive strategy by Xi, and instead argues that in the actual implementation each actor of Chinese bureaucracies and key interest groups self-interprets and reinterprets the central strategy to seek their own interests. Infrastructure projects invested under the BRI’s framework will create demands for the Chinese manufacturers and construction companies that have excessive productive capacities. The Chinese state capitalist system has allowed many unproductive companies to survive thanks to political connections under the government’s cooptation strategy.

China has also forayed into trade liberalization through the Regional Comprehensive Economic Partnership (RCEP). The RCEP is less ambitious than the CPTPP. Lack of the SOE reform requirement in the agreement will induce less incentive for FDI and GVCs based trade. Any foreign company wishing to do business in China will need to compete against Chinese companies that receive vast amounts of subsidies (Economy 2018, 211). Although the RCEP is not a revolutionary agreement, it is still important to analyze it in terms of China’s strategy to increase its influence in the region. As Xi gives a priority to political control over economic

efficiency, China does not commit to key domestic economic reforms and hence finds it difficult to lead the international rule-making of GVCs based trade.

Domestic politics does not extend to public opinion but elite politics is dominant in China's authoritarian decision making process. Thus, I analyze the CCP's elite politics to understand China's domestic response to GVCs based trade. Trump's trade war seems to have emboldened the conservative hardliners. With China and the United States both turning to nationalism, Japan—the third largest economy following the United States and China—is expected to be a leader on the international trade order.

Japan

The TPP was expected to play an important role as a rule maker in further developing the GVCs in the Asia-Pacific region. Although the U.S. withdrawal prevented the TPP from taking effect immediately, its agreed rules would be an important model for any forthcoming FTAs. That is why Japan took the initiative to conclude the CPTPP (or called the TPP 11), which is the same set of rules agreed upon by the original 12 signatories but not requiring the U.S. participation. Moreover, Japan and the European Union referred to the TPP's agreed rules in order to craft the Japan-EU Economic Partnership Agreement in July 2017. The NAFTA renegotiation among Canada, Mexico, and the United States also used the TPP's agreed rules as a benchmark to conclude the United States–Mexico–Canada Agreement (USMCA), even though the Trump administration criticized the TPP and praised the UCMCA.

Of course, there was much opposition to trade in Japan. To promote the TPP (later CPTPP) in its domestic politics, the Japanese government strategically centralized policy authority within a smaller portion of the cabinet, which created the unified interest in trade liberalization when

entering into international negotiations (Davis 2019). Additionally, although farmers should demand protectionism according to the S-S theorem, Japan's agricultural lobby was weakened due to the electoral and administrative reforms since 1994 as well as economic and demographic changes of the last few decades (Solís 2017, 157–64). Thus, when the Liberal Democratic Party's (LDP) Shinzō Abe administration decided to join the TPP negotiation in 2013, the agricultural lobby did not have a party firmly in support behind them since the Democratic Party of Japan (DPJ), which had been in office from 2009 to 2012, had already staked out a pro-trade position expressing Japan's interest in joining the TPP negotiation. The LDP administration has since been able to control trade policy because the agricultural sector did not support the DPJ any more.

Domestic politics of international trade tells us that public opinion does not simply respond to economic interests. Megumi Naoi and Ikuo Kume (2011) conduct a survey experiment in Japan to find why a highly developed nation has the consumers that support trade protectionism. They test the following two hypotheses: (1) sympathy, where consumers believe that farmers work hard for low pay; and (2) projection, where those with job insecurity project their feelings onto those in the agricultural sector. They find that those with high levels of job insecurity are more likely to support trade protectionism for agricultural products, even though they will economically lose from the protectionism as consumers due to higher costs. Income has little bearing on whether a person will support trade liberalization or protectionism for the agricultural sector. This finding suggests that public may support protectionism based on psychological factors rather than economic factors. Thus, Japanese public support for trade may be based on the social welfare safety net that its coordinated market capitalism provides.

Japan announced its participation in the TPP negotiation in March 2013 as the last one of the 12 negotiating countries. Among the 12 negotiating countries, Japan was one of the biggest

beneficiaries of the TPP because of its engagement in GVCs based intra-industry trade. Interestingly, when a Japanese manufacturing company opened a new affiliate in East Asia, that company's employment in Japan would *increase* because a certain stage of new production in a foreign affiliate would *create* another stage of new production in Japan (Ando and Kimura 2014). In other words, outsourcing of Japanese companies would not cause the closure of production facilities but their expansion (Kiyota and Maruyama 2017). As a result, when the TPP negotiation was taking place without Japan's participation, public opinion polls in Japan consistently supported the TPP (Kuno 2012). The Japanese economy was already integrated into the GVCs with other East Asian countries, and hence Japanese producers—both large corporations and medium-to-small enterprises—believed in positive effects of the advancement of such GVCs (Kimura 2013). Between 2002 and 2008, the Japanese economy saw constant expansion because of what Ulrike Schaeede calls “choose and focus” strategies, whereby companies focused on core areas and spin off unrelated businesses (Schaeede 2008). Since then, Japanese firms have concentrated on high-value-added, upstream stages of the GVCs based international division of labor in the Asia-Pacific region (Schaeede 2020). Thus, according to a 2018 survey experiment by Adam Liff and Kenneth McElwain (2020), there is strong support for free trade among Japanese public. In sum, the spread of GVCs has provided the basis of public support for the international rule-making of trade, like the CPTPP, and enabled Japan to play the leadership role in the international economic order.

Unlike the United States, Japanese labor unions are not major opponents to FTAs. For example, the Japan Trade Union Confederation (JTUC), or commonly known as Rengo (meaning “coalition”), which is a trade union national center with the membership of seven million, issued statements *supporting* the CPTPP both November 2017 when its international agreement was

made and June 2018 when the Japanese Diet ratified the CPTPP.⁹ In both statements, the Rengo evaluated that the CPTPP would create domestic jobs by promoting GVCs based trade in the Asia-Pacific region while appreciating the provision on labor standards stipulated in the CPTPP. Most Japanese labor unions are not industry-wide unions but enterprise unions, which means that the typical Japanese labor union collects the employees of a single firm, not employees of different firms in the same industry. Thus, for example, the Toyota employees in Japan belong to the Federation of All Toyota Workers' Unions while the General Motors employees in the United States belong to the United Auto Workers. Labor relations are more cordial under the enterprise union system. The enterprise union system gives both the employer and the union less incentive to bluff, makes both sides' commitments more credible in the negotiation, and enables both sides to reach an agreement more easily than the industry-wide union system (Flath 2014, 363–70). Thus, under the enterprise union system capital and labor can be more easily at the same side to seek the industry's common interests from trade.

Of course, the Abe administration had to listen to the anti-trade voice. It named five products (rice, wheat, meat, dairy products, and sugar) as the “sanctuary” (*seiiki*), and positioned them as pillars of Japanese protection against pressures to open the market. All of these were agricultural products, and hence the TPP negotiation seemed to be over opening the Japanese agricultural market. However, Patricia Maclachlan and Kay Shimizu (2016) argue that the Japanese motivation for agricultural reform was made by the *domestic* necessity for reform. Japanese agriculture was already in crisis, whether Japan would participate in the TPP or not, because of the aging farmer population. As Kazuhito Yamashita (2014a), an agricultural specialist

⁹ For the statement in 2017, see https://www.jtuc-rengo.or.jp/news/article_detail.php?id=933. For the statement in 2018, see https://www.jtuc-rengo.or.jp/news/article_detail.php?id=987.

in Japan, notes: Japanese agricultural production decreased from 11.7 trillion yen in 1984 (the highest ever) to 8.2 trillion yen in 2011; 60 percent of farmers were older than 65 years of age in 2010 (increased from 10 percent in 1960); and 400,000 hectares of farmlands were abandoned by 2010.

The biggest opponent to the TPP was the Japan Agricultural Cooperatives (JA: *Nōkyō*) (Yamashita 2014b, 147–60). The JA was notorious for its collusive relationship with the LDP. It functioned as an electoral machine of the LDP by systematically gathering the vote behind individual politicians and recruiting new members for both the party and personal support organizations of individual politicians called *kōenkai*, while cooperating with the LDP politicians who had collusive relations with the JA to defeat or weaken reformist efforts to adapt agriculture to the new situations of urbanization and globalization. And the bureaucracy (i.e., Ministry of Agriculture, Forestry, and Fisheries [MAFF]) maintained its strong influence by coordinating the relationship between the LDP politicians and the JA.

The high trade barriers for agricultural products do not protect agriculture but benefit the JA (Yamashita 2014b, chapter 3). The JA collects service charges when farmers sell agricultural products through the JA, and hence benefits from their high prices. Moreover, the JA is working for the “part-time farmers” (*kengyō nōka*) earning more from their non-agricultural jobs than from agriculture. Part-time farmers are strong in number but not helpful to reconstruct agriculture to be competitive in the global market (Yamashita 2015a). However, the part-time farmers’ strength in number gives the anti-reformist politicians strong incentives to listen to their voice for their votes. Thus, Abe’s commitment to JA reform was the key to whether he was committed to domestic economic reforms and whether the TPP negotiation would be successful (Yamashita 2015b).

Since the cabinet's Regulatory Reform Council (*Kisei Kaikaku Kaigi*) announced the "JA Reform Agenda" (*Nōkyō Kaikaku An*) in 2014, the JA reform moved forward with less opposition from anti-reformist politicians and bureaucracy than previous structural reforms such as the postal privatization during the Junichirō Koizumi administration. The JA reform would have greater direct impact on the results of elections than most of other structural reforms. However, it seemed much easier to reach agreements on the JA reform with the JA conceding to Abe's reform, which aimed to accelerate Japan's participation in the TPP. Yamashita (2015c) argues that the JA reform moved forward relatively smoothly because of a crack among the beneficiaries of the rent-seeking scheme—that is, the JA, anti-reformist politicians, and the MAFF bureaucracy. Because of urbanization, the Diet members from rural electoral districts had decreased. The decline of agriculture had reduced the political power of the MAFF. Thus the only actor who still benefited from the rent-seeking scheme was the JA.

Thanks to the political and administrative reforms in the 1990s, a Japanese prime minister has institutional conditions to implement his or her policy as a "strong prime minister" (*tsuyoi shushō*) (Machidori 2012). When Prime Minister Yasuhiro Nakasone tried to implement the privatization of public corporations in the 1980s, he had to do it without institutional tools to exercise his leadership. Abe implemented the JA reform using favorable institutional conditions to exercise his strong leadership—while he has much less charisma than the typical "strong prime ministers" such as Nakasone and Koizumi. Without the institutional conditions, the Japanese government might have withdrawn from the TPP when the United States withdrew from the TPP, accommodating the anti-reformist pressure from the MAFF. In that sense, Japan could take the initiative in rule-making of international trade because a Japanese leader could focus on reformist policies by overcoming the anti-reformist backlash from the beneficiaries of the vested interests.

The United States

In contrast to Japan, manufacturing in the United States is a comparatively small proportion of the entire economy, and the opposition to trade has been empowered by the frustration with expanded economic inequality. For example, Joseph Stiglitz (2014) once argued that the TPP would not promote employment but further threaten the safety net of the people whose lives had already been threatened by globalization, and hence that it would further expand economic inequality in the United States. However, economic inequality has expanded not because of trade or globalization per se, but because American domestic politics has failed to adjust economic and trade policies to the new reality of globalization, especially to increasing trade with developing countries (Alden 2017; Engler et al. 2018).

More than four decades ago, Stephen Magee (1978) showed that in the United States interests in trade was sector-specific and that capital and labor in the same sector took the same position—either support or oppose—to trade. However, once distinguishing skilled and unskilled workers, the S-S theorem can explain the division of interests between (human) capital and labor in developed countries regarding their increasing trade with developing countries. For example, it explains why unskilled workers support protectionism even when increasing trade would benefit their industries. When the United States approved China's entry into the WTO in 1999, labor unions representing auto workers (the UAW), lorry drivers (the Teamsters Union), and dockworkers (the International Longshore and Warehouse Union) were opposed (Friedman 2000). They were opposed despite the fact that increasing trade with China would benefit their industries. They feared that if workers' incomes dropped in import-competing industries it would depress labor income in *all* industries.

However, as discussed in this paper, GVCs based trade has made it increasingly difficult to protect domestic workers with protectionism. For example, the U.S. imposition of tariffs on auto parts under the Trump administration has hurt domestic auto producers that use imported parts even though the administration argued that tariffs would protect them. Car tariffs—presumably designed to protect U.S. autoworkers’ jobs—have raised production costs of car manufacturing in the United States. As a result, for example, in 2018 GM announced that it would close four plants in the United States and one in Canada, cutting 14,000 jobs—although GM denies that the Trump administration’s protectionist policy is the reason for the job cuts (Sandhu 2018).

Ironically, Trump’s trade war with China compelled foreign based MNCs in the United States to shift jobs to China (Ewing 2018). For example, Daimler and BMW—both German companies—are producing their luxury cars in the United States (Daimler in Alabama and BMW in South Carolina) and exporting them to China, meaning that they are affected by China’s retaliatory tariffs against the products imported from the United States.¹⁰ Tired of Trump’s trade war, BMW moved some production of the X3 sport utility vehicle—and may also move some production of its larger X5—from Spartanburg, South Carolina, to Shenyang, China to circumvent China’s new import tariffs.

There has been a lot of economics research regarding the impacts on prices in the United States due to Trump’s trade war tariffs. If the U.S. tariff does not decrease the world price, then the price should get fully passed through to the price paid by U.S. importers. The recent studies have reached the conclusion that the U.S. trade war tariffs have not lowered the world price but been passed through 100 percent to U.S. import prices, and hence U.S. consumers and firms that

¹⁰ In fact, BMW is the largest car exporter of the United States. The Spartanburg manufacturing plant in South Carolina has the highest production volume of the BMW’s plants in the *world*.

use imports as inputs have been paying the tariffs (Amiti, et al. 2019; Cavallo, et al. 2021; Fajgelbaum, et al. 2020).

Applying the S-S theorem to the United States which is a labor-scarce country compared with developing countries, unskilled labor benefits from protectionism and loses from trade with developing countries such as China and Mexico. The S-S theorem explains why the 1998 fast-track vote did not pass in the House because a good number of legislators, especially Democratic members, were concerned with the negative effects of trade on “workers who are less educated, who are unionized, and who are employed in import-competing industries” (Baldwin and Magee 2000, vii). The job market of manufacturing sectors in the United States has declined dramatically throughout the years due to new labor-saving technologies, which have negatively affected unskilled workers (Engler et al., 2018). The U.S. economy has slowly shifted away from the tradable sector, and labor-intensive jobs have moved from the United States toward developing countries (Spence 2011, 30–3). In short, globalization benefits the upper class but causes a decline in the middle to lower classes, especially unskilled workers, in the United States (Milonovic 2016, chapter 1).

Given that trade protectionism does not protect domestic producers and workers when much of trade has become GVCs based, it is important to compensate the losers of trade by establishing social welfare protection with significant income redistribution. Economic theory assumes that labor can move between different jobs with no cost. What this theory implies is that social welfare policies that lower the cost for labor to move from a declining sector to a growing sector—such as unemployment insurance and job training—would be essential to build support for trade (Scheve and Slaughter 2007). The cost of moving from one sector to another would be high if a worker loses basic health insurance coverage when changing jobs. Therefore, founding

a national health care system would help to enhance public support for trade by giving workers social welfare protection. Perhaps most importantly, education reform to improve basic skills in the workforce is key for workers in the United States to compete with those in developing countries (Engler, et al. 2018; Scheve and Slaughter 2019). During the second debate between the presidential candidates in the 2012 election, President Barack Obama argued for the importance of education reforms, stating that the United States would need skilled labor to compete in the global economy. If the productivity of better-paid U.S. workers is the same as that of less-paid developing countries' workers, U.S. workers would face downward pressure on their wages. Obama argued that the only sweeping solution to this problem is education reform to make U.S. workers more skilled and competitive. While trade protectionism neither builds the needed safety net nor make workers more productive, it makes domestic producers less competitive in GVCs based global economic competition. As a result, economic growth is constrained, making it more difficult to establish social welfare protection because declining growth lowers tax revenue.

Stiglitz (2014) insists that “agreements like the TPP have contributed in important ways to this inequality,” suggesting that FTAs per se are the main cause of economic inequality. I disagree but argue that the current unprecedented inequality in the United States has been brought out by the failure to upgrade the social welfare safety net to the new reality of global economic competition. In other words, the problem is not globalization itself but the skillset of the American people. The 133-page Peterson memo, titled *The United States in a Changing World Economy* (published in 1971), foresaw many of the coming challenges of trade (Alden 2017, 9–18). Peter George Peterson, Nixon’s economic advisor, understood that international trade would not be automatically good for all Americans all the time; instead, the United States would have to make itself remain competitive by investing in its infrastructure and its human capital. However, the

United States has failed to do so and has not supported its own workforce. The missteps have made it difficult for the United States to keep competitive in the face of global competition and allowed a populist backlash to globalization to emerge.

The S-S theorem explains why trade with developing countries has led to reduced wages for many unskilled workers in the United States. However, economic research shows that enhanced productivity because of automation has had a far bigger effect than import competition with or immigration from developing countries, pointing to the fact that U.S. manufacturers have increased their productivity through enhanced technologies and therefore need fewer workers. For example, although the U.S. steel industry lost 400,000 jobs (75 percent of its work force) from 1962–2005, its production did not decline (Collard-Wexler and De Loecker, 2015). Regardless of the economic reality, foreign countries—China or Mexico—are more psychologically appealing villains than machines or robots in the political context, because the impact of automation is less tangible and hence harder to understand.

Trump capitalized on the fear of globalization and ascended to the presidency by championing working-class opposition to trade and synonymizing them with American nationalism. Without rebuilding social welfare protection, Trump has pushed trade protectionism. Interestingly, it appears that the sympathy factor applies to the United States as well, given that many Americans rallied around the common worker and against “outsourcing.” As a result, the USMCA includes the provision that requires 40–45 percent of the value added in producing a vehicle to be from a factory that pays for labor at \$16 or more per hour. This provision makes the workability of the USMCA in flux because it is difficult to implement it, but it was politically appealing to send a pro-worker message. It appears that Americans are more sympathetic towards

the working class instead of firms even though Americans benefit from trade in the form of low prices (consumers) and GVCs (producers).

The H-O theory assumes that labor is mobile within borders, but not across borders. However, in the United States geographic mobility across state lines has been in decline lately, falling almost by half since the 1990s (Clark 2018; Kaplan and Schulhofer-Wohl 2017; Lowrey 2013). In fact, “Americans are less geographically mobile today than at any point since 1948” (Brooks 2016). If labor does not move from one region to another within the U.S. national border, the S-S theorem predicts that unskilled workers in the declining Rust Belt will lose from trade while those in the growing Sun Belt will benefit from trade. Currently, the discourse of U.S. trade politics is dominated by the sympathy towards the plight of the Rust Belt disregarding the prosperity of the Sun Belt. Thus, the support for trade protectionism has been rising in American public opinion and trade politics has become increasingly polarized.

When the backlash to globalization exacerbates economic conditions, both voters and politicians will be further inclined to conveniently place blame on trade and immigration. Thus, the vicious circle of unhealthy politics will continue. The United States has done little to support its workforce and adjust the social welfare safety net to automation and globalization. Without the safety net and the income redistribution system that would compensate losers with winners’ gains, anti-globalization populism has made the United States difficult to play a leadership role in the international economic order.

Conclusion

Over the last 30 years the nature of trade has changed, and over the last 10 years the political challenges have emerged for rule-making of GVCs based international trade. It is clear that

previous rules for trade created through the WTO (formerly the General Agreement on Tariffs and Trade) are no longer adequate. Instead, it is necessary to use FTAs for the new rule-making for the newly emerging GVCs based trade. As more international economic interactions have become GVCs based trade, the focus on trade negotiations has shifted from national border measures into domestic regulations. Nations need to agree on the *international* rules stipulating *domestic* regulations. The CPTPP is a major achievement in these areas, but without the participation of the United States the future of trade policymaking hangs in limbo. Japan and other middle power countries could be the future leaders of global trade, but they alone might not provide the economic incentive necessary to convince developing countries with large state sectors to begin a massive effort towards politically sensitive domestic economic reforms.

With the U.S. withdrawal from global rule-making of trade, China has a unique opportunity to show economic leadership. However, the CCP is focused on domestic stability for regime resilience and hence gives a priority to political control over economic efficiency. With President Xi in power, the SOE reform has been put on the backburner, and China has resisted trade liberalization and structural reforms opting instead to forge its own path for trade and investment.

Whether the United States comes back to the table is certainly one of the largest lingering questions, but Japan's ability to lead a global trade liberalization agenda and the motivations behind China's new initiatives both come with uncertainties. COVID-19 has now taken the central stage, freezing major trade developments and highlighting the necessity of strong social welfare protection. The world has a heavy burden to carry, and a holistic approach to trade will be one of the vital components to ensuring that the global economy gets back on track.

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