Global Value Chains and International Rule Making on Trade: From the World Trade Organization to Free Trade Agreements

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Upon his election in 2016, Donald Trump's campaign drew heavily on opposition to trade, outsourcing, and immigration, promoting the nationalist slogan of "America First." Taking aim at global trade, Trump pulled the United States out of the Trans-Pacific Partnership (TPP) agreement, and began raising tariffs on China which led to a trade war between the two states that has continued throughout his presidency. He also fought vigorously against the North American Free Trade Agreement (NAFTA), opting to negotiate the United States–Mexico–Canada Agreement (USMCA), which is decidedly more restrictive than the NAFTA.

Economists have long held that every state benefits from free trade. Yet, puzzlingly, every state currently takes at least some restrictions on trade. Why do governments restrict trade? The Stolper-Samuelson theorem postulates that protectionism benefits the scarce factor of production. In addition, the Ricardo-Viner model suggests that interests in trade may be industry-specific, where import-competing sectors of the economy want to protect the home market to reduce competition. Therefore, protectionist policies were created where such groups or industries could effectively organize.

However, during the 1990s the nature of globalization began to change. Fragmentation of manufacturing led to the development of global value chains (GVCs), which allowed corporations to locate different stages of production in different countries (Baldwin 2016a, 127–8). Under this division of labor, components and parts are manufactured in several states, assembled elsewhere, and then exported to global markets. Closely associated with the growth of GVCs is the growth of intra-industry trade, in which components and parts are traded across national borders when moving from one production stage to another. With the growth of GVCs based trade, protectionist policies would damage any corporation that use imports as inputs. How does the new globalization change the political economy of trade policy?

GVCs based intra-trade industry trade requires a different kind of rule-making for international trade. However, World Trade Organization (WTO) has become obsolete as a forum to discuss the rules to manage GVCs based trade. As a result, many nations have concluded free trade agreements (FTAs) for this rule-making. For GVCs based trade, such trade agreements must be comprehensive. Not only tariff reductions but also regulatory coherence, state-owned enterprise (SOE) reform, dispute settlements, and intellectual property protections are all important. This paper argues that domestic political and economic reforms as well as international new rule-making for GVCs based trade are promoted by the new globalization. Its scope is limited to an analysis of China, Japan, and the United States, as lessons from these three states could translate to other states. One of the important FTAs analyzed in this paper is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

The effects of trade liberalization on domestic politics will differ depending on the regime of the state and the agreement it enters into. There will likely be trends involving free trade's effect on producers and on consumers, but these are affected by the requirements in each trade agreement. Additionally, the Stolper-Samuelson theorem sheds some light on who in each state should oppose free trade. Trade creates winners and losers. In democracies, the state may have some difficulty convincing the public that trade is good, given that corporations and the state are the entities that realize the gains from trade. However, the losers' losses can be compensated with the winners' gains. Such a move is called Pareto improvement, which makes at least somebody (if not everybody) better off without making anyone worse off. Some form of redistribution (social safety net, universal basic income, universal health care, education reform, and other welfare programs) may create Pareto improvement and build public support for trade liberalization in each state's domestic politics.

History of Trade Policies

History of American Trade Policy

Modern U.S. trading begins in the 1950s, when presidential trade authority stabilized although it was frequently scrutinized by Congress (Irwin 2017, chap. 11). Each year Congress had to approve the President's trade powers or a list of changes that the President had made to U.S. trade policy. Another development was that the United States and other GATT (General Agreement on Tariffs and Trade) countries obtained a waiver allowing them to restrict agricultural imports. Notably, the Reciprocal Trade Agreement Act was likely not repealed by

Congress because the general public saw support of trade as a way to fight communist influence abroad. The 1960s saw the containerization (putting items in large containers) of trade, which resulted in much job losses although economic efficiency increased. Labor intensive industries were threatened by foreign competition; and hence, as jobs were lost and the United States began to run a trade deficit, calls for a return to protectionism rose (Ibid., 535–40).

In 1973, Congress created the fast track authority, which requires Congress to vote without amendments on any trade agreement negotiated by the President within 90 days. The following year, Congress passed the Trade Act of 1974, which allowed the President to negotiate tariff and non-tariff barriers, reduce import duties by up to 60%, and eliminate any import duties under 5% (Ibid., 551–2). In the late 1970s, a recession, along with a strong U.S. dollar, led to a large trade deficit with other countries like Japan, which caused permanent job losses in manufacturing (Ibid., 566–9). The 1980s ushered in a new change to employment: labor shifted to non-tradable goods like services. To prevent Congress from taking steps toward protectionism, President Ronald Reagan implemented various trade restrictions (Ibid., 571–4). After some diplomatic pressure, countries like Japan limited their exports to the United States; however, voluntary restraint agreements (VRAs) on steel did not work because states without VRAs began increasing their exports to the United States (Ibid., 576–9).

While the 1980s saw much import restriction and trade tension, the 1990s saw the United States open itself to free trade (Ibid., 625–44). After Canada and the United States signed a trade agreement and the Soviet Union disbanded, Mexico decided to create a trade agreement with the United States. The President's fast track authority was slowly renewed due to opposition from labor unions, who opposed any trade with Mexico on the grounds that a trade agreement would cause American firms to move jobs to Mexico. Eventually, a deal between Canada, Mexico, and the United States was successfully negotiated: NAFTA. In the United States, labor unions campaigned against NAFTA, which made it appear that the deal was dead. However, the Bill Clinton administration miraculously revived and successfully passed the deal by running an intense counter-campaign that included debating Ross Perot in a televised debate. With NAFTA's passage, a new kind of rule-making of trade was ushered in.

China's Economic Rise

Even though China is not the world's leading economic power yet, it has grown considerably over the last 40 years to arrive at its current state of development. Deng Xiaoping was vital to this development. Yukon Huang (2017, chap. 3) argues that, in contrast to China's focus on regional balance and equity, Deng's reforms led China's economy to become uniquely unbalanced. His reforms had three parts: (1) liberalize agriculture with a "household responsibility system"; (2) industrialize through township-and-village enterprises (TVEs); and (3) create special economic zones (SEZs). Farmers were still required to provide a minimum amount of harvest to the government, but they could sell any excess crop that they produced. The TVEs and SEZs created incentives for local governments to partner with the private sector to increase industrialization, which mainly occurred along the coast. Huang argues that part of the strength of these partnerships was that the state was able to receive bank loans that were not required to be paid back in full. Slowly, political ideology's role in guiding policy decreased and the role of market forces increased. Moreover, the SEZs created a form of "market socialism" in which SOEs acted in accordance with those market forces (Bramall 2009, 330).

By the 1990s, Deng had opened the economy to more foreign investment, although SOEs comprised most of the economy's enterprises (Ibid., 353–4). However, beginning in 1996, China began an unprecedented transition towards capitalism. A gradual privatization of SOEs began, which led to China's accession to the WTO in 2001, resulting in even more intense privatization—an effect of increased international competition (Ibid., 474–6). The SOEs were subject to the market, as they had to constrain their budgets or face bankruptcy or failure. However, in 2008 the Chinese government's stimulus package empowered SOEs to relax budget constraints. Slow economic growth and a slow-down in liberalization led to the return of excessive investment in SOEs, marring much of the progress towards a free market that had been made in previous decades (Magnus 2018, 45).

GATT and WTO

The Great Depression and World War II were part of the final era of worldwide protectionism. After the war ended in 1945, 23 countries gathered to create basic rules of trade with the intention of preventing protectionist policies and retaliatory measures (Bown, 2009, 11). These basic rules were created within the GATT. At its heart is the principle of reciprocity and the non-discrimination principles of most-favored nation treatment and national treatment, the latter of which disadvantaged liberal economies (Ibid., 15). Under the national treatment principle, foreign companies are to be treated the same as domestic companies within each state. However, each individual state has different rules governing their markets with some states being more restrictive than others. Therefore, companies from more restrictive states may dominate international markets since they benefit from international trade more than companies from more open states (Prestowitz, Tonelson, and Jerome 1991). Problems like these were important reasons why GATT negotiations in the Uruguay Round began to fall apart.

Surprisingly, some negotiations did break through during the round, and a new trade organization, the WTO, was created. One important new addition to global trade rules in the WTO was the new dispute settlement system. The GATT's dispute settlement mechanisms allowed for states to "frustrate the system both at the beginning and at the end," rendering those mechanisms inefficient (Dreyfuss and Lowenfield 1997, 276–7). Another improvement that the WTO made to the GATT regarded intellectual property. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) assured a basic level of property rights protection among all states. Because the WTO provided a mechanism to solve disputes, intellectual property rights violations could now be disputed under the organization. Even though only some of the problems with international trade were solved during the Uruguay Round, important strides were made. However, the next round, the Doha Round, would be filled with strife.

Collapse of the Doha Round

Between the Uruguay Round and the Doha Round, over 70 countries joined the WTO, shifting much of the power and trade dominance away from Canada, the European Union, Japan, and the United States (Baldwin 2016b, 106–9). The WTO essentially expanded the number of "veto-players" from four to over one hundred. Instead of forming coalitions to gain access to foreign markets, developing nations formed coalitions that prevented access to politically sensitive markets. However, in other areas of their economies unilateral tariff-cutting was common. Exporters in developed countries had less of an incentive to push for trade, which made WTO talks less attractive to those countries. Even though trade was expanding, the Doha Round was failing.

For what it was created to accomplish, the WTO has been largely successful (Ibid., 111–2). Its dispute settlement system is effective at coercing states to follow rulings, and it has "near-universal norms" for international trade. No major changes have come to the organization, though, since 1994. Trade liberalization over the last two decades has largely occurred outside of the WTO, with examples including unilateral tariff reductions and the rise of bilateral investment treaties. As a result, the WTO has been relegated to a symbol of trade liberalization, rather than its driver.

Emergence of Mega-FTAs

GATT/WTO's principle of reciprocity changed the domestic political landscape in the global North. Exporters were incentivized to lobby for the removal of domestic tariffs, as doing so would lead to other countries lowering their tariffs (Baldwin 2016a, 70). However, it was not until the information revolution of the 1990s that developing nations lowered their tariffs (Ibid., 75). Because of the ease of exchanging ideas, firms began shipping their expertise overseas. GVCs began to rise, leading developing countries to come to the realization that "protectionism has become destructionism" (Ibid., 101). The WTO's apparent uselessness to expand trade liberalization necessitated the use of FTAs to further the economic interests of different states.

Several realizations should be made from this shift toward GVCs. The globalization of the twentieth century emphasized inter-industry trade among nations (trade of final goods) and caused states to develop a comparative advantage to a specific industry. However, it has since been replaced with the new globalization, characterized by intra-industry trade where states develop a comparative advantage towards a specific stage of production within an industry (Ibid., chap. 4). During the old globalization, Ricardian comparative advantage was sensible because nations, the unit of analysis in Ricardian comparative advantage, produced one product domestically and then exported it; in essence, the state accounted for 100% of the value added to their products and specialized in certain sectors. In the new globalization, Ricardian comparative advantage must be re-interpreted to show that different states now specialize in stages of production within sectors. As a result, comparative advantage as previously known has been de-nationalized and there are new winners and losers created within each state.

One new trend in trade liberalization is the emergence of mega-FTAs. These new agreements generally involve rules on foreign direct investment in developing states. Essentially, if developing states reform their economies to become more pro-business, developed states will invest in those states (Ibid., 111). Two pertinent examples of such trade agreements are NAFTA and CPTPP. The NAFTA has played an important rule-making role to develop GVCs based trade in North America, and the CPTPP is to expected to play such a role in the Asia-Pacific region. In fact, the CPTPP outlines comprehensive rules on domestic regulations such as rules of origin, customs administration, SOEs and government procurement, anti-corruption measures, foreign direct investment, and intellectual property rights, as well as lowering tariffs.

In addition to the economic incentives, there are also political incentives to pursue mega-FTAs. Trade liberalization has largely moved towards the Asia-Pacific region. For the United States, the TPP appeared to be an opportunity to counter the Regional Comprehensive Economic Partnership (RCEP) and Chinese influence (Aggarwal 2016, 1012–3). Additionally, smaller states within East Asia sought to balance influence among China, Japan, and the United States, so that the three countries would compete for further influence in the region. Japan and the European Union referred to the TPP's agreed rules in order to craft the EU-Japan Economic Partnership Agreement (EPA), which was concluded in July 2017, and the NAFTA renegotiation among Canada, Mexico, and the United States used the TPP's agreed rules as a benchmark. These agreements have left large developing states like China and India out of trade liberalization. However, the RCEP, which consists of 16 countries (though India has recently left negotiations), contains much more flexible rules that allow for special and differential treatments for members based on their immediate needs. This flexibility has given the RCEP structural problems, making the agreement much weaker than the CPTPP (Rosenbaum 2018, 430).

Ultimately, the WTO has failed as an international trade rule-making institution. Whereas it is difficult to find consensus in the WTO with its 193 members, mega-FTAs make it easy to reach an agreement because there are fewer actors involved. The tradeoff, of course, is that the rules are spread less widely. The CPTPP and the NAFTA (now USMCA) are two agreements that are comprehensive in nature and encompass a sizeable percentage of the global economy. The RCEP is another such agreement that is being negotiated among 16 countries, including Australia, China, India, Japan, and South Korea. However, it is much less comprehensive than the CPTPP or the USMCA. In the RCEP, SOE reform and intellectual property rights are absent and tariff reductions are less expansive.

Economic Theories of International Trade

There are several theories relevant to the discussion of international trade; among these are the Hecksher-Ohlin (H-O) theory, the Stolper-Samuelson (S-S) theorem, and the Ricardo-Viner (R-V) model. H-O explains trade based on factor endowments. It relies heavily upon the idea of comparative advantage. Developing states that are abundant in unskilled labor (or land) should export labor-intensive manufactured goods such as textiles and clothing (or agricultural products), whereas developed states that are rich in (human) capital should specialize in more high-tech products and services. In sum, H-O can explain why developing states demand access to developed states' markets of textiles and apparel (or agriculture)—instead of protecting their own domestic markets—in trade negotiations.

Both S-S and R-V build upon H-O (and its assumptions) but have nuanced differences. S-S predicts that trade liberalization will benefit the abundant factor of production. Trade liberalization will 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. As a result, state economies will continue to invest in factors in which it holds a comparative advantage and let its inefficient industries fade out of existence.

S-S predicts that developing states, which are labor-rich and capital-poor, would see wage inequality decrease as a result of trade liberalization. However, in many states this theoretical prediction is not realized. The standard theorem only takes into account the comparative advantage in factors of production across states, not within each state. However, when analyzing the factors of production within each state, it is apparent that those with capital benefit from trade at the expense of those that are labor-rich. S-S is correct, generally speaking; that is, states that are labor-rich and capital-poor when compared to its trading partner will engage in trade, and that the abundant-factor holders will increase their incomes. S-S fails, though, to explain why wages do not increase in labor-abundant states.

R-V is similar to S-S, except it specifies what industries will benefit. Because of the model's sector-specificity, R-V can clearly distinguish the winners and losers of trade. Import-competing sectors want to protect the home market to reduce competition while exporting sectors want open foreign markets (assuming both states open their markets). Vitally, the model assumes that capital does not move between sectors while labor does. For example, if the price of manufacturing increases, R-V predicts that labor will move from agriculture to manufacturing but capital that is tied up in agriculture (tractors, farms, etc.) cannot be converted to manufacturing capital (factories, assembly lines, etc.). However, the model may not make accurate predictions for states with high capital mobility. As a result, the model is best used for: (1) analyzing the initial effects of a given trade policy when capital has not yet moved; and (2) explaining the effects of trade policy on states with lower levels of capital mobility for a longer period of time.

Branko Milanovich (2016) answers this puzzle with a theory of his own: a modified Kuznets hypothesis. The original hypothesis states that inequality is low at low income levels, rises as the economy develops, and falls once the economy reaches high-income levels. Milanovich's modification, what he calls "Kuznets Waves," argues that increases and decreases in inequality within countries have gradually alternated back and forth over time (Ibid., 46–50). Starting in the 1980s, an increase in inequality occurred because of (1) technological changes that were biased against unskilled labor and (2) globalization. These two factors caused the price of capital goods to decrease and domestic unskilled labor to be replaced by foreign labor. In the states of the Organization of Economic Cooperation and Development, an increase in income inequality was caused by disproportionate levels of male labor force participation and of men's earnings (Ibid., 109). Milanovich (113–5), based on his earlier theory that liberal social policy and social democracy causes income inequality to decrease, postulates that five different factors could decrease income inequality within countries, which are: (1) political change that results in progressive taxes, which Milanovich finds unlikely; (2) an increase in education to match the demand for skill; (3) dissipation of financial benefits accrued in the early stages of the tech revolution (Silicon Valley millionaires); (4) global income convergence; and (5) technological progress that causes an increase in efficiency of unskilled work. Essentially, when capitalists within a state are strong compared to labor (specifically unskilled labor), the method of combating income inequality is through skill development and a social safety net.

Having said that, the nature of trade has significantly changed over the last three decades. GVC-based trade has radically changed the way political economists describe the winners and losers of trade. Fragmentation of manufacturing has allowed firms to ship intermediate goods across borders, meaning that industries are no longer the proper unit of analysis for analyzing factors of production but now the sectors of production within industries are the unit of analysis. This evolution significantly changes the domestic politics of trade. Producers are now consumers, and hence they are more likely to advocate for trade liberalization than they were before. Even producers in import-competing industries may support free trade if they import intermediate goods from other states. The new globalization has certainly complicated the domestic politics of trade.

Domestic Politics of International Trade

Japan and the United States on Agriculture

The CPTPP includes regulatory coherence in the agricultural sector, effectively levelling the playing field among parties to the agreement. Such requirements were also included in the TPP, which the United States withdrew from. Japanese and U.S agricultural sectors have differing positions on the TPP/CPTPP: Japan is against the liberalization of agricultural products while the United States is in favor of it. However, Japan still supports the agreement while the

United States has withdrawn from it. The domestic politics of each country shows an interesting story in light of current theories like S-S and R-V.

Megumi Naoi and Ikuo Kume (2011) conducted a survey experiment in Japan to find why some highly developed societies have the consumers that support trade protectionism. The two hypotheses they test are: (1) sympathy, where consumers are primed by producers to believe that farmers work hard for low pay; and (2) projection, where those with job insecurity project their feelings onto those in the agricultural industry. They find that temporary workers and those with high levels of job insecurity correlate with a higher likelihood of supporting agricultural trade protection. Income has little bearing on whether a person will support trade liberalization or protectionism in the agricultural sector. Future research would need to focus on heterogeneous societies like the United States or have comparative analyses performed between homogeneous societies and heterogeneous societies, as these trends may not hold in heterogeneous societies.

Even though there is much opposition to trade liberalization in Japan, the government has still pushed for the TPP/CPTPP. Christina Davis (2019) analyzes Japan's strategy in promoting the TPP in its domestic politics. One strategy the government has used is centralizing policy authority within one portion of the cabinet, which allowed for the singular dominating interest of trade liberalization to be involved in trade negotiations. Additionally, the agricultural groups' power was weakened due to changes in the structure of districts and electoral law in general. The groups also did not have a party firmly in support behind them since the Democratic Party of Japan (DPJ) had already staked out a pro-trade liberalization position. The Liberal Democratic Party has now had the ability to control trade policy because the agricultural sector does not support the DPJ. The sector had to compromise.

Of course, the Japanese government needed a strategy to make the TPP more palatable to its citizens. Japan made the TPP the center of its economic and regional political strategy (Ibid.). The government presented the TPP as an agreement that would be a tool that begins structural reforms of Japan's economy and increases competition from global competitors, which makes the market more efficient. However, without China, Thailand, and the United States these talking points are greatly weakened. The other vital component of the TPP that Japan has touted is that the agreement gives Japan economic influence that directly counters China's influence in the region. By coupling the state's economic and regional political priorities together, Japan made the TPP (now the CPTPP) the center of its policymaking strategy both domestically and internationally.

Japan has ratified the CPTPP but the United States has not been involved with it. Mark McMinimy (2016) looks at the regulations that the TPP would have imposed on its signatories and presents American agricultural and food groups that supported or opposed the TPP. According to his analysis, American agricultural and food trade would experience a surplus in trade because the agreement would force Japan to lower its tariffs. However, tobacco is one of the few industries within the agreement that would not benefit from the TPP. The regulatory coherence that the TPP provides would benefit most of the U.S. agricultural sectors. One of the concerns expressed by the United Food and Commercial Workers Union International is that the TPP does not contain an ability to enforce rules against currency manipulation, which, according to them, would lead to more jobs being outsourced to other countries in the TPP.

It seems that both Japan and the United States had different motivations for their respective positions on the TPP/CPTPP. Japan's sizeable opposition to the trade deal presents a challenge to current understandings of free trade. Generally, the collective action problem would keep consumers from expressing a strong preference towards or against free trade. If such consumers are employed in economic sectors that would be helped by free trade, it would be expected that they would in fact support the trade deal. However, Naoi and Kume (2011) find that workers in Japan, regardless of sector employment, oppose trade deals if they have low job security. As for the United States, the story of opposition to trade is a bit clearer. During the election, Trump took aim at all trade policy and influenced workers in manufacturing industries within the Rust Belt to embrace him and his protectionist ideas. However, it appears that U.S. self-exclusion from the TPP is detrimental to various sectors of its economy, and so, if Japan moves forward with the TPP (now the CPTPP) it should incentivize the United States to engage in multilateral trade liberalization.

Japan and the United States on Intellectual Property Protections

Throughout the 2010s, Japan has been a champion of intellectual property protections in East Asia (Townsend, Gleeson, and Lopert 2018). In TPP negotiations, the United States had much trouble convincing other states to agree to strong intellectual property protections. Once Japan joined, other countries within the agreement began to accept stronger intellectual property provisions. What has enabled Japan to become a strong protector of intellectual property is the support of its pharmaceutical companies, especially of those specializing in research and development. Of course, consumers generally support less stringent intellectual property protections since the cost of medicine would be reduced; and yet, in states like Japan and the United States the collective action problem explains why special interests are able to have the most political power in the realm of intellectual property. For Japan, the TPP/CPTPP represents an opportunity for regulatory coherence for intellectual property rights. Multinational pharmaceutical corporations like Japan's Takeda Pharmaceutical Company, which do research and manufacturing across the world, greatly benefit from such protections and have lobbied the Japanese government for increased protection in the TPP/CPTPP.

The United States favored even stronger intellectual property protections than Japan, again due to the political lobbying from the healthcare industry (Rubenfire 2017). Various U.S. healthcare sectors were lukewarm on the agreement. In fact, when President Trump withdrew from the TPP agreement, no healthcare company or organization was unhappy (Ibid.). "Big Pharma" argued that the intellectual property protections in the TPP were not strong enough to make research secure, even though many of the TPP's intellectual property protections were stronger than those found in TRIPS (Townsend, Gleeson, and Lopert 2018, 91–2). However, manufacturers of generic drugs decried the intellectual property protections, arguing that the terms of the TPP did not effectively balance the interests of innovation and access to affordable drug prices (Ravenhill 2017, 583–4). It appeared that generic drug manufacturers were not heard by the Office of the United States Trade Representative, as one executive from a generic drug company said that "US negotiators have basically functioned as drug lobbyists" (Ibid., 584). Manufacturers of medical devices supported the TPP regardless of the level of intellectual property protections (Rubenfire 2017). NGOs like Doctors Without Borders criticized the agreement, arguing that its property rights protections were too strong (Ibid.).

A few conclusions can be drawn about the U.S. healthcare industry's attitude toward the TPP. The first is that there was no consensus regarding the strength of the intellectual property protections; the drug industry was in firm support of TRIPS Plus protections while NGOs were in favor of less intellectual property protections. As a result, any form of compromise between the two will result in weak overall support for trade. However, the second conclusion that can be drawn about the United States is that other countries, not NGOs or manufacturers of generic drugs, will pull it to accept intellectual property protections that are less than what the state originally asked for (Townsend, Gleeson, and Lopert 2018, 91–2). Therefore, in the healthcare industry, it appears that both international and domestic politics are involved. Based on the previous discussion about Japan's geopolitical goals, it is likely that the state would accept lower intellectual property protections than desired since the influence gained in the region is one of its highest priorities. For Japan, the international politics and its geopolitical goals are a strong driver.

American Domestic Politics

Current anti-trade sentiment in the United States is largely focused on China. Huang (2017) focuses on three common complaints that the United States has with China: trade deficits, job loss, and currency manipulation. He states that the large trade deficit comes from China being the final stage in the production network of various products: consumption. Even though China may ship a $750 iPhone to the United States, it only adds $8 to its value; therefore, the trade deficit is not a reliable indicator of a properly balanced trade deal (Ibid., 128–9). Huang (131–3) also argues that U.S. job losses occurred prior to and independently of trade with China, and that job losses would have continued throughout the twenty first century even if there was no trade with China either because of technological advancements or because of trade with some other East Asian countries. Finally, according to Huang (125–30), currency manipulation is nonexistent in China. The depreciation of the currency was not from forced manipulation by the government, but instead resulted from untying its currency from the U.S. dollar. In other words, currency depreciation was a result of natural market forces. Even if currency manipulation were occurring, the higher cost of importing would offset most of the advantages of higher export prices. In Huang's view, the problems that the United States has with China are not China's fault.

Edward Alden (2016, chap. 3) disagrees with Huang on whether currency manipulation occurred, but he certainly agrees with him that the United States is to blame for its own weakness. America's problem with its currency is simply that it is too strong. International organizations like the International Monetary Fund (IMF) and the WTO are supposed to, in theory, prevent states from manipulating its currency so that its worth falls below what market forces dictate. However, both organizations have failed at addressing the currency issue with its member states, allowing for these states to manipulate their currency if they desire. Even though GATT/WTO rounds have cut tariffs, currency fluctuations take away any benefits that tariff cuts have for strong currencies. The situation with China in the mid-2000s is one example of U.S. weakness to react to China's alleged currency manipulation. The George W. Bush Administration was afraid to damage U.S.-China relations, so it did not label China as a currency manipulator. Eventually, Congress pressured Bush to threaten China with the "currency manipulator" label, which caused China to begin strengthening its currency. China slowly became less competitive, but it was too late; the damage to the U.S. manufacturing sectors was already done. The U.S. unwillingness to place pressure on those who flaunt the rules of trade has damaged its economy and has sent a message to other countries that the state is passive.

Alden also seeks to answer why workers have turned against free trade (Ibid.). The answer is, in short, that the United States has failed to adjust to the new global economy, where American workers not only compete with other American workers, but they also compete with workers from developing countries. When trade deals are passed, one inevitable outcome is that some sectors of the economy will shrink while others will grow. The economy affected must find some way to shift the job market towards the growing sectors while helping those whose jobs were lost. One way to do both at the same time is worker retraining programs.

In 1962, President John F. Kennedy signed the Trade Expansion Act of 1962, which created a trade adjustment assistance (TAA) program designed to help companies and workers displaced by free trade (Ibid., 110–1). As the TAA evolved, it began to cover some of the loopholes that let some workers slip through the cracks. However, the program was incredibly expensive (Ibid., 120–2). From 1962 to 1975, the TAA cost about $85 million; from 1975 to 1981, $4 billion (Ibid., 120). Richard Nixon expanded the benefits of unemployment without fixing some of the apparent problems, one of which being the poor administration of the TAA. By the time Ronald Reagan took office, it became clear that the TAA was an incredibly wasteful program that did little to retrain workers to move to other job sectors even if they wanted to. Reagan cut the program by about $3 billion, and only 16,000 workers received any benefits, collectively receiving a total of $50 million. The program was effectively dead. It was not until Barack Obama's presidency that the TAA was re-established to its former glory, but House Republicans constrained it from becoming a broader program. The TAA was the promise that the government made to the American people when it began negotiating trade deals, and it has reneged on its promise. As a result, job training has lagged behind that of other countries.

As the United States has grown over the last 40–50 years, the job market has shifted as well (Ibid., 140–4). Education and job market success have become more intertwined; those without higher education have seen real earnings fall by nearly half. However, education in the United States has stalled, with students having shown little improvement over recent decades. Now, businesses are saying that they are experiencing high-skilled job shortage in the United

States. Generally speaking, the federal government cedes control of the quality of education to state governments. However, beginning with President Clinton, the United States saw the need to create national performance standards for education. Presidents Bush and Obama also pushed for education reform, the results of which have been mixed. High school graduation has reached record highs with 70% of them continuing to higher education. The United States, though, "has the highest college dropout rate in the developed world" (Ibid., 143). Additionally, the United States has a positive correlation between wealth and education, which is reinforced by funding most schools through property taxes. Finally, the United States has failed to sufficiently train high-quality teachers; other states' school systems have rigorous requirements for teachers that are matched with high salaries. The United States has largely fallen behind on education, which is yet another reason why it is "losing" on international trade.

One of the largest problems for the United States in its quest to compete effectively in the international market is its inability to make trade beneficial for both its citizens and its corporations, not merely the corporations. Competitive economies are economies whose companies do well in global markets and whose people benefit from rising wages and lowering prices (Ibid., 6). However, for people to have the benefit of rising wages they must be able to compete in the global economy. Of course, the problem is not globalization itself but the skillset of the American people (Ibid., 8). The Peterson memo, *The United States in a Changing World*, foresaw many of the coming challenges of trade. Pete Peterson, Nixon's economic advisor, understood that international trade would not be automatically good for all Americans; instead, the United States would have to continue to make itself competitive by investing in its infrastructure and its human capital (Ibid., 9–18). However, the United States has failed to do so. It does not shape the rules of trade, it does not encourage investment in infrastructure or human capital, and it does not support its own workforce. These missteps have made it difficult for the United States to prosper in the face of foreign economic competition from international trade.

While U.S. domestic policy has not responded to the needs of the working class, its trade policy has failed as well, and there are numerous reasons. First, it has been unable to maintain balanced trading relationships. The United States has lost many jobs to countries like China, enough so that there is a "moderately negative impact on the number of jobs in the United States" (Ibid., 31). The only response that the United States has had is to negotiate strict rules of trade in the hopes that job losses will reverse if the playing field is level (Ibid., chap. 2). However, the United States is largely unable to close the loopholes. The situation with China is one such example. The United States believed that, once acceding to the WTO, China would adhere to the rules of the WTO game, and therefore the United States would have a balanced economic relationship with China. Unfortunately for the United States, China is not fully adhering to the WTO rules; SOEs and industrial policies designed to reduce market competition are still abundant and have led to imbalanced trade between the two states. The United States continually believes that they will be able to enforce trade rules; yet there is ineffective enforcement for them, especially when those rules are embedded within large agreements. In order to improve its enforcement, the United States will likely have to pay close attention to the state's obedience to the trade rules and have the power to pressure the state if it is skirting the rules. Ultimately, foreign competition that displaces working-class Americans has not prompted the state to provide a strong social safety net. The United States' resulting rise in protectionism, then, has stemmed from its failure to adjust to the new global rule-making of international trade.

Chinese Domestic Politics

When discussing China, it is of utmost importance to refrain from referring to the state as a unitary actor; that is, one must recognize the factions governing the Chinese Communist Party (CCP). Chinese leadership is divided between reformist internationalists and conservative hardliners. Carl Minzner notes that the events at Tiananmen Square launched a series of effects that have stalled any efforts to privatize SOEs (Minzner 34–5). 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). The early years of Xi Jinping's presidency began with hopes of market reform; however, in 2015 the state shelved any reforms that would threaten the dominance of SOEs. In 2017, China strengthened SOEs, moving away from any true reform. Since 2010, the total number of SOEs has increased from 120,000 to 170,000 (Magnus 2018, 67).

If China was as efficient at production as other Asian countries, then its productivity would rise by 0.7 to 1.2 percentage points per year, according to the IMF (Lardy 2019, 49). The problems with Chinese production efficiency can be found by analyzing state and private firm efficiency. Between 2005 and 2016, there was a rapid rise in the size of financial losses for SOEs (Ibid., 50–54). However, even though they make up over one third of the total output of all firms, the losses from these firms only make up 10% of the losses of all industrial firms, indicating that SOEs are disproportionately more inefficient than private firms.

Elizabeth Economy (2019) argues that China's political economy rests heavily on the CCP's domestic political strength. During his presidency, Xi's strategy has been to centralize power to himself. The state's role in Chinese society has greatly increased. One consequence of such control is an increase in protectionism. Citing public support polling, Economy (95) notes that rising income levels are vital to continued stability of the CCP; without them, citizens would be even more agitated by the Party. A key part of this story is the strength of SOEs. They are a sign to the Chinese people that the government will always provide a job for the unemployed, no matter how inefficient the company becomes. Economy (118–9) concludes that the lack of fundamental reform of SOEs indicates that the CCP views them as an important political tool that it cannot give up.

Hiroki Takeuchi (2019) agrees with this analysis, noting that above all others domestic stability is the CCP's top priority. His analysis differs in that he discusses the state in terms of two factions: conservative hardliners and reformist internationalists. Both factions agree that maintaining social stability is most important to achieve the utmost goal of regime resilience, but they have differing stances on how the CCP should approach the future. According to Takeuchi, theoretically, the TPP that requires commitment to domestic economic reforms would empower reformist internationalists in Chinese domestic politics, pressure China to commit to significant domestic reforms, and hence make China's behavior more cooperative because the reformist internationalists prefer cooperative foreign policy.

This argument implies that the CPTPP should be open for China's participation in the future. The option to opt into the CPTPP would give the reformist internationalists sway over the conservative hardliners, pushing the Chinese government to commit to the SOE reform. And perhaps most important to note is that the effect of empowering the reformist internationalists would occur even if China is not an immediate signatory of the CPTPP. If China implements the SOE reform, the CPTPP including China would further deepen economic interdependence, which would contribute to regional security. If China does not implement the SOE reform, the

CPTPP would give its signatories an advantage to benefit from GVCs based trade and help them confront China's challenge to the current rule-based liberal international order. While the CPTPP would serve this purpose, the RCEP would not.

In recent years, China has attempted to build its influence in the East Asian region through different initiatives. One of these is the Belt and Road Initiative (BRI). China seeks to connect over sixty different countries through the creation of ports, railroads, highways, and energy infrastructure (Economy 2019, 190–6). As noted earlier, China's main concern is its domestic stability, which includes geopolitical security as well. As a result, the BRI is a direct answer to President Obama's pivot to Asia. The BRI appears to be successful thus far; even European countries have tried to gain access and the American embassy has given advice to U.S. companies on business opportunities for the BRI (Ibid., 194). China's grand strategy through the BRI is to tie participating countries closer to China through trade and investment, all on China's terms.

China has also forayed into trade liberalization through the RCEP. As noted earlier, the RCEP is less ambitious than other mega-FTAs such as the CPTPP, the EU-Japan EPA, and the USMCA. With India leaving the RCEP, the trade deal will have a smaller effect on global trade than originally intended. Additionally, the lack of SOE reform in the agreement has reduced the incentive for trade volume to significantly increase under the agreement. Any foreign companies wishing to do business in China will need to compete against Chinese corporations that receive vast amounts of subsidies (Ibid., 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. According to Japanese leading economist Motoshige Itoh, free trade is not as important to China as investment opportunities.[1] With more aggressive claims made in the East and South China Seas, China has made it abundantly clear that regional influence and power is its main priority. Again, China does not act in accordance with market demands; rather, it does whatever is necessary to promote the stability of one-party rule in domestic politics.

Prescriptions and the Future of International Trade

United States and Japan

The new globalization in the United States and Japan shows that special interests appear to be highly influential on each state's trade policy, although it appears that the United States is affected to a greater extent. By discussing geopolitical strategy, Japan has been able to convince the public of the need for greater trade liberalization in spite of special interest lobbying. The state has weathered the challenges of the American abandonment of the TPP quite well, although the CPTPP is a weaker agreement without the United States. In response to the trade war, Japanese companies have grown increasingly cautious about production in China with some production being moved to other states like Vietnam. The trade war itself is concerning, as a weaker Chinese economy may harm the strength of the Japanese yen and lead to decreased overall investment from China.[2]

The United States, on the other hand, has seen an increase in working-class opposition to trade liberalization. Trump was able to ascend to the Presidency by championing these workers, synonymizing them with the American ideal. Rather than advocate for a strengthened social safety net, Trump has supported trade protectionism. Interestingly, it appears that the sympathy

[1] The second author's interview with Motoshige Itoh, Tokyo, Japan, July 17, 2019.
[2] Ibid.

factor found by Naoi and Kume (2011) applies to the United States as well, given that many Americans rallied around the common worker and against "outsourcing." Additionally, the USMCA that has been ratified by all three states (but not yet implemented) is more restrictive than the NAFTA which it replaces. The workability of the agreement is still in flux as some of the USMCA's requirements are difficult for companies to adhere to. One such provision in the USMCA is the requirement that 40–45% of the labor that is used in creating a car be from a factory that pays for labor at $16 or more per hour. By comparison, in Mexico workers are currently receiving $8 to $24 per day.[3]

From a more theoretical standpoint, it appears that S-S has some valuable information. While the theorem considers capital, land, and labor into its prediction of what countries will support trade liberalization, an important distinction should be made between skilled and unskilled labor. In capital rich, unskilled-labor scarce countries, corporations will be more likely to place some stages of production in countries that are unskilled-labor rich. However, unskilled workers in the home country will oppose free trade. Whether the state takes trade liberalization or protectionism will largely depend upon the effectiveness of the political message being shared by those most affected by the issue of trade. Currently, it appears that Americans are more sympathetic towards the plight of the working class instead of corporations even though Americans benefit from trade in the form of low-prices and GVCs.

As noted earlier, H-O relies on the assumption that labor is mobile within borders, but not across borders. Given that the new globalization has led to fragmentation of manufacturing and therefore has affected different workers in different ways, it is vital to recognize that H-O is

[3] The second author's interview with Japanese leading specialist on Latin American economy Taeko Hoshino, Tokyo, Japan, July 17, 2019.

currently too limited to make proper predictions of what each state will trade. If the model were updated under the assumption that labor is mobile across borders and that there are different classes of labor, then the model may be able to predict how states will act.

In a similar vein, R-V needs to be updated. The model has great potential, but it is currently limited by its lack of consideration for fragmentation of manufacturing within each industry. Instead of focusing on whether a specific sector of the economy is an exporter or import-competing, R-V should focus on whether a specific stage of production tends to export or if it competes with imports. If it is updated in this way, then the model will be able to look within industry at the various stages of production, leading to more accurate and precise predictions on which workers or corporations will support or oppose trade liberalization. Finally, it is vital to understand the role that international politics plays into whether states take free trade. Japan may not have successfully signed the CPTPP had it not established the importance of the agreement to its geopolitical strategy, even though the newly-adjusted S-S and R-V predict that a state will favor free trade. Future research should analyze whether the structure of international politics is an important method of attracting public support for free trade, especially in developing states in East Asia, where such states seek to balance China's influence with that of some other strong state.

China

In China, domestic politics does not usually extend to popular opinion; elite politics is dominant in decision making. As a result, theories like H-O, S-S, and R-V cannot properly account for the state's actions. Instead, CCP politics must be analyzed if one wishes to understand China's actions on trade. Therefore, it will be appropriate for the future research to view China in terms of the tension between reformist internationalists and conservative hardliners within the CCP. It appears that under President Xi China is acting in response to U.S. actions from the early 2010s, seeking to develop its own power and security wherever possible, and resisting the market incentives of trade liberalization. It appears the conservative hardliners have been emboldened by President Trump's trade war. With the United States and China both turning to nationalism, Japan—the third largest economy following the United States and China—must lead the charge to take the lead and pave the way for more international trade, with cooperation from other CPTPP members of middle power such as Australia, Canada, and Mexico.

Implications for the Future of Trade

Over the last 30 years the nature of trade has changed significantly, and in the last five years new political challenges to trade have emerged. What is clear for the future is that previous rules for trade created through the GATT/WTO are no longer adequate. Instead, new rule-making using mega-FTAs is required. As more international economic interactions have become GVCs based trade, the focus on trade negotiations has shifted from national border measures into domestic regulations. States need to agree on the *international* rules stipulating *domestic* regulations. The TPP was a major achievement in these areas, but with the United States out of the picture the future of trade liberalization hangs in limbo. Japan and the European Union could be the future leaders of global trade, but they alone may not provide the economic incentive necessary to convince developing states with large state sectors to begin a massive effort towards structural reform.

The rising growth of protectionism in the United States can only be quelled when it begins taking steps towards reducing the high levels of income inequality within the state. Here Milanovich's (2016) solutions come back into focus. Progressive taxes, an increased development of skills, a reduction of inequality directly related to technological innovation, global income convergence, and the kind of automation that *helps* unskilled labor can all reduce income inequality and build public support for trade. In essence, the United States will need to provide a strong social safety net so that many of their citizens' basic needs are not directly tied to their employment. Something else that will aid the state is the use of increased labor standards in trade agreements. While not ideal for many proponents of trade liberalization, reducing opposition to trade requires making some concessions, and putting labor standards within these agreements would be one such concession. However, whether other developing states are willing to agree to increased labor standards is a different matter.

With the U.S. withdrawal from global rule-making, China has a unique opportunity to show economic leadership. However, the CCP is focused on domestic stability for regime resilience. With President Xi in power, China has put forth several new initiatives designed to grow the state's regional power. The SOE reform has been put on the backburner, and China has resisted U.S.-led trade liberalization opting instead to forge its own path for trade and investment. The conflict between the conservative hardliners and the reformist internationalists will continue to rage on.

It has become abundantly clear that the trade policy of the old globalization cannot be applied without significant reforms. The new globalization has upended all notions of what political economists expected trade policy to look like in the twenty first century. 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 are both uncertainties that will inevitably guide us towards the future. COVID-19 has now taken center stage, freezing all major trade developments and highlighting the necessity of a strong social safety net. The world has a heavy burden to carry, and a holistic approach to trade policy will be one of the vital components to ensuring the global economy gets back on track.

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