

# Trade, Security, and Authoritarianism: Domestic Politics of Foreign Economic Policy in China

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Would trade bring security and stability in international relations? While realist theories focus on zero-sum, conflicting interests in the anarchic nature of the international system, liberal theories argue, first, that economic interdependence in the market system produces common interests and therefore decreases conflict among states and decrease the role of military power and the insecurity it breeds.<sup>1</sup> Institutions, then, both international and domestic, can mitigate the effects of anarchy and, as a result, the scope for positive-sum, mutually beneficial cooperation is much more expansive than realism argues.<sup>2</sup> In other words, while realists conclude that international cooperation is difficult, and conflict and insecurity are enduring features of world politics, liberals argue that market interactions and institutions can strengthen each state's security

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<sup>1</sup> Ikenberry 2011; and Mearsheimer 2001.

<sup>2</sup> Keohane 1984; Lake 2011; and McDonald 2009.

by promoting international cooperation. The question of whether trade would bring security and stability in international relations is particularly important to evaluate the implications of China's rise on U.S. foreign policy, which has a long history of "supporting democratic transitions and economic liberalization around the world."<sup>3</sup> China has become one of the most important players in the global market economy without being democratized. China's involvement in the global economy leads to an optimistic view as Edward Steinfeld argues that China's economic growth does not undermine the U.S.-led liberal international order but actually enhances it because China is playing our game by playing our rules.<sup>4</sup>

The fact that China has been committed to economic liberalization without democratic transitions motivates us to advance the liberal arguments in theoretical debates of international relations by examining the security implications of the emerging trade relationship between authoritarian and democratic countries. The development of global value chains (GVCs) in the Asia-Pacific, including China, over the last two decades has brought a new international division of labor between developed and developing countries, which includes both authoritarian and democratic countries.<sup>5</sup> Interestingly, the spread of GVCs has changed the politics of international trade negotiations. In the past trade negotiations mainly discussed lowering tariffs and other trade barriers imposed at the national border. However, the focus on trade negotiations has shifted from national border measures into domestic regulations, as the GVCs of multinational corporations (MNCs) have spread all over the world, and in manufacturing industries it has become common practice for different stages of production to be located in different countries. In the meantime,

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<sup>3</sup> McDonald 2009, 1.

<sup>4</sup> Steinfeld 2012.

<sup>5</sup> Kimura 2013. 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."

the World Trade Organization has failed to function as a forum to discuss complicated and comprehensive rules needed to manage GVCs based intra-industry trade; as a result, many nations—both authoritarian and democratic—have concluded FTAs all over the world for this rule-making. Therefore, to understand whether trade would bring security and stability, it is important to examine how FTAs might enhance international cooperation in the security relationships.

In this paper I develop a simple game-theoretic model to investigate security implications of trade and FTAs with authoritarian countries, taking into consideration different natures of the regime types. In the model, two states—one authoritarian and the other democratic—strategically interact with each other. The central implication of this game-theoretic model is as follows. If its leadership is internationalist, the authoritarian state will take cooperative foreign policy. Thus, if an FTA empowers internationalists in the power balance of domestic politics among the authoritarian state's leadership, the FTA will make the authoritarian state's behavior in international relations more cooperative. Such effects are expected in some of the FTAs under certain conditions. If the FTA requires structural economic reforms to the signatory nations, it would undermine the vested interests of the collusive rent-seeking mechanism. Thus, the reformists who want to advance structural reforms often face backlash from the conservatives who enjoy the benefits from those vested interests.<sup>6</sup> The FTAs stipulating comprehensive rules on GVCs based intra-industry trade impose a yes-or-no answer on the governments regarding the politically sensitive issues that would undermine the vested interests—such as the state-owned enterprise (SOE) reform in China. Therefore, international rule-making on trade will empower the

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<sup>6</sup> Conservatism here is defined simply as the position to protect vested interests and is not related to the conservative ideology in American politics.

reformists and make each nation's behavior more cooperative. Among the FTAs in the Asia-Pacific, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) that would require the participating states to be committed to domestic economic reforms, such as SOE reforms, would serve this purpose while the Regional Comprehensive Economic Partnership (RCEP) would not.

The broader implications of this game-theoretic model are concerned with the debate of whether economic interdependence or democracy brings peace and stability to international relations. The literature of commercial liberalism has argued that nations will not fight a war if they trade with each other because no nation is interested in fighting war with another nation with which it trades. Thus, the theoretical argument called commercial liberalism, also called the “capitalist peace” theory, provokes the debate of whether peace and security are brought by economic liberalization or democratic transitions when one observes peace secured in a certain region. In fact, the democratic peace theory has long been influential on American foreign policy. For example, President George W. Bush argued that U.S. national interests would be furthered by bringing democracy to the countries of the Middle East, and he saw the invasion of Iraq and other policies designed to encourage democratization as vital to bringing stability to that region and reducing threat of terrorist attacks on the United States.<sup>7</sup> By contrast, Patrick McDonald suggests that American foreign policy should promote economic liberalization rather than democratic transitions.<sup>8</sup> He argues that it is difficult to bring peace in the country where capitalism is not rooted because peace is brought by private property and competitive markets, which constrain the

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<sup>7</sup> See Transcript of Bush's Remarks on Iraq: 'We Will Finish the Work of Fallen,' *New York Times*, 14 April 2004, <http://www.nytimes.com/2004/04/14/us/president-s-conference-transcript-bush-s-remarks-iraq-we-will-finish-work-fallen.html>, accessed 14 December 2017.

<sup>8</sup> McDonald 2009.

political rent seeking of leaders and make them more responsive to popular demands. In short, his findings suggest that there is no direct relationship between democracy and peace. However, it is easier to secure property rights regime under democracy than authoritarianism. Therefore, I would advocate that the FTA that requires commitment to structural reforms would advance private property and competitive markets in domestic politics and make the nation's behavior more cooperative in international relations.

This paper has four parts. First, I briefly discuss previous theoretical debates on the issue of trade and security in international relations. Second, I present a basic game representing a crisis bargaining between an authoritarian state and a democratic state in which there is uncertainty over the other player's payoffs, and examine how the beliefs and payoffs interact. Analysis of this model shows when the bilateral relationship is cooperative and when it is not. Third, I apply the model to security implications that an FTA might have. The conclusion follows. I argue that security relations will be indeed marked by more international cooperation if they conclude the FTA that requires structural economic reforms to the signatory nations.

## **Trade and Security**

The question of how trade matters for security has long been salient in the literature on international conflict and cooperation. One can discern two basic strands of arguments. The first one is rooted in two classic works: Adam Smith's *The Wealth of Nations* (1776) and David Ricardo's *On the Principles of Political Economy and Taxation* (1817).<sup>9</sup> The second one, as sophisticatedly argued by McDonald, focuses more on domestic institutions to argue that

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<sup>9</sup> Ricardo 2009 [1817]; Smith 1937 [1776].

international commerce reduces the chance of military conflict among trading partners.<sup>10</sup> Moreover, Saumitra Jha shows how trade promotes the founding of domestic institutions, providing the basis of ethnic tolerance, which would lead to peace, by carefully examining the historical legacy of ethnic tolerance between Hindus and Muslims in South Asia.<sup>11</sup>

The first strand of the literature on commercial liberal theories often build their arguments by taking the following simple assumption: nations will not fight a war if they trade each other, because no nation is interested in fighting war with another nation with which it trades.<sup>12</sup> This theoretically sound assumption originates in the works by Smith and Ricardo. Smith suggests the benefit of the division of labor where people specialize based on their skills or endowments and trade for what they need. In this way, self-interested economic exchange makes everyone better off through the “invisible hand” of the market. Applying Smith’s theory to international trade, Ricardo proposes the idea of a “comparative advantage” where countries specialize in producing goods that they can produce relatively efficiently and import goods which others are relatively efficient at making, and argues that trade among states diffuse the general benefit and binds together by one common tie of shared interests. Ricardo’s theory of comparative advantage underlies liberal faith in free markets: that is, a system of free trade, in which countries specialize in the areas in which they have a comparative advantage, is most efficient and leads to economic growth and prosperity for every state. It also underlies commercial liberal view about pacifying effects of economic interdependence, suggesting that the comparative advantage leads to the division of labor, leading to the mutual dependence that brings peace to bilateral relations.

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<sup>10</sup> McDonald, 2009.

<sup>11</sup> Jha 2013.

<sup>12</sup> See, for example, Rosecrance 1986.

The second, more institutionalist, strand focuses on the roles of domestic politics on the government's decision-making about war and peace. McDonald argues that free trade *policy* (not the trade volume) brings peace highlighting the political importance of domestic economic institutions.<sup>13</sup> He suggests that market institutions such as secured private property rights and competitive market structures would prevent the government from waging war “for particularistic or selfish reasons that undermine the broader welfare of society while simultaneously fortifying the domestic political status of the governing elite,” and that peace is achieved when the economic gains of military expansion and domestic political power are limited.<sup>14</sup> The secured private property rights would push “a government toward peace by influencing the distribution of political power between a government and its citizenry within a domestic political order.”<sup>15</sup> Moreover, competitive domestic markets in the state with lower trade barriers would enable the government to realize the economic gains from globalization in the peaceful international environment, because the increasing competition in the domestic economy brought by international trade would lead to the larger tax revenue that accrue from the larger national production if the domestic markets are competitive. In the meantime, limiting competitive markets would motivate the government to allocate and redistribute scarce resources and revenue in favor of the political supporters that might not gain from globalization and hence would not appreciate the peaceful international environment.<sup>16</sup> Thus, in order to maximize economic gains from the domestic economy, the state would be committed to free trade policy if it has established a secured property rights regime and institutionalized competitive and open markets. In other words, the state that has established a

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<sup>13</sup> McDonald 2009.

<sup>14</sup> Ibid., 23.

<sup>15</sup> Ibid., 52.

<sup>16</sup> Ibid., 65.

secured property rights regime and institutionalized competitive and open markets would not only be committed to free trade but also behave cooperatively and peacefully in international relations.

Other than McDonald, some scholars have written how commercial activities influence conflict and cooperation in world politics. Etel Solingen argues that domestic politics over economic reform shapes regional orders in international relations.<sup>17</sup> Stephen Brooks presents how MNCs' economic activities have affected the states' calculation of their security policies.<sup>18</sup> For the last two decades, the GVCs of MNCs in manufacturing industries have spread all over the world—especially in the Asia-Pacific—and it has become common practice for different stages of production to be located in different countries. To analyze the implications of emerging intra-industry trade of manufacturing industries induced by the spread of GVCs in the Asia-Pacific, Henry Yeung introduces the perspective of economic geography to political economy by discussing economic development and state-firm relations in East Asia (mainly in South Korea, Taiwan, and Singapore) to reveal how firms' activities influence the government's domestic and foreign economic policies.<sup>19</sup> And most recently, William Norris presents how the Chinese government uses domestic economic actors and policies for its foreign policy, discussing the interactions of international relations and domestic politics as well as those of security and economy.<sup>20</sup> Norris and Yeung both show that the state's foreign economic policy is influenced by both the external structure of international relations and the internal conditions of domestic politics. In other words, when states come to the table for international negotiation and institution building,

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<sup>17</sup> For example, see Solingen 1998. See also the anthology of her work: Solingen 2015.

<sup>18</sup> Brooks 2005.

<sup>19</sup> Yeung 2016.

<sup>20</sup> Norris 2016. Similarly, Scott Kastner examines how domestic politics influence both trade and security policies across the Taiwan Strait. See Kastner 2009.

their behaviors are influenced by domestic and international politics, regardless the state is authoritarian or democratic.

I develop my argument in this paper based on these accounts of trade and security in the previous literature. The traditional literature of commercial liberalism by Smith and Ricardo presents the source of motivation for nations to cooperate. With this incentive, economic interactions in the markets may constrain state choices for military power, interactions in international relations may be driven by common, positive-sum interests, and hence the danger of war may be lessened or eliminated through economic interdependence. Moreover, trade may build a prosperous middle class that sustains democracy, which may promote free markets and trade, and this virtuous circle will bring peace to world politics. Furthermore, interdependence will create a demand for governance on international trade and give a strong incentive for nations to establish international institutions, which will further facilitate cooperation and interdependence. This virtuous circle is also expected to bring peace to international relations. Overall, trade is at the center to alleviate the problems that make international cooperation difficult and promotes cooperation under the formally anarchic international system. In the meantime, McDonald provides micro foundations of domestic politics with the commercial liberal theory in international relations. Domestic economic institutions are particularly important to explore what would make nations prefer seeking the benefits from international trade to seeking the other benefits that might form the state leader's policy preferences. To answer this question, in what follows I present a simple game-theoretic model of crisis bargaining between an authoritarian state and a democratic state.

## The Game-Theoretic Model

### *The Structure of the Model*

In this section, I provide a game-theoretic analysis on security implications of the FTA that require structural economic reforms to signatory nations. There are two actors, an authoritarian state and a democratic state. The authoritarian state decides whether to be aggressive to expand its sphere of influence or to be cooperative to enjoy the economic benefit from interdependent relations with the democratic state. If the authoritarian state has taken an aggressive stance, then the democratic state will have to decide whether to retaliate the authoritarian state's aggression or to yield to it to maintain the economic benefit from interdependent relations. If the democratic state has chosen to retaliate, then the authoritarian state will decide whether to escalate the conflict or back down. The crucial dilemma for the democratic state is that it does not know if the authoritarian state is hardliner or not, that is, whether the authoritarian state is inclined to escalate the conflict even at sacrificing the economic benefit from interdependent relations.

This scenario can be formalized in a simple incomplete information game, as shown in Figure 1. The nature node decides whether to make the authoritarian state hardliner or internationalist. The crucial difference between the types is that the hardliner type prefers to risk the escalation of conflict over enjoying the economic benefit of interdependent relations, whereas the internationalist type has the opposite preference; that is, the hardliner type's payoff for the conflict escalation,  $F_A^*$  (for "fighting" to maintain a hardliner position), is higher than its payoff for benefiting from economic interdependence,  $E_A$  (i.e.,  $F_A^* > E_A$ ). For the internationalist type, the economic benefit from interdependent relations,  $E_A$ , is higher than the political benefit from fighting,  $F_A$  ( $E_A > F_A$ ).

<Figure 1 around here>

The nature node makes the authoritarian state hardliner with probability  $p$  on the left branch of the game tree, and internationalist with probability  $1 - p$  on the right branch of the tree. As indicated by the information set linking the democratic state's decision nodes, the democratic state is not informed of what type of player it faces. However, the probability that the authoritarian state is hardliner,  $p$ , is known to the democratic state and can be thought of as the democratic state's level of suspicion on the authoritarian state. In other words, the smaller  $p$  is, the more certain the democratic state is that the authoritarian state is internationalist appreciating the economic benefit from international trade. This prior expectation regarding the authoritarian state's type can be a product of several things. If the authoritarian state has been involved in the global economy, this could result in a lower level of  $p$ . For instance, China has advanced market-oriented economic reforms since the 1980s, which has led China to benefit from following the U.S.-led liberal international order; and as a result, the United States may expect China to maintain good relations with its democratic trading partners like the United States and Japan. The prior expectation could also be a result of a membership of international institutions. If the authoritarian state is enmeshed in U.S.-led economic institutions (such as the World Trade Organization), then it may generally have a stronger incentive to cooperate with democratic states, which means a low  $p$ , as the institutions may facilitate international cooperation by creating the forum of repeated interactions and issue linkage across time with multiple partners. Finally, the prior expectation could be influenced by domestic politics in the authoritarian state. If those who appreciate the benefit from international cooperation is empowered in the power balance in the authoritarian state's domestic politics, and if the information is credibly signaled to other states, then the democratic state will believe that the authoritarian state's type is more likely to be internationalist. For instance, if internationalists are empowered vis-à-vis hardliners in the power balance of

Chinese domestic politics, then the United States will expect China to be more likely to cooperate in international relations.

Following the Nature node, the authoritarian state then has the first move and may take aggressive foreign policy or cooperative policy toward the democratic state. If the authoritarian state decides to take cooperative policy, the game ends and both players get their economic interdependence payoff,  $E_A$  for the authoritarian state and  $E_D$  for the democratic state. If the authoritarian state decides to take aggressive policy, the democratic state has the option to retaliate the aggression or yield to it. If the democratic state decides to yield, the game ends by changing the balance of power in the authoritarian state's favor. In this acquiescence outcome, where the authoritarian state gets  $ACQ_A$  and the democratic state gets  $ACQ_D$ , the democratic state loses payoffs while the authoritarian state gains payoffs, compared with the payoffs earned from the economic benefit of maintained interdependent relations (i.e.,  $ACQ_A > E_A$  and  $ACQ_D < E_D$ ). If the democratic state decides to retaliate, the authoritarian state has the option to escalate the conflict or back down. If the authoritarian state backs down, then it suffers from the decision to back down although still benefiting from economic interdependence, while the democratic state benefits from continued interdependent relations. Thus, the authoritarian state gets the payoff of  $B_A$ , lower than  $E_A$  or  $F_A$ , while the democratic state gets  $E_D$  ( $E_A > B_A > F_A$ ). Finally, if the authoritarian state escalates, then the authoritarian state gets the fighting payoff,  $F_A^*$  if hardliner or  $F_A$  if internationalist.

### *Equilibria in the Model*

What are the equilibria of this game? The solution concept I employ is the perfect Bayesian equilibrium, where beliefs be updated on the equilibrium path according to Bayes' rule. Backward

induction indicates that in the last node, on the left branch where the authoritarian state is hardliner, the authoritarian state will escalate the conflict, and on the right branch where the authoritarian state is internationalist, the authoritarian state will back down. Suppose that  $p'$  is the democratic state's perception of the updated probability that the authoritarian state is hardliner, once the democratic state has seen that the authoritarian state has taken an aggressive stance. Then, the democratic state's expected payoff from retaliating is  $p'F_D + (1 - p')E_D$ , and this will be greater than  $ACQ_D$ , the expected payoff from yielding, if  $p'$  is smaller than a critical threshold  $p^*$  defined in the following equation:

$$p^* = \frac{E_D - ACQ_D}{E_D - F_D}$$

If  $p' > p^*$ , the democratic state expects the authoritarian state sufficiently likely to be hardliner and will yield. If  $p' < p^*$ , then the democratic state expects the authoritarian states unlikely to be hardliner and will retaliate. The value of  $p^*$  depends on how much the democratic state appreciates the benefit from fighting, and thus  $p^*$  defines the democratic state's attitude toward the risk of retaliating against the authoritarian state. The greater  $p^*$  is, the more likely to be internationalist the authoritarian state has to be, for the democratic state to yield to the authoritarian state's aggressive stance.<sup>21</sup> The lower  $p^*$  is, the greater risk of retaliation the democratic state has to run as it benefits less from the authoritarian state's escalation.

In the pooling equilibrium both types of the authoritarian state take an aggressive stance, meaning that in the pooling equilibrium  $p' = p$ . In this equilibrium, the democratic state yields if  $p > p^*$  and retaliates if  $p < p^*$ , and the authoritarian state responds by escalating if hardliner and by backing down if internationalist. Note that this equilibrium is possible when  $p$  is larger than

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<sup>21</sup> Indeed, the democratic state will always retaliate regardless of the value of  $p'$  once  $p^*$  exceeds a certain threshold (i.e.,  $F_D > ACQ_D$ ).

$p^*$ .<sup>22</sup> As long as  $p > p^*$ , the democratic state is expected to yield once the authoritarian state has taken the aggressive stance, so even the internationalist type of the authoritarian state takes the aggressive stance, benefiting from the changed balance of power in the authoritarian state's favor. Thus, in the pooling equilibrium the authoritarian state always takes an aggressive stance and then the democratic state always yields. This represents the cases in which once the authoritarian state has established the expectation that it is hardliner, unless the democratic state has established the expectation that it is hawkish, even the internationalist type of the authoritarian state will have an incentive to be provocative.

In the separating equilibrium, only the hardliner type of the authoritarian state takes the aggressive stance while the internationalist type always takes the cooperative stance. The democratic state therefore knows what type of the authoritarian state is being faced when seeing the authoritarian state's aggressive stance, meaning that in the separating equilibrium  $p' = 1$  which is larger than  $p^*$  as long as  $F_D < ACQ_D$ . The democratic state retaliates if  $F_D > ACQ_D$  and yields if  $F_D < ACQ_D$ . If the democratic state retaliates, in the last node the authoritarian state escalates if hardliner and backs down if internationalist. This equilibrium is possible if and only if  $F_D > ACQ_D$ . If  $F_D < ACQ_D$ , the internationalist type of the authoritarian state has an incentive to deviate from taking the cooperative stance, given that the democratic state will choose to yield (i.e.,  $ACQ_A > E_A$ ). In the separating equilibrium, the internationalist type of the authoritarian state takes a cooperative stance if the democratic state has established the expectation that it is hawkish.

In the semi-separating equilibrium, the internationalist type of the authoritarian state takes an aggressive stance with probability  $b$  ( $0 < b < 1$ ) and a cooperative stance with probability  $1 - b$ ,

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<sup>22</sup> If  $p < p^*$ , the internationalist type of the authoritarian state has an incentive to deviate from taking the aggressive stance, given that the democratic state will choose to retaliate (i.e.,  $E_A > B_A$ ).

while the hardliner always takes an aggressive stance, meaning that in the semi-separating equilibrium  $p' = \frac{p}{p+(1-p)b}$ .<sup>23</sup> Both the authoritarian state and the democratic state randomize their strategies, taking a mixed strategy. Let  $r$  be the probability that the democratic state retaliates. The condition for the semi-separating equilibrium to hold with respect to  $r$  is  $rB_A + (1-r)ACQ_A = E_A$ . Thus, in the semi-separating equilibrium  $r = \frac{ACQ_A - E_A}{ACQ_A - B_A}$ . The condition for the semi-separating equilibrium to hold with respect to  $b$  is  $p' = p^*$ , which is:  $b = \frac{p(ACQ_D - F_D)}{(1-p)(E_D - ACQ_D)}$ .

[More discussions about the implications of the equilibrium here under construction]

### The “Beyond-Economics” Importance of Free Trade Agreements

To provide some empirical background for this game-theoretic model, I discuss how FTAs would influence security in the Asia-Pacific region, with special attention to FTAs’ impacts on Chinese domestic politics and its foreign policy making. I argue that the FTA that requires structural economic reforms to the signatory nations would make security relations marked by increased international cooperation, because each state is motivated to engage in appropriate institution building in both international and domestic politics. The reformists who want to

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<sup>23</sup> The separating equilibrium is an extreme version of the semi-separating equilibrium, where  $b = 0$ . However, this equilibrium is not a perfect Bayesian equilibrium. In the separating equilibrium, only the hardliner type of the authoritarian state takes the aggressive stance while the internationalist type always takes the cooperative stance. The democratic state therefore knows what type of the authoritarian state is being faced when seeing the authoritarian state’s aggressive stance, meaning that in the separating equilibrium  $p' = 1$ , which is larger than  $p^*$  as long as  $F_D < ACQ_D$ . The democratic state retaliates if  $F_D > ACQ_D$  and yields if  $F_D < ACQ_D$ . If the democratic state retaliates, in the last node the authoritarian state escalates if hardliner and backs down if internationalist. This equilibrium is possible if and only if  $F_D > ACQ_D$ . If  $F_D < ACQ_D$ , the internationalist type of the authoritarian state has an incentive to deviate from taking the cooperative stance, given that the democratic state will choose to yield (i.e.,  $ACQ_A > E_A$ ). However,  $F_D < ACQ_D$  to define  $p^*$ . Therefore, there is no separating equilibrium in this model.

advance structural reforms would face the backlash from the anti-reformists who enjoy the benefits of vested interests. Thus, the reformists would have a strong incentive to use the FTA requiring structural reforms as external pressure to advance their reform policies in order to achieve sustainable economic growth.

There is a large literature discussing Chinese elite politics, although the discussion ends up with conflicting interpretations on almost every issue due to the difficulty of collecting empirical evidence.<sup>24</sup> My goal here is not to bring new facts or to present a completely new interpretation. Instead I try reinterpret Chinese domestic politics over FTAs by showing how internationalists and reformists make coalitions to confront the coalitions of anti-reformists (conservatives) and nationalists (hardliners). The discussion here is built on Julien Gewirtz's argument that a coalition of Chinese reformers and Western economists was what made it possible for the post-Mao economic reform to emerge in the 1980s. Gewirtz suggests that the origin of China's current prosperity is not nationalism but internationalism.<sup>25</sup>

Toward the end I examine how trade affects security while China has achieved economic development by benefiting from the GVCs based international trade.<sup>26</sup> In doing so, we can see the broader implications of my game-theoretic model to analyze the reality that is, as always, more complicated than the model. Two complications have been added since Trump was elected U.S. President. First, it is now salient to ask the question of whether the U.S.-led international order is dead as anti-internationalism is rising in the United States and in other parts of the world. In *Liberal Leviathan*, published in 2011 as a response to the George W. Bush administration's Iraq

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<sup>24</sup> One of the best collections is Alice Miller's series of essays in *China Leadership Monitor*, <https://www.hoover.org/profiles/alice-l-miller>. See also Baum 1994; Fewsmith 1994 and 2001; Li 1997, 2001, and 2016; and Vogel 2013.

<sup>25</sup> Gewirtz 2017.

<sup>26</sup> Haas 2017.

War, John Ikenberry showed the possibility of a breakdown of liberal international order but argued that the breakdown would be unlikely because the United States benefited from the current U.S.-led liberal international order.<sup>27</sup> However, since the election of President Trump the breakdown has become a much more likely scenario. Thus, toward the end I examine how the GVCs created by MNCs affect international politics in what Richard Haas calls “a world in disarray” in his book published just before the election of Trump.<sup>28</sup> Second, the implications drawn from the model suggests the changing political economy of the Asia-Pacific and the world due to China’s economic rise, the relative decline of U.S. economic power, and deepened regional integration.<sup>29</sup> Backed by newly acquire economic power, China is certainly interested in lowering U.S. influence in East Asia, taking an initiative of forming international order, and breaking the ties between the United States and its allies. Although the Trump administration has been using provocative rhetoric, the administration’s unpredictable nature raises a suspicion that the United States may suddenly make a “deal” with China by promising to lower the U.S. commitment to the security of East Asia. Although the credibility of the U.S. commitment to the regional security will plummet, the Trump administration may not care about the U.S. reputation among its regional allies. I do not claim that this scenario is likely but suggest that it is consistent with the equilibria of the model examined in this paper.

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<sup>27</sup> Ikenberry 2011, 310–31.

<sup>28</sup> Haas 2017.

<sup>29</sup> I do not at all mean that the *absolute* decline of U.S. power has taken place. What I mean by the “decline of U.S. power” is simply a logical inference from China’s rise. If one country’s power rises, the other country’s power at least relatively declines, but it does not mean that the country’s power absolutely declines.

### *Internationalists Meet Reformists*

The model distinguishes between the reformist internationalist type of actor and the conservative hardliner type. In fact, Miyamoto Yūji—former Japanese ambassador to China—suggests that the Chinese leadership is divided into reformist internationalists (*kokusai kyōchō kaikaku-ha*) and conservative hardliners (*taigai kyōkō hoshu-ha*) over how to respond to internal issues, such as maintaining social stability, as well as external issues, such as responding to globalized world politics.<sup>30</sup> The 2008 global economic crisis empowered the hardliners in the power balance of Chinese domestic politics, and since then the hardliners and the internationalists have been in conflict over the decision making of China’s foreign policy. Moreover, according to Miyamoto, the reformists on domestic policies and the internationalists on foreign policies are aligned, while the conservatives resisting structural reforms on domestic policies are aligned with the hardliners on foreign policies. Although both the reformist internationalists and the conservative hardliners agree that maintaining social stability is most important to achieve the utmost goal of regime resilience, fearful of domestic unrest and challenges to party rule, they have exactly opposite views on how to achieve this goal. On the one hand, the reformist internationalists argue that China should implement economic reform to achieve sustainable economic growth, which would bring social stability and enable one-party rule to be maintained. The FTA requiring structural economic reforms would impose on China a yes-no answer regarding politically sensitive issues such as the SOE reform, the implementation of intellectual property rights, the improvement of labor conditions, regulatory coherence to other countries, and dispute settlement over foreign direct investment, to name a few. In other words, joining such an FTA would require

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<sup>30</sup> Miyamoto Yūji, “Chūgoku ‘Shin no Kaikaku-ha’ to Renkei o” [Japan Should Cooperate with “Real Reformists”], *Nihon Keizai Shimbun*, 26 December 2013. When introducing a Chinese or Japanese source, I put the author’s surname first and given name last.

China to be committed to the “real economic reform” that the reformist internationalists want to advance.<sup>31</sup> On the other hand, the conservative hardliners argue that China should keep the rent-seeking mechanism that supports corrupt vested interests under state capitalism to maintain one-party rule.<sup>32</sup> Therefore, the FTA requiring structural economic reforms would impose on China the *gaiatsu* (literally “foreign pressure”) to empower the reformist internationalists by encouraging the “real economic reform.”<sup>33</sup>

In the model, empowered reformist internationalists bring more likelihood of international cooperation in the separating equilibrium. Translating this to Chinese domestic politics over FTAs, the reformist internationalists insist that China should be committed to domestic economic reforms by joining the FTA that requires structural economic reforms and to cooperative foreign policy in order to appreciate a peaceful international environment, so that it can benefit from the interdependent relationship with the global economy. This could be the case in the model if the democratic state’s expected probability that the authoritarian state’s leadership is internationalist (i.e.,  $1 - p$ ) is higher. Thus, one can argue that the FTA requiring structural reforms would make China’s behavior more cooperative in international politics by empowering the reformist internationalists in the power balance in Chinese domestic politics. Perhaps the most important factor to note is that the effect of empowering the reformist internationalists would occur even if

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<sup>31</sup> Of course, China’s accession to any FTA would be negotiated with the members over a lengthy period, and China would have ample opportunity to try to protect the vested interests that the conservative hardliners desperately want to protect. However, the opportunity to join the FTA requiring structural economic reforms would at least empower the reformist internationalists by giving China a clear incentive to be committed to the reform.

<sup>32</sup> It is important to consider China as a plural form, because otherwise one might take an anti-China tone in this paper. In actuality, this paper’s position is for the reformist internationalists and against the conservative hardliners.

<sup>33</sup> The term *gaiatsu* was frequently used during U.S.-Japan trade negotiations in the 1980s and 1990s. See Schoppa 1997.

China is not an immediate signatory of the FTA. Indeed, China is not a signatory of the CPTPP. However, taking into consideration the FTA's security implications discussed here, as long as kept open for China's future participation, the CPTPP would promote domestic economic reforms in China and strengthen security in East Asia. By contrast, in terms of the model, raising the value of  $p$  would undermine security in the region. The conservative hardliners insist that such an FTA would directly undermine the rent-seeking mechanism enjoyed by those who have particularistic vested interests under the state capitalist system, and hence China should adopt abrasive and nationalist foreign policy projecting its power even if it may cause friction in international relations. The rise of China has been changing the security environment in the Asia-Pacific. Thus, failing to found the CPTPP or any other FTA requiring structural economic reforms would not simply continue the status quo, but efforts to empower the reformist internationalists in Chinese domestic politics should be made to maintain the status quo. Also, one should note that economically desired policy will not be made unless it is politically feasible. Thus, in order to make China committed to domestic economic reforms, the reformist internationalists should be empowered and foreign policy to empower the reformist internationalists, such as the FTA requiring structural economic reforms, should be implemented.

### *The Political Economy of One-Party Rule*

Deng Xiaoping, who introduced the market economy with the slogan of “open-up and reform” (*gaige kaifeng*), clearly proclaimed that China should adopt the cooperative foreign policy to implement domestic economic reforms. He even introduced the concept of “keeping a low profile” (*taoguang yanghui*) as a pillar of Chinese foreign policy, and argued that China should not project its power but should focus on economic development. Moreover, as he established

political and economic institutions to achieve economic development, he expanded popular political participation to a limited extent, without contradicting the absolute principle of maintaining one-party rule. Although Deng's absolute principle was maintaining one-party rule, he supported reformist internationalist ideas and policies even when he purged those who were sympathetic to the demand for democratization. For example, Deng expressed his frustration with the conservative hardliners when he ousted a reformist internationalist Hu Yaobang in 1987, as Gewirtz says: "Although he had agreed that Hu had to go, Deng wanted to stress that his overall goals remained intact. He went even further, announcing a break with Chen Yun's [conservative] economic ideology."<sup>34</sup> Interestingly, Deng used Hu's purge as an opportunity to undermine the conservative hardliners and empower the reformist internationalists. The reformist internationalists like Zhao Ziyang indeed faced backlash. The conservative hardliners revealed their nationalist and xenophobic position, as Gewirtz describes: "In pushing for reversals of Zhao's [Zhao Ziyang's] policies, senior conservative leaders specifically targeted Zhao's engagement with *foreign* ideas" (emphasis added).<sup>35</sup> In light of the game-theoretic model here, these attitudes of Deng can be conceived as a decrease in the value of  $p$  by empowering the reformist internationalists. The confrontation between the reformist internationalists and the conservative hardliners suggests that the former sought ideas while the latter relied on ideology. Of course, "Deng Xiaoping was absolutely unwilling to let this ferment of new ideas and policies undercut the authority of the CCP [Chinese Communist Party]."<sup>36</sup> At the same time, Deng and the reformist internationalists desperately needed "to adopt a remarkable new policy: to travel far and wide,

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<sup>34</sup> Gewirtz 2017, 184.

<sup>35</sup> Ibid., 214.

<sup>36</sup> Ibid., 48.

across national borders and ideological boundaries, to seek new ideas.”<sup>37</sup> In sum, in the 1980s internationalism worked as a *gaiatsu* to implement reformist policies.

The 1989 student movement reminded Deng of the historical lesson that the market economy would lead to increasing popular demands on the regime, wherein people’s dissatisfaction with corruption, inequality, and inflation results in demands for democratization. After the 1989 student movement, “conservative leaders in China launched a new Patriotic Education Campaign,” which launched another nationalist movement and strengthened the position of the conservative hardliners.<sup>38</sup> However, even though “in the early 1990s, after the disaster at Tiananmen, the CCP would shift its line and ensure that economic reform and political reform were conceptually separated,” Deng “attempted to signal internally that his commitment to economic reform remained paramount.”<sup>39</sup> In the meantime, the conservative hardliners were then empowered: “because Hu Yaobang was now dead and Zhao was under house arrest, conservatives dominated the remaining senior Party leadership after Tiananmen.”<sup>40</sup> Interestingly, although Zhao was purged in 1989, “reformers [brought] back many of the substantive policies he had advocated for the Chinese economy in the 1980s and for which he and his Western influenced ‘brain trust’ had been attacked—albeit without full acknowledgment of their supposedly treacherous origins.”<sup>41</sup> For example, when “the conservatives criticized the pre-1989 reforms as dangerously decentralizing and stressed the importance of the continued centralization of economic policy...Zhu Rongji seized this moment to assert his role as an economic czar with the skills to

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<sup>37</sup> Ibid., 28.

<sup>38</sup> Ibid., 234.

<sup>39</sup> Ibid., 219 and 227.

<sup>40</sup> Ibid., 227.

<sup>41</sup> Ibid., 230.

replace Chen Yun and the reformist credentials to please Deng.”<sup>42</sup> Zhu’s economic policy advisors Wu Jinglian and Zhou Xiaochuan “acknowledged clear ‘influences’ from other market economies” in Zhu’s reformist economic policies.<sup>43</sup> In short, the reformist ideas influenced by foreign market economies empowered the Chinese reformist internationalists even after the 1989 student movement and provided the foundation for today’s economic prosperity.

Jiang Zemin was different from the reformist internationalists such as Zhao or Zhu. His commitment to reformism and internationalism was much weaker.<sup>44</sup> Jiang had good reason not to be committed to reformist internationalism. He came into office just after the Tiananmen Incident and his primary goal was to prevent the market economy from leading to increasing popular demands for democratization. Thus, he took the cooptation strategy that encouraged former officials and former SOE managers to become nominally private entrepreneurs.<sup>45</sup> This cooptation strategy helped China prevent the market economy from increasing the demand for democratization.<sup>46</sup> At the same time, it formed the state capitalist system where the CCP champions the collusive rent-seeking mechanism by distributing the rent to various societal groups, which has since overshadowed the Chinese economy.<sup>47</sup>

Critics of the cooptation argument point out the observation that the number of private firms increased rapidly in the 1990s.<sup>48</sup> However, Yasheng Huang argues that although private entrepreneurs in the 1980s contributed significantly to rapid development, those since the 1990s

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<sup>42</sup> Ibid., 242.

<sup>43</sup> Ibid., 255.

<sup>44</sup> Ibid., 257–61.

<sup>45</sup> Chen and Dickson 2010.

<sup>46</sup> Tsai 2007.

<sup>47</sup> Huang 2008; and Wright 2010.

<sup>48</sup> Chen and Dickson 2010, 18.

have not.<sup>49</sup> While most of the studies include in the private entrepreneurs the firms that are formally registered as “privately managed enterprises” (*siying qiye*), Huang also includes small-scale individual household enterprises (*getihu qiye*). These unregistered small-scale individual household enterprises have the tendency to try to avoid interactions with the state.<sup>50</sup> In the meantime, many of the registered private entrepreneurs had “previous professional experience that gives them the political ties that are essential for success in business” such as the experience of a SOE manager or a government official.<sup>51</sup> Not surprisingly, those nominally private entrepreneurs who have strong ties to the state tend not to support democracy or democratization but to support authoritarianism due to their shared interest with the regime.<sup>52</sup> In other words, in the model the increasing number of private firms indicates the *increase* in the value of  $p$ .

Hu Jintao, who succeeded Jiang in 2002, raised the slogan of “harmonious society” (*hexie shehui*) to curb corruption rooted in the state capitalist system and to solve the economic inequality that had rapidly expanded in the Chinese economy. However, some evidence suggests that Hu was never able to consolidate his power base and failed to undermine the corrupt rent-seeking mechanism, and as a result, economic inequality expanded during his ten-year tenure.<sup>53</sup> To shrink economic inequality, it was inevitable that the corrupt vested interest structure be curbed and the “real economic reform” of the SOE reform be implemented, but one can easily imagine that Hu faced desperate resistance and backlash from the conservative hardliners led by Jiang, and as a result Hu’s reform floundered.<sup>54</sup> However, Hu was one time successful in breaking Jiang’s

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<sup>49</sup> Huang 2008.

<sup>50</sup> Tsai 2007.

<sup>51</sup> Chen and Dickson 2010, 36.

<sup>52</sup> Wright 2010.

<sup>53</sup> See Kokubun 2017, 217–21; and Miyamoto 2015, 85–8.

<sup>54</sup> Miyamoto 2015, 69–71.

resistance and backlash. In 2006, he accused Chen Liangyu, considered very close to Jiang, of a serious violation of disciplines (i.e., corruption), dismissed him from Party Secretary of Shanghai, and suspended him from any position of the CCP. Against this move, in 2007 Jiang managed to promote Xi Jinping into Party Secretary of Shanghai as Chen's successor; and Xi had to feel indebted to Jiang for this promotion.<sup>55</sup> As a result, Hu was unable to select Li Keqiang—his favorite candidate for his successor—but had to select Xi to be his top potential successor in the National Party Congress of 2007.<sup>56</sup> Thus, when Xi succeeded Hu in 2012, he had to take over the corrupt vested interests under state capitalism, championed by Jiang, the problem that Hu was unable to solve.

In short, since the 1990s the CCP has used the collusive rent-seeking mechanism under the state capitalist system as a tool to maintain popular support for one-party rule, and hence has to keep creating the economic rents to be distributed. Especially since 1997 when Deng passed away and China lost a charismatic leader, Chinese domestic politics has become a power struggle among the leaders over particularistic vested interests under the state capitalist system; and it was a necessary consequence of introducing a market economy while maintaining one-party rule. However, the CCP now faces the dilemma: the “real economic reform” that would undermine the rent-seeking mechanism will be necessary to sustain economic growth. Moreover, it will be necessary to adopt cooperative foreign policy, so that China can maintain good relationships with its trading partners like the United States and Japan. The reformist internationalists as well as the conservative hardliners have understood this logic. However, they have completely opposite stakes in the “real economic reform” and hence the FTA requiring structural economic reforms

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<sup>55</sup> Ibid., 86.

<sup>56</sup> Kokubun 2017, 219.

became a source of contention within the CCP. In his recent book, Gewirtz successfully reveals the inconvenient truth for the conservative hardliners: the reformist ideas brought by Western economists empowered the Chinese reformers in the 1980s and provided the foundation for today's economic prosperity.<sup>57</sup> Although “Foreign Minister Wang Yi recently claimed that ‘socialism with Chinese characteristics’ was ‘grown out of the soil of China,’ and ‘former vice premier Zeng Peiyan ... fully credits [the development of the socialist market economy] to ‘Chinese Communists,’” according to Gewirtz, the Chinese socialist market economy was rooted in Zhao’s effort to import ideas from Western economists.<sup>58</sup> Moreover, at each crucial point of the power struggle between the reformists and the conservatives, the reformists were enabled by their coalition with internationalists. In fact, the origin of China’s current prosperity is internationalism, not nationalism. Interestingly, Kokubun Ryōsei, a leading China specialist in Japan, points out the tendency that China takes a more cooperative stance toward Japan when the reformist internationalists are in the advantageous position vis-à-vis the conservative hardliners in Chinese domestic politics.<sup>59</sup> He argues that Jiang made nationalism and the hardliner position in international relations a tool to protect the corrupt vested interests under state capitalism, and that is why the conservative hardliners must be contained for the nation to take a cooperative foreign policy.

### *Is China a Responsible Stakeholder?*

Now that China has become the second largest economy in the world, and that the United States opts for the backseat of liberal international order, whether China is a responsible

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<sup>57</sup> Gewirtz 2017.

<sup>58</sup> Ibid., 10–1.

<sup>59</sup> Kokubun 2017, 243–9.

stakeholder is a \$64,000 question. The answers depend on whether Xi Jinping is reformist internationalist. First, the most optimistic answer suggests that China benefits from the current U.S.-led liberal international order and hence that the Xi administration has plenty of reasons to take reformist internationalist policies. In the 1990s immediately after the end of the Cold War, the United States was confident in its ability to solve many, if not all, of the problems in the world. However, the 9/11 terrorist attacks in 2001 and the Iraq War that began in 2003 made the United States realize that it could not manage every problem in the world but would need to prioritize the problems. Later, during the Barack Obama administration, the pivot (or rebalancing) to Asia became a popular topic in policy discussions of American foreign policy—the “pivot” in other words means the “priority”—and the pivot to Asia above all means that the United States gives priority to Asia over any other region such as the Middle East or Russia. The background of this renewed interest in Asia is the dynamic economic development of the Asia-Pacific and the rise of China in both security and the economy.<sup>60</sup> Thus, as Thomas Finger, political scientist and former chairman of the National Intelligence Council, argued, by incorporating China into the U.S.-led international order, the pivot to Asia would help the United States to maintain supremacy in post-Cold War international politics.<sup>61</sup> In this scenario, any policy incorporating China into the U.S.-led international order, like encouraging China to join the FTA requiring the commitment to structural reforms, can be interpreted as an increase in  $p$  in accordance with the game-theoretic model. Seyom Brown argues that to examine whether a powerful country, like China, is a responsible stakeholder one should consider not only “capability” but also “intention.”<sup>62</sup> Of course, no FTA will alter China’s worldview or ambitions. However, proposing an FTA requiring

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<sup>60</sup> Clinton 2011.

<sup>61</sup> Thomas Finger interview with author, 5 November 2014.

<sup>62</sup> Brown 2008.

structural reforms will positively influence China's "intention" by empowering the reformist internationalists in the power balance of Chinese domestic politics. Therefore, such an FTA makes China's behavior more cooperative in international relations.

However, the second, less optimistic, answer suggests that China challenges the U.S.-led rule-based international order, which will be a threat for the states that follow the current order. For example, Patrick Walsh, former commander of the U.S. Navy Pacific Fleet, insists that China's goal is building a Chinese-led international order and hence China will reject being incorporated into the U.S.-led international order. He states: "China does not have the intention to follow the existing international-law-based agreements that have been functioning. Instead China tries to reject the U.S.-established rules and international order."<sup>63</sup> For the instance of the South China Sea, exclusive economic zones (EEZs) originally existed based on the lines agreed upon by the surrounding nations, but China has recently challenged them and declared the whole South China Sea as China's territorial waters. When Walsh raised the legitimacy of this declaration with the Chinese participation at a conference, the Chinese participant brushed it aside saying: "Because we claim it." From China's stand point, the existing EEZs in the South China Sea were determined without China's participation when China was not powerful enough to participate in such a decision, and hence China should redraw the lines now that it has sufficient power to push its own demands. In other words, China is challenging the rules that have been determined without its participation.

Weighing in with this pessimistic scenario, the third answer focuses on China's attempt to build a Chinese-led international order by founding several international institutions, such as the Asian Infrastructure Investment Bank (AIIB) and the One Belt and One Road Initiative. China is

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<sup>63</sup> Patrick Walsh interview with author, 5 May 2014.

also trying to take the initiative in the negotiation of the RCEP to compete with the TPP 11 in which China has not participated. However, it is not certain whether the Chinese-led international order is welcomed by other nations. Xi's pompous nationalist slogans, such as the "China dream" (*Zhongguo meng*) and the "great restoration of the Chinese nation" (*Zhonghua minzu weida fuxing*), make other nations doubt China's intention to use its power as a responsible stakeholder. On China's intention to be a responsible stakeholder, Elizabeth Economy argues that Xi gives the highest priority to tightening his grip over anything.<sup>64</sup> In other words, Xi seems to be trying to apply the method of maintaining one-party rule in the domestic sphere to manage China's influence in the international sphere. In the domestic sphere, he tightens his grip on the control of political power and social stability by cracking down on dissidents and curbing corruption. Meanwhile, in the international sphere, he tightens his grip on the control of the international order by projecting China's power in whatever way it can. According to Economy, China projects its power by establishing the AIIB, expands its sphere of influence in Central Asia and more broadly in Eurasia by leading the Shanghai Cooperation Organization, and tries to build a Chinese-led security system by undermining U.S. influence in the Asia-Pacific. Thus, backed by newly acquired economic power, China is certainly interested in lowering U.S. influence in East Asia, taking an initiative of forming international order, and breaking the ties between the United States and its allies. This answer reflects the changing political economy of the Asia-Pacific and the world due to China's economic rise, the relative decline of U.S. economic power, and deepened regional integration.<sup>65</sup>

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<sup>64</sup> Economy 2014.

<sup>65</sup> I do not at all mean that the *absolute* decline of U.S. power has taken place. What I mean by the "decline of U.S. power" is simply a logical inference from China's rise. If one country's power rises, the other country's power at least relatively declines, but it does not mean that the country's power absolutely declines.

Considering the division between the reformist internationalists and the conservative hardliners in Chinese domestic politics, what implications does China's attempt to build a Chinese-led international order? We should keep in mind that the reformist internationalists and the conservative hardliners have very different interests. Both sides try to empower themselves through the founding of the international economic institutions. For example, the reformist internationalists think that administrating an international development bank like the AIIB will provide China with an opportunity to learn the know-how of loaning for infrastructure projects in developing countries. Moreover, monitoring by developed countries participating in the AIIB, such as Germany and United Kingdom, will work as a *gaiatsu* to implement reformist policies to refine China's market economic institutions, which will decrease the value of  $p$  in the model. Meanwhile, the conservative hardliners think that infrastructure projects invested by the AIIB will create effective demands for the manufacturers and construction companies that have excessive productive capacities. China's state capitalist system has allowed many zombie companies to survive thanks to political connections under the co-optation strategy. In short, the AIIB might empower the reformist internationalists and make China behave as a responsible stakeholder, if monitoring by the participants of developed countries work; however, it might empower conservative hardliners and make China behave abrasively, if it is taken as a cornucopia of reward for zombie companies.

Although China is eager to expand its influence in the Asia-Pacific, it does not seem to feel any responsibility for whether its behavior will lead to regional stability or have any influence on the regional security. It is doubtful whether it can provide international public goods of regional stability and peace in lieu of the United States even if it becomes as powerful as the United States. In that sense, the rise of China in the early twenty-first century may be similar to that of Russia

(Soviet Union) in the early twentieth century, which also did not have any intention to provide international public goods. I do not conclude that the rise of China will follow that of Russia. However, if U.S. influence in Asia retreats under the current conditions, the region could become destabilized. And now, as the U.S. influence in Asia indeed retreats under the Trump administration, the role of the stabilizer falls to China. Therefore, the reformist internationalists must prevail over the conservative hardliners in the power struggle under the Xi administration. To achieve the goal, because many nations doubt China's intention to use its power as a responsible stakeholder to build a Chinese-led international order, the FTA requiring structural economic reforms is<sup>66</sup> not just a trade agreement but may become the foundation of security in the Asia-Pacific.

#### *U.S.-China Relations Under the Trump Administration*

As a result of the election of Trump to be the U.S. President, the United States has become the epicenter of uncertainty against liberal international order. John Ikenberry says that “the world’s most powerful state has begun to sabotage the order it created.” Although Trump’s saying lacks consistency overall, unfortunately he is consistent with unpredictability. The United States has become the epicenter of uncertainty in international politics because the U.S. President has repeatedly given irregular remarks using the twitter like a kid’s toy. I suspect the reason why Trump is consistently unpredictable is that his saying is not based on his strategy but based on his psychology. A *New York Times* columnist David Brooks, who has written the most intellectual analysis on Trump and his supporters, wrote: “It’s not clear if Trump is combative because he sees the world as dangerous or if he sees the world as dangerous because it justifies his combativeness.

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<sup>66</sup> Ikenberry 2017, 2.

Either way, Trumpism is a posture that leads to the now familiar cycle of threat perception, insult, enemy-making, aggrievement, self-pity, assault and counterassault.”<sup>67</sup> While many analysts have struggled with figuring out rationality in his saying and his administration’s policy-making, it would make much more sense if he takes a certain view not because he believes the view for some reason but because it satisfies his ego and justifies his psychology.<sup>68</sup> Moreover, Trump is a hard-core anti-institutionalist. Even if some of the voices in the administration that do not appear to share his view try to reason with him on how rule-making through multilateral institutions benefits U.S. strategic interests, he will not listen to their advice because his ears do not respond to strategy but to psychology. Furthermore, he hates domestic institutions such as the economic regulations that make the market economy function. He also attacks democratic institutions such as the separation of powers and the freedom of speech because they hurt his feelings. Unfortunately, for his supporters the less civil he is the more attractive his saying is, as his anti-institutional attitude and lack of civility are criticized by those who, he tells them, look down upon them.<sup>69</sup>

With this unpredictable nature of the Trump administration, the game-theoretic analysis in this paper suggests a pessimistic perspective to U.S.-China relations. According to Miyamoto Yūji, Beijing is good at managing the issues for which it has prepared carefully in advance but not good at taking proper steps to meet the situation according to circumstances.<sup>70</sup> This is because Chinese foreign policy is influenced by domestic politics, especially by the power struggles within the Chinese Communist Party (CCP). Thus, the unpredictable nature of the Trump administration is

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<sup>67</sup> David Brooks, A Gift for Donald Trump, *New York Times*, 10 February 2017, <https://www.nytimes.com/2017/02/10/opinion/a-gift-for-donald-trump.html>.

<sup>68</sup> The exceptional work to analyze Trump’s psychology is Lee, ed. 2017.

<sup>69</sup> See David Brooks, When Politics Becomes Your Idol, *New York Times*, 30 October 2017, <https://www.nytimes.com/2017/10/30/opinion/when-politics-becomes-your-idol.html>.

<sup>70</sup> Miyamoto Yūji, Chūgoku wa Toranpu ni Do Tachimukau no ka? [How Does China Face Trump?]. *Foresight*, 2 February 2017, <http://www.fsight.jp/articles/-/41969>.

a big challenge for the China that is not good at taking measures suited to the changing occasion. However, before managing the external challenge of the Trump administration's unpredictability, the Xi administration has to face the internal threat of domestic stability. Since 2011, China has spent more for police than national defense. The biggest threat for the Chinese government is not the United States (with the overwhelming military power), Japan (with which China has historically had friction and conflict), nor Russia (which shares long borders with China), but its own people's dissatisfaction with the state and society. To maintain one-party rule, China's authoritarian regime has used local governments as a scapegoat to sway the people's dissatisfaction with the central government.<sup>71</sup> As a result, since the 1990s, the rise of resentment over rural taxation, land condemnation, and official corruption has led to increasing popular protests against local governments, and those protests have often escalated into burning the buildings of the targeted local government.<sup>72</sup> In addition, the first year of the Trump administration was also the year when the CCP's National Party Congress convened in October. Deciding who to join the leadership for the second term of the Xi administration is the biggest task of the Congress—that takes place once in five years. Thus, one can easily imagine that Xi was occupied with the power struggle over the leadership personnel. Although Xi was expected to stay in power for his second term, the personnel determined at the Congress in 2017 would have grave implications on the leadership after 2022 when Xi's second term ends. Xi looked confident when welcoming Trump to China in November just after the National Party Congress was over, perhaps because he has successfully ended the Congress and consolidated his power basis.

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<sup>71</sup> Bernstein and Lü 2000; Chen 2015; Ong 2012; Takeuchi 2014.

<sup>72</sup> Cai 2010; Chen 2012; O'Brien and Li 2006.

In the meantime, the model developed here shows that the worst case scenario for the U.S. allies in the Asia-Pacific is quite rational in equilibrium given that both countries have difficult problems of unstable domestic politics. After having successfully sent a credible signal that the United States takes an aggressive stance against China, the United States would have an incentive to later back down compromising with China when the Xi administration caters to the Trump administration. In the model's equilibrium, even the internationalist China will take aggressive policy if it believes that the United States is hardliner although it will take cooperative foreign policy otherwise. Put another way, if the United States has formed the expectation that it takes aggressive policy toward China, then China will take aggressive policy toward the United States, even if the Xi Jinping administration is internationalist. Thereafter, the United States may respond by escalating the tension, which will create a vicious circle of the security dilemma in China-U.S. relations.

Then, what would happen if the United States backs down in exchange of China's compromise on economic issues such as the agreement of voluntary export restraints to the United States or the appreciation of the renminbi to the U.S. dollars? Ironically, this kind of "deal" may satisfy the interests of both China and the United States. While China will be satisfied with the lower presence of the United States in East Asia, the United States will be satisfied with maintaining economic interactions with China. Although the credibility of the U.S. commitment to the regional security will plummet, the Trump administration may not care about the U.S. reputation among its allies. Backed by newly acquired economic power, China is certainly interested in lowering U.S. influence in East Asia, taking an initiative of forming international order, and breaking the ties between the United States and its allies. Although the Trump administration has been using provocative rhetoric, the administration's unpredictable

characteristics raise a suspicion that the United States may suddenly make a “deal” with China by promising to lower the U.S. commitment to the security of East Asia. I do not claim that this scenario is likely but suggest that it is consistent with the model’s equilibrium. Even though preferring the lower commitment by the United States, the current military balance does not give China sufficient power to control the whole East Asia or the Western Pacific Ocean. However, if the Trump administration’s decision-making is influenced more by protectionist and anti-internationalist advisors and cabinet members such as Robert Lighthizer (U.S. Trade Representative), Peter Navarro (Director of the White House National Trade Council), and Wilbur Ross (U.S. Secretary of Commerce) while neglecting security experts such as James Mattis (U.S. Secretary of Defense), this scenario would not be groundless any more.

Finally, I would also like to emphasize the roles of other countries in the age when the Trump administration’s “America First” policies deepens the crisis of the American-led system. The second largest economy next to the United States is China. In the 2017 World Economic Forum in Davos, Xi gave a clear statement opposing protectionism, and China has shown the intention to take over the driver’s seat of international order. However, as shown in this paper, it is questionable whether the China that is concerned with the internal threat of domestic stability can play a decisive role in the new international order, replacing the United States, which has played the role since the end of World War II. To lead the global economy, it is inevitable for China to be committed to structural economic reforms and the Xi administration must manage the backlash from the conservative-hardliners in domestic elite politics. Then, looking at the third and fourth largest economies following the United States and China, they are Japan and Germany.<sup>73</sup>

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<sup>73</sup> Interestingly, Ikenberry says Prime Minister Shinzo Abe of Japan and Chancellor Angela Merkel of Germany are “the only two leaders of consequence left standing who support it [the liberal international order].” Ikenberry 2017, 3.

Chancellor Angela Merkel of Germany has taken a clear position on the refugee issue, and hence Germany has seemed to lead international order in the aspect of democracy and human rights. Meanwhile, Japan has limitations to lead international order in democracy or human rights, but has ability to lead international order in the aspect of free trade. Indeed, Japan has now taken the initiative to conclude the CPTPP: that is the almost same set of rules agreed upon by the original 12 signatories of the Trans-Pacific Partnership (TPP) but not requiring the U.S participation. Although the U.S. withdrawal prevented the TPP from taking effect immediately, its agreed rules are an important model for any forthcoming FTA; and hence even the NAFTA renegotiation among Canada, Mexico, and the United States is also expected to use the TPP's agreed rules as a benchmark—even though the Trump administration has criticized both deals.

## **Conclusion**

The overall implication of the model and case study presented here is that the FTA requiring structural reforms in domestic economy can enhance regional security in international relations by empowering reformist internationalists in domestic politics. The model suggests that the FTA that requires the state to commit to structural reforms makes the authoritarian state behave cooperatively in international relations. This process can be seen at work in the political economy of China's foreign policy making since it started the market-oriented reform in the 1980s. In other words, the model suggests a way to make an authoritarian state to behave cooperatively and peacefully without democratization.

This is an encouraging message for those interested in building support for FTAs and free trade. In November 2016, Trump was elected the next President of the United States. He then declared the withdrawal from the TPP immediately after his inauguration in January 2017.

Originally, for the TPP to come into effect, six or more nations had to approve it and yet those approving nations had to represent more than 85 percent of the GDP of the 12 signatories, which meant that the TPP would not come into effect without the United States or Japan. The model in this paper implies that the failure of the TPP would empower the conservative hardliners in Chinese domestic politics, make China's behavior in international relations more aggressive, and undermine the security of the Asia-Pacific region. That is arguably the reason why Japan took over the driver's seat of this FTA's negotiation and took the initiative to conclude the CPTPP.

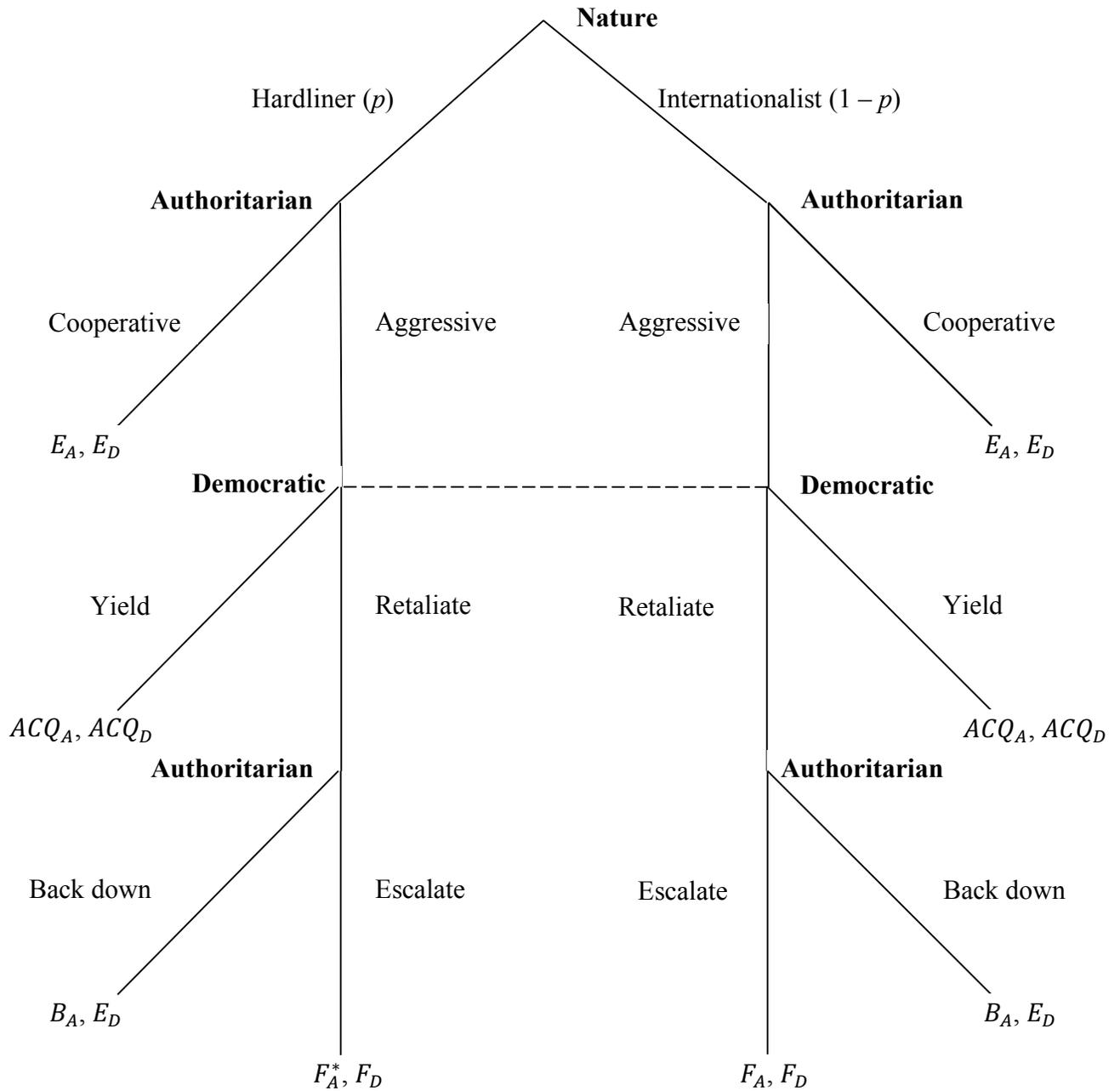
The model also provides a theoretical underpinning for the security implications of the emerging intra-industry trade of manufacturing industries induced by the spread of GVCs. The development of GVCs in the Asia-Pacific over the last two decades has brought a new international division of labor between developed and developing countries, which also include both authoritarian and democratic states. Thus, in the international sphere, the states in the Asia-Pacific have a strong incentive to establish internationally adopted rules by concluding FTAs to manage GVCs based intra-industry trade. Meanwhile, in the domestic sphere, governments in the Asia-Pacific have a strong incentive to use the FTAs as external pressure to advance structural reforms to achieve sustainable economic growth. The argument developed in this paper has particularly important implications for policy debates over the FTAs such as the CPTPP or the NAFTA, which are expected to play an important role as rule makers in further developing the GVCs in the Asia-Pacific. The game-theoretic model presented here may contribute to developing a theoretical foundation for security implications of GVCs based intra-industry trade. Skeptics of the TPP have often overlooked the new trend of international trade in the Asia-Pacific, assume that the mainstream of international trade is inter-industry, and argue that the tariffs are already low,

making the TPP unnecessary.<sup>74</sup> However, in reality, the CPTPP would be necessary economically to promote GVCs based intra-industry trade in the Asia-Pacific, and it would be necessary politically to strengthen regional security with the empowerment of reformist internationalists against conservative hardliners.

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<sup>74</sup> See, for example, Paul Krugman, No Big Deal, *New York Times*, 27 February 2014, <https://www.nytimes.com/2014/02/28/opinion/krugman-no-big-deal.html>.

**FIGURE 1.** *The crisis bargaining game*



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