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### The Political Economy of the Globalization Backlash: Sources and Implications

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For at least two decades, scholars and other observers have understood that international economic integration—globalization—has in the past, and could in the present, give rise to a backlash.<sup>1</sup> Over the past few years, in much of the advanced industrial world, we have gotten a sense of what that backlash looks like.

Political discontent has been central to the globalization backlash. Dissatisfaction has taken the form of large increases in voting for extremist political parties, the emergence of new parties and movements, and challenges from within existing parties. Large numbers of voters have rejected existing political institutions, parties, and politicians, often in favor of “populists” of the Right or Left whose common themes include skepticism about economic integration and resentment of ruling elites. In the United States, both Bernard Sanders and Donald Trump ran on programs that were openly hostile to international trade, investment, and finance; Trump also campaigned in favor of tighter controls on immigration. In Europe, the populist turn of the Right has largely centered on antagonism to European integration and immigration; the populism of the Left has mostly attacked austerity programs associated

<sup>1</sup> I want to thank the following for useful comments and suggestions on this chapter: Matilde Bombardini, Alessandra Casella, Andrew Coe, Lindsay Dolan, Chase Foster, Peter Hall, George Hoguet, Stephen Kaplan, Casey Kearney, Helen Milner, Stefanie Rickard, Ken Shepsle, Jack Snyder, David Stasavage, Dustin Tingley, and Stefanie Walter.

with the European Union's disastrous attempts to manage the eurozone debt crisis.

This chapter analyzes the sources of contemporary political discontent, with particular attention to the United States. I focus on the economic and political roots of the populist upsurge, leaving cultural and related issues to others. On the economic front, economic integration has had an adverse impact on many communities, and compensatory mechanisms have not addressed this impact effectively; there has been a *failure of compensation*. On the political front, large groups in the population have been alienated from mainstream political institutions, finding it hard to have their concerns taken seriously by existing political institutions; there has been a *failure of representation*. Both failures have been developing for decades, and there are many obstacles to overcoming them. I suggest some possible paths that politics may take in the current situation and their implications.

## POLITICS AND THE DISTRIBUTIONAL EFFECTS OF ECONOMIC INTEGRATION

Increasing a country's ties to the international economy improves aggregate social welfare, but it also creates both winners and losers. A substantial and growing literature seeks to clarify how the distributional impact of globalization affects politics. The general conclusion is that groups and regions harmed by greater exposure to the international economy are more likely to vote for populist and extreme political parties and candidates as well as measures to reduce globalization. Most studies emphasize the impact of trade in manufactured products, especially with low-wage developing countries, for it is this trade that is expected, both theoretically and empirically, to have the most prominent negative effects on workers in North America and western Europe.<sup>2</sup>

Increased exposure to Chinese imports into western European countries is associated with more nationalistic voting and more votes for extreme right-wing parties (Colantone and Stanig, 2018b). In France specifically, regions more affected by low-wage import competition from developing countries were significantly more likely to vote for the

<sup>2</sup> Most of these studies use some variant of the China shock instrument first developed in Autor, Dorn, and Hanson 2013.

National Front, an extremist party hostile to both globalization and European integration, and this effect has grown over time. In the United Kingdom, exposure to Chinese import competition has been associated with a rise in authoritarian values, especially aggression born of frustration (Ballard-Rosa et al. 2017). Voting on the referendum to leave the European Union (dubbed Brexit) was also affected by susceptibility to trade. While some supporters of Brexit saw it as freeing the United Kingdom from the European Union's strictures on economic activity, surveys indicate that a substantial proportion of Brexit voters saw it as a way to limit economic ties with the rest of Europe, including immigration. In fact, areas harder hit by trade competition, in particular from China, were more likely to vote to leave the European Union (Colantone and Stanig 2018a).<sup>3</sup>

Many regions in the United States have experienced job losses and reduced wages due to the China shock, and more generally to low-wage imports from developing countries.<sup>4</sup> These regions have become more politically polarized since 2000 (Autor et al. 2016a). Their legislators have tended to vote in more protectionist directions (Feigenbaum and Hall 2015). And perhaps most strikingly, they were more likely to swing their votes toward Trump in the 2016 presidential election (Autor et al. 2016b; see also Jensen, Quinn, and Weymouth 2017). More generally, job losses due to trade have twice as large a negative impact on votes for incumbent politicians than do job losses for other reasons. This effect is stronger in midwestern industrial states; in some of them, the negative effect of trade-related job loss is greater than the difference in votes between incumbents and challengers (Margalit 2011).

Americans often blame globalization for job insecurity, due largely to the employment effects of low-wage foreign competition. It is also common for Americans to blame globalization for the increasing disparities between the middle class and the top 10 or 1 percent of US society. Bankers, corporate executives, and professionals in the

<sup>3</sup> Sascha Becker, Thiemo Fetzer, and Dennis Novy (2017) argue that the vote was more strongly affected by underlying socioeconomic characteristics of constituencies, and in particular by low income and education, high unemployment, and substantial employment in manufacturing.

<sup>4</sup> While I am not familiar with studies on the analogous distributional implications of the integration of capital markets, there are a few on the impact of foreign direct investment, or what's called offshoring. See especially Owen and Johnston 2017.

internationalized segments of the US economy are seen as having taken great advantage of their global ties, while leaving the middle and working classes behind.

There is no doubt that there are also noneconomic sources of the turn toward populism, including cultural bias and ethnic prejudice. I address one of these noneconomic sources below, but leave most to others. Similarly, the economic trends in question are not solely due to economic integration. Skill-biased technological change certainly has put downward pressure on the earnings of un- and semiskilled workers, and (probably fruitless) debates continue over the relative importance of trade and technological change. Nonetheless, technological change is not typically a policy variable, while trade and other international economic activities are; in addition, a focus on trade appeals to many—including many politicians—because it appears to make foreigners pay for some of the costs of globalization. For the purposes of this chapter, I focus on the economic sources of the populist backlash. I also, for both reasons of data availability and personal comparative advantage, draw most of my examples from the United States.

Two significant points are sometimes lost in current discussions. First, the broad trends that underlie present-day discontent are of long duration; they did not start when China joined the WTO. The first major wave of manufactured imports from low-wage developing countries began in the late 1960s, and accelerated through the 1970s and 1980s. As early as 1978, a year before China started opening up to the world economy, US manufactured imports from developing countries were at least 25 percent of the total, up from 13 percent ten years earlier (Grossman 1982, 272).<sup>5</sup> By 1990, when both the deindustrialization of the rust belt and “trade and wages” debate among economists were in full swing, developing countries accounted for 36 percent of the United States’ manufactured imports; at that point, China was only fourth on the list of developing country exporters, well behind Taiwan, Mexico, and Korea.<sup>6</sup>

A second significant point is that these economic trends have a powerful impact on *communities* as well as individuals. This is a consequence of the historical geographic concentration of US manufacturing in the

<sup>5</sup> Another study (Sachs and Shatz 1994, 1) put the 1978 number at 29 percent.

<sup>6</sup> For a summary of the state of the debate on trade and deindustrialization since the 1990s, see Krugman 2008; and Krugman’s chapter in this volume.

Midwest and parts of the South, and the fact that many of the industrial facilities hit hard by import competition are in towns or small cities. These communities have experienced a series of cascading effects of trade- and investment-related pressures on local manufacturing. The direct economic impact includes higher unemployment and lower wages in the short run, and eventually more underemployment, less labor force participation, and out-migration by the more mobile inhabitants. Over time there are *indirect* economic effects. As the local economy suffers, local income and property values fall, which leads to a decline in local government tax revenue and hence a deterioration of local public services.<sup>7</sup> The erosion of a community's economic base eventually has *social* effects, including a rise in alcoholism, opioid abuse, and suicidality (Pierce and Schott, forthcoming).

In the United States at least, there is substantial, albeit at this point only suggestive, evidence for this trajectory.<sup>8</sup> More recently, the extremely sharp and long recession that began in December 2007 severely aggravated ongoing trends, especially for those outside the top 25 percent of the income distribution. Median household wealth, for example, was still 34 percent below its 2007 levels ten years after the crisis began (Wolff 2017). This is, I believe, a major source of the political discontent that bubbled up, first with the Tea Party movement in 2010, and then with the candidacies of Sanders and Trump.

To identify economic integration as a significant source of political dissatisfaction is not to imply that voters have a clear notion of precisely how trade affects them. It is perfectly plausible—and indeed likely—that subjective perceptions of trade's impact are in many cases based on a broad sense of unease about current economic trends rather than on a clear analysis of the distributional impact of trade. Trade in particular and globalization more generally contributed to a general decline in the quality of life in many communities in the United States. Residents of these communities are aware of the decline, and although they may have no clear sense of its sources, one visible indicator is that local factories that used to provide decent-paying jobs have closed or moved abroad due to foreign competition. The generalized dissatisfaction that

<sup>7</sup> For a careful discussion and documentation of these effects, see Feler and Senses 2017.

<sup>8</sup> With colleagues, I am working to gather more systematic evidence about the process, and other scholars are engaged in similar enterprises.

results takes many forms, including a hostility to international economic engagement. Again, this is *not* to suggest that voters have a sophisticated model of the distributional impact of trade. It is to say that they know that their communities are doing poorly, trade probably played some role in the problem, and existing politicians have not done enough to halt the decline. This provides a foundation that populist political entrepreneurs can use for their own purposes—including fanning the flames of economic nationalism.

Indeed, in both the United States and Europe, the populist upsurge contains at least as much hostility toward political “elites” and traditional political institutions more broadly as it does toward globalization *per se*. It is difficult to separate the two strands of hostility: elites are blamed for having failed to manage globalization adequately, and globalization is blamed for having unduly rewarded elites. Nonetheless, in most of the contemporary populist political movements there is a strong strain of distrust in government itself. It is to this that I now turn.

## POLITICS AND THE LOSS OF CONFIDENCE IN GOVERNMENT

Closely related to accelerating skepticism about globalization has been a loss of trust in the institutions of government. This has been apparent in US public opinion: after fluctuating over the course of the 1980s and 1990s, the proportion of Americans who say they trust the government in Washington, DC, all or most of the time has dropped continually from the vicinity of 50 percent around the year 2000 to below 20 percent today. There are differences among socioeconomic and partisan groups, but the decline in confidence in the government is universal. Not surprisingly, groups more likely to support Trump’s candidacy were also less likely to trust the federal government; whites, older people, and those without a college degree all evince more distrust than blacks or Hispanics, younger people, and those with a college degree.<sup>9</sup>

European public opinion has undergone a similar evolution. In the case of Europe, the collapse in confidence began with the European debt crisis, and it takes the form of increased distrust of national governments, the institutions of the European Union, or both. Here too,

<sup>9</sup> For one comprehensive survey, see Pew Research Center 2015.

there are clear differences across countries and socioeconomic groups. People in the more crisis-affected debtor nations have lost much more confidence in the European Union and their national governments than have those in the less hard-hit creditor nations. Nonetheless, dissatisfaction with the functioning of traditional political institutions, parties, and politicians has grown in every country. The level of dissatisfaction as well as its growth have been greater among poorer and less educated Europeans than among wealthier and better-educated ones.<sup>10</sup>

Increased hostility to existing political parties, governments, and European institutions is clearly central to the populist upsurge. In both the United States and many European countries, those drawn to populism regard mainstream politicians and policy makers as indifferent to the concerns of common people. This does not necessarily mean that those voting for more extreme political parties share the views of the parties themselves. In fact, there is evidence in Europe that voters' ideological proclivities have not changed; what has changed has been their willingness to vote for more extreme candidates. The obvious implication is that at least some of the voting for more extreme, populist, political parties and candidates is classical "protest voting."

Nevertheless, it is clear that there have been substantial changes in the politics of globalization in much of Europe and North America. Important segments of the public are hostile to economic integration—international in the United States, and European in the European Union—while similarly important segments of the voting public are distrustful of traditional political parties and politicians. In what follows, I suggest that hostility to globalization is largely due to the failures of compensation, while distrust of political institutions is the result of the failures of representation.

## THE FAILURES OF COMPENSATION

A basic principle of economics is that economic policies or trends that increase aggregate social welfare can be Pareto improvements with the right redistributive policies. Even if the policy or trend harms some, income can be reallocated from the beneficiaries to the losers in such

<sup>10</sup> For detailed, complementary data and analysis of these trends, see Algan et al. 2017; Dustmann et al. 2017; Frieden 2016; Foster and Frieden 2017.

a way as to make everyone better off. Any realistic model of trade, for example, posits that there will be winners and losers. But in principle, a compensatory scheme can be designed that addresses the costs to the losers without erasing the gains of the winners.

A basic principle of political economy, however, is that the winners from an economic policy or trend do not like having their gains taxed away in order to compensate the losers. This means that many Pareto improvements may not be politically feasible. If it is politically infeasible to compensate the losers from economic integration, the actual or potential losers are likely to react with hostility to both the political system and economic integration. To put it differently, a globalization backlash is likely to be mitigated by compensation mechanisms, and the absence of adequate compensation is likely to feed a globalization backlash.

The economic and social problems associated with the distributional impact of globalization have deep roots, and it will take substantial long-term policies to address these roots. Most advanced societies need to improve the quality of as well as access to education in order to help overcome the skills mismatch that has contributed to distress in some segments of the labor market and job shortages in others. Many countries are saddled with an outdated economic infrastructure, including in telecommunications, whose modernization will help bring more people and regions into the mainstream of economic life. But these reforms are for the long run, and are politically and economically difficult. More immediately pressing problems have fed the populist upsurge, and more immediate responses are necessary.

In this context, it is clear that governments in at least some countries have failed to provide compensation sufficient to overcome the concerns of those harmed by international economic integration. It is equally apparent—given the great variation in the appeal of populist antiglobalization movements among industrial countries—that the extent of this failure varies substantially among countries. This, then, suggests a question that is important both analytically and for policy makers: What explains why governments might be more or less likely to provide compensation for those harmed by international trade and investment?

There is long-standing evidence that small, open economies have developed more encompassing compensatory policies. These policies

are often associated with a substantial centralization of the institutions of both labor and management, and coordination between them and the government. The logic is that small, open economies have evolved to minimize the political costs of openness, inasmuch as their small size makes openness a necessity. In turn, political institutions in these countries have evolved so that major socioeconomic groups internalize the potential economic, social, and political costs of economic integration, and are willing to support compensatory policies. In the stylized picture of the political economies that fit this characterization, labor and management dependent on access to the world economy work together with government to cushion the impact of foreign competition with some combination of monetary transfers, retraining, mobility assistance, and related measures.<sup>11</sup>

The political economy of compensation is complicated, and varies from country to country. On the one hand, there is some evidence that even in the United States, export-oriented firms support compensation—as do those most negatively affected (Rickard 2015; Walter 2010). There are major differences, however, due to both variation in the causes and effects of the displacement, and among political systems (see, for example, Burgoon 2000; Menendez 2016).

Casual observation suggests that countries with broad and deep social safety nets that address many of the distributional effects of globalization have seen relatively small populist movements. On the other hand, the populist upsurge reflected in the campaigns of Sanders and Trump was particularly powerful in the United States, whose compensatory mechanisms and safety net are probably the least extensive among advanced countries.

The United States' principal compensation scheme, TAA, is small, politically contentious, and largely ineffective (see the chapters by Lori Kletzer and Gordon Hanson in this volume). It reaches few workers; indeed, trade-affected workers are far more likely to have recourse to disability benefits than TAA benefits. Perhaps more important, TAA is targeted at individuals, who must show direct harm from imports. This means that the program cannot address the broad effects of globalization on *communities* rather than specific workers—the main

<sup>11</sup> For early statements of this view, see Cameron 1977; Katzenstein 1985. For a work that systematizes and generalizes the argument, see Rodrik 1998.

channel for transmission of globalization discontent to the political system.

Compensation mechanisms vary across countries because policy makers supply them in line with the political incentives to do so. These incentives are a function of the organization of both groups representing potential beneficiaries of these social policies and those concerned to keep incipient opposition to economic integration at bay. The canonical examples are societies in which labor and management are extensively organized and centralized, and where they have a history of working together and with government to address potentially disruptive sociopolitical discontent. This pattern tends to be more prevalent in small, open economies, including Scandinavian social democracies, and the other developed northern European societies. At the other extreme are larger economies as well as societies in which labor and management are weakly organized, fragmented, or both, and in which there is little tradition of labor, management, and the government working together consensually to address social problems. The prototype of such a socioeconomic system is the United States. As noted, political support for compensation in the form of TAA is extremely limited—a fact reflected in its small budget and narrow reach.

Where socioeconomic structures and their political reflection give policy makers few incentives to attempt Pareto-improving social insurance or compensation, supply will lag demand—and this failure of compensation provides fertile ground for the rise of extremist opponents of both globalization and prevailing political institutions. Compensation failure thus can feed into a sense that the very foundations of representative government have failed as well. There are, in other words, clear connections between the failures of compensation and representation.

## THE FAILURES OF REPRESENTATION

The widespread loss of confidence in government has expressed itself differently in different countries. In most, however, it has taken the form of opposing traditional, “mainstream” political institutions, parties, and politicians. As already mentioned, there is little, if any, indication that voters have actually become more extreme ideologically. But in many countries, they have shown a decided willingness to vote for

extremist political parties, movements, and candidates within parties. Many voters appear to be looking for ways to indicate their displeasure with the political and policy status quo. Traditional, mainstream political parties and politicians have not brought many of these voters' concerns prominently enough to the political agenda. Such a failure of representation takes different forms in different political settings.

Some Western political systems have been dominated by two major parties (or coalitions) that have consensually supported the trend toward increased international economic integration—in some cases, without substantial compensation. In such “cartelized” political systems, those who feel ill treated and unrepresented by the dominant parties have only two choices: they can vote for either new political parties that challenge the trend or insurgent candidates within the existing parties. France’s experience with the National Front seems closest to the former pattern; the US trajectories of the Sanders and Trump candidacies conform to the latter pattern. The United Kingdom experienced a similar phenomenon: given general agreement between the bulk of both major parties, disgruntled politicians and voters found a way to reject existing trends via Brexit. What ties all these instances together is that voters appear dissatisfied with the extent to which existing politicians represent their interests. When dissatisfied voters are given few options they like by the two dominant parties, they can react either by deserting traditional parties or voting to fundamentally transform them. On the Left, Syriza in Greece and Podemos in Spain would appear to fit into the category of creating a new force in what had been a largely two-party (or two-bloc) system.

Countries whose electoral systems give rise to multiple parties—typically with some form of proportional representation—present a different environment. Where new parties can enter easily or there is already a wide spectrum of views represented, unhappy voters have a protest option with a chance of being represented in the legislature. While some proportional representation systems have higher entry barriers, in many the degree of cartelization of the political system is lower than in systems dominated by two parties. This has made it possible, for example, for the extreme Left in Portugal to be both well represented in the legislature and effectively a part of the ruling coalition, while the extreme Right in Austria is an official coalition partner in government. The rise of Alternative für Deutschland and similar right-wing

populist movements in northern Europe is similar: electoral protest has taken the form of voting for small extreme parties. Italy, with its mixed electoral system, is a bit of a hybrid: the right-wing, populist Northern League and new antiestablishment Five Star Movement supplanted the more established center Left and center Right.

Whatever one may think of the presence of Communists and neo-fascists in parliament, the fact that disgruntled voters have an opportunity to express their dissatisfaction may act as something of an escape valve for the pressures that contributed to the victory of Trump in the United States and Brexit in the United Kingdom. In countries like the United States, the sense on the part of many people that they had no political voice was a serious enough failure of representation to play a major role in Trump's rise. The presence of parties like Alternative für Deutschland in Germany and the Communists in Portugal provides an outlet for those who feel they lack true representation. These mechanisms may help explain the different course that the rise of populist and antiglobalization sentiment has taken in different countries.

## IMPLICATIONS FOR THE FUTURE

It is not difficult to project the continuation of these trends into the future: populist candidates will win more elections, and there will be a turn toward more economically nationalist policies in some countries, which encourages others to move in the same direction. International economic cooperation will begin to break down, while traditional centrist political parties will find it more difficult to sustain the domestic and international commitments that have dominated the post–World War II period.

While this downward spiral is certainly plausible, it is also possible to imagine forces that counteract it. There are powerful interests, especially in the business community, that stand to lose a great deal if international trade, finance, and investment are impeded by increasingly nationalistic and protectionist governments. Yet given the powerful populist sentiments in many countries—not least in the United States—it is not clear that the opposition of big business would be sufficient to slow the turn toward more nationalist and protectionist policies. An alternative possibility is that internationalist businesses, and the social classes that rely on them, accept that part of the cost of their

access to the world economy is paying for much more generous compensation for people and regions that have not shared in globalization-fed prosperity.

The notion that the United States' globalization winners might accept redistribution toward its losers may seem improbable. To some extent, however, this was precisely the arrangement that structured the construction of the Bretton Woods order in the aftermath of World War II: an agreement that both economic openness and the welfare state were reasonable goals (Ruggie 1982). Indeed, few would have anticipated that the Great Depression of the 1930s would create a Democratic Party coalition that included southern segregationists, northern business and labor, and northern blacks—and yet that coalition dominated both national politics and the building of the postwar world order for decades. By the same token, the farmer-labor entente that was the core of many postwar European political alliances came after decades of bitter conflict between the two groups (Luebert 1991).

It may be the case that until recently, most politicians in the United States and Europe felt little need to represent the concerns of those people and communities hard hit by globalization, but in the current environment they have strong incentives to take notice. Trump and Marine Le Pen are hardly the only politicians to have recognized trends in public opinion, and we can expect that there will be a new generation of politicians attempting to ride the populist wave. Some of them may see the possibility of different coalitions, given national socioeconomic and political conditions. Any observer of US politics is struck by the spectacle of the Democratic Party's attempts to recraft and repackage itself in this new environment. The fact that so far it has been unsuccessful does not mean that success is impossible.

There is also an international dimension to the dynamic. If country after country turns inward, the incentives of the remaining nations to maintain strong international economic ties declines. This was the downward spiral that characterized international economic relations in the early 1930s. If, however, some of the major powers are able to make purposive steps in the direction of sustaining economic cooperation, the incentives to turn inward are weakened. The domestic political economy of international cooperation interacts with its international politics: the stronger domestic political support is for international

engagement, the easier is cooperation, and the more successful is cooperation, the stronger is domestic political support.

## CONCLUSION

The industrialized world is being swept by a wave of popular sentiment skeptical of economic integration and hostile to the political institutions that have encouraged it. The economic sources of this populist upsurge are of long duration, and are both broad and deep.

Populist skepticism about globalization and European integration largely grows out of the failures of compensation: the weakness of mechanisms to address the social costs of international trade, investment, and immigration. Populist distrust of existing political institutions largely reflects the failures of representation: the unwillingness or inability of mainstream political parties and politicians to address the concerns of those who feel they have been left behind by the galloping pace of economic change.

The growing success of these populist movements may signal a turn away from the world economy, at least for some countries. If the trend gathers enough momentum, it could substantially reverse the past several decades of economic integration and international cooperation.

Yet there is nothing inevitable about the inadequacy of compensation and defects of representation that have provoked the strongest movements against international economic integration since the 1930s. Socioeconomic interests, political parties, and politicians created the conditions that have spawned the current trends. They can create the conditions for an effective response to these trends—one that does not unravel the social and economic gains of the past fifty years, and instead makes them more inclusive and expansive.

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