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THE FORMATION AND TRANSFORMATION OF TRADING STATES:
LIBERALIZATION AND STATE INSTITUTIONAL CHANGE SINCE 1947

A Prospectus

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General Argument

The conventional view is that liberalization is weakening the state. This position may be traced at least as far back as David Ricardo's *Principles of Political Economy and Taxation* and there are several contemporary versions-- Ray Vernon's *Sovereignty at Bay*, Charles Kindleberger's work on the internationalization of American business, much of the globalization and governance literature (particularly economic arguments that international trade liberalization is shifting authority from the state to both substate and supranational levels), and the rediscovery of transgovernmentalism-- all of which have spilled over into the law literature. These arguments rest on activities of nonstate or transgovernmental actors, a purported interdependence between states (usually bolstered by an argument about nonstate actors), or on a market efficiency rationale for reduced state intervention and the consequent competitive pressure on states to shrink. These arguments also tend to assume (expressly or implicitly) that liberalization is taking an ideal form prescribed by classical economics. Empirically, since the early 1990s, many have focused on the transformation of state-led and formerly centrally planned economies.

While trade liberalization has favored the transformation of state-led and formerly centrally planned economies, changes in the state are not fully explained by liberalization in the abstract. The conventional story about the state needs to be modified to take into account the distinctive institutional form and process of contemporary liberalization (i.e., the evolving nature of embedded liberalism) and ways in which state institutions have strengthened. In short, we need a more complete understanding of the relationship between the contemporary institutions of liberalization and state institutional change. This book attempts to do that by explaining how GATT/WTO liberalization has transformed the state.

The form and content of twentieth century liberalization have been negotiated between states, primarily powerful ones, creating demands on (and incentives for change in) the constituent states of the trading system. The United States drafted the GATT 1947 (making some concessions to Britain), establishing a process for and rules about trade liberalization, but allowing the United States (and all other contracting parties) to maintain several non-liberal laws and associated state institutions. Moreover, the GATT 1947 rules silently assumed and incentivized certain characteristics about the states that would accept the agreement; many of those characteristics mirrored U.S. and British state economic institutions. Hence, when the United States accepted the GATT 1947, it had to legislate nothing and modify none of its state institutions. Similarly, the agenda-setting that led to the WTO Agreements was dominated by Washington and Brussels, establishing agreements that demanded relatively little legal or institutional change in the EC or the United States.

Yet for most other countries, the procedural and substantive requirements of joining and participating in the GATT/WTO, and the opportunities and incentives created by the regime, have required or favored substantial change in state institutions. The GATT/WTO has simultaneously favored diminished state intervention in the domestic economy in some countries (particularly in previously centrally planned and state-led economies) and at the same time reinvigorated the state in many ways. Taken together, these changes suggest convergence towards some aspects of U.S. and Western European models of the state. The demands on state institutions acceding to the GATT/WTO system have increased over time as liberalization has deepened (as illustrated by a simple comparison of the 1955 GATT Model Protocol of Accession with contemporary protocols). A similar story may be told about state institutional change demanded of countries joining the EC/EU and accepting the *acquis communautaire*, and for Mexico's acceptance of NAFTA.

Finally, the process and demands of negotiating successive rounds of deepening liberalization have created incentives for institutional transformation in powerful countries. For example, as the universe of policies subject to trade negotiations has expanded with deeper liberalization, authority over those policies has become more centralized within states and the EC/EU (i.e., from sub-federal levels to the central government, and from several non-trade ministries to trade ministries).

State Changes Favored By the World's Main Trade Regime

The contemporary form of trade liberalization has facilitated a bounded-convergent transformation of the state along five dimensions. [As explained in the next section, the extent of change along each dimension in a particular country depends largely on certain national attributes.]

1. Reduced Role for State-Led and Central Planning Institutions. GATT/WTO trade liberalization, and the trade and investment diversion suffered or feared by those countries outside the GATT/WTO system, have favored reducing the state's direct role in domestic economic planning-- central planning, state trading enterprise systems, state-owned enterprises, and state-led capitalism.

2. Elements of New State Capacity. At the same time, the GATT/WTO: (1) expressly permits, employs, and disciplines *increased regulatory capacity* over sectors once controlled by-- and fallout from-- dismantled state trading and state-owned enterprises (especially over competition, financial services, telecoms, labor policies, etc.); (2) provides opportunities (that combine with strategic trade goals to become incentives) for *strategic trade institutions* that can administer anti-dumping, countervailing duty, and safeguards laws, technology policy (but not industrial policy), export promotion capacity, and technical standards and testing; (3) *requires (or is moving towards requiring) the establishment and maintenance of state institutions* supporting intellectual property rights, environmental protection, and labor rights; and (5) favors the establishment of *capacity for addressing internal spillovers* from liberalization-- internal revenue generation (to replace revenue previously generated from duties), a social safety net that

can address dislocations associated with liberalization, and more technical standards and testing (to protect consumers, workers, and the internal environment from damage from imported goods). [NAFTA demanded even more exaggerated changes in Mexico. In the EC/EU, much of this capacity has been established regionally.]

3. Shifts of Authority. The GATT/WTO has required or created incentives for shifts of authority within the state. While formerly state-led and central planning systems have experienced diminished state authority over the economy, in other countries authority over the economy has in some ways become more concentrated in the state: (1) in federal systems, from sub-federal levels to the central government (so the state can negotiate with a single voice and comply with international obligations); (2) in presidential systems, from the legislative to the executive branch (so the executive can bargain credibly and secretly); and (3) to trade ministries from other ministries-- or to the external affairs division of trade and industry ministries-- as previous "non-trade" topics, such as intellectual property, environment, labor, etc. have become trade topics.

4. Changes in National Policy-Making Processes. Transformation of national processes of policy-making has accompanied shifts in capacity and the concentration of authority. The institutions of trade policy-making have adapted so that broader sets of interests can feed into the new locus of trade policy authority, and so that institutions previously at the center of non-trade policy-making processes can participate in the new and expanded trade policy processes.

5. National Legal System Changes. The process and outcomes of GATT/WTO trade liberalization have favored and been accompanied by: (a) an expansion in constitutionally acceptable forms of international agreements (e.g., in the U.S., from

treaties to executive agreements and congressional-executive agreements, for speed, secrecy, and credibility); (b) greater judicial deference to the political branches on the negotiation [and domestic legal effects] of trade agreements; and (c) marginal increased rule of law along some dimensions-- formalization, transparency, and independent judicial review (e.g., all are required by GATT articles, TRIPs, and accession agreements).

State Change in National Context

The extent of change along each dimension depends on a country's starting point— in particular, its level of economic development, the extent and form of state intervention in the economy prior to institutional adjustment, and whether it has enough market power to help set the global trade agenda. Of course, the trade regime's pressure on states to adapt in a functional manner is mediated by particular national histories and strategic choices. Empirically, the extent and nature of state institutional change clusters into the following three categories of national economic systems, listed in ascending order of change—from those country-types experiencing the least state institutional change to those experiencing the most.

Least Developed Countries (LDCs). State institutional change associated with trade regime demands has been least extensive in LDCs. In the world's poorest countries, exemplified by Tanzania, Chad, and Zaire, there has been little institutional shift associated with GATT/WTO liberalization across any of the five dimensions, largely because most of the demands of the GATT/WTO system have been formally suspended or simply not enforced for LDCs. Moreover, in most LDCs, state institutional

capacity and political authority structures have not reached a threshold at which trade regime demands would have any meaning.

Advanced Industrial Countries. The market size of the United States, and the EC/EU since the early 1970s, has enabled the transatlantic powers to drive the development of GATT/WTO rules. Hence, the external trade-related impetus for institutional transformation in these states/entities has *not* been the substance of GATT/WTO obligations, but rather the exigencies of the GATT/WTO bargaining process, the strategic and tactical advantages of establishing a particular trade bargaining tool set, and the expanding scope of trade negotiations. And the political vehicle for change has *not* been external pressure to comply with GATT/WTO obligations, but rather economic internationalists within the state and interest groups newly drawn into trade policy by economic spillovers from deepening integration. In short, these states and the EC/EU have reorganized to effectively govern world trade. Three subcategories of powerful states/entities may be usefully analyzed.

Western Advanced Industrial Countries. In Germany and the United States, the GATT/WTO system has demanded state institutional change primarily along two dimensions: GATT/WTO negotiations have favored shifts of authority (e.g., toward trade ministries in the central government) and changes in policy-making processes.

EC/EU. Within the EC/EU, there has been change along three dimensions: authority shifted toward a single site so that the EC/EU could participate in agenda-setting at the GATT/WTO; new state capacity developed at the EC level so that the Commission could have a full trade bargaining tool set (e.g., antidumping, countervailing

duty, and competition law and administration); and the foregoing demanded changes in processes of trade policy-making at the EC-level.

State-Led Advanced Industrial Countries. In state-led advanced industrial countries, the global trading system has favored not only shifts of authority and changes in trade policy-making processes, but also a reduced role in industrial policy and-- in some cases—new state capacities. Both France and Japan were in many ways similar state-led economies prior to 1983. Since then, France has shifted into the Western advanced industrial model as it has been able to build state capacity to provide a safety net that catches social dislocation associated with adjustment away from a state-led economy. In contrast, Japan has not established such capacity and has not succeeded at substantially reducing the role of the state in the economy, although the process of transformation there may still be underway.

Developing Countries. As suggested above, the opportunities and incentives embodied in the GATT/WTO agreements have precipitated change along all five dimensions in developing countries. These countries may be analyzed as in three groups: those that previously followed import substitution industrialization policies (e.g., Mexico, Brazil, Argentina, India), those that were state-led (e.g., Indonesia, Malaysia, Korea), and transitional countries (e.g., China, Russia). Unlike the LDCs, these states have not experienced continuous suspended application of GATT/WTO rules. Their markets or exports have been substantial enough to attract EC/EU or U.S. interest in applying GATT/WTO rules, which have demanded state institutional change.

Conclusion: Bounded Convergence Toward the "Trading State"

Since the middle of the Twentieth Century, international trade law and bargaining over the substance of that law have played a transformative role, helping define evolution of the form of the state. With each increment of deeper postwar liberalization, most states have been transforming and converging subtly along various dimensions towards a U.S.-European-influenced ideal-type: the trading state. Increasingly, international trade law and trading states reflect each other. Rather than dissipating the structure of the state, the legalized world trading system is reinforcing, reinventing, and replicating the U.S.-European model of the trading state. Hence, the formation of trading states may be seen as Waltz's second image mirrored: U.S. and European state structures are reflected in GATT/WTO rules, which have been molding the structure of other states.